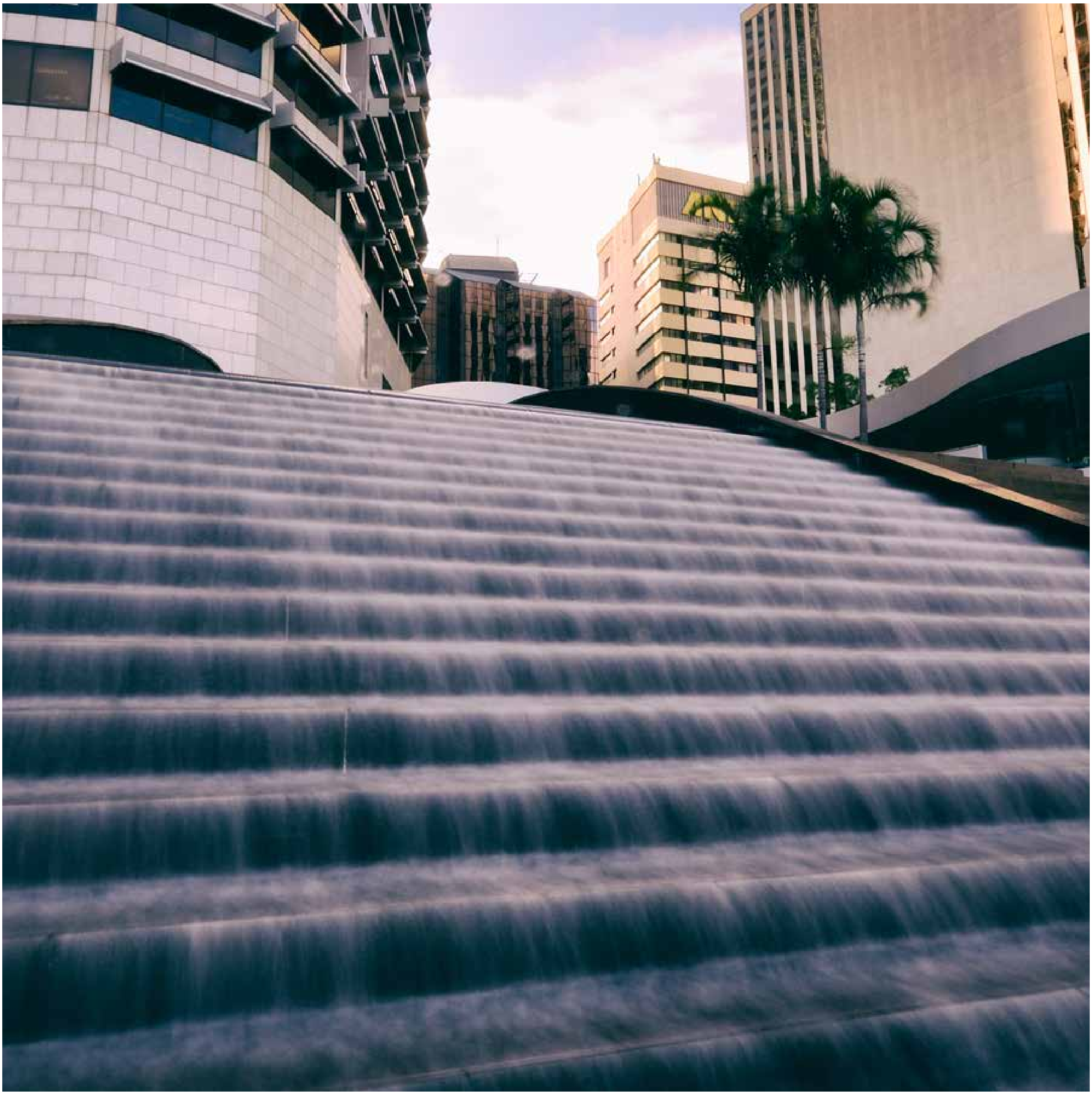
DECEMBER 2016

PROPERTY OF PITCHER PARTNERS



PITCHER PARTNERS
ACCOUNTANTS • AUDITORS • ADVISORS

Inside Cover:
Melbourne CBD

Front Cover:
Brisbane CBD

PITCHER PARTNERS
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WELCOME

By Andrew Beitz, Partner, Pitcher Partners Adelaide

At Pitcher Partners we have a passion for the property industry. We are attuned to the needs of all contributors in this complex and exciting sector – owners, developers, investors, builders, values, agents and of course debt/equity participants. We have a well-established and proven track record in contributing to our clients' success based on our extensive knowledge and our intimate approach to servicing our clients.

This issue of Property of Pitcher Partners focuses on "Property and Tax".

Firstly, we look at the residential and commercial snapshots where Knight Frank will discuss how the market is fairing as well as three themes for real estate investors in the commercial space. They also take a look at the latest trends in co-living.

Phil Shepherd of our Adelaide office gives a quick snapshot of the latest state by state tax changes and the implications this may have on the property market.

Cole Wilkinson of Pitcher Partners Brisbane takes us through Margin Scheme traps. Eligibility for the Margin Scheme requires a number of key criteria and this article focused on some tricks and traps around documentation and valuations.

Melbourne Pitcher Partners' Nicholas Lee discusses how the proposed changes in the leases accounting standard and how this may impact financial results. To date, the new Standard has not generated much discussion in the property industry, despite the impact this may have on tenants.

Scott Edden of Pitcher Partners Newcastle takes a detailed look into the Federal Governments focus on foreign owned property, in particular the Foreign Resident Capital Gains Tax Withholding Regime.

Across in Perth, Leon Mok takes us through a case study with AP Energy which highlights the application of Australian tax rules to foreign residents who have interests in entities holding Australian property.

Finally Scott McGill of Pitcher Partners Sydney answers all your tax questions on Airbnb. Scott looks at what needs to be declared, what deductions can be claimed as well as CGT and other taxes.

We welcome your feedback – if you have any suggestions on articles you would like us to cover in future editions please send them through to info@pitcher-sa.com.au.

PROPERTY MARKET REPORT

By Matt Whitby, Head of Research & Consulting, Knight Frank Australia and Paul Henley, Head of Commercial Sales, Knight Frank Australia

Residential

Prime Perspective

The value of the world's leading prime residential property markets rose on average by 4.4% over the 2015/16 financial year, according to Knight Frank's unique Prime International Residential Index (PIRI). This is the highest rate of growth observed over the last two years.

The latest move by policy makers in Vancouver to apply an additional tax for foreign buyers mirrors similar moves over the last few years across the Asia-Pacific. Most notably, Hong Kong and Singapore have added 15% additional buyers stamp duties, while the Australian states of Victoria, Queensland and New South Wales have also recently introduced various additional levies for foreign buyers.

- Vancouver leads the rankings for the fifth consecutive quarter. Prime prices have increased by 36.4% in the financial year but July saw the surprise announcement that the British Colombia Government plans to introduce a new 15% tax for foreign buyers, effective from 2 August 2016.
- Other top performers this quarter include Shanghai (22.5%), Cape Town (16.1%), Toronto (12.6%), Melbourne (11.0%) and Sydney (10.2%); all saw annual price growth reach double figures in the year to June.
- A breakdown by world region shows Australasia is on top; prime prices increased by 11% on average year-on-year (see Figure).
- Hong Kong has eclipsed Taipei this quarter to take the title of weakest-performing residential market. Prime prices slipped 8% in the year to June as supply increased and concerns over the slowdown in the local economy persisted.
- The majority of our top ten ranking cities have been on the receiving end of new cooling measures in the last 12 months.

The global economy is still in a precarious state lacking any real engine of growth. Low oil prices, deflationary concerns in the Eurozone, uncertainty surrounding the impact of the UK's Brexit decision, weaker-than-forecast US GDP figures, the likelihood of US rate hikes commencing in December and the bond yield spike caused by the Trump ascendency.

While the global uncertainty continues, Australia is considered highly desirable for long-term wealth preservation. It also helps that Australia is highly ranked for lifestyle and well-placed for the education of future generations. This is despite the application fees that have been imposed by Foreign Investment Review Board (FIRB), as well as the foreign investor duties and land tax surcharges predominantly aimed at Sydney, Melbourne and Brisbane.

Locally, Australia has seen a steady recovery in non-mining activity towards a more services sector-dominated economy. The share market has experienced an upward trajectory over the course of 2016, whilst business confidence remains positive in this low-interest environment.

Breakdown by world region

Average annual % change to Q2 2016

Source: Knight Frank Research, S&P Case Shiller, Ken Corporation

Commercial

Three Themes for real estate investors

Low yields across real estate and fixed income are leading investors to balance and broaden their views of appropriate investment assets

Every time the global economy is on the verge of returning to a normal interest rate environment it is buffeted by an unforeseen shock. The latest chain of events in the EU and the uncertainty posed by a Trump presidency will leave real estate investors grappling with innovative ways to build successful portfolios.

1. Pricing and portfolio rebalancing

Commercial real estate has benefited from major capital inflows in an environment of low interest rates and loose monetary policy across many major global economies. Any interest rate increases in advanced economies (other than the US) are on the back burner, following the UK referendum vote to leave the EU. However it appears we have moved from the 'lower for longer' environment into a period of rising bond yields, not withstanding 10-year bond yields remaining negative in Japan, Germany, Switzerland; around 1.40% in the UK, France and Hong Kong; and 2.70% in Australia, albeit up 40 basis points over the past month alone.

Real estate yields have fallen, leaving pricing at historically high levels, but with sensible risk premiums still in place. Despite real estate in many large global markets being perceived as late cycle, there are a number of factors that make the prospect of dramatic rises in yields unlikely, not withstanding the recent bond rout.

Going forward, a muted supply pipeline and low vacancy rates in many cities, including Sydney and Melbourne, is likely to keep property yields low. There has been far less reliance on debt finance in the current cycle when compared with the previous cycle. With the major pricing correction of 2007-09 still in the minds of many investors, owners and developers are considering the balance of their portfolios, while maintaining a solid asset allocation to real estate at circa 7%-10%.

Portfolio rebalancing exercises should keep liquidity in the market in the short-term as investors trade higher risk assets for lower risk, long income assets, as well as developing more large, urban re-gen, mixed-use sites.

Asian investors continue to expand their property allocation to Australia, as the currency remains low, albeit resilient. Destinations are broadening away from just Sydney and Melbourne, with Perth and Adelaide now gaining a share of activity.

2. Real estate to real assets

Property has always vied with many other asset classes in competition for capital, but over the last ten years definitions have shifted. Property has grown in scale from a small number of core sectors to cover a wide range of asset types under the real estate banner. Now real estate is often viewed by investors as an asset type that sits within real assets alongside infrastructure, which incorporates major ports, toll roads and bridges, airports, railway lines, power stations, telecom networks, and a myriad of other physical assets.

Infrastructure is local but portfolios can be diversified globally, and it exists in a physical sense. Due to the low yield investment environment, allocations to infrastructure are rising.

In July 2016, Brookfield raised US$14bn for the largest infrastructure fund ever, proving there is huge appetite for the asset class. In September, the Victorian state government successfully negotiated an AU$9.7 billion lease for the Port of Melbourne. The 50-year lease will see the commercial operations of Australia's largest container and cargo port taken over by the Lonsdale Consortium, comprised of the Future Fund, QIC, GIP and OMERS.

Infrastructure benefits from many of the same characteristics that make property attractive to investors. It is scalable and provides a steady income, which is perfect for asset-liability matching. Global infrastructure investment should continue to be a driver of real estate investment going forward.

3. Buildings with beds

The days of building balanced portfolios around the trinity of retail, office and industrial assets are over. Residential investment is moving into the mainstream in countries where it previously languished, through growth of the private rented sector. Additionally, understanding a multitude of temporary and permanent accommodation options is becoming a necessity for large investors, as both demographics and globalisation support the demand for hotels, student housing, senior living and healthcare.

Demographics favour investment in housing for those at the beginning and end of their adult lives. University draws many people to new cities, and increasingly to new countries, and the trend of increased enrolment into tertiary education doesn't seem to be abating. A lack of appropriate product in many cities has resulted in developer and investor interest in recent years, creating a new institutional property asset class that is large enough to feature in balanced and specialist portfolios alike. This phenomenon has been particularly obvious in Australia in recent times, with activity picking up strongly.

At the other end of the demographic spectrum, senior living and aged care home assets are experiencing similar supply and demand dynamics, as large ageing populations in the largest economies in Europe, North America and the Asia-Pacific have the financial means to demand better accommodation and care as they grow older. UN world population projections predict a 12% increase in the number of people aged over 75 between 2015 and 2020, and another 18% growth in this cohort by 2025.

Real estate needs to meet the demands of the growing number of people travelling for business and pleasure, with a range of hotel products to suit all budgets (from new hostels in Europe to six star resorts in the Middle East to five star hotels in Sydney) and duration (from basic single night business hotels to longer stay apart-hotels). Global passenger numbers will increase by around 5% p.a. for the next five years, and the hotel sector in gateway cities such as Sydney and Melbourne should continue to benefit from this increase in travellers.

Case Study – Sydney's future as a co-living, co-functioning hub:

The fixed address of the future will be your email.

Across the US and throughout Europe the popular collaborative co-working movement and the millennial trend of transience, technological reliability and lack of ownership is playing a key part in the emergence of a new co-living movement, powering the flourishing institutional private rental sector (PRS).

Since the mid-1970s social and economic changes in Sydney have altered the demand for alternative housing types away from the more traditional detached dwelling structure. A further 856,000 people are projected to call the Sydney Metropolitan region home by 2026, with 52% of residents anticipated to gravitate towards the inner and middle ring of the city. Technological advances, global mobility, essentiality of flexibility and a lack of affordable and/or desirable housing options will direct these people to a new form of institutionalised private rented housing.

This will be in the form of PRS or build-to-rent, where the asset is built or reconfigured for long term rent, not sale – a purpose built student accommodation model for young professionals and early families. While serviced apartments allow for space and privacy in your own surroundings, their key differentiator from hotels, they do not provide a sense of community or lifestyle meaning. PRS assets aim to fill that gap and this lifestyle-focus differentiates this new form of renting from any other. Only recently have the first groups begun to establish platforms to develop and operate in this sector within Australia, with Macquarie Capital and Greystar being one example.

Co-living blends this PRS concept a little further and introduces the ideas behind co-working. WeLive, an offshoot of WeWork, has already begun to offer private bedrooms and studios within residential co-living neighbourhoods, occupying a former office building in the heart of New York's financial district and another located just south of downtown Washington DC.

The attractiveness of a consistent rental income stream in this low interest rate environment, coupled with a growing belief by millennials and the iGeneration in fostering community and meaningful relationships through the use of technology, will open the door to new real estate opportunities on our shores. Co-living and institutional PRS, as heralded in the US and Europe, may soon be the models adopted for development in Sydney, despite yields remaining low.

Adapting living city policies and creating a dynamic smart urban environment are high on the agenda of both the NSW Premier and the City of Sydney Council. The recently released Central Sydney Strategy suggests the adoption of new development controls which will limit residential and serviced apartment floor space in large developments to a maximum of 50% to provide for a genuine mixed-use outcome and stem the loss of employment floor space.

The new model of mixed-use development proposed in the strategy could lead to an increase in the feasibility and viability of PRS or co-living spaces within the Sydney CBD. Co-living and modern PRS structures will permeate Sydney's CBD and fringe as quickly as co-working has risen as a global phenomenon.

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AIRBNB

STILL PLENTY OF QUESTIONS

By Scott McGill,
Partner, Private Clients & Tax Advisory, Sydney

Whether speaking to clients or simply to people at a barbecue, I still find myself regularly asked the question, "is Airbnb a problem for me or my tax?" I usually respond with, "no, not really as long as you know what you're doing ... are you doing it? Does it work for you?"

This counter-question is usually followed by some uncomfortable shuffling, some mumbles and the sheepish question, "I don't have to put it in my tax return do I?"

The answer is yes, and you do need to keep some records. If you are using Airbnb or any other sharing economy platform, they retain records and yes, the ATO can and will access those records.

By the way, if you're putting your main residence on Airbnb, this will limit your Capital Gains Tax (CGT) exemption on that residence. Wide eyes and uncomfortable silence tends to follow this answer.

"What about GST, surely..."

The answer here is usually a more straightforward no, but that will depend on exactly what you are renting out.

Let's look at what we have.

Does it go in my tax return?

The Australian Taxation Office's published view is that renting out your property via the sharing economy is no different to more traditional methods, and hence the income needs to go in your tax return. The only exception the ATO see is if you were to offer the property below market value – say as a favour to family or a friend – and you ask to claim a loss for tax purposes.

The only other circumstance that could potentially fall outside this interpretation is where rooms in a share house are on AirBnB just to recover costs while their regular occupants are on holidays etc. This is very common among 20-somethings paying Sydney rents!

What deductions can I claim?

Understanding deductions and what the net impact on your tax return will be is the key to stripping away the mystery and making an informed decision on continuing to rent out part or all of your property on Airbnb, and how hard you push the prices.

The expenses you can claim fall into two broad categories:

- Cash or out of pocket costs that reduce your net return before tax. These include fees or commissions from the facilitator/agent, electricity and gas costs, council rates, land tax, insurance, cleaning and maintenance, repairs, and of course, interest charged (but not the whole repayment!)

  It's worth noting that if you are positive here, you may pay tax, but you are still ahead after tax. A loss here – analogous to 'negative gearing' if you like – costs real cash flow, regardless of the tax benefits.

- Non-cash deductions that reduce your tax position. These are capital allowances; allowed depreciation or deductions over time for identified building (structure) costs – at a generous 2.5% per annum where eligible – and higher rates for furniture and fixtures such as carpet, stoves, hot water systems, air-condition, curtains, light fittings and so on.

  The cost of these is usually embedded in your purchase price, but also will apply where you purchase new items or undertake renovations where that cost cannot be claimed as a repair. The real beauty of these items is that taxable income is reduced and tax saved on something that is not a weekly or monthly out of pocket expense.

Can I claim it all?

Yes, but only where you rent out your whole property for the whole of the year. Other than that you must apportion for time rented, including when it's on the market and empty/available, and also where only part of the property is rented.

There is plenty of guidance available regarding this on the ATO website, but for the sake of an example, let's say you leased one of two bedrooms out for six months of the year and your guest also had equal access to common areas.

You take 50% of the claim as relating to the rented area and reduce another 50% for only half of the year, which means 25% of your expenses can be claimed against the six months' income. For more complex arrangements, floor area calculations are required.

You can of course claim 100% of expenses just in regard to the letting – such as the facilitator or agent's fees and depreciation on furniture and fittings in the leased room.

Do the calculations, know where you stand, and get advice if you need it.

What about CGT and other taxes?

Properties, like other assets, are normally subject to CGT where they are later sold for more than your cost base – which includes the purchase price, eligible improvements and sometimes holding costs provided they are not claimed for tax.

Your main residence is however normally exempt from CGT, but people who are leasing out part or all of their main residence need to be concerned.

In short, an apportionment will need to be made for the period and usage that will pro-rata your exemption and result in part of any gain being not exempt and subject to CGT. There are many options and some complex calculations here, so I do recommend that you get advice if you are using your main residence in the sharing economy.

Letting your property may also subject you to land tax in your state. This applies in all states, but the rules, thresholds and exemptions are different in each state, so you may need further advice.

And GST?

Here's some good news. GST will not normally apply to residential premises, which covers most of Airbnb. However there are always exceptions. If you are leasing out something that looks and feels like a hotel room or commercial residential accommodation and you are providing things such as food and board, internet, concierge, transport services etc. you may have an issue and GST may apply.

You will also have an issue and may need to charge GST if the property is commercial or industrial or indeed does not have a house on it (such as a spot to camp or park a caravan).

There is however a threshold of $75,000, and provided you are under this income amount per annum you are pretty safe. Once again, if you're in any doubt, you should get advice.

Hopefully this has allayed a few concerns and highlighted where you may need assistance – for which we are more than happy to help you find a workable solution.

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TENANTS AND LANDLORDS – COMMERCIAL LEASES

CHANGES IN LEASES ACCOUNTING STANDARD MAY IMPACT FINANCIAL RESULTS

By Andrew Clugston, Executive Director, Pitcher Partners Melbourne and Nick Lee, Client Director, Pitcher Partners Melbourne

AASB 16: what you need to know

After much debate, earlier this year on January 13 2016, the International Accounting Standards Board (IASB) released a new standard for lease accounting: International Financial Reporting Standards (IFRS) 16 Leases. Subsequent to this, in February 2016, the Australian Accounting Standards Board (AASB) published the Australian equivalent to IFRS 16 - AASB 16 Leases.

To date, the new Standard has not generated much discussion in the property industry, despite the impact the Standard is expected to have on the financial statements of parties to lease agreements, particularly tenants.

The new Standard won't take effect until financial periods beginning on or after January 1, 2019, but if you're signing a long-term lease on commercial property that will include periods beyond 2019, you will necessarily be affected by the changes.

The intent of the new Standard is to facilitate greater transparency in financial reporting by removing the 'shadow debt' created from operating leases. This enhanced transparency, however, will have significant accounting implications for tenants.

Other items based on earnings before interest, tax, depreciation and amortisation (EBITDA), such as banking covenants, business valuations and employee performance measures may also be impacted by the change.

Although impacted to a lesser extent, landlords should also be aware of the changes to aid negotiations with tenants.

AASB 16 – what are the changes?

Currently, all leases are classified as either operating or finance leases, and are accounted for differently subject to their classification. Under the new Standard, tenants will account for all leases on the same basis. Accordingly, under the new Standard there will be no distinction as far as tenants are concerned between operating and finance leases.

Broadly, all leases (with some limited exceptions) will be accounted for under AASB 16 by tenants in a manner similar to the way finance leases are currently accounted for under the current Standard, AASB 117 Leases. Consequently, except in some limited circumstances, tenants will be required to recognise both an asset ('right-of-use') and a lease liability in respect of each lease. In contrast, there will be no substantial changes to the manner in which landlords account for leases.

The impacts of the new Standard on the reported results of tenants can be broadly categorised as follows:

- Balance sheet
- Income statement
- Cash flow statement
- Lease accounting administration

Balance sheet

Requiring tenants to recognise operating leases in their balance sheets will result in increased levels of reported assets and liabilities.

Depending on the composition and structure of a tenant's balance sheet, recognition of operating lease commitments as liabilities could have a detrimental effect on the tenant's gearing and other related ratios, which in turn could have adverse consequences for their banking covenants.

Similar to the current accounting for finance leases, the recognition of lease assets and liabilities may also necessitate tenants recognising deferred income tax balances arising from these operating lease arrangements, further impacting their balance sheet structure and earnings profile.

Income statement

The current requirement for tenants to classify rental payments as an operating expense in their income statement will be replaced under the new Standard with the requirement to recognise separately depreciation/amortisation of a leased asset from interest expense in respect to the lease liability.

This change is expected to improve EBITDA measures, which may have flow-on implications for other areas, such as business valuation methodologies, employee performance measures and banking covenants that are based on EBITDA measures, although analysts are likely to normalise earnings to take in to account these changes.

Tenants should also be aware that not only will the classification of rental payments change under the new Standard, the pattern and timing of the recognition of lease-related expenses in operating profit are likely to change. Because interest expense will be calculated on a different basis (using the effective interest method) to the depreciation/amortisation expense, this will generally result in a different rental expense profile as compared to that under the current Standard.

The following diagram illustrates the implications for lease expenses recognised by tenants under AASB 16.

	Before January 2019		On and after 1 January 2019
	Finance leases	Operating leases	All leases
Revenue	X	X	X
Operating costs (excluding depreciation and amortisation)	–	Single expense	–
EBITDA			
Depreciation and amortisation	Depreciation	–	Depreciation
Operating profit			
Finance costs	Interest	–	Interest
Profit before tax			

Cash flow statement

Under the current Standard, financial lease payments are generally classified as arising from financing activities, whilst operating lease payments are generally classified as arising from operating activities. Under the new Standard, however, cash flows attributable to the reduction in the lease liability balance will be classified as arising from financing activities and cash flows attributable to the interest on the lease liability will be classified as either arising from operating or financing activities.

Lease accounting administration

In addition to the financial implications, it is worth considering if your current accounting systems are sufficiently robust to deal with the reporting requirements under AASB 16.

Although much of the information that will be required under AASB 16 is currently collected by tenants, most tenants would not have sufficiently sophisticated systems to enable them to calculate the carrying amounts of lease assets and liabilities on an on-going basis. A more sophisticated finance system may be required to capture and report on this information without error, particularly for those entities that are tenants in multiple lease arrangements.

Given the changes to lease accounting that are currently on the horizon, we recommend that prior to finalising any lease arrangement you consider meeting with your Pitcher Partners advisor to discuss how you might be affected.

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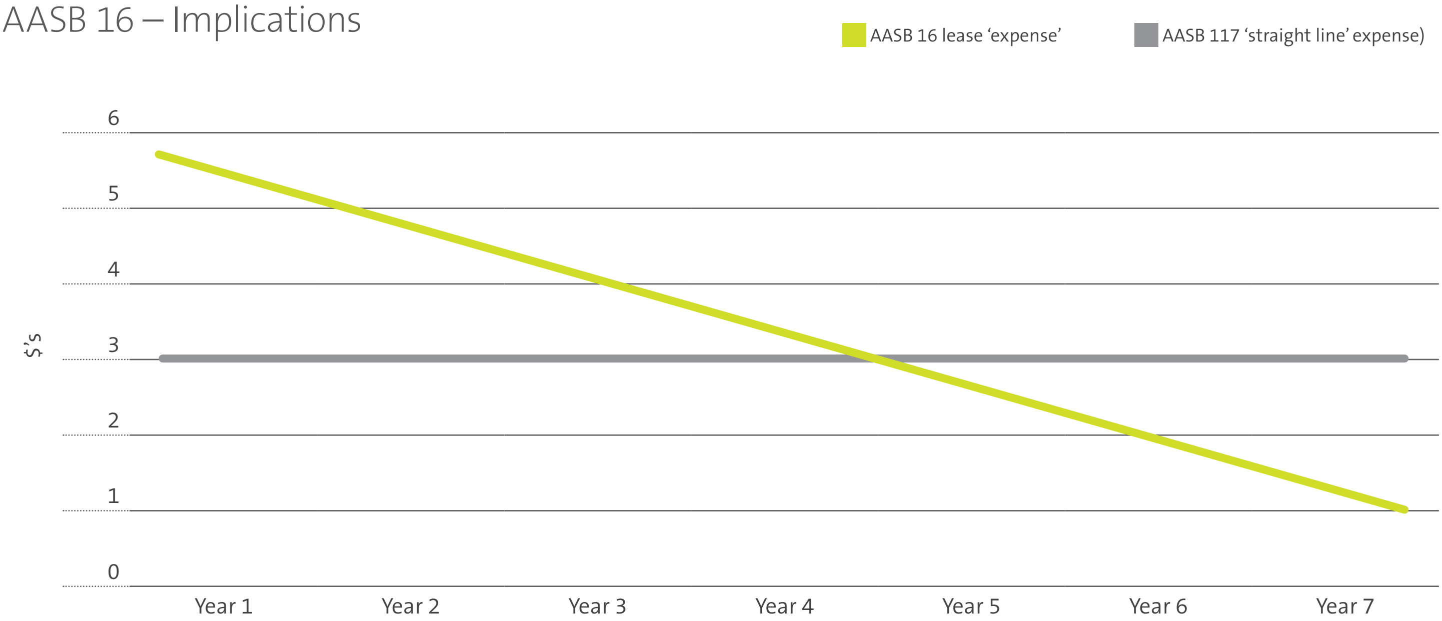
AASB 16 – Implications



THE AP ENERGY CASE

AND THE IMPORTANCE OF MARKET VALUATIONS

By Leon Mok, Executive Director, Pitcher Partners Perth

Earlier this year, the Federal Court of Australia heard the case of FCT v AP Energy Investments Pty Ltd (AP Energy). This case highlights the application of Australian tax rules to foreign residents who have interests in entities holding Australian property.

Under Australian tax rules, foreign residents are not subject to Australian Capital Gains Tax (CGT) on the disposal of Australian assets unless the asset is Taxable Australian Property (TAP). A number of asset classes fall into the definition of TAP. The most common of these asset classes is Taxable Australian Real Property (TARP) which includes land situated in Australia and mining, quarrying and prospecting rights over Australian resources.

It is well known to foreign investors directly holding TARP that their investment in Australian property constitutes TAP and is subject to CGT. However, one asset class that is also TAP but is easily overlooked are Indirect Australian Real Property Interests.

In broad terms, an Indirect Australian Real Property Interest arises where a foreign resident holds an interest of at least 10% in an entity holding TARP, and the market value of the TARP in that entity represents more that 50% of the assets of that entity by value.

Indirect Australian Real Property Interests can arise through both direct holdings of a land-holding entity as well as indirect interests in that entity. As an example, take a scenario where a foreign resident that wholly owns Company 1, which in turn wholly owns Company 2 which has TARP as its only asset. The foreign resident is taken to have an Indirect Australian Real Property Interest. Where the foreign resident sells the shares held in the Company 1, that sale would be subject to Australian CGT.

In AP Energy, a foreign resident sold 75% of their 21.4% interest in an Australia entity. The Australian entity was a mining company that held various mining rights that fell within the definition of TARP. It was clear that the 10% threshold had been reached. As such, the question of whether the shares held by the foreign resident were Indirect Australian Real Property Interests turned on the question of whether the market value of TARP interests held by the Australian entity was more than 50% of the value of all its assets (known as the principal asset test).

Central to the dispute was the methodology used by the taxpayer to value its non-TARP assets, in particular its mining information. It was the taxpayer's assertion that the market valuation undertaken on mining information (a non-TARP asset) resulted in a value so high that TARP comprised less than 50% of the assets by value. The Commissioner of Taxation (the Commissioner) challenged the valuation. After a somewhat lengthy process, the federal court found for the taxpayer. The case highlights the role that valuation methodologies play in the principal asset test and confirms that this is an area that the Commissioner will review and challenge.

Foreign residents firstly need to be aware that indirect interests in Australian real property can give rise to an Australian CGT exposure. In addition, undertaking a sufficiently robust market valuation process is critical to determining if the principal asset test has been met.

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SNAPSHOT

OF RECENT TAX CHANGES AFFECTING PROPERTY TRANSACTIONS

By Phil Shepherd, Principal, Pitcher Partners Adelaide

Our thoughts

At a federal level, a concerted effort has been made to clamp down on foreign residents avoiding tax on Australian real estate gains. While we support the efforts to ensure foreign residents are paying their fair share of tax, the new CGT withholding regime will affect many tax paying Australian residents who are now required to understand and comply with new legislation. The new regime imposes a compliance burden (and the penalties for non-compliance) on the purchaser, not the foreign land owner.

With the eastern sea-board continuing to experience growth in residential housing prices, fuelled by foreign investment, the "low hanging fruit" for state revenues is clearly the cost of entry into the market. Perhaps quite logically, the eastern states have each implemented their own surcharge regimes for foreign land owners. While it would have been nice to see some uniformity across the states and the federation as to whom exactly is a 'foreign person', it seems we now have different definitions for the purposes of:

- The federal CGT withholding rules
- The national agricultural land titles register
- NSW surcharge regime
- QLD surcharge regime
- VIC surcharge regime

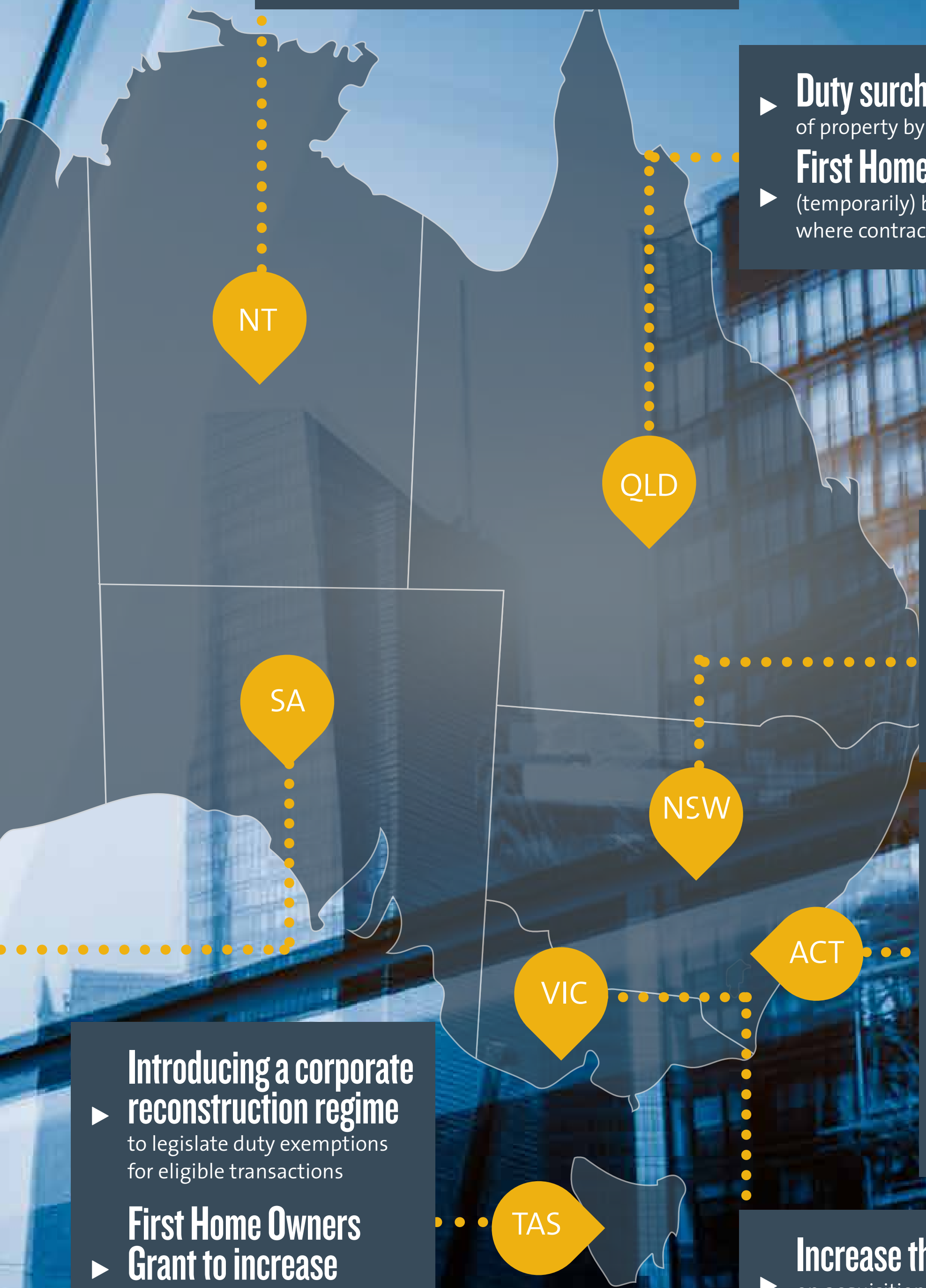
Given these differences, careful consideration should be given to the structure of landholding entities to minimise the impact of the surcharges as much as possible – both at the time of acquisition and on an ongoing basis – bearing in mind that some Australian entities may be deemed 'foreign persons' under the new rules.

FEDERAL

- A new CGT withholding tax regime applies from 1 July 2016. The new rules require a purchaser of a direct or indirect interest in TARP assets of $2 million or more to withhold 10% of the purchase price where the vendor is a foreign resident.
- National Register of Foreign Ownership of Agricultural Land Titles now operational
- New information sharing laws require the states and territories to provide information to the ATO about property transactions.

- **No changes** announced directly affecting property transactions

- **Phased abolition of duty on transfers** of non-residential, non-primary production land to be completed by 1/7/18
- **2 year Land Tax exemption** from 1/7/16 where a taxpayer renovates or rebuilds their Principal Place of Residence



A discount of up to 50%
(capped at $10,000) on the stamp duty for first home buyers purchasing an established home between 24 May 2016 to 30 June 2017

- **Duty surcharge of 3%** to apply to acquisitions of property by foreign persons from 1 October 2016
- **First Home Owners Grant to be increased**
(temporarily) by $5,000 for newly constructed homes where contract signed between 1/1/16 and 30/6/17

- **Duty surcharge of 4%**
to apply to acquisitions of residential land by foreign persons
- **Land tax surcharge of 0.75%**
on residential land owned by foreign persons

- **Phase out of duty**
on commercial property valued below $1.5m by 1/7/18
- **A flat rate of duty of 5%**
applying to the value of commercial property transactions > $1.5m from 1/7/18
- **Residential conveyance**
duty rates will continue to reduce each year

- **Introducing a corporate reconstruction regime**
to legislate duty exemptions for eligible transactions
- **First Home Owners Grant to increase**
by $10,000 between 1/1/16 to 30/7/17
- **Replace the current 'land rich' regime**
with a 'landholder' regime to align with other states

- **Increase the duty surcharge to 7%**
on acquisitions of residential property by foreign persons after 1/7/16
- **Land tax surcharge for 'absentee owners'**
of both commercial and residential property increasing to 1.5% from 1/1/17

MARGIN SCHEME TRAPS

– DOT YOUR I'S AND CROSS YOUR T'S

By Cole Wilkinson, Partner, Pitcher Partners Brisbane

The Margin Scheme was introduced at the same time as the GST legislation to provide a concessional treatment for the calculation of GST on certain sales of real estate, generally new residential sales.

As most property developers would know, the Margin Scheme can be very beneficial to the feasibility of a project, ultimately increasing the final project profit through the reduction of GST required to be remitted to the ATO. The base case concessional treatment under the scheme allows for the GST on a supply to be calculated as 1/11th of the 'margin'. The margin is defined as the difference between the original purchase price of the property and the sale price.

Eligibility for the Margin Scheme requires a number of key criteria to be met. As the full criteria are too detailed to be covered in this article, we have focused on some tricks and traps around documentation and valuations.

Firstly, the documentation requirements, although quite simple, can jeopardise the availability of the Margin Scheme if they are not correctly followed. In order to be eligible, the Margin Scheme must be agreed in writing by both parties.

This agreement must be made by the time the supply is made, which is usually the settlement date. The most common form for the written agreement is the inclusion of an election provision within the sale contract.

Developers should ensure they are aware of these requirements and check the draft contracts to ensure they meet the criteria.

It is also advisable to obtain proper advice from a lawyer or accountant prior to signing the contracts. Once the incorrect contract is signed, the developer would need to contact the purchaser separately to request they sign a separate agreement prior to settlement date.

This can be a difficult process and often will result in more scrutiny and questions from the purchaser than if it was included as a standard clause in the original contract.

If a signed agreement is not obtained by the settlement date, the developer would need to apply to the Commissioner of Taxation to request an extension of time. This process is lengthy and time consuming and is only granted under certain circumstances.

Another more complex area of the Margin Scheme that may require consideration is the valuation requirements.

The most common situation where a valuation is required is where the property was purchased prior to 1 July 2000.

Where a valuation is required, there are three broad methods that are approved by the ATO. These are:

1. Written valuation by a professional valuer
2. Adoption of the amount of consideration received by the supplier under an arm's length Contract before the valuation date
3. Adoption of the value determined by the Government as the most recent valuation of the land for rating or land tax purposes before the valuation date

Although the Margin Scheme has been in place for many years now, the legislation still contains a number of tricks and traps and it is important that developers ensure they obtain the correct advice and are comfortable that they have met all the requirements under the legislation.

Please contact your Pitcher Partners advisor if you require any assistance with any Margin Scheme enquiries.

Contact

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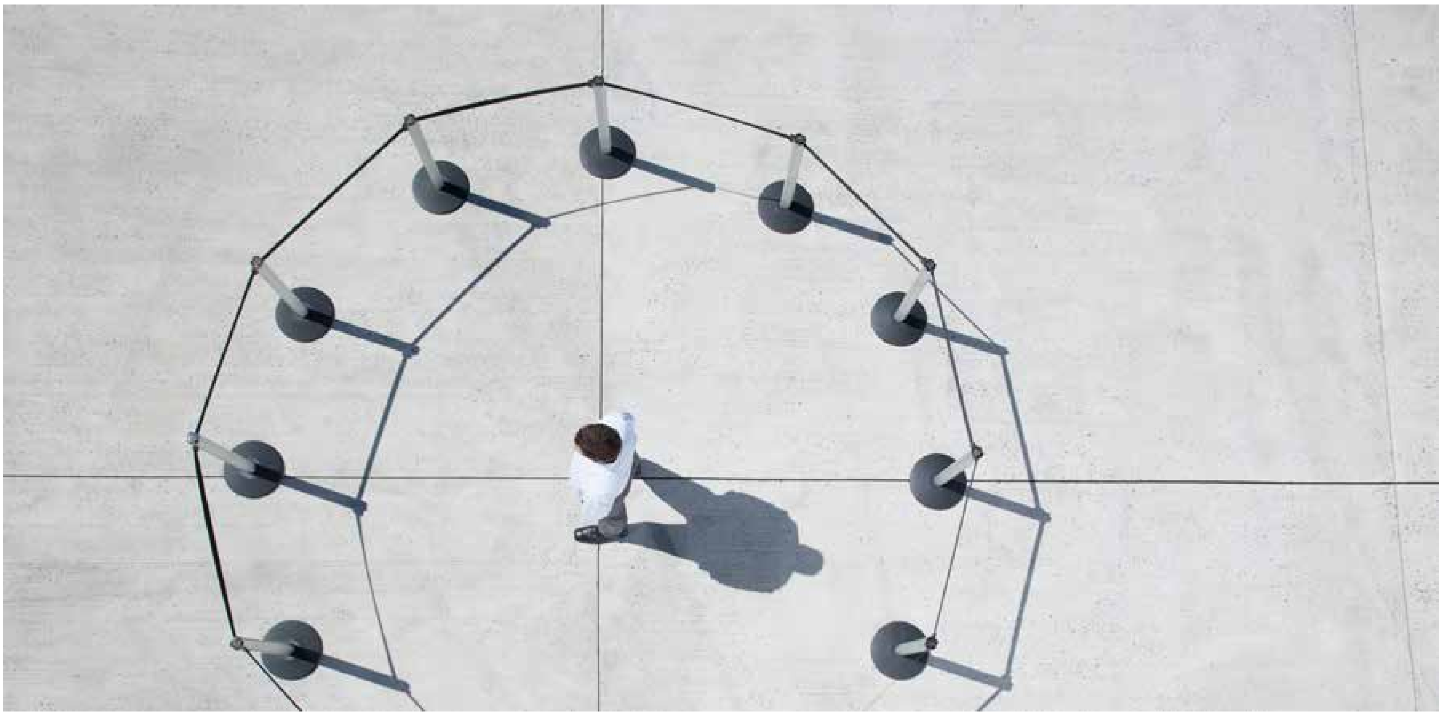

PROPERTY SALES IN THE FEDERAL GOVERNMENT'S CROSSHAIRS

By Scott Edden, Partner,
Pitcher Partners Newcastle

The number of Australian properties owned by foreign residents has increased. As a result, as of 1 July 2016, the government has enacted new laws to claw back up to 10 per cent of the sale price for real estate sold by foreign residents at $2m and above, under a Foreign Resident Capital Gains Tax Withholding Regime.

Broadly, this applies to all properties. Furthermore, if the purchaser does not receive a clearance certificate prior to settlement, they are required to withhold 10 per cent of the purchase price and remit it to the ATO. Failure to withhold will result in substantial penalties, namely an extra 10 per cent penalty, resulting in payment of 110% of the purchase price by the purchaser.

Who can prepare the forms to apply for a clearance certificate?

It is important to understand that only tax agents, practising solicitors or the taxpayer may complete the forms to apply for a clearance certificate. Conveyancers that are not practising solicitors are not able complete these forms.

What Australian resident vendors should know

If you are selling property with a market value of $2m or above, you will need to apply for a clearance certificate and provide this to the purchaser before settlement to ensure no funds are withheld from the sale proceeds.

This certificate is valid for 12 months. If you fail to provide this certificate by settlement, the purchaser would be required to withhold 10 per cent of the purchase price and pay this to the ATO. These certificates are taking approximately 28 days to be issued, which does not give much time within normal settlement terms. You should apply for a clearance certificate as soon as you place your property on the market, where the price is expected to be at or above $2m.

The ATO has implemented an automated process for issuing a clearance certificate and more information about this can be found on the ATO website.

In the event that a transaction contains multiple vendors, each vendor must obtain their own clearance certificate. A clearance certificate will also be required where a transaction is between members of a tax consolidated group.

Where the vendor is not entitled to a clearance certificate, but believes a withholding is inappropriate, the vendor can apply for a variation and a 'Variation application for foreign residents and other parties' form, requesting a lesser withholding rate be determined by the ATO.

What foreign resident vendors should know

The 10% withholding represents a non-final withholding tax and, as such, foreign resident vendors may still be required to lodge an Australian tax return in respect of a gain arising from the disposal of the relevant property, with a credit available in respect of any amount paid to the ATO under these provisions.

How can we assist?

For further information, or for assistance with completion of the clearance certificate application or preparation of a tax return in respect of a relevant property disposal, please contact your Pitcher Partners advisor.

Contact

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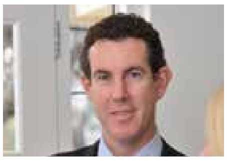

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