# FINANCE

PROPERTY

Abdul Ghani Ismail

# GST POSER ON PROPERTIES

Should developers include GST in their pricing prior to the April 1 deadline? *Personal Money* looks into the issue.

***By Nurul Iman Dimyati***

In anticipation of the Goods and Services Tax (GST), demand for properties is expected to surge before its implementation in April 2015.

Terence Wong, property analyst at CIMB Investment Bank Research, says this will not be a surprising scenario. Buyers are expected to take advantage of current market conditions following a slew of efforts by the government last year to cool property prices and rein in household debt.

"When it comes to prices, the pre-GST prices are still the question (whether it will go up). Post-GST, we will definitely see a rise," Wong says.

Bank Negara Malaysia imposed a number of cooling measures last year to arrest rising property prices. These included putting in place more stringent criteria for mortgage loans.

On the fiscal front, the government raised the Real Property Gains Tax (RPGT) to 30% for properties disposed of within three years. It also raised the value of properties that foreigners are allowed to buy from RM500,000 to RM1 million.

However, there have been concerns about whether GST will be chargeable on properties that have been invoiced and paid for in full before April 2015 but the title transferred only after that date. This is based on speculation that developers have been doing GST-related re-costing exercise ahead of the April 1 deadline.

Wong says he won't be surprised if developers are making preparations for it, but adds that the completed ones will not incur the extra cost. Those still under construction will probably incur additional costs. This includes the tax-exempted residential properties.

"For residential properties, the impact of the proposed GST framework may result in pressure on selling prices, depending on the ability of the supply chain to harness tax savings." > WAN

## PRE- AND POST-GST SCENARIOS

PwC Malaysia senior executive director Wan Heng Choon says the proposed GST law will treat residential properties as exempt supplies. This means the GST will apply throughout the supply chain until the developer. The supply chain includes building materials suppliers and contractors.

"For residential properties, the impact of the proposed GST framework may result in pressure on selling prices, depending on the ability of the supply chain to harness tax savings," he explains.

Tax savings are mainly in the form

of sales and service tax (SST), of between 5% and 10%, which will be removed once GST is in place.

Supplies, which were previously not subject to sales tax, will be taxable under GST, which is a broad-based tax. There will be an increase in the cost base, thus putting pressure on the selling price for end-buyers.

Materials such as timber, sand, stones, water, electricity, development services and labour are currently not subject to the SST. However, these will be subject to GST.

Unlike residential properties, the sale of commercial properties will be subject to the 6% tax. In this case, the impact of GST should be tax neutral since the buyer is entitled to claim input tax credit on the purchase of the property.

But according to Wan, it will adversely impact investors who acquire commercial properties that are not used as premises for a business. He explains, "For example, an individual buys a shoplot to derive rental income and decides not to register for GST because the rental received, together with any other taxable supplies that he makes, do not exceed the RM500,000 registration threshold. In this scenario, the GST will increase the price paid by the buyer."

Regarding pricing adjustments for the tax prior to GST implementation, Wan says some developers have included GST clauses into the agreements prior to the announcement of the tax. However, for those that did not, they may have to absorb the tax on commercial properties as part of their margins if they cannot convince the buyers to renegotiate the consideration for the sale (where they are able to claim input tax).

"Developers are just beginning to take stock of the tax in their business, the effects of which are most likely to translate into higher prices after April 1, 2015," he says.

Crowe Horwath managing partner Poon Yew Hoe opines that this is a game of tug of war between contractors and developers, as construction costs are charged to developers by contractors. "Based on our experience, it will appear that the contractor has not really agreed to lower the prices yet. If the contractors don't lower the prices, then it means the developer themselves will have to bear GST."

Poon explains that in the pre-GST scenario, a developer only has to pay the contractor RM10 million. But once GST kicks in, the contractors are going to charge RM10 million plus 6%. This RM600,000 is called input tax and it cannot be recovered from the government in the future and becomes an extra cost for them. Due to this unrecovered GST, the cost to the developer increases.

"It is a situation of whether the developer is willing to absorb it and make a lower profit. The developers' decision will probably be based on what the market can bear and what their competitors are doing," he says.

However, Poon adds that a situation where developers re-evaluate their pricing should not arise pre-GST. Developers would have the construction contracts locked in already, except if it is a work in progress, where the contractor is required to charge GST on the work done after April 1, 2015.

"Let's say my construction cost comes up to RM6 million. That RM6 million contract is up to April 1, 2015, and has been done up to RM5 million. The contractor won't charge GST on that RM5 million, but the contractor must still charge me GST on the RM1 million that hasn't been spent. When the contractor charges that extra cost, there's this dispute as to who will bear it.

"If the developer bears the GST, it will make less profit. If the contractor bears the GST, then the contractor makes less profit. That is going to be a problem. Developers' prices to the buyers cannot be changed anymore because most of these people have already signed the contracts," explains Poon.

For units that have not yet been sold, the developer will look at the market to see how strong demand is. They will price the property based on what they think is reasonable to ensure profit margin is not impacted.

It is up to the market to decide whether to buy at that price. If a project hasn't been launched, or has been launched but units haven't been sold yet, the developer may adjust the price.

It is difficult for consumers to determine whether the prices quoted for residential properties have already factored in GST in both scenarios. However, suppliers of commercial property will have to disclose the GST in the value of invoices issued or agreements entered into after April 1, 2015.

Real Estate and Housing Developers' Association (Rehda) Malaysia executive committee member Sam Tan says residential properties currently do not include GST. The increase in house prices, he adds, is due to cost push factors, such as high land cost, conversion charges, development charges, premium cost, quit rent and stamp duty. High capital contributions and compliance cost also contribute to the increases in selling prices.

"Until such time GST kicks in, developers will not include the tax in their selling price, unless there is a clause in the contract signed prior to the GST announcement in 2013 that prices are subject to review pending GST implementation," says Tan.

However, in the post-GST scenario, he says residential property developers might be forced to increase the selling price to make up for the extra cost, and they will have to make a choice of either absorbing it or reducing their profit margin to remain competitive. "Chances are developers will adjust according to market conditions, where the extra cost is passed on to property buyers," he says.

Rehda suggests that the first two years following the implementation of GST be considered "provisional" or "learning curve" period, and proposes that the government does not impose heavy penalties on developers during that period.

The association also proposes that affordable housing be zero-rated and treatment for residential properties to either be zero-rated or at least standard-rated. This means that developers can claim back the input tax from the government and do not have to pass on the increase to house buyers.

Malaysian Institute of Estate Agents (MIEA) president Siva Shanker says it is inevitable that developers will pass on the costs to the buyer. However, when speaking of increased prices before GST, he believes it is all a matter of supply and demand.

"I don't think developers are increasing the price because of GST. I think they are increasing their prices because they are doing very well and selling everything. If they have the last block available for sale, they will try to push up the price."

## CONSUMERS' CONCERNS

National Consumer Complaint Centre (NCCC) president Datuk Paul Selvaraj has voiced his concerns about the whole value chain when it comes to GST. "Our concern with any supply chain now is that people may not pass the savings to the consumer and may pocket the difference."

As housing is a major concern and issue for consumers, he hopes extra focus will be put on it. This is to ensure consumers are not taken for a ride in the name of GST.

"We just want to make sure there is no profiteering in terms of people using GST as an excuse to inflate prices beyond the tax value, and that [enforcement] can only be done by the authorities after studying the tax figures that have been submitted.

"They must submit the data all along the supply chain, so the tax authorities can make sure there is no profiteering on any part of the chain," he says. So far, there has been no official GST-related complaints over properties.

All the experts advise property buyers to be extra vigilant over the next few years, while waiting for the market to normalise. Siva says buyers should look at the developer's track record, the property itself and the sale price.

Some research and analysis on the market price is recommended. If it is higher than the market price, he cautions people to avoid buying it. He believes that if enough people refuse to buy, developers will correct their pricing structure and bring it down to a more reasonable level.

Poon suggests that consumers be more careful with their sale and purchase agreements. "In my sale and purchase agreement, I will note two things. One is that the developer shouldn't charge any GST [pre-GST]. If they charge me GST, I need a bank loan to finance the extra GST. That can be a problem.

"Item two is, notwithstanding that the developer cannot charge me GST on the property itself pre-implementation, but under the law, the developer should be able to charge me GST on the extras (for projects completed after March 31, 2015). This means the free items that come after the completion of construction, such as free kitchen cabinets, air conditioners and so on. So, whether the developer charges me GST on these extras must be checked. At the end of the day, it depends on the agreement."