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LAWYERS

Taxation and Revenue

Margin Scheme Changes

Damian O'Connor
d.oconnor@hopgoodganim.com.au

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INGRAINED INTELLIGENCE

Important Margin Scheme Changes

The latest round of legislative change to the operation of the margin scheme received royal assent on 9 December 2008. The changed rules apply where:

- you acquired the property your are selling through a supply made after 8 December 2008;
- the supply to you was not made under a written agreement, right or option:
  - entered into or granted before 8 December 2008; and
  - which specified the consideration payable or a way of working the consideration out.

The reasoning behind these exceptions seems to be that if a supplier is already locked into acquiring a property at a price that does not reflect the additional GST costs under the new legislation the old rules should apply.

For acquisition agreements made after 8 December 2008, the new rules will need to be taken into account in determining whether the margin scheme can be used on any on-sales, working out the ultimate GST cost, (both of which will require information from the entity who supplied the property to you) and negotiating the price to be paid.

Background Division 75

The margin scheme legislation is set out in Division 75 of the GST Act and where it applies the amount of GST payable is calculated on the margin for the supply, not the full value of the supply.

Where the property in question was acquired before 1 July 2000 the margin is the difference between the consideration received from the sale and the valuation of the property as at 1 July 2000.

The original margin scheme legislation provided that if you acquired property in such a way that it was not a taxable supply to you, you could use the margin scheme for the on-sale of the property.

If the acquisition was a taxable supply (e.g. it was not GST free or not from an unregistered Mum and Dad) you could not use the margin scheme unless the person you acquired the property from supplied it to you using the margin scheme.

A large number of amendments were made to the margin scheme provisions in 2005, including the requirement that the parties agree in writing at or before the time of the supply that the margin scheme would apply, and rules preventing the use of the margin scheme following certain transactions within GST groups and GST joint ventures.

Broadly, these amendments were designed to stop arrangements where a transaction that was not a taxable supply, for example dealings between members of GST groups or joint ventures, could be used to enable a related entity to use the margin scheme for an on-sale with the margin being calculated by reference to the last acquisition cost (from the related party) giving, in many cases, a low or nil margin.

Even after these 2005 amendments the position remained (apart from these specific prohibitions) that if a property was acquired in such a way that it was not a taxable supply (e.g. it was GST free, or it was acquired for no consideration or the supply or acquisition was by Mum and Dad who were not required to be registered for GST) the margin scheme could be used to manage the GST cost for an on-sale.

You could acquire a property as a taxable supply (and therefore be entitled to input tax credits) and then transfer it to a related entity through a non-taxable supply (such as a GST free going concern or for no consideration). The associate would have acquired the property in a way that allowed it to use the margin scheme for on-sales.

New legislation

Ineligible for margin scheme

New section 75-5(3) provides that an acquisition is ineligible for the margin scheme if the property was acquired as a going concern, farmland for farming or from an associate for no consideration and the entity who supplied the property to you acquired the property through a taxable supply on which the margin scheme did not apply (the "Look Back" Rule).

This means that even if the supply to you was not a taxable supply, you will need to consider whether the entity that made the supply to you could have used the margin scheme.

If the supplier to you could not have applied the margin scheme, you cannot use the margin scheme, even if you acquired the property GST-free.

Calculating the margin

New subsection 75-11(4) provides that the calculation of the margin (where the supplier to you could have used the margin scheme) will require you to work out the consideration paid by the supplier for the property (or its valuation or market value when it was acquired by the supplier) so that when you sell the property GST is payable on the difference between the consideration you receive for on-sales and the cost of the property to the supplier to you.

Aside from the practical difficulties in establishing these factors, one of the consequences of the new legislation is that GST payable on value added or profit made by the earlier supplier will now have to be met by you when you make margin scheme supplies to other parties.

Other parts of the new legislation deal with input tax credit adjustments where taxable and GST free property acquisitions are amalgamated and supplied under the margin scheme.

Anti-avoidance changes

The new legislation contains changes to the GST anti-avoidance rules. If a scheme is entered into with the purpose of allowing a choice to be made (such as the choice to apply the margin scheme) then any tax benefits may be struck out. The ATO says it may seek to apply these anti-avoidance rules where arrangements are put in place to take advantage of the fact that the legislation only requires a supplier to Look Back through the immediate previous transaction to determine whether the new rules apply.

For example, if A acquired a property through a taxable supply to which the margin scheme did not apply and sold it to B using the going concern exemption, the result would be that a sale by B could not access the margin scheme (because A could not have used the margin scheme on the supply to B).

If, however, A acquired the property under a taxable supply to which the margin scheme was not applied, and sold the property to B as farmland for farming, B then sold the property to C as a going concern, and C sold the property to other parties, C could prima facie utilise the margin scheme because the supply by A to B was not a taxable supply and therefore C's acquisition was not an ineligible acquisition, as B could have used the margin scheme.

Practical issues

Amongst the major changes that this new legislation makes is that the GST payable in respect of the value added or the profit on the supply to you will become your liability. This is a very big change in the philosophy of GST. The Explanatory Memorandum introducing the legislation optimistically states that "this potential tax liability (will be) contemplated by the parties when they negotiate the GST free sale price. At the time of the GST free sale, (you) could ensure that the necessary documentation evidencing the supplier's acquisition price... (is) obtained."

The ATO view is that the same outcome for GST purposes will be achieved if the supply to you was made under the margin scheme rather than as a non-taxable supply. There may be a timing difference if the supply to you is treated as a margin scheme sale.

Summary

The former legislation allowed margin scheme eligibility to be reinstated by plugging in a non-taxable supply, such as a going concern, with the result that increases in value could escape the GST net.

The new legislation now requires that where you acquire a property GST-free, you can only use the margin scheme if, disregarding the GST-free sale, the supply to you could have been under the margin scheme. If you can use the margin scheme you must now pay GST on the value added by the previous owner. The margin is the difference between what the previous owner paid for the property (or its value) and what you sell it for.

This increased exposure to GST will need to be factored into price calculations. Sufficient information and warranties should be obtained from vendors so that a properly informed decision about GST costs can be made.

We expect the ATO will closely examine margin scheme transactions as part of its GST audit program.

Damian O'Connor
d.oconnor@hopgoodganim.com.au