

Proposed Margin Scheme Changes

April 2005

On 17 March 2005, the Tax Laws Amendment (2005 Measures No. 2 Bill) 2005 was introduced into the House of Representatives.

The Bill proposes changes to various taxation laws including changes to the application of the margin scheme.

A summary of the main changes proposed is as follows:

- Both parties must agree in writing before the making of a supply (or within such further period as the Commissioner allows) that the supplier will apply the margin scheme. Previously the application of the margin scheme was entirely at the supplier's discretion. This could be particularly problematic where the vendor intended to apply the margin scheme and has stated a GST inclusive price in a contract entered into prior to this announcement. If the purchaser refuses to apply the margin scheme, the vendor may have to remit $\frac{1}{11}$ instead of applying the margin scheme.

An example is as follows:

| | Purchaser Agrees to Apply Margin Scheme | Purchaser Refuses to Apply Margin Scheme |
|------------------------|---|--|
| Sale Price Inc GST | \$20,000,000 | \$20,000,000 |
| GST Remitted | \$1,090,909 | \$1,818,182 |
| Net Proceeds | \$18,909,091 | \$18,181,818 |
| Value @ 1/7/00 Inc GST | \$8,000,000 | |

- Where a property was acquired GST free as either the supply of a going concern or as farmland, the margin is to be calculated based on the value as at 1 July 2000 and not the GST free acquisition price after that date.

Therefore even if a property was purchased as a going concern or as farmland in 2010 and sold in 2015, the GST cost base will still be 1 July 2000.

A vendor must therefore have an approved valuation as at 1 July 2000.

This could have a detrimental effect on property developers and their financiers who already purchased land based on profits forecast under the existing margin scheme rules.

An example is as follows:

| Proposed Changes | | Existing Conditions | |
|--------------------------|---------------------|---------------------------|---------------------|
| Gross Realisation | \$60,000,000 | Gross Realisation | \$60,000,000 |
| Value @ 1/7/00 Inc GST | \$8,000,000 | Acquisition Price Inc GST | \$20,000,000 |
| Margin | \$52,000,000 | Margin | \$40,000,000 |
| GST Liability (1/11th) | \$4,727,273 | GST Liability (1/11th) | \$3,636,364 |
| Net Proceeds | \$55,272,727 | Net Proceeds | \$56,363,636 |
| Profit Reduced by | \$1,090,909 | | |

- Any costs associated with the acquisition, for example stamp duty, legal fees, etc, are no longer to be included for the purposes of calculating the margin.
- The margin scheme will be able to be applied to the supply of amalgamated land where some but not all of the property had been purchased as a taxable supply for which the margin scheme was not applied. However, to the extent that the margin scheme was not applied on purchase, an increasing adjustment will apply to recover any input tax credits previously claimed.

Although the Bill has not yet been passed, the changes will apply from the date the Bill was introduced into Parliament, being 17 March 2005.

The changes are in effect retrospective as property developers who acquired property under the farmland or going concern exemptions in the past will potentially face increased GST liabilities when projects are sold and settled. This should be considered when projecting profits and negotiating on the purchase of properties.

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