

## Chapter 2

### Schedule 1—GST and the sale of real property, integrity measure

2.1 The provisions relating to the goods and services tax (GST) and the sale of real property were announced in the 2008–09 Budget and clarify whether a supplier, when buying or selling a business (or real property), will incur a liability for GST.

2.2 Special rules exist for real property that allow taxpayers an alternative means of calculating GST.<sup>1</sup> These rules are known as the 'margin scheme'. The margin scheme is generally used for new residential property developments.

2.3 The bill seeks to maintain the integrity of the GST tax base by ensuring that property sales cannot be structured in a way that GST does not apply to the value added to real property. These amendments:

- ensure that where the margin scheme is used, the value added is included in determining the GST subsequently payable;
- ensure that eligibility to use the margin scheme cannot be reinstated by interposing a GST-free or non-taxable supply; and
- confirm that the GST general anti-avoidance provisions can apply to contrived arrangements entered into to avoid GST.<sup>2</sup>

2.4 The Department of the Treasury claims that if the measure does not proceed the 'risk to revenue will increase substantially as more property developments are structured to take advantage of the tax minimisation opportunities'.<sup>3</sup>

#### Operation of the margin scheme in the existing provisions

2.5 Under the margin scheme provisions, GST is generally payable only on the value added to property on or after 1 July 2000. It levies GST only on the margin by which the value of the property increases each time it is sold by a registered entity.

2.6 While the margin scheme was designed to ensure that GST is payable only on the incremental value added to land by each party in a series of transactions, the

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1 In the common law, real property refers to land and land improvements including buildings and machinery sited on land.

2 Explanatory memorandum, p. 11.

3 The Department of the Treasury, *Submission 6*, p. 2.

interaction between the margin scheme provisions and the going concern provisions has given rise to an anomaly.

2.7 A supply of a going concern occurs when a business is sold, and that sale includes all of the things that are necessary for the business to continue operating; and the business is carried on, up until the day of sale. Real property may be acquired GST-free under the going concern or farmland provisions, or acquired from a registered associate without consideration.

2.8 Under the current legislative arrangements, as a result of the interaction of these provisions, GST is only paid on the margin between the final sale price and the amount paid to acquire the land before improvements have been undertaken (i.e. they do not include the value added by the supplier of the property as part of a going concern or the value added by an associate). This is illustrated by the diagram and table supplied by Treasury reproduced on the following two pages.

2.9 The Treasury considers that the interaction between these provisions has created a loophole which allows entities registered for GST to minimise the GST they pay on real estate transactions. As the explanatory memorandum states:

A registered entity that supplies real property as part of a GST-free going concern, as GST-free farmland, or as a non-taxable supply to a registered associate for no consideration does not pay GST on its value added. If the entity that acquires the real property later sells it under the margin scheme, it only pays GST on its own value added in these circumstances. The value added by the entity from which it acquired the property is not taxed.<sup>4</sup>

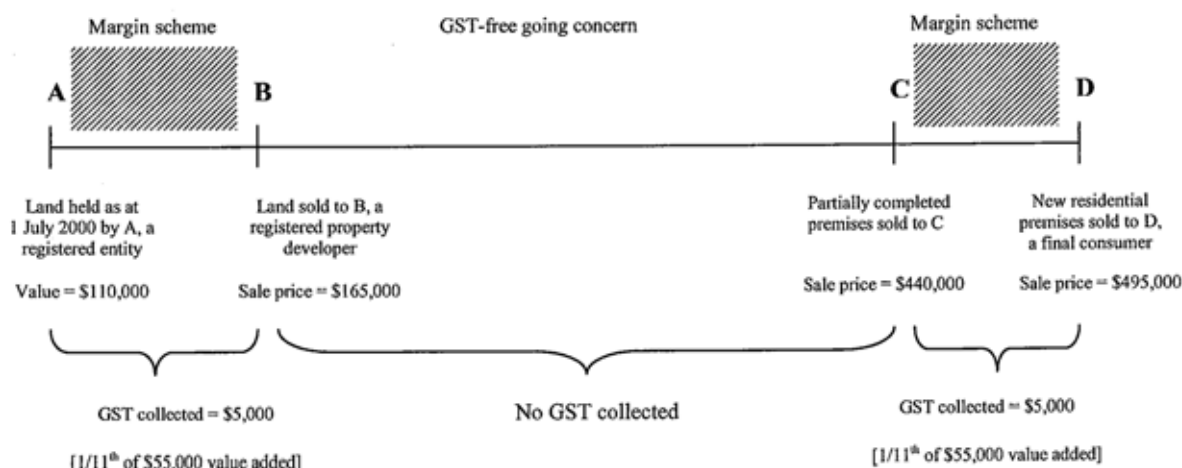
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4 Explanatory memorandum, p. 15.

**ILLUSTRATION 1 - reduced GST liabilities from the interaction of the margin scheme and the GST free going concern and farm land provisions**

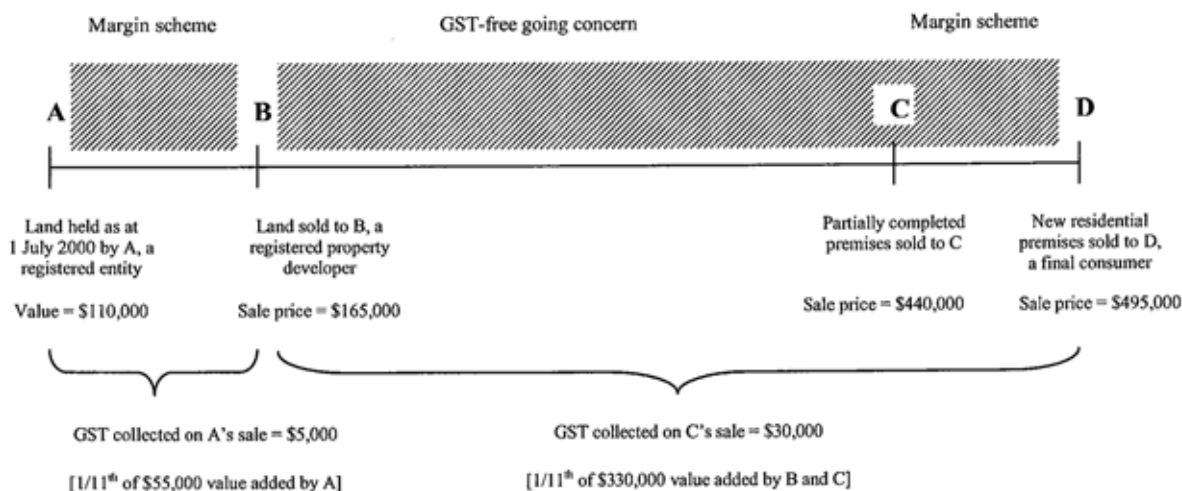
A, a GST-registered entity, holds land on 1 July 2000 valued at \$110,000  
 A sells land under the margin scheme to B, a GST-registered property developer, for \$165,000  
 B partially constructs new residential premises on the land, sells to C as a GST-free going concern for \$440,000  
 C completes construction and sells to a final consumer under the margin scheme for \$495,000.

**Outcome under current law**



**Total GST Collected \$10,000**

**Outcome under measure**



**Total GST Collected \$35,000**

**Summary table**

	Current law	Proposed Outcome	Difference
<b>GST payable by Entity A</b>	\$5,000	\$5,000	-
<b>GST payable by Entity B</b>	\$0	\$0	-
<b>GST payable by Entity C</b>	\$5,000	\$30,000	\$25,000
<b>Total GST collected</b>	\$10,000	\$35,000	\$25,000

GST is collected on the entire value added (\$385,000) by A, B and C

Due to the fact that C is required to pay GST on B's value added

Illustration and table supplied by the Department of the Treasury, *Submission 6*, p. 9

## Proposed legislation

2.10 Under the proposed legislation there will be changes to the margin scheme, requiring the final owner to pay GST on the full value added to the site.<sup>5</sup> This ensures that each registered supplier in a series of transactions remits the GST applicable to the value added by them.<sup>6</sup>

2.11 Schedule 1 ensures that a supply that is ineligible for the margin scheme continues to be ineligible for the margin scheme after it is supplied as part of a GST-free sale of a going concern. This is achieved by specifying that a supply is ineligible for the margin scheme if the previous supplier acquired the entire interest through a taxable supply on which the GST was worked out without applying the margin scheme.

5 The full value added is the difference between its initial value when the GST was introduced (1 July 2000) and the ultimate transaction value.

6 The Department of the Treasury informed the committee that 'amendments to address similar integrity issues were withdrawn from the Tax Laws Amendment (2005 Measures No.2) Bill. These were withdrawn in light of industry concerns over-taxation and retrospective application. The previous measure was intended to tax the increase in value from 1 July 2000 even though property may not have been in the GST system until after that time. The new integrity measure will only look back through one sale prior to the final sale under the margin scheme and not back through one sale prior to the final sale under the margin scheme and not back to 1 July 2000'. The Department of the Treasury, *Submission 6*, p. 1.

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## Housing affordability

2.12 Both the Urban Development Institute of Australia (UDIA) and the Property Council of Australia (PCA) expressed concern that the proposed legislation will act as 'an increased tax on new housing developments' and these will ultimately be passed on to the home buyer.<sup>7</sup>

2.13 UDIA suggested that the changes 'will have a significant impact on the future costs of housing developments', while PCA claimed that the proposed margin scheme will affect housing supply:

The businesses that are developing property will face significant increases in the cost of developing that property. Straight away this increase in the cost of development means that there will be a reduced supply of viable future residential developments. Essentially, what we are saying is it will cost more to develop property, which will mean fewer houses will be built.<sup>8</sup>

2.14 The Urban Development Institute of Australia suggested that a major developer has calculated that the cost of the measure to be in order of:

- \$11,000 per lot on a 60 lot infill development; and
- \$4,800 per lot on a 717 lot mixed townhouse and land development.<sup>9</sup>

2.15 Both UDIA and PCA further argued that the proposed changes are at odds with the Federal Government's commitment to improving housing affordability and that the cost impact will exceed the benefit of the new first home buyers grant:

Increased costs for new housing will affect the price of all houses in the market. This will work against the government's initiative to boost the first home [buyers] grant.<sup>10</sup>

It is, in effect, an increased tax on new housing developments which will be passed on to homebuyers through increased prices—and by this we note that on Treasury's estimates the revenues that will be raised by this measure are more than what the government will be spending on its Housing Affordability Fund.<sup>11</sup>

2.16 By contrast, the Department of the Treasury suggested that groups like UDIA and PCA had overstated the effect that the proposed changes would have on house

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7 See, for example, Urban Development Institute of Australia, *Submission 3*, p. 2.

8 Mr Andrew Mihno, Property Council of Australia, *Proof Committee Hansard*, 28 October 2008, p. 2.

9 Urban Development Institute of Australia, *Submission 3*, p. 3.

10 Mr Andrew Mihno, Property Council of Australia, *Proof Committee Hansard*, 28 October 2008, p. 2.

11 Mr Richard Lindsay, Urban Development Institute of Australia, *Proof Committee Hansard*, 28 October 2008, p. 4.

prices and housing supply. The Treasury argued that the current (tax minimisation) scheme had simply resulted in 'above-normal profits' for property developers.<sup>12</sup> Furthermore:

The section of the housing market directly affected by the integrity measure is relatively small compared to the whole housing market.<sup>13</sup>

2.17 In estimating the proportion of the market likely to be affected by the changes the Treasury stated:

Based on ABS data of building activity in Australia, Treasury estimates the total taxable value of new residential property in 2008/09 will be around \$30 billion rising to around \$35 billion in 2011–12. New residential property represents about 12 per cent of the total value of the market. Treasury estimates that the value of property potentially affected in 2008/09 is around \$3.7 billion or about 1.5 per cent of all residential property sales.<sup>14</sup>

2.18 In refuting the claims of industry bodies, the Treasury further suggested that they believed 'closing the loophole' would have 'no impact on prices' and that the amendments would 'ensure a level playing field for participants in the property industry'.<sup>15</sup>

2.19 The financial impact of the proposed changes is estimated at: 2008–09 \$43m; 2009–10 \$135m; 2010–11 \$160m; 2011–12 \$185m; giving a total of \$523 million over the next 4 years.<sup>16</sup>

2.20 This total of \$0.5 billion needs to be placed within the context of the total taxable value of new residential property. As outlined above, the Treasury estimated that the value of the market is around \$30 billion per year, or at least \$120 billion over four years.

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12 The Department of the Treasury, *Submission 6*, p. 3.

13 The Department of the Treasury, *Submission 6*, p. 1.

14 The Department of the Treasury, *Submission 6*, p. 3.

15 The Department of the Treasury, *Submission 6*, pp. 1, 3.

16 Explanatory memorandum, p. 7.

## Application of the measure

2.21 While there was some concern expressed by UDIA over whether the measure would be applied retrospectively—largely because of the way that this would affect existing developments—the explanatory memorandum clearly states: 'The measure has effect from the date of Royal Assent'.<sup>17</sup>

2.22 This was further reinforced by the submission by the Department of the Treasury which claimed that the changes will only apply from the date of Royal Assent so as not to affect existing contractual arrangements.<sup>18</sup> Because the measure will be applied prospectively, the Treasury argued that 'property developers will be able to take the new provisions into account when examining the feasibility of future development proposals'.<sup>19</sup>

## Anti-avoidance provisions

2.23 In its submission UDIA expressed concerns about the Schedule's anti-avoidance provisions (Div 165), claiming that the proposed amendment will make the anti-avoidance provisions of the *A New Tax System (Goods and Services Tax) Act* more stringent than those applicable to the *Income Tax Assessment Act*. UDIA argues:

The extension of the anti-avoidance provisions in the manner intended will create significant uncertainty for any taxpayer (not merely those that are involved in dealing with real property) where they are considering invoking one of the elections that is specifically provided for in the current GST law.<sup>20</sup>

2.24 The Department of the Treasury explained that during the consultations they undertook with key stakeholders concerns were raised about the amendments to the GST anti-avoidance provisions. It suggested that such concerns were unwarranted as the proposed amendments introduce a concept that is already contained in the income tax anti-avoidance provisions and are intended to clarify the operation of the GST anti-avoidance provisions and eliminate '*contrived* behaviour'.<sup>21</sup>

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17 Urban Development Institute of Australia, *Submission 3*, p. 3; Explanatory memorandum, p. 7. This is reiterated in paragraph 1.21 of the explanatory memorandum which, when referring to the anti-avoidance provisions in the bill, states: 'this measure will apply prospectively so that arrangements already entered into will not be impacted'.

18 The Department of the Treasury, *Submission 6*, p. 1.

19 The Department of the Treasury, *Submission 6*, p. 3.

20 Urban Development Institute of Australia, *Submission 3*, p. 5.

21 The Department of the Treasury, *Submission 6*, p. 3.

## **Date of acquisition**

2.25 The UDIA also recommended that the proposed legislation clarify the meaning of 'date of acquisition':

Under a real property scenario I can sign an agreement with you to sell the property, but the date at which you acquire that property can be some significant time later. And when I say significant, it can be years later. When we are dealing with the date of acquisition there is now uncertainty as to whether that is the date on which you sign the contract for the acquisition of the property, or whether it is the date on which you actually take settlement of that property.<sup>22</sup>

## **Committee view**

2.26 The committee agreed with the Treasury that the proposed changes to the legislation would not have a significant impact on the cost of housing. The measures only affected a very small proportion of the housing market. Moreover, only a proportion of the cost would be passed onto homebuyers, with some passed back to the suppliers of land and some borne by the property development sector in reduced profits.

2.27 The committee also agreed with Treasury that if the current provisions were not changed, there was a risk that future property development transactions would be structured in such a way as to give rise to a significant and inequitable loss of GST revenue.

2.28 The committee notes the UDIA's uncertainty about the interpretation of 'date of acquisition' and they should be given an explanation or the definition clarified in the legislation.

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22 Mr Bruce Hamilton, Urban Development Institute of Australia, *Proof Committee Hansard*, 28 October 2008, p. 5.