

GST margin scheme changes

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The *Tax Law Amendment (2008 Measures No 5) Bill 2008 (Cth)* (**Bill**) was recently introduced to Federal Parliament. The Bill sets out a range of proposed GST margin scheme amendments which will affect the eligibility of taxpayers to apply the margin scheme to particular arrangements, the calculation of the margin and GST payable and extend the application of the GST anti-avoidance provisions (Schedule 1 to the Bill).

In this article, we examine the proposed amendments and their effect on the GST treatment of supplies of real property.

Purpose of amendments

The amendments are targeted at the application of the margin scheme in certain real property contexts, namely:

- property acquired as a going concern (Subdivision 38-J of the *A New Tax System (Goods and Services Tax) Act 1999 (Cth)* (**GST Act**)) (ie a GST-free supply);
- property acquired as farm land (Subdivision 38-O of the GST Act) (ie a GST-free supply); or
- property acquired from an associate for no consideration (ie a non-taxable supply).

Under current law, transactions may be structured in a way that the margin scheme may still be 'reinstated' (ie apply) by interposing certain GST-free or non-taxable supplies prior to selling the property (*Explanatory Memorandum* to the Bill (**EM**), paragraph 1.10). As such, the proposed amendments are intended to have the following consequences:

- to ensure the eligibility to use the margin scheme cannot be 'reinstated' by interposing a GST-free or non-taxable supply;
- to ensure that if the margin scheme is applied after certain GST-free or non-taxable supplies have been made, the value added by the registered entity which made that supply is included in determining the GST subsequently payable under the margin scheme; and
- to confirm that the GST general anti-avoidance provisions can apply to contrived arrangements entered into to avoid GST (paragraph 1.2 of the EM).

Eligibility to apply margin scheme

Under current law, if an entity makes an acquisition through a taxable supply where GST is calculated without applying the margin scheme, that acquiring entity will not be entitled to apply the margin scheme upon making its own taxable supply. The reason is the entity would have been able to claim input tax credits on the acquisition and should not be entitled to further relief under the margin scheme (paragraph 1.29 of the EM).

Under the proposed amendments, a supply of real property that would have been ineligible for the margin scheme cannot be re-eligible for the margin scheme even if it was acquired as part of a GST-free or non-taxable supply (item 2 of Schedule 1 to the Bill). The Bill proposes that an entity which acquires property as part of a GST-free or non-taxable supply is required to *look back* through one transaction (ie the previous sale) to determine whether the entity is eligible to use the margin scheme (paragraph 1.31 of the EM).

Moreover, the proposed amendments extend to acquisitions from an associate that may not be by way of a supply (item 3 of Schedule 1 to the Bill). The following example in the EM, demonstrates the application of the proposed amendments.

Example

A is registered for GST and held vacant land as at 1 July 2000. A sells the property to B, a property developer who is registered for GST. The supply is a taxable supply, but the margin scheme is not applied to the sale.

B then begins construction of a unit complex on the vacant land. Prior to completing construction, B sells the partly constructed unit development to C as a going concern. In this case, B does not remit GST and C is not entitled to input tax credits.

C finishes its unit development and sells a unit to D, a private individual not registered for GST.

Under the proposed amendments, C will not be able to apply the margin scheme on its sale to D, as B acquired the property as a taxable supply in respect of which the margin scheme was not applied. C will need to *look back* to the previous sale (ie from B to C), in which B was not eligible to apply the margin scheme. Therefore, C cannot apply the margin scheme to the supply.

Margin on real property supplies after GST-free/non-taxable supplies

Under current law, an entity making a GST-free or non-taxable supply of property does not have a GST liability on the value the entity adds to the property. The calculation of the margin on a subsequent sale of the property under the margin scheme only takes into account the value added by the supplier under the margin scheme. As a result, the margin applied is lower and thus the GST payable is artificially reduced (paragraph 1.41 of the EM).

To address this concern, under the proposed amendments, the approach is to *look through* the prior GST-free or non-taxable supply in order to calculate the margin for supplies of property under the margin scheme. Depending on the date of acquisition of the property by the previous entity and the GST registration status of the previous entity, the margin will be calculated by reference to the following:

- the consideration paid by the previous entity for the acquisition;
- a valuation of the property when the previous entity acquired the property (as at 1 July 2000 or on the day of acquisition); or
- a valuation of the property when the entity first becomes registered on or after 1 July 2000 (item 4 of Schedule 1 to the Bill).

The proposed amendments ensure that the interposed GST-free or non-taxable supply is *looked through* and the arrangements do not reset the margin applicable (paragraph 1.42 of the EM).

The following example from the EM, demonstrates the calculation of the margin following a GST-free supply of real property.

Example

A is registered for GST and held land as at 1 July 2000 valued at \$110,000. A sells the land to B for \$165,000 and the margin scheme was applied to the sale. A's GST liability is based on A's value added to the property (ie $1/11^{\text{th}}$ of \$55,000; GST payable is \$5,000).

B begins operating an enterprise of construction and sale of a unit complex and later sells the construction site as a going concern to C. As the supply is a going concern, B pays no GST on the sale price of \$440,000.

The sale from B to C is a GST-free supply, therefore, there is an interposing of a GST-free supply in this instance. The tax on B's value added thus becomes payable on C's sale. This potential tax liability was known to the parties when they negotiated the GST-free sale price. C must obtain all the relevant documentation to evidence B's acquisition price of the real property obtained (ie the acquisition price of \$165,000). C then completes the construction and sells it to D for \$495,000 and applies the margin scheme.

Under current law, the margin calculated would be \$55,000 (ie \$495,000 - \$440,000) and the GST payable on the margin would be \$5,000.

However, under the proposed amendments, in calculating the margin on the sale, C will need to subtract B's acquisition price (and not C's acquisition price) from C's final sale price. The resulting margin will therefore be \$330,000 and C will need to pay \$30,000 (ie $1/11^{\text{th}}$ of the margin) to the ATO.

Extension of anti-avoidance provisions

The proposed amendments only require an entity to *look back* through one preceding transaction. This is due to the cost of compliance and also to reduce the complexity of the system. As such, by interposing more than one GST-free or non-taxable supply in a contrived arrangement, the entity could still effectively circumvent the proposed amendments (paragraph 1.53 of the EM).

To address this concern, it is proposed that the GST general anti-avoidance provision be extended to contrived arrangements, such as those mentioned above. However, the proposed amendments have a broader implication. That is, they will apply to any type of contrived arrangement, rather than just margin scheme arrangements (paragraph 1.57 of the EM).

The Bill proposes that the GST general anti-avoidance provisions adopt a similar approach to the general anti-avoidance provisions of Part IVA of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**). Accordingly, if a GST benefit is attributable to the making of a choice, election or application or agreement, then consideration will need to be given to the purpose of creating any circumstance or state of affairs that enables such a choice, election, application or agreement (item 11 of Schedule 1 to the Bill).

Similarly to Part IVA of the ITAA 1936, the purpose must either be the sole or dominant purpose. This ensures that entities merely taking advantage of the concessions in accordance with the object of the provisions are not caught by the anti-avoidance provisions (paragraph 1.58 of the EM).

Transitional provisions

The new changes to the margin scheme will apply to new supplies. New supplies are supplies that comply with the following:

- made on or after the commencement of the Bill; and
- are not made under a written agreement entered into before the commencement or pursuant to a right or option granted before the commencement, where consideration or a way of working out the consideration is specified (item 13 of Schedule 1 to the Bill).

In short, the new rules only apply to entities entering into written agreements on or after the commencement of the Bill. This is to ensure that parties entering into negotiations of a supply of real property have the chance to negotiate the contract price and the opportunity to obtain all evidence of consideration or valuation required when applying the margin scheme (paragraph 1.63 of the EM).

Conclusion

The proposed amendments to the margin scheme are likely to introduce an additional layer of complexity when parties negotiate a real property transaction. If a purchaser wishes to purchase real property and apply the margin scheme at a later date, the following may need to be considered by the purchaser prior to purchasing from a vendor:

- how the vendor acquired their property, as there may be a requirement to *look back* to an earlier sale;
- the consideration provided for the acquisition of the property and/or the value of the property to the vendor;
- whether the vendor is willing to provide any warranties and/or representations in relation to the above matters; and
- whether the purchaser is willing to pay GST on the value added to the property by the vendor upon a sale by the purchaser.