GST - HOW IT AFFECTS YOU TODAY

Background

With the return of the Coalition, we can expect some form of a GST in place in Australia by 1 July 2000. The political debate over the impact on food and low income earners overshadows the reality that the GST affects many property transactions taking place today. The Coalition's package proposes that a 10% GST will apply from 1 July 2000 to :

- construction, sale and leasing of all non-residential land and buildings
- construction and sale of new residential accommodation;
- repair and renovation of existing residential accommodation.

Impact on Property Contracts

Construction and leasing contracts which you have already commenced or which you will shortly commence may be subject to a cost increase of 10% on payments after 1 July 2000. The question whether this increase can be passed from builders to developers or from building owners to tenants will be determined by the contract in place and by legislation to be tabled in Federal Parliament within a month. It is expected that the legislation will follow the New Zealand model and:

- require payments under "reviewable" contracts to be subject to GST from 1 July 2000 (see diagram below); and
- allow "non-reviewable" contracts to be GST-free until they are completed or until the first opportunity for a review. This concession is likely to apply only to contracts entered before the date the legislation is tabled in Federal Parliament.

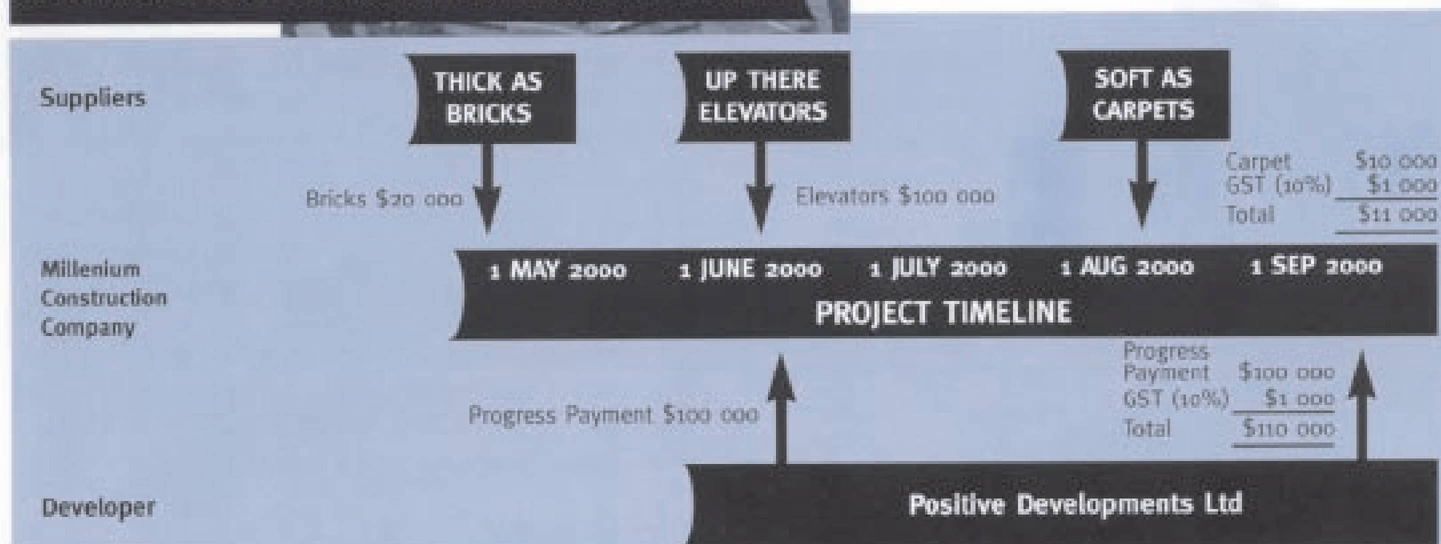
If GST is charged then at best one of the parties will have to fund the GST charge for between 21 and 111 days before a refund is available from the ATO. If the property is to be used for residential leasing or for certain financial services no refund will be available.

Recommended Course of Action

Property developers, property owners, tenants and construction companies would be wise to immediately examine all current and proposed contracts to determine whether GST will apply and whether it can be passed on. Contracts should be amended now if possible to place you in the most favourable position after GST.

If GST will apply there may be advantages in accelerating construction work to ensure most payments precede the GST introduction date. Particular emphasis should be placed on planning for developments involving both commercial and residential property.

GST ON A CONTRACT STRADDLING THE INTRODUCTION DATE



EXAMPLE OF IMPACT OF GST ON CONSTRUCTION CONTRACT STRADDLING 1 July 2000

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IN THIS ISSUE:

- The Specific attributes of property Investment.
- The spectrum of services offered by the quantity surveyor.
- Tax review to be major blow to the property sector.
- How the GST affects you today.

PROPERTY INVESTMENT - SOME ESSENTIAL HINTS

Many individuals and organisations fail to generate the maximum after tax or 'real return' from a property investment. Significant opportunities exist for the astute investor through property ownership that no other investment vehicle can provide.

Specific attributes of a property investment include;

- historical long term sector capital growth;
- access to a relativily stable investment platform;
- a safe harbour from the fluctuations of the stock market;
- significant taxation benefits in the form of plant and building write off.

This last point has provided many investors with significant 'real' after tax returns that can be forecast with relative certianty. This relative certainty is provided by a combination of rental stream and a complete 'actual' plant and building write off caculation. This actual calculation of plant and building write off should be developed by an experienced property depreciation and construction cost consultant and will include as a minimum, a 10 year depreciation projection.

The **maximisation of a depreciation** claim on any building requires a unique combination of construction costing skills and experience combined with an intimate knowledge of the Income Tax Assessment Act 1997 (ITAA97). This rare combination of skills rests in the sole domain of the property depreciation and construction cost consultant. BMT & ASSOC Pty Ltd specialise in depreciation and will ensure the client obtains the maximum depreciation potential of a given property.

Some examples of buildings that will attract a claim for depreciation include; ■ rented units and houses; ■ nursing homes; ■ hotels; ■ offices; ■ warehouses; ■ motels; ■ retail buildings; ■ industrial/manufacturing facilities; ■ private hospitals;

Most other types of buildings, if used for income producing purposes, will also attract a claim for depreciation.

BMT & ASSOC can assess any building irrespective of age, that may attract a claim for depreciation with respect to the plant and equipment items contained within the property including **air-conditioning, carpets, light fittings, fitout** etc.

The individual property holder as well as corporations with large portfolios often allow depreciation to become a low priority and hence the tax credits generated from each individual property investment is not maximised. Experience has shown clients that do engage a specialist, such as BMT & ASSOC, obtain significant tax benefits of up to 50-100% over and above what would have previously been claimed.

BMT specialise in maximising the depreciation potential of a given property and are able to provide an obligation free quote on any new, existing or proposed development.

The BMT service is unique as it focuses on providing the client with the maximum deduction possible in the first five years of ownership. This enables the client to free up scarce committed capital for use in other investments, thus maximising the 'real return'.

QUANTITY SURVEYING - SERVICE SUMMARY

BMT have been asked on several occasions for an explanation and summary of the spectrum of services offered by the Quantity Surveyor.

Many people are not aware that the quantity surveyor is the "knight in shining armor" for many different parties involved with a construction project who require cost advice.

The misunderstanding of the quantity surveyors true scope of services often leads to complications associated with the financial management of the construction process for all parties involved. The Quantity Surveyor's service summary is illustrated in the below table. The reader should note that these stages may be employed individually or grouped into a work package depending on the specific project requirements;

Should further information be required with respect to any of these services please do not hesitate to contact BMT as this space only allows a brief summary the Quantity Surveyors role. ■

Pre-Construction Stage	Construction Period	Post-Construction Stage
■ Initial 'broad order of cost' estimate ■ Indicative Budget Estimate & detailed Feasibility study; ■ Budget Estimate and Cost Plan ■ Cost checks during the design period ■ Final pre-tender estimate or Bill of Quantities and Estimate ■ Tender Evaluation.	■ Assessment of Contractor Claims; ■ Assessment of Work in Progress; ■ Forecasting and Reporting; ■ Project Auditing Role for lending institutions; and ■ Final Accounts;	■ Asset Registers; ■ Insurance Claims Preparation; ■ Replacement cost estimates for Insurance Purposes; ■ Sinking Fund Forecasting; and ■ Tax Depreciation schedules – Single / Portfolio.

PROPERTY INVESTORS TO LOSE $MILLIONS

The current business tax review initiative has dangled a huge carrot in front of the business community - to lower the corporate tax rate from 36% to 30%. On face value, this appears to be fantastic news for the business community.

However, the Government has set parameters for such a proposal stating any change must be revenue negative, that is, benefits derived from the review must be offset by income derived from other sources. In a major blow to the property sector, the source of that revenue is likely to be derived from property depreciation.

Although a lower tax rate is essentially desirable, the prescribed method is restrictive. The review has focussed on the removal or dampening of three key areas of business tax concessions, these being the research and development allowance (currently at 125%), accelerated depreciation of plant and equipment and the capital allowance provision for buildings.

The impacts of the dampening measures on the three investment concessions include:

- A decrease in the willingness of business to invest in new property and infrastructure;
- A slow down in the rate of replacement of old and out dated plant and equipment;
- The use of older and inefficient plant, ultimately effecting business productivity, future profitability and ultimately job creation; and
- Lower investment in new plant and capital allows older, higher polluting plant to continue in operation, continuing the high levels of pollutants produced by older items of plant.

Ultimately, the removal or dampening of these concessions will create a divide between those industries that are innovative and invest in physical infrastructure to obtain assessable income and those industries that apply outdated technology and do not invest in their specific industries future.

The desire to create a 'flat earth' tax environment will only be accomplished at the expense of disadvantaging select sections of the business community.

A 'win/win' situation is created for industries that do not derive significant income from innovation or utilising physical assets.

Simply removing tax concessions will not allow for significant differences in industry structures and incomes streams. This simple "Treasury" view of business taxation means that property and infrastructure based organisations are faced with significant real decline in profit or indeed real losses. The majority of property or items of plant and equipment used for income producing purposes will be affected. Specific investment vehicles that will be adversely affected include:

1. Office developments;
2. Rail and road infrastructure projects;
3. Retail complexes;
4. Nursing homes;
5. Private hospitals;
6. Industrial and manufacturing developments;
7. Hotels and motels; and,
8. Property Trusts.

As a simple example of how the removal of the accelerated depreciation and the capital allowance provision affects the viability of property ownership the following can be seen as a good guide;

1. An investment house holding $100M in property, deriving its sole income from the rent of the physical space buildings provide. This organisation could pay up to $15-20M more in tax over a period of five years with significantly less incentive to invest in new property or upgrade existing plant.

2. A financial services focused organisation who owns no property, rents all required space. This organisation will reap the benefit of paying 6% less tax. Loosing no concessions, it will be a win/win result.

The review raises a number of concerns for the property sector. Will the attainment of a lower corporate tax rate be preferable to retaining incentives for investing in infrastructure and plant and equipment? Will it merely disadvantage some industries that derive their main income from physical infrastructure? Indeed, how can any industry that employs significant capital assets recoup that investment and hope to fund replacement of those assets if capital allowances and depreciation of plant is not tax deductible?

The risk to the industry is not only the result such a dramatic change would have if implemented, but the uncertainty the review process itself creates in the marketplace.

As the Commonwealth Minister for Industry stated, "accelerated depreciation is highly legitimate if you want (physical) investment; there is a correlation between that and investment." Why then is the Government looking to dampen depreciation benefits? ■

YOUR CURRENT CONTRACTS AND GST : SUPPLIER BEWARE !

Overseas experience shows that countless Australian companies will "get it wrong" with GST in the lead up period to GST Day (1 July 2000) and beyond.

Those in the know will avoid these costly traps, and start thinking about GST - and start negotiating all their contracts with GST in mind - today rather than in 18 months time. Where GST applies, the relevant GST is generally payable by the supplier, not by the recipient of the supply.

GST is a supplier liability, under our proposed GST law, not a recipient liability.

Although the proposed GST law includes extensive transitional rules, for contracts spanning 1 July 2000, your worst possible present strategy is to sit on your hands and hope for the best, that is, hope that the complex transitional rules will somehow magically protect you.

Your best possible present strategy is to, first, review all your commercial agreements (with both your customers and your suppliers) that are presently being negotiated or re-negotiated (or that will be negotiated in the future) and, second, identify all possible GST transition issues and, third, resolve those issues before signing off on those agreements.

These are some GST questions you should be asking now:

- What right of recovery of GST will your company have - under all relevant contracts - where your company is making a GST taxable supply ?
- What are the likely GST implications for your company - in terms of cash flow, accounting and systems requirements, IT, structuring, and grouping of companies - and what should your company be doing about it now ?

GST will create winners and losers, right across Australia. Those in the know, will win. Those who "wing it", will lose. ■

This article was prepared by Michael Inglis who provides practical taxation advice to a wide range of accountants and solicitors. A consultant tax barrister, he practises in the MLC Centre, Sydney: tel 9233-4861

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