

# CONSULTATION PAPER ON THE REVIEW OF THE MARGIN SCHEME

The Government announced on 12 May 2009 it will review the operation of the GST margin scheme. The review flows from a Board of Taxation recommendation in its review of the Legal Framework for the Administration of the Goods and Services Tax (GST). The review will examine the effectiveness and efficiency of the margin scheme in achieving its policy intention.

The Treasury invites public comment on whether the margin scheme is meeting its objectives and what improvements would streamline its application and further reduce compliance costs and maintain the integrity of the GST. To facilitate this, the Treasury has prepared the following discussion paper.

## SCOPE OF THE REVIEW

The margin scheme has been a feature of the GST regime (Division 75 of the GST Act) from its commencement on 1 July 2000.

The application of GST to real property transactions, in particular the margin scheme, was raised at most of the consultation sessions which the Board of Taxation held during August 2008 as part of its Review of the Legal Framework for the Administration of the GST. Submissions raised concerns about the complexity and compliance burden arising from the current provisions and the scheme's failure to meet its objectives in all circumstances.<sup>1</sup>

The administrative compliance burden imposed on taxpayers in the residential property sector may (for some taxpayers, in certain situations) become more of an impost than the value of the underlying concession afforded by the margin scheme. [Property Council of Australia]

The policy intent behind Division 75, in the Institute's opinion, is an attempt to allow the vendor of real property to restrict the GST payable on the taxable supplies of real property to the value added since 1 July 2000 in the course of a GST registered enterprise. While the Institute supports this policy, we submit that Division 75 in its current form has serious flaws and fails to achieve the basic rationale behind a margin scheme. [The Institute of Chartered Accountants in Australia]

Industry representatives also raised similar concerns through the National Tax Liaison Group forums held by the Tax Office.<sup>2</sup>

This discussion paper explores options to improve the mechanism used to achieve margin scheme objectives, in particular, to reduce the complexity of legislative provisions and

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1 Board of Taxation, *Review of the Legal Framework for the Administration of the Goods and Services Tax*, December 2008, pages 94-96.

2 The forum membership comprises representatives of the major tax, law and accounting professional associations and senior members of the Tax Office. Minutes of the NTLG GST Sub-committee can be accessed via the following web site: <http://www.ato.gov.au/taxprofessionals/pathway.asp?pc=001/005/036>.

ensure they operate effectively. The underlying policy objectives of the margin scheme are not the subject of this review.

Broader property-related issues, such as the distinction between residential/commercial residential premises, fall outside the scope of this review. These issues go beyond margin scheme considerations.

A number of the Board of Taxation's recent recommendations relating to GST administration will affect the scope of the margin scheme review, for example, recommendations on the sale of going concerns, partnerships and redesign of adjustment provisions.<sup>3</sup> As the Government implements these recommendations consideration will be given to their interaction to ensure margin scheme policy objectives are achieved. Further opportunities will arise for consultation as these measures are implemented and consequently fall outside the scope of this review.

## What is the intention of the margin scheme

The margin scheme intends to ensure that GST is payable only on the incremental value added to real property (for example, a freehold interest in land) by each registered entity in a series of transactions on or after 1 July 2000. The Explanatory Memorandum (EM) to the GST legislation, in discussing the margin scheme, states<sup>4</sup>:

This will ensure that the GST is only payable on the value added after the commencement of the GST system.<sup>5</sup>

This policy intent was recently reaffirmed by the Government in the EM to *Tax Laws Amendment (2008 Measures No. 5) Act 2008* (145 of 2008):

GST is intended to be payable on the value added, including capital appreciation, to real property on or after 1 July 2000 (the date that GST commenced) by an entity registered for GST.

The margin scheme was designed to ensure that GST is payable only on the incremental value added to land by each registered party in a series of transactions.

Broadly, the margin scheme is designed to ensure that if parties agree to apply the scheme:

- the value added to real property before it enters the GST system (generally, 1 July 2000) is not taxed;
- as a general rule, each registered entity that sells real property pays GST on the value added only<sup>6</sup>; and

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<sup>3</sup> Board of Taxation, *Review of the Legal Framework for the Administration of the Goods and Services Tax*, December 2008, recommendations 33, 36, and 4, respectively.

<sup>4</sup> See paragraph 6.100 of the Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act).

<sup>5</sup> That is, to value added on or from 1 July 2000 or a later date, depending upon whether the owner of the real property was registered, or required to be registered, as at 1 July 2000 or a later date, or if the supplier is the Commonwealth, State or Territory government, to value added on or from the day the taxable supply takes place.

- the value added to real property by private consumers is not taxed.<sup>7</sup>

Although it delivers a more favourable GST outcome for the acquisition of real property than the application of the basic GST rules, the margin scheme is not intended as a property and construction industry assistance measure.

## How does the margin scheme currently work

Under the margin scheme, GST is generally payable only on the value added to real property from 1 July 2000 (the date the GST Act starts). It levies GST only on the 'margin' or the increase in the value of the property each time it is sold after 1 July 2000.

Therefore, the buyer and seller of real property can agree to calculate GST under either:

- basic rules where GST is 1/11<sup>th</sup> of the GST inclusive price and the buyer may be able to claim an input tax credit (ITC); or
- margin scheme where, subject to certain eligibility criteria being met, GST is 1/11<sup>th</sup> of the margin and the buyer cannot claim an ITC.

Under the margin scheme, the margin, or value added that is subject to GST, is equal to the difference between the price the property is sold for and if it was acquired:

- before 1 July 2000 – the value of the property as at 1 July 2000 or the date the supplier was registered for GST or applied for registration (the valuation method); or
- after 1 July 2000 – the price it was acquired for (the consideration method).

Some important restrictions also apply to the use of the margin scheme. For example, the margin scheme can only apply where:

- the property was not acquired as a taxable supply under the basic rules. This is because the buyer would have claimed an ITC on the property's purchase and therefore GST would not have been collected on the marginal increase in value; and
- there is a written agreement between the supplier and recipient that the margin scheme is to apply.

As the margin scheme represents a departure from the basic rules under the GST law it necessarily involves some additional level of 'complexity' to ensure it interacts with other GST provisions. It may require obtaining valuations of real property as at 1 July 2000 or identifying if the seller is eligible to sell using the margin scheme.

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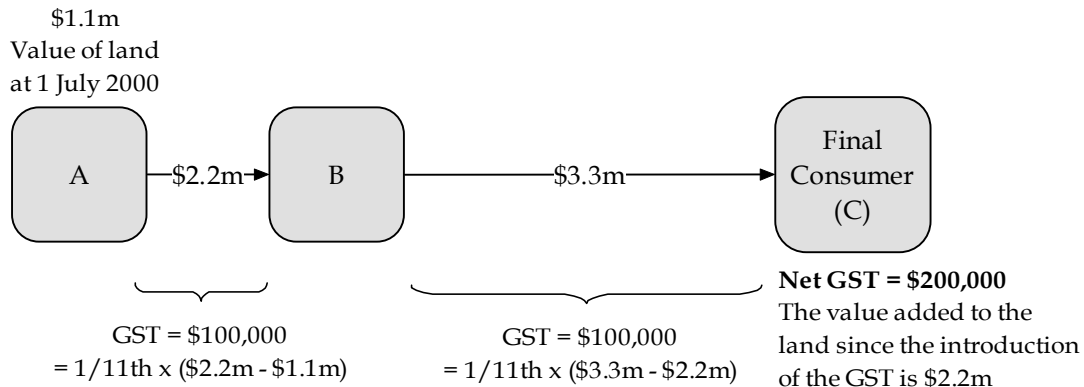
6 The amendments to the margin scheme in Schedule 1 of *Tax Laws Amendment (2008 Measures No.5) Act 2008* (145 of 2008) in effect impose the cost base of one entity onto another entity in specified circumstances, such as the sale of property acquired previously as part of a sale of a GST free going concern. However, this is intended to ensure that GST is paid on all the value added to real property by registered entities on or after 1 July 2000.

7 As discussed later, concerns have been raised that the current legislation does not always give effect to this policy intention.

### Example — Margin Scheme post-1 July 2000

GST = 1/11th of the margin of the supply of real property

**Margin** = GST exclusive sale price less either valuation or GST inclusive cost



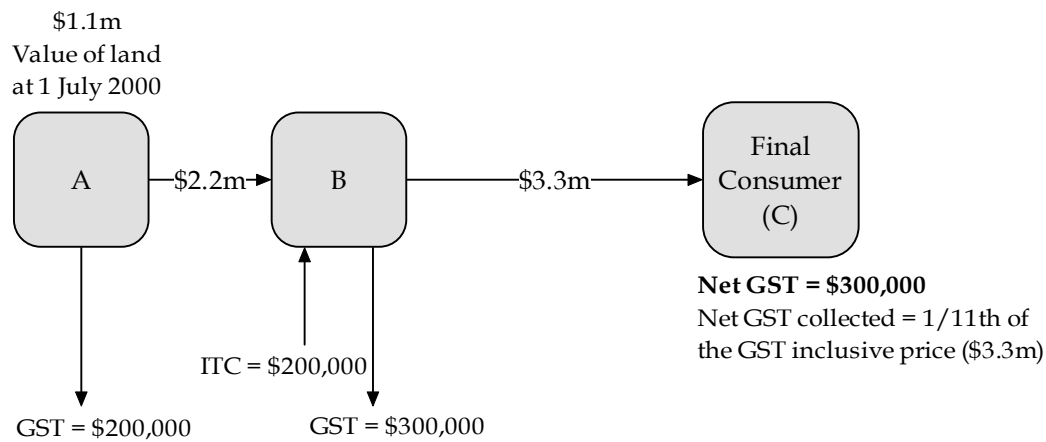
Registered property owner A sells vacant land to developer B who in turn builds a luxury house on the property and sells the property to final consumer C.

Under the margin scheme, GST is payable on the difference between A's purchase price (or value at 1 July 2000) and sale price to B (1/11<sup>th</sup> of the margin, or \$100,000). Under the margin scheme no ITCs are available for the purchase of the vacant land. When the developed property is sold to C under the margin scheme, GST is payable on the difference between B's purchase price and the sale price to C (1/11<sup>th</sup> of the margin, or \$100,000). As a result, GST has been paid on the value added to the property in each transaction (1/11<sup>th</sup> of \$2.2 million being \$200,000 of GST).

### Example — Basic rules post-1 July 2000

**GST = 1/11th of the GST inclusive sale price**

**ITC = 1/11th of the GST inclusive cost**



Registered property owner A sells vacant land to developer B who in turn builds a luxury house on the property and sells it to the final consumer, C.

Under the basic rules the sale to B would be taxable supply, so A remits GST (1/11<sup>th</sup> of the sale price) and B claims an ITC for the same amount. In effect there has been no net revenue collected from this transaction. When the property is sold to C, the supply is a taxable supply so B remits GST (1/11<sup>th</sup> of the sale price) and C cannot claim an input tax credit.

The above examples illustrate how the margin scheme can be used to exclude GST applying to the value of real property before 1 July 2000 and how each registered entity pays GST only on their value added. Where entities use the basic rules, the pre-1 July 2000 value of property is taxed as GST is applied to the full sale price which, using the above example, includes the pre-1 July 2000 value of the land (valued at \$1.1 million as at 1 July 2000). In applying the margin scheme to the transaction, this pre-1 July 2000 value is not subject to GST.

## ISSUES FOR DISCUSSION

### Does the margin scheme's current legislative framework operate as intended?

Division 75 of the GST Act provides the legislative framework for the margin scheme's operation. The Division also contains other provisions to ensure the scheme's integrity and that the original policy intention is met. A number of public rulings and other publications issued by the Commissioner of Taxation support this legislative framework and assist taxpayers with the law's interpretation and application.

The margin scheme provisions in the GST Act, over time, have:

- been subject to a series of legislative changes primarily targeted at arrangements that sought to apply the margin scheme in ways not intended and with outcomes inconsistent with the policy intention. These measures have largely been aimed at maintaining the integrity of the GST base. For example, by addressing arrangements aimed at increasing the cost base available and thereby reducing the margin upon which GST is payable. It is

worth noting that of the 10 Taxpayer alerts issued by the Commissioner of Taxation that relate to GST, four specifically involve the margin scheme;

- required clarification on the scheme's application, giving rise to compliance costs for taxpayers and administrative costs for the Tax Office. This level of uncertainty in how the scheme should apply may be reflected in adverse audit findings, a disproportionate level of taxpayer objections and increasing litigation.

Submissions made to the Board of Taxation's review raised the following examples of where the existing margin scheme resulted in perceived outcomes that were inconsistent with the stated policy intention or problematic in its application:

- dealings in property by general and tax law partnerships raise doubts as to whether the margin scheme can be effectively applied to certain supplies made either between partners of the partnership or by the partnership itself (see issue 1 of Attachment);
- there is no provision allowing a decreasing adjustment where an entity acquires real property under the margin scheme but subsequently sells part or all of the real property as a fully taxable supply. In these circumstances there is embedded GST (see issue 2 of Attachment);
- while the value of real property brought into the GST system after 1 July 2000 is excluded where the real property was held before 1 July 2000 by an unregistered entity, this does not generally apply in circumstances where the real property has been acquired after 1 July 2000 by another unregistered entity and subsequently brought into the GST system (see issue 3 of Attachment).

#### Questions:

1. Are there other examples where the application of the margin scheme provisions result in outcomes that you consider to be inconsistent with the stated policy intention?
2. Are there other areas of the margin scheme that you find to be problematic?

Other submissions made to the Board of Taxation's review highlighted the complexity and compliance burden associated with the application of the margin scheme. These included that:

- some 30 per cent of all GST litigation is property related, with about one-third of these involving aspects of the margin scheme<sup>8</sup>;
- there are over 200 pages of Tax Office publications<sup>9</sup> outlining their view on how the margin scheme's operation and the Courts have, in some cases, taken views which have appeared inconsistent with existing practice;

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8 Based on litigation cases as at 27 February 2009, there were 155 cases before the courts, 48 of which relate to property and 16 of these involve the margin scheme.

9 Margin scheme issues are specifically addressed in six Goods and Services Tax Rulings (GSTR) plus one draft GSTR, a Goods and Services Tax Determinations (GSTD), four Law Administrative Practice Statements (PSLA)

- the need to obtain valuations for margin scheme purposes has added to the compliance burden, as has the level of disputation between taxpayers and the Tax Office over professional valuations obtained specifically for margin scheme purposes. There are currently some 24 disputes involving valuations obtained by taxpayers<sup>10</sup>;
- if the number of private ruling requests is any guide<sup>11</sup>, then the fact that 341 results are returned from a search of the term 'margin scheme' provides some indication of the level of uncertainty that exists in the community and demands placed on the Tax Office in interpreting and applying the current provisions;
- developers choosing to acquire real property under the margin scheme face additional carrying costs because they are denied input tax credits (in effect, the GST borne in acquiring real property under the margin scheme is carried until such time as the real property is sold);
- purchasers may be required to 'look through' the current transaction going back a number of years to obtain information about earlier valuations for the property being acquired or, indeed, to establish if the vendor is eligible to sell using the margin scheme, adding to compliance costs and uncertainty.

These, and other compliance issues, along with the level of uncertainty arising from the existing legislative framework, adds to business costs in the construction and property development sectors of the economy, costs which then flow through to end consumers. This also adds to administration costs for the Tax Office and opportunity costs associated with litigation through the courts.

#### Questions:

3. Are there other instances where you consider that the current legislative and administrative application of the margin scheme is unnecessarily adding to complexity and costs of compliance?

## Options for discussion

The options canvassed here are aimed at simplifying the existing legislative framework, removing unnecessary complexity and uncertainty while achieving the same policy outcomes and maintaining the integrity of the GST base.

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and five Margin Scheme Legislative Determinations (MSV), as well as six fact sheets and other sources such as the Issues Register on the Tax Office website.

10 The use of valuations and how this was being administered by the Tax Office was also commented upon by the Inspector-General of Taxation in his report on the 'Review of the Tax Office's administration of GST audits for large taxpayers, 22 January 2008'.

11 As measured by the number appearing on the Register of Private Binding rulings, The Commissioner began publishing edited versions of private rulings on the register from 1 July 2001.

We would welcome your views on some or all of the options explored below as well as any others which you consider could reduce complexity and compliance costs.

### **Option 1: Replace existing legislative framework with a clear set of principles<sup>12</sup>**

This approach would see the current approach being retained as the basis for delivering the intended policy outcomes, but simplifying the existing legislative framework with a collection of principles.

The advantages of adopting a robust set of principles include:

- clearer communication of the policy intent of the law which can often be masked by a series of lengthy black letter law provisions;
- increased flexibility in the law to deal with new developments or structures which may not otherwise qualify for treatment under the existing law yet fall within the policy intention as outlined by Parliament;
- fewer legislative amendments; and
- greater certainty and reduced compliance costs as a coherent principles approach would provide clear guidance as to the desired GST outcome for any given set of transactions dealing with real property.

This approach may result in some greater use of the private rulings process until taxpayers become familiar with the changed law. However, it is not clear that this would result in a net increase in private ruling requests. There are already significant numbers of private ruling issued in this area. It should also be noted that the large body of case law and ATO materials dealing with the existing law would be expected to have continued relevance under this alternate approach.

#### **What might a set of principles look like?**

Below is an example, at a high level only, of what a set of principle may look like. A final set of principles would only be enacted after further detailed consultation with interested stakeholders.

Treasury would welcome any alternative suggestions you may have.

#### **Example of a principled approach — margin scheme**

*Object: the policy intent underlying the margin scheme is threefold:*

- *The first is to ensure that GST is not payable on the value of real property so far as that value has already borne GST. This is an essential feature of a GST regime.*
- *The second is to ensure that GST is not payable on the value of real property so far as that value changes while the property is owned by an unregistered entity.*

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<sup>12</sup> For a detailed discussion of principle-based drafting see Greg Pinder, 'The coherent principles approach to tax law design', Economic Roundup, Autumn 2005, The Treasury.

- *The third is to ensure that GST is not payable on the value of real property so far as that value represents the value of the property at 1 July 2000. This reflects a decision not to include values as at 1 July 2000 in the GST base.*

#### **Principle to achieve all three objectives:**

*If you make a taxable supply of real property and you and the recipient agree in writing that the margin scheme is to apply, GST is payable only on any increase in value of the real property since:*

- *you acquired it; or*
- *if you acquired it before 1 July 2000 – the start of 1 July 2000, or when you first became registered or required to be registered, whichever is later;*

*unless you acquired the entire property through a taxable supply on which the GST was worked out under the basic GST rules.*

*If the margin scheme applies, the recipient is not entitled to an input tax credit for acquiring the real property.*

#### **Unfolding this principle**

Adopting a set of legislated principles would still require a series of procedural rules<sup>13</sup> to cover:

- eligibility criteria relating to GST groups, joint ventures, going concerns, farmland and associates which are in addition to the general criteria that the property must not be acquired through a taxable supply on which the GST was worked out under the basic rules;
- adjustments relating to input tax credit entitlements, bad debts and later payments, as well as adjustments to avoid taxing the value added more than once; and
- rules for determining the cost base for margin scheme purposes. For example, in most cases, the acquisition price and disposal price reflect the value of the property at the time of acquisition and disposal. In non-arm's length cases, it would be open to the Commissioner to determine that the consideration did not reflect the actual value.

The principles eventually developed would need to be tested by way of further consultation to ensure they achieve the stated policy outcomes and ensure the integrity of the GST base.

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<sup>13</sup> These procedural rules could be either legislated or further developed by the Tax Office using the existing public rulings processes, or a combination of both. Alternatively, some of these procedural rules could be dealt with through amendments to the existing special GST rules themselves (for example, the grouping provisions) rather than adding to the margin scheme provisions.

### Questions:

4. Would a clear set of principles reduce margin scheme compliance costs and lead to greater certainty when dealing with transactions involving real property?
5. Would you prefer that procedural rules supporting the principle be legislated or developed by the Tax Office?
6. Do you foresee any concerns with such an approach?

### Option 2: Replace the margin scheme with a notional input tax credit regime

This option involves replacing the margin scheme with a notional input tax credit regime, like the second hand goods provisions contained in Division 66 of the GST Act. The main difference in approach is that rather than taxing the difference between the sale price and the cost of acquisition or the valuation (that is the margin), the full sale price would be subject to GST, but a notional input tax credit would be provided in respect of real property that enters or re-enters the GST system (as outlined below).

A feature of Australia's second hand goods approach is that notional input tax credits are available, not upfront upon acquisition, but as an offset to GST payable on a subsequent sale. This differs significantly from the New Zealand second hand goods approach, which also applies to land, where the notional input tax credit is generally available upfront.

#### Broad overview of this option

In its simplest form, the regime would provide a notional input tax credit to an entity that makes a taxable supply of real property<sup>14</sup> that:

- the entity acquired before 1 July 2000; or
- the entity acquired on or after 1 July 2000 through:
  - a supply made by an unregistered entity; or
  - a supply made by a registered entity that was not made in the course or furtherance of an enterprise; or
  - a GST free supply of unimproved land made by the Commonwealth, a State or a Territory;
  - a supply that is GST free under section 38-475 of the GST Act (farmland) or GST free under section 13 of the GST transition Act <sup>15</sup>; or
  - an input-taxed supply.

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<sup>14</sup> The supply would still have to satisfy criteria similar to that in subsection 75-5(1) of the GST Act. That is, a notional input tax credit would not, for instance, be given to an entity that makes a supply by way of a short-term lease.

<sup>15</sup> *A New Tax System (Goods and Services Tax Transition) Act 1999*.

The amount of the notional input tax credit provided to an entity for real property it acquired before 1 July 2000 would be equal to 1/11<sup>th</sup> of the value of the real property as at 1 July 2000 or the date the entity registered for GST<sup>16</sup>; whichever is the latter.

Where the real property was acquired on or after 1 July 2000 the notional input tax credit provided would be equal to 1/11<sup>th</sup> of the purchase price of that property.

In both instances, the notional input tax credit would be attributable to the same tax period as the GST payable on the entity's taxable on-supply of the property. The amount of the notional input tax credit would be limited to the amount of GST payable on the on-supply.<sup>17</sup>

This regime would otherwise generally rely on the basic GST rules. If an entity which receives a notional input tax credit makes a taxable supply of property to a registered entity, that registered entity would be entitled to an input tax credit under the basic rules (if it acquires the property for a creditable purpose).

Some further rules would be required to achieve the correct policy outcome.

The example below illustrates how the regime would operate in its simplest form.

#### **Example 1: Operation of the notional input tax credit regime**

*Assume the following facts:*

- *in 2010, Entity A makes a taxable supply of land that it held on 1 July 2000 to Entity B for \$440,000;*
- *the value of the land as at 1 July 2000 was \$220,000;*
- *Entity B constructs new residential premises on the land and, in 2012, makes a taxable supply of those premises to Entity C, an unregistered individual, for \$990,000.*

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<sup>16</sup> By this we mean the date of effect of the entity's registration or the day on which it applied for registration (if earlier).

<sup>17</sup> For instance, if an entity makes a taxable supply of real property that it held on 1 July 2000 for \$440,000 and the value of that real property as at 1 July 2000 was \$550,000 – the entity would receive a notional input tax credit of \$40,000 (rather than \$50,000).

	Margin scheme approach	Notional input tax credit approach
Value of land as at 1 July 2000 held by registered Entity A	\$220,000	\$220,000
Sale to registered Entity B after 1 July 2000	\$440,000	\$440,000
Margin	\$220,000	na
GST payable on initial sale by Entity A	\$20,000 (1/11 <sup>th</sup> of the margin)	\$40,000 (using basic rules)
Input tax credit/Notional input tax credit for Entity A	na (acquisition under margin scheme)	\$20,000 (based on value of land as at 1 July 2000 and claimable upon subsequent sale to Entity B)
Net GST payable on sale of land by Entity A	\$20,000	\$20,000 (\$40,000 less \$20,000 notional input tax credit)
Input tax credit claimable by Entity B	na (acquisition under margin scheme)	\$40,000
Sale of developed new residential premises by Entity B to unregistered Entity C	\$990,000	\$990,000
Margin	\$550,000	na
GST payable by Entity B	\$50,000 (1/11 <sup>th</sup> of the margin)	\$90,000 (using basic rules)
Net GST payable on sale of residential premises by Entity B	\$50,000	\$50,000 (\$90,000 less \$40,000 input tax credit)
Total net GST revenue	\$70,000 (\$20,000 + \$50,000)	\$70,000 (\$20,000 + \$50,000)

In both cases, the value added through the chain of transactions is \$770,000 (the final sale value of \$990,000 less the initial value of land at 1 July 2000 of \$220,000) and the GST payable is \$70,000.

Whilst a similar outcome could be achieved by allowing a notional input tax credit to be claimed at the time of acquisition (as is generally the case in New Zealand), rather than at the later point of sale, this would have a significant one-off revenue cost. This revenue cost would need to be assessed against any potential reduction in compliance costs and increased efficiency.

#### Other matters that would need to be considered as part of this approach

Further testing of this approach against a range of different scenarios would need to be considered to ensure that the benefits of replacing the current margin scheme with a notional input tax credit regime would outweigh the costs. For example assume the same facts as in example 1 above, but for the fact that:

- Entity B instead constructs commercial premises; and
- Entity C is instead a GST-registered entity that intends to use the property supplied by Entity B as business premises.

In this revised scenario, Entity A and Entity B would still be liable to pay the same amount of GST they were required to pay in Example 1 above. However, Entity C could claim an input tax credit of \$90,000. This credit would exceed the combined GST collected from Entity A and Entity B (\$70,000) by an amount equal to the notional input tax credit (\$20,000).

Using example 1 again but now assuming the sale between Entity A and Entity B is not a taxable supply because of a special GST rule, for instance Entity A and Entity B are members of the same GST group. Here Entity A is not entitled to a notional input tax credit on the basis that its on-supply of the property to Entity B is not a taxable supply. Entity B, however, is required to pay GST of \$90,000 on its sale to Entity C which is \$20,000 more than 1/11<sup>th</sup> of the value added by registered entities on or after 1 July 2000.

These examples show that further special rules would be required to avoid a notional input tax credit regime from resulting in windfall gains, or losses, relative to those outcomes under the current margin scheme approach. Furthermore, our analysis of example 1 did not consider the potential impact on the revenue due to timing differences between the operation of the margin scheme and the notional input tax credit regime.

Transitional rules are also likely to be required. For example, this would be necessary where an entity, in carrying on its enterprise, acquires property under the margin scheme and on-sells that property under the new regime.

#### Questions:

7. What are the advantages and disadvantages of replacing the margin scheme with a notional input tax credit regime?
8. What modifications (if any) need to be made to the regime to address the matters discussed above, in particular revenue integrity issues, and any other matters?
9. What transitional rules do you consider would be required?

### **Option 3: Make further technical amendments to the existing legislative framework**

This option involves retaining the existing legislative framework and addressing deficiencies in its operation and interaction with other provisions through further technical amendments. This does not rule out re-writing the existing provisions where this will simplify the existing law and reduce compliance costs.

This option retains a scheme that people are familiar with and is supported by a body of case law. The Tax Office view is well known and expressed in various rulings, both private and public, and in publications such as fact sheets.

The existing law has been amended previously to address instances where outcomes have been contrary to the policy intent underlying the margin scheme, and to maintain the integrity of the GST base.

Further legislative 'fixes' to the existing law would need to ensure the benefits are not outweighed by increased complexity and do not result in unintended consequences, including adverse impacts on the revenue. Amendments could seek to address the following specific issues:

- the potential for some real property transactions to have the value added taxed more than once. For example, where real property acquired under the margin scheme is sold as a taxable supply using the basic rules or real property acquired post-1 July 2000 by an unregistered entity and is subsequently brought into the GST system;
- complexities and ambiguities in valuations obtained for the purposes of the margin scheme (this is discussed further below);
- interactions with other provisions in the GST law, such as company amalgamations and representatives of incapacitated entities;
- application of the margin scheme to tax law partnerships and general law partnerships;

- unintended policy outcomes as identified, for example, in Taxpayer Alerts issued by the Tax Office<sup>18</sup>.

#### Questions:

10. Would you support continuing with the current legislative structure?
11. Would further specific amendments such as those proposed above lead to greater simplicity, more certainty and a reduction in compliance costs or the reverse?
12. Are there other areas where interaction between the margin scheme and other provisions of the GST law cause concern or result in unintended outcomes?
13. What other amendments do you consider necessary and why?

#### Valuations

Both taxpayers and the Tax Office identified the issue of valuations for the margin scheme as leading to significant disputation and additional compliance costs.

Valuations are generally required where the margin scheme is being applied to real property held prior to 1 July 2000, or where it is being acquired from an associate, or as a GST free going concern, or from a fellow member of a GST group<sup>19</sup>. Valuations must be 'approved' valuations.<sup>20</sup> The Tax Office has issued a determination (MSV 2005/3)<sup>21</sup> specifying the requirements for making valuations for calculating the margin for taxable supplies of real property made on or after 1 December 2005.

#### Question:

14. Should other approaches to dealing with the requirement for a valuation be explored? If yes what suggestions do you have and would they reduce the potential for disputation whilst maintaining revenue integrity?

#### Comments

Treasury invites comments on the issues and options presented, along with other approaches for simplifying the current margin scheme regime so it delivers the same policy outcome.

Submissions will be made publicly available via the Treasury website. If you do not want your submission to be made publicly available, please indicate that clearly.

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18 For example, Taxpayer Alert, TA 2009/4 – Land owner's use of a registered associate to maximise input tax credit entitlements and reduce Goods and Services Tax (GST) payable under the margin scheme.

19 See section 75-11 of the GST Act.

20 Section 75-35 of the GST Act.

21 A New Tax System (Goods and Services Tax) Margin Scheme Valuation Requirements Determination MSV 2005/3.

Email submissions to: [marginscheme@treasury.gov.au](mailto:marginscheme@treasury.gov.au)

Written submissions to: General Manager  
Indirect Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

For enquiries, please call Rob Dalla-Costa on (02) 6263 3328.

Submissions are due by: 31 July 2009.

# ATTACHMENT

## FURTHER DETAILS OF PROBLEMATIC AREAS OR EXAMPLES WHERE THE POLICY INTENT OF THE MARGIN SCHEME MAY NOT BE MET

### 1. The application of the margin scheme to dealings by general and tax law partnerships

The community is uncertain about how to apply the margin scheme if a partner contributes real property to a partnership and the partnership subsequently sells the property (or part of the property) as a partnership asset.

The Tax Office recently issued a public ruling GSTR 2009/1<sup>22</sup>, on the issue as it relates to general law partnerships. This ruling includes:

- supply of real property as a capital contribution to a general law partnership in exchange for an interest in the partnership can be a supply by way of sale under subsection 75-5(1) of the GST Act. (See paragraphs 34 to 55);
- calculation of the margin where the general law partnership supplies real property that was acquired from its partners by way of capital contribution. (See paragraphs 56 to 75);
- consequences of a reconstitution of the general law partnership. (See paragraphs 76 to 80);
- distribution of real property by a general law partnership to a partner as a result of general dissolution can be a supply by way of sale for the purposes of subsection 75-5(1) of the GST Act. (See paragraphs 81 to 83); and
- calculation of the margin if a former partner in a general law partnership supplies real property that was acquired as a result of the partnership's general dissolution. (See paragraphs 84 to 98).

### 2. No provisions for a decreasing adjustment

No provision allows a decreasing adjustment if an entity acquires real property under the margin scheme and subsequently sells all or part of the real property under a taxable supply, with GST worked out under the normal rules, or as a GST free supply. In these circumstances GST is embedded.

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<sup>22</sup> GSTR 2009/1: Goods and services tax: general law partnerships and the margin scheme, issued 8 April 2009.

### Example 1

Entity A sells real property to entity B for \$1,000,000 under a taxable supply and the GST is worked out using the margin scheme. Entity A works out that the GST payable on the supply is \$5,000. Entity B is not entitled to input tax credits on the acquisition.

Entity B subsequently makes a taxable supply of the real property for \$1,320,000. Entity B does not enter into an agreement with the recipient that the margin scheme shall apply to working out the GST on the supply. Entity B is required to remit to the Tax Office GST of \$120,000 in relation to the supply.

The revenue has effectively received an aggregate of \$125,000 GST in relation to the supply of the real property, being an amount which is greater than 1/11<sup>th</sup> of the consideration of the latter supply.

### Example 2

Entity X sells real property to entity Y for \$2,500,000 under a taxable supply and the GST was worked out using the margin scheme. Entity X works out that the GST payable on the supply is \$12,000. Entity Y is not entitled to input tax credits on the acquisition.

Entity Y subsequently makes a GST free supply of the real property for \$3,800,000. Although the supply is GST free, there is embedded GST of \$12,000.

## 3. Real property acquired after 1 July 2000 by an unregistered entity and subsequently brought into the GST system

While provisions in the GST Act exclude the value of real property brought into the GST system after 1 July 2000 where an unregistered entity held the property before that date, this does not generally apply in circumstances where another unregistered entity acquires the real property after 1 July 2000 and subsequently brings it into the GST system.

### Example 3

An entity acquires a commercial property for \$165,000 on 30 October 2005. The property is acquired as part of the entity's enterprise but the entity is not registered or required to be registered for GST. On 1 May 2007 the entity registers for GST. The property is sold for \$440,000 and settlement occurs on 6 December 2008. (Assume that at the date of registration the property was valued at \$220,000).

In accordance with the provisions of subsection 75-10(2), the margin for the supply of the property is \$275,000 (that is, \$440,000 - \$165,000). The GST payable is \$25,000 (that is, 1/11 of \$275,000). If a rule similar to item 2, subsection 75-10(3), which applies for property acquired pre-GST, were applied, the relevant value would have been \$220,000 and not \$165,000 and the GST \$20,000 and not \$25,000.

The value added to real property may be taxed more than once where the entity supplying the real property does not have a cost base for margin scheme purposes. For example, if an

entity acquires the real property through a court order and the entity does not provide consideration for the acquisition and the entity and the supplier are not associates.