

# GST alert

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## Margin Scheme - The Law

Under the margin scheme, the amount of GST on eligible supplies is generally payable on the value added to the land since its acquisition (for post 1 July 2000 acquisitions) or since 1 July 2000 (for pre 1 July 2000 acquisitions).

On 17 March 2005, significant changes to the operation of the margin scheme were introduced in the Tax Laws Amendment (2005 Measures No 2) Bill 2005 now Act No 78 of 2005 (the Act).

One amendment within the Act relates to supplies of real property between associates. Previously, where land was transferred between associates under the margin scheme, the market value substitution rules did not apply. From 17 March 2005, if either the acquisition or supply of the property was from or to an associate, the margin will be calculated with reference to the particular GST-inclusive market value of the property at the time of any non-arm's length transaction. Where the relevant non-arm's length transaction was prior to 1 July 2000, the market value is calculated with reference to the approved valuation as at 1 July 2000. This will ensure that where the property is bought or sold for non-arm's length consideration between associates under the margin scheme, the appropriate amount of GST is paid.

Another amendment contained in the Act requires the use of the margin scheme be agreed in writing by the vendor and purchaser. This agreement must be made on or before the day of settlement, or within such further time as the Commissioner allows. This amendment will apply to settlements on or after 29 June 2005. It is recommended that contracts for the disposal of real property settling on or after 29 June 2005 contain appropriate clauses where it is agreed that the margin scheme is to be used. Where a contract has already been entered into, and settlement is after that date, a separate agreement may be required.

The margin scheme will now also be available in respect of amalgamated land where some, but not all, of the property would have been eligible for the margin scheme. Where this is the case, and the margin scheme is chosen to apply, increasing adjustments will arise so as to recover any input tax credits claimed.

One of the major changes that the original Bill was to introduce was that the margin scheme must be calculated with reference to the GST-inclusive market value of the property at 1 July 2000 if the property was acquired as a GST-free going concern. That is, the margin was to be calculated as the difference between the consideration for the supply and the GST-inclusive market

valuation of the property as at 1 July 2000. This measure has been removed from the final Bill, and Treasury will engage in further consultation with industry to ensure that the proposed measures apply appropriately.

## Changes to GST free supplies of services offshore

From 1 April 2005, changes to the GST legislation result in certain supplies of services being subject to GST where previously the provisions of such services were GST free.

Broadly, where a supply is made to an entity outside of Australia and that entity uses the supply in making an input taxed supply involving real property situated in Australia, then the first supply will be subject to GST. The two main instances where GST will now apply relate to supplies made in relation to the leasing, hire or licence of residential premises and the supply of Australian property by way of sale.

As a result, the following supplies may now be subject to GST where they are made to an entity outside Australia:

- Solicitors fees in relation to the conveyance of Australian residential premises
- Real estate agents fees in relation to the tenancy of Australian residential premises
- Any other legal fees incurred in relation to Australian residential premises
- Building insurance
- Public liability insurance
- Advertising services

Example:

Advertising services are provided to the non-resident owner of a residential unit in order to find a tenant for the unit. A fee of \$1,100 is charged. Under the new rules, GST of \$100 is payable by the advertising agency where previously the supply would have been GST free.

Accounting systems will therefore need to be updated to ensure the proper GST treatment is applied to such supplies. Further, and more importantly, prices for such services will need to be increased accordingly if the supplier is not to end up out of pocket after GST has been paid.

## GST - supplies to be made after 1 July 2005

The GST transitional rules provide that for contracts entered into before 8 July 1999 (or 2 December 1998 where the recipient of the supply would not have been entitled to a full input tax credit) no GST is payable on the supply until such time as a "review opportunity" arises (if at all). Generally, a "review opportunity" is any ability to alter the price payable under the contract.

### End of the transitional period on 1 July 2005

The GST transitional rule will end on 1 July 2005. This means that for contracts mentioned above, GST will be payable on supplies made after 1 July 2005 under those contracts. Recent amending legislation has been enacted to deal with the imposition of GST on supplies post 1 July 2005.

### The options

Essentially three options have been provided under the amendments:

#### Option 1

The supplier and recipient agree on a new price for the supply, taking into account that GST of 1/11th of the new price will be payable by the supplier to the ATO. The most probable scenario would be that the recipient agrees to pay the price plus GST, if it can claim a full input tax credit for the GST paid. This will leave the supplier in a GST neutral position. In this regard, such a scenario is common for most items currently acquired by business (ie GST is paid and a full credit claimed by the recipient).

Example:

The contract currently states that the price payable is \$100 per month. The supplier and recipient agree that the new price will be \$110. The supplier remits \$10 to the ATO as GST and keeps the \$100. The recipient claims a \$10 input tax credit and is therefore no worse off, having paid \$100 net.

#### Option 2

Prior to the supplier and recipient agreeing on a new price, if the contract provides that the price may be changed to take account

of GST or similar value added tax imposed on the supply, the recipient may elect to pay the GST on the supply instead of the supplier.

In this instance the price will remain as is. The GST payable by the recipient will be 1/10th of the price currently payable. As the price has not changed, the amount payable to the supplier by the recipient (after the payment of GST) will be less than before. In other words, the supplier will be out of pocket. An input tax credit may still be claimable by the recipient (if registered for GST), in which case the recipient will not be out of pocket and may make a windfall gain.

Example:

Current price of the supplies - \$100. The recipient elects to pay the GST and remits \$10 to the ATO and \$90 to the supplier. As it is registered for GST the recipient claims an input tax credit of \$10. The supplier now receives only \$90, whereas it previously received \$100. It is now out of pocket. In addition, the recipient has only paid \$90, whereas it previously paid \$100. It is \$10 better off.

#### Option 3

The supplier makes an offer to the recipient regarding a change in price, the new price being determined using an independent third party arbitrator (called an "arbitrated offer"). If the recipient does not accept the arbitrated offer, the recipient (and not the supplier) must pay GST of 1/10th of the price to the ATO. Again, the supplier will be worse off and the recipient better off as under option 2.

Where options 1 and 2 are not taken and the supplier does not make an arbitrated offer under option 3, the supplier will be required to pay GST of 1/11th of the price originally payable under the supply agreement. No recovery from the recipient will be available and the supplier will be out of pocket. The recipient, if registered for GST, may be able to claim an input tax credit for the GST paid and may therefore make a windfall gain.

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