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The Taxation Institute of Australia (**Taxation Institute**) refers to the consultation paper entitled "Review of the margin scheme" released by Treasury on 12 May 2009.

The Taxation Institute welcomes the opportunity to participate in this consultation process, and thanks you for allowing the Taxation Institute additional time within which to respond.

The submission that follows is consistent with the comments made by representatives of the Taxation Institute present at the consultation meeting held with Treasury on Friday 3 July 2009. Those representatives were Lachlan Wolfers, Gina Lazanas and Ian Jeffrey.

### **Retain existing margin scheme provisions**

The Taxation Institute's preferred position is Option 3, which involves retaining the existing margin scheme provisions and addressing deficiencies in its operation. The Taxation Institute reaches this view for the following reasons:

1. The Taxation Institute fully acknowledges that the margin scheme provisions have proved to be too complex in practise. However, the Taxation Institute are concerned that further changes at this stage will only result in a new set of rules, which will undoubtedly give rise to a new set of issues and problems. Put simply, the cost and risk of moving to a new regime is greater than maintaining the existing regime and making appropriate changes to address deficiencies in its operation.
2. Many of the problems which have been identified with the margin scheme provisions are either transitional issues which are reducing over time, or are historical issues only which arose when the law (or administrative practice) was uncertain. For example:
  - Concerns with valuations arose primarily because of the ATO's early determinations being vague and uncertain. The use of valuations was far more prevalent in the early stages of GST, just after 1 July 2000. However, as time passes, this method of valuation is used less often. In particular, it is less common for developers to be selling properties which are held as at 1 July 2000. As such, valuation issues now arise less commonly.
  - In the early stages of GST, there were a number of disputes between vendors and the ATO, and between vendors and purchasers, concerning whether a choice had been made to apply the margin scheme. This has now been dealt with by s75-5(1A) of the *A New Tax System (Goods and Services Tax) Act 1999 (GST Act)* and the need to have in place a written agreement to apply the margin scheme. In response to this legislative change, standard form contracts now include provisions for the parties to agree to apply the margin scheme.

- A number of legislative amendments have been made to close off perceived avoidance activity, or to overcome 'step-ups' in cost base through the use of the going concern or farmland concessions. Those amendments having been made only recently. It is unlikely that there will continue to be the same level of uncertainty or disputes with these provisions as a consequence of those changes.
  - The ATO's approach to resolving valuation issues under the margin scheme was heavily criticised 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). In response, the ATO is slowly progressing and resolving many of these audits.
3. Recent cases have settled a number of contentious issues arising under the margin scheme provisions, such as *Sterling Guardian* and *Brady King*. It is expected that the number of disputes likely to arise in the future will diminish. By contrast, if a new legislative regime is implemented, there is a real risk that new areas of uncertainty or disputes will arise.
  4. The vast majority of land sales contracts occur under standard form contracts prepared by the Law Societies in each State and Territory and other similar bodies. The Taxation Institute is concerned that if changes are made to the margin scheme provisions then those standard form contracts will need to be rewritten. This often has a significant lead time.

In short, it is important for Treasury to be conscious of the fact that the margin scheme provisions need to be understood and applied by a very broad cross section of the community – including taxpayers, conveyancers, real estate agents, lawyers and accountants. Any significant changes are likely to have a lengthy lead time in terms of the education of those affected by these provisions.

The Taxation Institute is of the view that a number of the legislative changes which have been made were unnecessary, and many could have been avoided if the ATO had taken a more principled based approach to the interpretation of these provisions since 1 July 2000. However, having gone down that pathway, the Taxation Institute is of the view that further change would potentially only exacerbate the community's concerns about complexity in this area.

While the Taxation Institute does not support a move to principles based drafting of these provisions, the Taxation Institute does recommend that the margin scheme provisions should be reordered. The reordering should be done so as to ensure that the following principles are given prominence:

- You cannot apply the margin scheme to the sale of a property if you acquired it as a fully taxable supply.
- If you acquire the property under the margin scheme, you cannot claim an input tax credit for the acquisition.
- Normally, your liability when property is supplied under the margin scheme will be based on 1/11<sup>th</sup> of the difference between the consideration for the supply and the consideration for the acquisition of the property.

The Taxation Institute anticipates that these principles would be expected to be invoked in over 95% of all sales of new residential property. Unfortunately, the numerous legislative amendments which have been made to the margin scheme provisions since 1 July 2000 have meant that these core principles have become lost or hidden in the detail of the legislation.

### **Technical changes**

The Taxation Institute is concerned about the overly-complex approach to interpretation of the margin scheme provisions which is being taken by the ATO in its public rulings. For example, the rulings concerning partnerships and the margin scheme, and partitions and the margin scheme are likely to be sources of considerable dispute in years to come. The reason being complex interpretations that, at times, can be counterintuitive or lead to GST liabilities applying when the vendor is not deriving real cash consideration for the sale. Recent history in other areas of taxation

suggests that when tax is imposed other than at the point of effective realisation of an asset, potential for inadvertent avoidance or non-compliance arise. For example, this is one factor which led to the introduction of the CGT scrip-for-scrip rollover provisions, and also underlies recent concerns with employee share schemes.

Put simply, the Taxation Institute strongly urges Treasury and the ATO to reconsider the recent rulings issued by the ATO in relation to partnerships and the margin scheme, and partitions and the margin scheme. These issues will undoubtedly be the cause of disputes in years to come. Despite the Taxation Institute's representatives expressing these concerns in meetings with the ATO, the ATO has issued their rulings.

The Taxation Institute further supports technical corrections in the following areas:

- 1 To remove the requirement in s75-5(1) of the GST Act for there to be a "sale" of the freehold interest or stratum unit in order to apply the margin scheme. There is no logical reason why the margin scheme should be limited to "sales".
- 2 To ensure that s75-15 of the GST Act applies not only where a taxpayer supplies only "part of" the land or premises which they acquired, but also where they supply "an interest in" the land or premises which they acquired. This is intended to cater for situations where a taxpayer acquires say a freehold interest in property and 'sells' the property by way of the grant of a long-term lease. In theory, the margin scheme provisions apply to such a transaction, but there are no valuation rules which adequately deal with this.
- 3 To introduce simple provisions dealing with the margin scheme and partnerships, and partitions of property to overcome the current complexity in public rulings.
- 4 To ensure that when a taxpayer acquires real property post 1 July 2000 which they venture into an enterprise, that they can utilise the market value of the property at the time it is so ventured. At present, item 2 of s75-10(3) of the GST Act only applies where the property is acquired before 1 July 2000. There is no obvious policy reason why the provision should be limited in this way.
- 5 To amend the discretion conferred on the Commissioner under s75-5(1A) of the GST Act to allow further time to apply the margin scheme. At present the Commissioner may only exercise his discretion where there is a written agreement to apply the margin scheme. In practise, there may be instances where there is no mischief in the vendor seeking to apply the margin scheme, but they are unable to due to the purchaser unreasonably refusing or being unable to enter into a written agreement. Examples include purchasers who have died since the property was acquired, or become insolvent, or who refuse so as to obtain some other commercial benefit in circumstances where the margin scheme is of no detriment to them (e.g. a private purchaser).
- 6 To amend s75-22 of the GST Act so as to allow a decreasing adjustment, not just an increasing adjustment.

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The Taxation Institute welcomes the opportunity to provide further clarification of any of the issues raised in this submission. Any queries concerning this submission should be directed to Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis on (02) 8223 0011 or Lachlan Wolfers, Partner, KPMG on 02 9355 7515 who, with contributions from other members, wrote this submission.

Yours faithfully



David Williams  
Vice President