Implementation of the recommendations of Treasury's review of the GST margin scheme

Discussion paper

10 December 2010

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CONSULTATION PROCESS

REQUEST FOR FEEDBACK AND COMMENTS

The Government is seeking your feedback and comments on the design of the measures in this paper. Submissions may address all of the measures set out in this paper or one or more of these. Submissions should also identify any other issues, including interaction issues with other parts of the tax law, which may be relevant to the design of the measures.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website, unless you indicate that you would like all or part of your submission to remain in-confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: 21 January 2011

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FOREWORD

I am very pleased to release this consultation paper on the implementation of the 2010 Budget measure to restructure the GST margin scheme with effect from 1 July 2011.

In a press release on 11 May 2010, the former Assistant Treasurer announced the enactment of a package of measures relating to the GST margin scheme provisions. The new structure will give prominence to the core provisions of the law, and a technical amendment will allow an approved valuation of the premises to be used to calculate the margin on subdivided land. Currently, the law requires that only the consideration method be used.

The measure will achieve the policy intent of the GST margin scheme in a more effective manner. It is expected to clarify the law, simplify compliance for taxpayers and reduce the potential for disputes between taxpayers and the ATO

The Government looks forward to receiving the community's views on the implementation of the measure.

Assistant Treasurer and Minister for Financial Services and Superannuation
The Hon Bill Shorten MP

CHAPTER 1: INTRODUCTION AND OVERVIEW

INTRODUCTION

1 On 11 May 2010, the Government announced its response to Treasury's review of the GST margin scheme. The media release is available on the Assistant Treasurer's website (http://ministers.treasury.gov.au). Treasury's discussion paper on the margin scheme and submissions received to its review are available from its website (http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1528).

Background

2 The Government canvassed publicly a range of options aimed at achieving the desired policy outcomes underlying the existing margin scheme in a simpler and more efficient way, including replacing the existing scheme with a set of principles (not supported by any submissions) and considering completely new approaches to delivering similar policy outcomes (again, not supported by most submissions). There was a general consensus from submissions that specific concerns with the margin scheme could be addressed through further amendments to the existing legislative framework.

3 It was the Government's view that in order to address industry's concerns within the existing legislative framework, additional rules would be required to, amongst other things, provide for decreasing adjustments in certain instances, new valuations dates and, potentially, new methods for working out cost bases in certain scenarios. Each of these rules was likely to increase complexity for taxpayers, tax practitioners and the ATO. They would involve significant additional revenue costs.

4 The current policy contains a number of trade-offs where what might appear to be the desirable policy outcome in relation to the amount of tax collected is foregone in favour of simplicity and integrity considerations. Addressing these 'gaps' would not necessarily have lead to a more effective regime but rather an unwinding of existing trade-offs, for example such that the objective of collecting the 'right amount' of tax in the relevant instances is placed ahead of simplicity and integrity considerations.

5 In weighing up these factors the Government decided that the costs and risks to revenue integrity associated with addressing these gaps would outweigh the potential benefits, result in more rather than less complex legislation and place additional information needs on taxpayers which may be commercially difficult to obtain.

6 However, the Government agreed to:

- restructure the margin scheme provisions to give prominence to the core provisions with exceptions set out separately and to insert objects clauses for the key provisions so that the intention is clear; and
- implement a minor technical amendment, effective from 1 July 2012, to remove an anomaly to allow an approved valuation of the land to be used for the purposes of calculating the margin on subdivided land.

7 Changes to the interaction of tax law partnerships with the margin scheme rules are being addressed as part of the Government's earlier response to the Board of Taxation's recommendation on the administration of the GST.

Purpose of this paper

8 The purpose of this paper is to provide additional information on how the announced Government measures might operate and to seek feedback on their design and implementation.

Consultation processes

9 The paper provides a level of detail similar to that in the drafting instructions Treasury will provide to the Office of Parliamentary Counsel (OPC).

Objectives of reforms

10 The key objective of the Government's reforms to the GST margin scheme is to clarify the law and simplify compliance for taxpayers and the ATO.

11 In achieving these objectives the Government announced it will:

- restructure the margin scheme provisions to give prominence to the core provisions of the margin scheme with exceptions set out separately and insert objects clauses for the key provisions so that the intention is clear; and

- implement a minor technical amendment to remove an anomaly to allow an approved valuation of the land to be used for the purposes of calculating the margin on subdivided land.

12 These changes are not expected to have any impact on revenue but provide an opportunity to address the additional complexity that has arisen from legislative changes made to address risks to revenue that had arisen since July 2000. Simplifying the interaction with the law by having the core provisions up front in the legislation should benefit small/medium sized business involved in the building industry. These small/medium sized enterprises have limited resources with which to seek professional advice on the application of the margin scheme to their transactions.

Timetable for reforms

13 The reforms to the GST margin scheme will apply from 1 July 2012.

CHAPTER 2: IMPLEMENTATION INFORMATION

RESTRUCTURE OF THE GST MARGIN SCHEME PROVISIONS

Government decision

14 Restructure the margin scheme provisions to give prominence to the main principles (that is, the core provisions of the law) with exceptions set out separately and insert objects clauses for the key provisions so that the intention is clear.

Background

Operation of existing law

15 In broad terms, Division 75 of the GST Act sets out special rules for real property that allow taxpayers an alternative means of calculating GST. The margin scheme rules ensure that GST is payable only on the incremental value added to land by each registered entity in a series of transactions after the land enters the GST system (generally on or after 1 July 2000).

16 Taxpayers selling real property generally have the choice of calculating GST under the basic rules (GST is one-eleventh of the GST inclusive price) and the purchaser may have an input tax credit entitlement, or under the margin scheme (GST is one-eleventh of the margin) with no input tax credit entitlement.

17 The current structure of the Division 75 margin scheme provisions results in complexity, uncertain outcomes and significant compliance issues.

18 As the margin scheme represents a departure from the basic rules of GST law, it necessarily involves an additional level of complexity, such as the need to obtain valuations of real property or to identify if the vendor is eligible to sell using the margin scheme.

PROPOSAL

19 It is proposed that the GST margin scheme provisions are restructured.

20 The margin scheme allows sellers of real property to pay GST equal to one-eleventh of the margin rather than one-eleventh of the total sale price.

21 Depending on when, and from whom, one buys the property, the margin is generally the difference between the sale price and:

- the amount the seller paid for the property (consideration method); or
- a valuation of property at a given date (valuation method).

22 The sections that capture the core provisions of the margin scheme could be placed at the front of Division 75 under Subdivision A.

23 The existing non-operative theme statement could be revisited to expand it to cover the entire division.

24 The sections of Division 75 will be renumbered to align with any new subdivisions.

25 For discussion purposes we have set out below one possible scheme for how the restructured legislation may look and are open to alternatives or how the proposed structure could be made more effective in achieving the objectives set by Government.

Commentary

26 The core provisions of the margin scheme are the fundamental propositions and concepts with which all valid margin scheme transactions necessarily have a nexus. Without the operation of the core provisions, the policy intent behind the margin scheme would not be realised and the scheme itself could not operate.

27 The core provisions should be placed at the front of Division 75 and could be distinctly set out in their own Subdivision. This will give clarity and certainty to the operation of the margin scheme, significantly aiding taxpayers' compliance with the GST law.

28 The core provisions of the GST margin scheme are:

Subdivision	Section
75-A — Core Rules	75-5: Eligibility 75-5(3): Ineligibility (restructure into a table) 75-10: Amount of GST on taxable supplies 75-35: Approved valuations 75-14: Carve out to consideration 75-20: Not creditable acquisitions 75-30: Tax invoices

* Please note that the table identifies the existing sections that will be renumbered under the proposed Subdivision 75-A. In addition, the identifying words are not the proposed new headings for the sections, but merely serve to illustrate the operation of the sections.

29 In addition, section 75-5(3) could be restructured to simplify the ineligibility rules of the margin scheme.

In particular circumstances special rules apply to taxpayers wishing to calculate the margin on supplies of real property

30 The provisions containing rules for the application of the margin scheme in particular circumstances for calculating the margin could be placed together behind the core rules under Subdivision B of Division 75.

31 Further, section 75-11 could be restructured to simplify the rules for the application of the margin scheme in particular circumstances and to avoid the extensive repetition of the current layout.

Commentary

32 The current structure of the provisions dealing with supplies in particular circumstances is complex, leading to significant compliance issues. The new structure will aid compliance by making the calculation of the margin in the circumstances set out easier to follow.

33 The rules for the application of the margin scheme in particular circumstances of the GST margin scheme are:

Subdivision	Section
75-B — Application of the margin scheme in particular circumstances	75-11: Supplies in particular circumstances 75-12: Partial payment of consideration 75-13: Associates 75-15: Subdivided land 75-16: Partial acquisitions

* Please note that the table identifies the existing sections that will be renumbered under the proposed Subdivision 75-B. In addition, the identifying words are not the proposed new headings for the sections, but merely serve to illustrate the operation of the sections.

The adjustment provisions provide for the correct GST outcome

34 The adjustment provisions could collectively be placed behind the rules for the application of the margin scheme in particular circumstances under Subdivision C of Division 75.

Commentary

35 The adjustment provisions allow a change that either increases (increasing adjustment) or decreases (decreasing adjustment) a taxpayer's net GST liability on the margin of the supply of real property. Adjustments can also be used for bad debts, where the buyer defaults, and in situations where the full price under the contract was not initially paid but a further amount of consideration has subsequently been paid.

36 The new structure of Division 75, with adjustments at the end, allows taxpayers to first confirm that their supply of real property is eligible for the margin scheme, before calculating the margin on the supply, and finally determining whether any adjustments to the GST liability are required.

37 The adjustment provisions of the GST margin scheme are:

Subdivision	Section
75-C — Adjustments	75-22: Increasing adjustment 75-25: Adjustment relating to bad debts 75-27: Decreasing adjustment for later payment

* Please note that the table identifies the existing sections that will be renumbered under the proposed Subdivision 75-C. In addition, the identifying words are not the proposed new headings for the sections, but merely serve to illustrate the operation of the sections.

Focus question

1. Is there an alternative structure that could better achieve the Government's objective of giving prominence to the GST margin scheme provisions?

AMENDMENT TO THE APPLICATION OF THE GST MARGIN SCHEME TO SUBDIVIDED LAND

Government decision

38 Implement a minor technical amendment to remove an anomaly to allow an approved valuation of the land to be used for the purposes of calculating the margin scheme.

Background

39 Section 75-15 provides for the calculation of the margin on the supply of a freehold interest, stratum unit or long term lease that relates to only part of the land or premises acquired by the supplier. The section provides that for the purposes of determining the margin on a supply of part of the interest, unit or lease that was acquired, the consideration is the corresponding proportion of the consideration for that acquisition.

40 Thus the section does not adequately provide for the calculation of the margin on the supply of an interest, unit or lease that relates to only part of the land or premises acquired by the supplier because it does not allow the margin to be calculated proportionate to an approved valuation of the land or premises originally acquired.

Operation of existing law

41 Section 75-15 of the Act provides for the calculation of the margin on the supply of an interest, unit or lease that relates to only part of the land or premises acquired by the supplier. Currently, this section expressly provides for only the consideration method to be used to calculate the margin on the supply.

42 Under the consideration method, GST is payable on the value added to the property by the supplier. Where the supplier owned the property prior to 1 July 2000, the consideration method could result in GST being paid on value added before the introduction of the GST. In such circumstances the valuation method generally results in GST only being applied to the value added from 1 July 2000 or when the supplier was required to be registered — whichever is the later.

PROPOSAL

43 It is proposed that an approved valuation of the land or premises can be used to calculate the margin on subdivided land for the purposes of the GST margin scheme.

Commentary

44 The principle confirms the ATO view of the law set out at paragraphs 126 to 129 of the ATO ruling, GSTR 2006/8. In addition, it is consistent with paragraphs 66 to 69 of GSTR 2006/7, which deal with circumstances where the real property is acquired before 1 July 2000. The ATO view is that if the real property was not in existence at the valuation date but is part of the real property that was in existence at that date, a valuation of the real property in existence at the valuation date is made and it is apportioned on a fair and reasonable basis to ascertain the valuation that relates to the real property that is supplied.

45 Example: valuing real property that is subdivided after the valuation date

- Before 1 July 2000, a developer acquires Lot 20 for the sale price of $150,000 with an area of 100 hectares and has it valued on 1 July 2000 at a market value of $200,000. On 1 July 2009, the developer subdivided Lot 20 creating Lot 1 with an area of 25 hectares. Lot 1 was sold by the developer on 30 June 2010 for $90,000.

- The value of Lot 1 is the proportion of the valuation of the interest acquired by the developer that is in existence as at 1 July 2000, that is, Lot 20. This proportion is $50,000 (1/4 of $200,000 on the assumption that the land is of approximately uniform value per square metre).

46 The principle will ensure the margin scheme achieves its policy intention. The margin will be the difference between the proportion of an approved valuation as at 1 July 2000 and the consideration received ($90,000 — $50,000 = $40,000). This is in contrast to the current provision, under which the margin is the proportion of consideration paid before 1 July 2000 and the consideration received.