CHAPTER 20

What happens on sale of a farm or if your family inherits it?

This chapter deals with:

- GST on selling a farm
- various exemption schemes
- the optional margin scheme if a GST liability exists
- inheriting a farm
- the application of GST on death

Selling a farm

Introduction

It is very important to analyse the GST rules applying to the sale of your farm (or a part of it) before you set the price or put it to auction. If the sale is subject to GST, then you must pay 1/11th of the price in GST (subject to the potential operation of the margin scheme: see below). The rules are complex and can be confusing. It is important that you obtain advice from a solicitor or accountant who understands the way it works.

Example

You agree to sell your farm for $1,000,000. The sale is subject to GST. Within 21 days of the end of the tax period in which settlement takes place, you will be liable to pay $90,909 in GST. During that tax period you are entitled to input tax credits associated with other transactions of $10,000.

The net amount to pay is $80,909.

The following sections set out the factors that will help you to work out whether or not GST is payable. They can be summarised by the following analysis. If you work through these questions you will know whether or not you have to pay GST on the sale of your farm. The GST-free status only applies to the sale of land; anything included in the sale that is not land will be subject to GST unless it is the sale of a going concern. These things are discussed in more detail later.

1. Can you describe your farm as land on which a farming business has been carried on for at least 5 years?
   - if yes, go to 2,
   - if no, go to 3.
2. Does the buyer intend to carry on a farm business on the land too?
   - if yes, the sale is GST-free,
   - if no, go to 3.
3. If it is a walk-in-walk-out sale can and will you and the buyer agree to treat it as the sale of a going concern?
   - if yes, the sale is GST-free,
   - if no, go to 4.
4. Is the landowning entity registered or required to be registered?
   - if yes, go to 5,
   - if no, the sale is not a taxable supply and no GST is payable.
5. Will you choose to apply the margin scheme?
   - if yes, GST is payable only on the increase in value since 1 July 2000, or since you acquired it if after that date,
   - if no, the sale is subject to GST.

Carrying on a farm business

Farm sales will be GST-free if two very important conditions are met. The first is that someone, not necessarily the owner of the farm, has carried on a farm business on it for at least five years directly preceding the sale. The second is that the purchaser intends to do the same. However, only the land can be GST-free under this provision; the livestock, plant and equipment cannot be GST-free.

Example

Fred and Mary Smith have agreed to sell their farm to Ted Brown. They own the farm as tenants in common. A partnership of Fred and Mary has carried on the farm business for more than five years directly preceding the sale. Ted plans to carry on a farm business on the land in his own name as a sole trader.

The sale is GST-free.

Even if you haven't owned the farm for 5 years the sale will still be GST-free so long as someone carried on a farm business during the five years directly preceding the sale.

Example

Fred and Mary Smith have agreed to sell their farm to Ted Brown, who they know will carry on a farm business on it. They only bought the farm 3 years ago. The person they bought it from had carried on a farm business for 10 years. The sale is GST-free.

It is important to find out what the purchaser plans to do. If, for example, the purchaser plans to subdivide the farm and sell it for housing lots, then the sale will not be GST-free.

This situation can be avoided if your solicitor or conveyancer puts an appropriate clause in the contract of sale.

Example

Fred and Mary Smith have agreed to sell their farm to Ted Brown for $1,000,000. They own the farm as tenants in common. A partnership of Fred and Mary has carried on the farm business for the last 20 years.

They know that Ted intends to buy the land in a family trust, and to farm the land. What they do not know is that the family trust is not the entity in which he will carry on the business.

The sale is not GST-free. Fred and Mary will have to pay GST of $90,909 subject to any input tax credits they have to offset the liability.

Things other than land included in the sale

Fixtures, such as buildings and fences, form part of the land for normal legal and GST purposes. If the land is GST-free then the fixtures on it will also be GST-free. In broad terms anything that is fastened to the land with the intention that it will stay there indefinitely is a fixture. The reverse of this is that anything included in the sale that is not a fixture will be subject to GST if:

- your selling entity (ie the landowner, whether it is you or your family trust or company etc) is registered or required to be registered,
- it does not qualify as the sale of a going concern (if it does it will be GST-free).

Normally at least some things are included in farm sales that are not fixtures. Examples include livestock; portable yards; some shearing shed equipment such as handpieces, wool tables and electric wool presses; portable calf marking cradles; moveable irrigation equipment; and fruit bins.

Intergenerational transfers

Transfers between family members will also be GST-free provided the two basic conditions are met. In other words, the land has been used for farming for at least 5 years before the sale and the transferee intends to carry this on. This will tie in neatly with the intergenerational stamp duty exemptions available in many states.

Example

Fred and Mary Smith want to retire. They have agreed to transfer their farm to their son Christopher subject to the bank mortgage. Christopher wants to carry on the same business as his parents did. The transfer is GST-free.

Farm land can also be GST-free if sold to a family member even if the family member will not carry on farming, but only if sold at less than market value for potential residential purposes and subdivided from land on which farming has been carried on for at least 5 years.

Walk-in-walk-out (going concern) sales

If a farm is sold on a walk-in-walk-out basis then the sale may be GST-free. This means that no GST is payable on any part of the price, even if the land has one or more residences on it.

The following conditions must be satisfied before it is a GST-free sale:

- the buyer must be registered or be required to be registered for GST,
- the buyer and seller must agree in writing, before or at the time of sale, that it is the sale of a going concern,
- the seller must provide to the buyer everything needed to continue the business, and
- the seller must continue the business until completion.

Whether the buyer is registered for GST

Unless the buyer is already registered for GST or is required to be so, the timing of registration is a key issue if it is likely that the turnover for the month of delivery and the following 11 months will be less than $50,000. In this case the buyer is not required to register. The buyer must be registered when the supply is made. Usually this will be the day the sale is completed and delivery given.

If the likely turnover is $50,000 or more, then the requirement to register starts from the time the buyer does something in the course of commencing the business. The requirement to register will be in place on the day of delivery.

Example

Fred and Mary Smith agree to sell their farm on a walk-in-walk-out basis to Ted and Freda Brown. Fred and Mary agree to leave everything in the sale. The business has gross sales of about $40,000. The contract for sale has a clause by which they agree that the sale is of a going concern. Fred and Mary keep the business going until delivery.

Before the sale Ted and Freda were not registered because their previous business had been in a family trust. They know they have to register but fail to do so until the day after delivery.

Because at the time the supply was made Ted and Freda were not registered, and were not required to register, the sale is not GST-free.

Everything needed to continue the business is provided

It is important to include everything in the sale. This includes all the livestock, plant, equipment and land that the seller normally uses in the business (or at least sufficient of each that the buyer can continue to carry on a business).

Example

Fred and Mary Smith agree to sell their farm on a walk-in-walk-out basis to Ted and Freda Brown. Fred and Mary agree to leave everything in the sale except their stud rams. They want to take these to their next property.

The sale is not GST-free unless what they have sold can be carried on as a business without the stud rams.

The seller must be the "provider"

It must be the seller that provides everything needed to continue the business. Generally, the farm cannot be sold as a going concern if the farm business and the farmland are owned by different entities.

However, sometimes the structure of activities may be such that a different enterprise can be identified which could be sold GST-free as the sale of a going concern, for example if the land-owning entity leases the land to the operating entity. Nevertheless, while the land-owning entity could sell its enterprise in such a situation, the land is still a necessary ingredient of the operating business and so the operating entity would need to supply the land by assigning the lease to achieve GST-free status for its enterprise. As the purchaser would generally want title to the land, not just a lease, it may therefore not be possible to get both enterprises GST-free even if two separate enterprises can be identified in such a situation.

Example

Fred and Mary Smith agree to sell their farm to Ted and Freda Brown on a walk-in-walk-out basis. A partnership of Fred and Mary own the farm business. A family company owns the farmland. There is no formal lease between the family company and the partnership and no rent is paid for the use of the land.

The sale cannot be the sale of a going concern because only the family company, and not Fred and Mary, can supply the land – a vital part of the business.

The buyer must be the "acquirer"

It must be the buyer that acquires everything needed to continue the business. The farm cannot be sold as a going concern if the farm business and the farmland are purchased by different entities. The recipient of the supply (the purchaser) must receive from the supplier (the seller) everything necessary for the continued operation of the business.

Example

Fred and Mary Smith agree to sell their farm to Ted and Freda Brown on a walk-in-walk-out basis. A partnership of Ted and Freda will operate the farm business. However, they decide to buy the land in Freda's name only.

The sale cannot be the sale of a going concern because the partnership of Ted and Freda will not acquire the land – a vital part of the business.

The sale is not GST-free.

Again, depending on the formal structures involved, it may sometimes be possible to satisfy the requirement in relation to a narrower enterprise of one of the entities involved, but it is less likely in this scenario as the seller must also have been carrying on that enterprise.

Registration of the vendor

The sale will not be subject to GST if the entity selling it isn't registered or required to be registered.

Example

You are selling your farm. It is owned by a family trust that you control. You have carried on the farm business as a sole trader and have not been paying any rent to the trust. You are registered for GST purposes but your family trust is not. The trust does not carry on any business and is not required to be registered.

The sale is not subject to GST.

Does the sale price include GST?

If your analysis shows that the sale will be subject to GST, then you will have to consider whether or not you can sell on a GST-exclusive basis. In other words, whether or not you can require the buyer to pay an extra 10% to cover the GST that you must pay out of the price.

GST, if it is payable, is 1/11th of the price. You can only recover this amount from the purchaser if the contract for sale gives you that right. It is very important to check this with your solicitor or conveyancer.

Contracts for sale must specify either that GST is included in the price, or that the buyer must pay an extra 10% to cover GST.

The amount of GST payable on a sale

GST is payable on the gross selling price of land to the extent it is not input taxed. If you are liable to GST on the sale price, then you will be entitled to a refund (an "input tax credit") on your expenses of sale, to the extent they were not incurred to make an input taxed sale.

The sale will be partly input taxed if the property includes a residence. For GST purposes this means a building and surrounding land that is either:

- occupied as a residence, or
- intended and capable of being occupied as a residence.

Example

You sell your farm for $1,000,000, including GST. A deposit of $100,000 is paid to the agent when the contract is signed. On settlement $200 is deducted from the price to cover the purchaser's cost of registering the discharge of the mortgage on the farm. $500 is added for rates paid in advance. The agent's commission of $25,000 is deducted from the deposit. Your legal fees and disbursements are $5,000. The net amount received is $970,300.

The separate value of the homestead and station hands' cottages is assessed at $100,000.

You must pay GST on $900,000 (ie $1,000,000 sale price less value of homestead and cottages), which at 1/11th of $900,000 is $81,818.18. The $100,000 appropriated to the residences is input taxed and therefore not subject to GST.

You are entitled to an input tax credit for 90% of the expenses of sale. You are not entitled to an input tax credit for expenses incurred in making a sale of the residences.

The $200 deducted to register the discharge of the mortgage will not entitle you to an input tax credit because the discharge is a financial supply and therefore input taxed. The deduction of $500 for rates paid in advance will not reduce the GST payable because it is part of the way in which the price is paid.

Provided you satisfy the conditions for eligibility, you will be entitled to an input tax credit of 1/11th of 90% of the commission of $25,000 and the legal fees of $5,000, or $2,454.54. The net amount payable in relation to the sale is $79,363.64.

Margin scheme

If your farm sale is subject to GST you can choose to apply what is called the "margin scheme". You can choose to apply this when you file your GST return for the tax period in which you finalise the sale. Broadly speaking, if you do choose to apply the margin scheme you will only pay GST on increases in value after 1 July 2000.

If you bought your farm after 1 July 2000, and the margin scheme was not used by the person who sold it to you, then you are not allowed to use the margin scheme either.

The amount of GST you pay is 1/11th of the "margin".

If you bought the farm after 1 July 2000, then the margin is the amount by which the net sale price exceeds the net purchase price. If you bought the farm before 1 July 2000, then the margin is the difference between the net sale price and a valuation as at 1 July 2000.

If you buy the farm before 1 July 2000 but don't become registered, or required to be registered for GST purposes until after 1 July 2000, then the valuation must be done on the date you become registered, or the date on which you apply for registration, whichever is the earlier. It is important to note that this only applies if there were no improvements on the farm as at 1 July 2000. If there were improvements, then the valuation must be done on that date.

Finally, it is important to remember that you do not need the purchaser's consent to make this choice. This can have a harsh effect on the purchaser because if you do choose to apply the margin scheme, then the purchaser is not entitled to an input tax credit.

Example

You sell your farm at auction for $1,100,000. Nothing was said by the auctioneer about GST. As it happens the sale is subject to GST.

You discuss this with your accountant. 1/11th of the sale price is $100,000. You would rather not pay this.

Your accountant suggests you choose the margin scheme in your GST return. You bought the farm before 1 July 2000 with improvements on it. You obtain a valuation which comes in at $990,000. You pay GST of 1/11th of the margin of $110,000 which amounts to $10,000.