The Institute of Chartered Accountants in Australia

21 January 2011

Ms Brenda Berkeley
The General Manager
Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attention: Mr Rob Dalla Costa

By email: marginscheme@treasury.gov.au

Dear Brenda

Implementation of recommendations from review of GST margin scheme

The Institute of Chartered Accountants in Australia (the Institute) welcomes the opportunity to make a submission in relation to the discussion paper on 'Implementation of the recommendations of Treasury's review of the GST margin scheme, 10 December 2010' (the discussion paper). The discussion paper implements the announced 2010 Budget measure to restructure the GST margin scheme with effect from 1 July 2011.

Background

On 12 May 2009, 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. The Institute responded to that invitation with its submission to Treasury dated 10 August 2009. In that submission, the Institute recommended abolition of the margin scheme and replacing it with a provision that treated property similar to second hand goods by giving a notional input tax credit. Most other respondents to Treasury's original discussion paper indicated that the specific concerns within the margin scheme would be best addressed through further amendments to the existing legislative framework.

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The 2010 Budget announced the Government's decision to:

- restructure the margin scheme provisions to give prominence to the main principles 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, 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.

Key comments

While we appreciate the opportunity of commenting on the discussion paper, the Institute's principal comment is that we do not believe the proposed change will lead to meaningful or lasting improvement. Certainly, we agree with the announcement that a minor technical amendment will be made to ensure that an approved valuation of the land can be used for the purpose of calculating the margin on subdivided land. However, apart from this specific amendment, we find it difficult to identify any clear proposal that we can comment or provide feedback on at this point. It does not appear to us that the discussion paper describes the proposed legislative restructuring in sufficient detail for the Institute to make informed or precise comments. Therefore, we are constrained in the comments we are able to make at this stage, in advance of the exposure draft legislation being released.

If the proposed changes are not expected to have any impact on revenue, it suggests to us that it is expected that the specific wording of the relevant core provisions will not change materially. If so, the discussion paper appears to merely propose different locations and orders for the relevant provisions. The Institute's concern is that the policy adopted by the Government essentially does little more than rely on the addition of "a set of principles" to address the fundamental issues that exist with the margin scheme.

The discussion paper indicates that neither the Institute nor any other respondent recommended replacing the existing margin scheme with a set of principles. We suggest that neither the Institute nor any other respondent agreed with that approach because GST practitioners do not believe that it will lead to any real improvements in the application of the margin scheme.

The Institute reiterates our view previously expressed to Treasury that the margin scheme is increasingly complicated, its application is increasingly uncertain and it has fundamental problems that need to be addressed. To that end, the Institute's primary submission is that the Government announcement represents a less than ideal policy option in our view, and should be withdrawn or revised.

If the announced policy cannot be revised in the short term, the Institute has three specific comments in respect of the discussion paper and the margin scheme generally. Each is discussed in turn below:

1. **Residential property and margin scheme policy** – there is a need for the Government to develop and clearly articulate the overall GST policy for taxing property and particularly residential property and the margin scheme itself. The Institute believes that many of the legislative changes, following the *Marana* decision, to the real property provisions demonstrate a failure to fully understand how a value added tax on private consumption expenditure should apply to real property transactions.

The discussion paper and responses to it are not the forum in which to address these matters in detail. Suffice to say that the Institute believes that the purpose of the margin scheme is *to tax the value added to real property since 1 July 2000 in the course or furtherance of a GST registered enterprise*.

Stone J in *Sterling Guardian Pty Ltd v Commr of Taxation* [2005] FCA 1166 said at p17:

> *"Where the margin scheme is available it allows a taxpayer to pay tax on the ``value added'' by that taxpayer's business, that is on the sale price less the cost of the land sold."*

The purpose of the margin scheme is to tax the value added by a taxpayer's enterprise, not the increase in value simply by virtue of an entity's ownership. The Institute recommends that the purpose of the margin scheme suggested above (or equivalent expression of that purpose) be inserted within s 75-1 itself as the object of the whole division.

2. **Objects clauses for key provisions** – the Institute submits that inserting objects clauses for the key provisions will be of limited value without first inserting the purpose of the margin scheme at the start of Division 75 itself. We submit that those object clauses need to be based on, and reflect, the expressed overarching purpose of the margin scheme.

   We believe that the proposed object clauses should have been listed in the 2010 discussion paper so that the proposed margin scheme restructuring could be analysed appropriately and valuable feedback provided. We also foresee difficulties in aligning some of the existing provisions with the objects of those key provisions if the objects are drafted to reflect the overall purpose of the margin scheme. That is because, in our view, some of the existing Division 75 provisions do not reflect a coherent purpose that is consistent with the overall purpose of the margin scheme itself.

3. **Problems with the existing margin scheme** – the Institute is concerned that the proposed restructuring not only represents a lost opportunity to correct current problems with the margin scheme but may, in fact, make them harder to change. We list below the margin scheme issues that we raised in our 10 August 2009 submission, which we believe will not be addressed by the 2010 Budget announcement:

   - Past transactions and treatments determine future eligibility and liabilities;
   - Risks, costs and uncertainty resulting from the dependence on valuations;
   - Application of GST to value added since 1 July 2000 that was not in the course or furtherance of a GST-registered enterprise;
   - Application of GST to gains made before an entity is registered for GST;
   - Application of GST to value added prior to 1 July 2000;
   - Cascading GST in respect of integrated residential and commercial developments;
   - Identity of property issues at each stage of the supply chain; and
   - Complexity and deficiency of provisions dealing with purchases from or supplies to associates or land that was acquired as farm land or as/within a going concern.

The Institute submits that these existing problems within the margin scheme will not be dealt with under the proposed changes and need to be addressed as the first priority. The Institute would appreciate the opportunity to meet with Treasury to discuss the potential scope for legislative amendments which could offer a solution within the bounds of Treasury's remit to clarify the intended operation of the margin scheme.

If you have any questions regarding the contents of this submission, or would like to discuss any aspect in further detail, please contact Donna Bagnall on (02) 9290 5761.

Yours sincerely

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The Institute of Chartered Accountants in Australia