PS LA 2005/2 (GA) - GST and time of choice to apply the margin scheme

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This document has changed over time. This version was published on *1 July 2000*

Generated on: 30 November 2026, 04:29:07 AM

Australian Government
Australian Taxation Office

Practice Statement Law Administration

PS LA 2005/2 (GA)

FOI status: may be released

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SUBJECT: **GST and time of choice to apply the margin scheme**

PURPOSE: **To explain when the Commissioner may accept that an entity, which did not choose to apply the margin scheme to work out the GST on a taxable supply of real property until after it made the supply, may account for GST as if the margin scheme applies.**

STATEMENT

1. This practice statement applies to supplies that are not covered under the provisions contained in the *Tax Laws Amendment (2005 Measures No. 2) Act 2005* that require the supplier and recipient to agree in writing that the margin scheme is to apply. The provisions relate to supplies made under contracts entered into on or after 29 June 2005, other than those supplies made pursuant to rights or options granted before 29 June 2005.[1]

2. Therefore, this practice statement applies to supplies made before 29 June 2005 and also to supplies where the supplier entered into a contract or granted rights or options over the real property before 29 June 2005, but made the supply after that date.

3. The practice statement sets out the limited circumstances when the Commissioner will ordinarily accept that an entity ('the supplier'), which did not choose to apply the margin scheme to work out the GST on a taxable supply of real property until after it made the supply, may account for GST on the supply as if the margin scheme applies.

[1] PSLA 2005/15 The Commissioner's discretion to extend the time in which the agreement in writing must be made to apply the margin scheme under Division 75 of the *A New Tax System (Goods and Services Tax) Act 1999,* is a practice statement that sets out the circumstances in which the Tax Office may exercise the Commissioner's discretion to extend the time in which an agreement in writing must be made to apply the margin scheme.

4. Those limited circumstances are where the Commissioner is satisfied that:

   (i) the supplier did not choose to apply the margin scheme until after it made the supply due to a genuine mistake; and

   (ii) all other requirements for the supplier to be entitled to apply the margin scheme in working out the amount of GST on the supply are satisfied; and

   (iii) the recipient of the supply does not, and is not likely to have, an entitlement to an input tax credit or a decreasing adjustment in relation to its acquisition of the real property; and

   (iv) the price for the supply was not agreed by the parties on the basis that GST would be 1/11th of the consideration for the supply; and

   (v) there is no arrangement that has the effect of producing an outcome contrary to the policy of the legislation[2].

5. A supplier may have paid GST on a taxable supply which was not calculated under the margin scheme but where the circumstances described in paragraph 4 apply. In those circumstances, the credit or refund will ordinarily be allowed if the other requirements for refunds or credits of GST are satisfied[3], and there is no unjust enrichment as a result of the credit or refund.

EXPLANATION

Legislative context

6. All legislative references in this practice statement are to the *A New Tax System (Goods and Services Tax) Act 1999*.

7. Normally GST is calculated as 1/11th of the consideration for a taxable supply in accordance with Subdivision 9-C. However, if GST is calculated under the margin scheme for a taxable supply of real property the GST payable is 1/11th of the margin for the supply.

8. If subsection 75-10(2) applies, the margin is the amount by which the consideration for the supply exceeds the consideration for the supplier's acquisition of the real property. If subsection 75-10(3) applies, the margin is the amount by which the consideration for the supply exceeds a valuation of the real property made in accordance with that provision.

9. The intention of the margin scheme is to ensure that, if the margin scheme is applied to work out the GST on a supply of real property, GST is only payable on the value added by the supplier after the commencement of the GST system.[4] It follows that GST calculated under the margin scheme may be significantly less than the amount calculated under the basic rules.

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[2] *Federal Commissioner of Taxation v. Asiamet (No.1) Resources Pty Ltd* (2004) 137 FCR 146; [2004] FCAFC 73.
[3] See for example sections 36 and 39 of the *Tax Administration Act 1953.*
[4] Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998* at paragraph 6.100.

10. For supplies other than those requiring a written agreement to apply the margin scheme, subsection 75-5(1) provides that the supplier 'may choose to apply the margin scheme in working out the amount of GST' if the supplier makes a taxable supply of real property by selling a freehold interest in land or stratum unit or granting or selling a long-term lease.

11. However, the supplier cannot choose to apply the margin scheme if the supplier acquired the interest, unit or long-term lease through a taxable supply on which the GST was worked out without applying the margin scheme.

12. An entity that is registered or required to be registered for GST is entitled to input tax credits for creditable acquisitions that it makes.[5] However, an acquisition is not a creditable acquisition if the supply of the interest, unit or long-term lease was a taxable supply under the margin scheme.[6]

Time of choice to apply the margin scheme – the Commissioner's view

13. It is the Commissioner's view that, in relation to supplies not requiring a written agreement to apply the margin scheme, the supplier must choose to apply the margin scheme at or before the time it makes the supply[7].

Genuine mistakes

14. The supplier may fail to choose to apply the margin scheme by the time it makes the supply as a result of a genuine mistake. Such a mistake could result in a sizeable unforeseen liability, especially where GST calculated on the margin would have been a small amount relative to the GST calculated as 1/11th of the selling price.

15. Examples of circumstances where the supplier may not have chosen to apply the margin scheme until after it made the supply due to a genuine mistake may include a genuine mistake about whether:

    (i) the supply of real property was a taxable supply (see Examples 1 and 2 at paragraphs 31 to 44); or

    (ii) the supplier was required to be registered for GST when the supply was made (see Example 3 at paragraphs 45 to 52).

16. Taxing the full consideration in these circumstances may be regarded as contrary to the policy intent of the margin scheme and result in GST being paid on value added before the commencement of the GST system where the supplier owned the real property before 1 July 2000.

[5] Section 11-20.
[6] Section 75-20.
[7] GSTR 2000/21 Goods and Services Tax: the margin scheme for supplies of real property held prior to 1 July 2000 ; Fact Sheet, How to use the margin scheme to work out GST when you sell real property that you acquired before 1 July 2000; and Fact Sheet, How does the margin scheme apply to supplies of real property acquired on or after 1 July 2000 outline the Commissioner's views regarding in what circumstances the margin scheme may be used, how valuations are to be made, when you must choose to apply the margin scheme and what documentation is required.

17. The amounts of GST payable under the core provisions may be substantial relative to the amounts payable under the margin scheme. Where that is the case, the Commissioner's resources are likely to be disproportionately employed in resolving disputes in this area if genuine mistakes have occurred and there has been no intention to avoid or minimise GST.

18. For these reasons, the Commissioner considers that there are circumstances in which, consistent with good administration of the GST legislation, he may accept that GST may be accounted for *as if* the margin scheme applied even though the supplier chose to use the margin scheme after it made the supply.

19. In doing so, the Commissioner is not prepared to allow GST to be accounted for in that way in every case where the supplier chooses to apply the margin scheme after it made the supply. That would, in our view, be contrary to the requirements of the legislation and is therefore not an option available to the Commissioner consistent with his duty to administer the legislation.

20. The Commissioner is also mindful that any decision of this kind should not affect the position of the recipient. Therefore, the Commissioner would not regard the margin scheme as *applying* if the supplier wants to choose to apply the margin scheme after it makes the taxable supply. That would be contrary to our view of the proper construction of the provisions and could disadvantage a recipient who might otherwise be entitled to an input tax credit.

21. Therefore, while each matter will need to be considered by reference to the facts and circumstances of the case, the Commissioner will, in the limited circumstances set out at paragraph 4 above, ordinarily accept that the supplier may account for GST *as if* the margin scheme applies even though, on our view of the legislation, the choice to apply the margin scheme had not been made by the required time. The practice statement does not affect the position of a purchaser who would not be entitled to apply the margin scheme on a subsequent taxable supply of the real property.

22. However, the Commissioner could not responsibly allow GST to be accounted for as if the margin scheme applies if the recipient of the supply would nevertheless be entitled to an input tax credit for its acquisition of the real property. That could involve paying input tax credits in amounts higher than the GST paid on the relevant supply. Even if the recipient is not registered or required to be registered for GST, and therefore not entitled to an input tax credit, there would be a remaining risk that the recipient may subsequently apply for registration with the registration backdated to the date of acquisition of the real property. By doing so, the recipient might become entitled to an input tax credit for acquisition of the real property.

23. Accordingly, under this practice statement, a supplier cannot account for GST as if the margin scheme applied unless the Commissioner is satisfied that the recipient is not entitled, and not likely to become entitled, to an input tax credit for its acquisition of the real property.

24. The Commissioner considered merely limiting this condition to cases where the recipient is not likely to become entitled to an input tax credit for its acquisition of the real property. However, there would be a remaining risk to revenue in that case if a decreasing adjustment is made under Division 129. For that reason, this practice statement also does not provide for a supplier to account for GST as if the margin scheme applied unless the Commissioner is satisfied that the recipient is

not likely to become entitled to a decreasing adjustment in relation to its acquisition of the real property.

25. The Commissioner therefore expects that this practice statement is more likely to enable a supplier to account for GST as if the margin scheme applied where the recipient would not ordinarily be entitled to an input tax credit, such as where the real property is acquired for private residential use. In cases where the real property is used for commercial purposes, it is likely to be more difficult to satisfy the Commissioner that the recipient is not likely to become entitled to an input tax credit or decreasing adjustment for its acquisition of the property.

26. Further, this practice statement is intended to assist suppliers who have made genuine mistakes in the application of the GST law. It is not intended to allow a supplier, who has negotiated a price with a purchaser on the basis that GST of 1/11th of the consideration is payable, to obtain a windfall by accounting for GST as if the margin scheme applies. Therefore the practice statement does not apply if the parties agreed on the price for the supply on the basis that GST would be 1/11th of the consideration.

27. As the purpose of the practice statement is to assist suppliers who have made genuine mistakes, it does not apply if the desire to account for GST as if the margin scheme applies is part of an arrangement to avoid GST or otherwise obtain an outcome contrary to the policy of the legislation.

28. Requests to account for GST as if the margin scheme applies should be made in writing to the Commissioner by or on behalf of the supplier. The written request should contain sufficient detail for the Commissioner to determine whether the requirements in paragraph 4 are satisfied. Any decision on whether a supplier may account for GST as if the margin scheme applies must be approved by an Executive Level 2 officer (or above).

29. A decision not to allow the supplier to account for GST as if the margin scheme applied is not a reviewable GST decision under subsection 62(2) of the *Tax Administration Act 1953*. However, if a supplier feels we have made a mistake, in the interests of sound administration we would generally review the decision, as mentioned in the Taxpayer's Charter.

Examples

30. Set out below are examples of where, because of a genuine mistake, the supplier inadvertently did not choose to apply the margin scheme until after the time that it made the supply.

Example 1: genuine mistake that the supply was GST-free

31. In January 2002 Farmer Joe acquired farm land for $440,000 from a supplier that was not registered or required to be registered for GST. He registered for GST and began running the farm.

32. In June 2004 Farmer Joe sold his farm land for $528,000 to a retired couple for use as their home. The retired couple were not registered for GST and had no intention of farming the land.

33. Farmer Joe mistakenly believed he was entitled to treat the sale of his farm land as GST-free under the farm land exemptions in the GST Act. As a result, he did not

choose to apply the margin scheme to the sale of the farm land at or before the time he made the supply to the retired couple.

34. It was subsequently discovered that the sale of Joe's farm land was not GST-free under the farm land exemptions. It was a taxable supply. Farmer Joe would therefore be liable for GST of 1/11th of the sale price for the farm land, being $48,000 (1/11th of $528,000).

35. If Farmer Joe had applied the margin scheme he would have been liable for GST of 1/11th of the margin for the supply, being $8,000 (1/11th of [$528,000 - $440,000]).

36. The retired couple who purchased the property are not registered for GST and do not carry on any enterprise. The Commissioner is satisfied that the retired couple is unlikely to become entitled to an input tax credit or decreasing adjustment for their acquisition of the property. There was no reference to GST being calculated as 1/11th of the selling price in the contract for the sale of the property.

37. As the other conditions in paragraph 4 above are satisfied, the Commissioner would accept that GST may be accounted for as if the margin scheme would apply. That is, the Commissioner would accept that Farmer Joe's GST liability would be satisfied by a payment of $8000.

Example 2: genuine mistake that the supply was not taxable – pre 1 July 2000 contract

38. Building Co purchased vacant land in September 1999.

39. The site was developed into townhouses which were completed in June 2000. A contract for sale of one of the townhouses for $275,000 was entered into on 25 June 2000. The buyer, who is not registered for GST, purchased the townhouse as an investment and intends to rent it to tenants for use as a home. The contract of sale settled in August 2000 for that amount. Building Co was registered for GST.[8]

40. Building Co made a taxable supply and would have been entitled to choose to apply the margin scheme to calculate the GST on the supply. However, because the contract was executed in June 2000 before the commencement of GST, Building Co mistakenly believed that the supply was not subject to GST. Consequently, it did not consider the calculation of GST and therefore did not choose to apply the margin scheme. GST would therefore be payable on the full consideration for the supply rather than the margin. As the contract was executed a few days before 1 July 2000, the margin would have been nil.

41. Therefore, Building Co would be liable for GST of 1/11th of the full sale price for the supply under the normal rules, being $25,000 (1/11th of $275,000).

42. If Building Co could have applied the margin scheme, it would have been liable for GST of 1/11th of the margin for the supply, being nil (1/11th of [$275,000 - 275,000]).

43. As the purchaser is not registered for GST and purchased the townhouse as an investment property for renting to tenants for use as a private home, the Commissioner is satisfied that the purchaser is not likely to become entitled to an input tax credit or decreasing adjustment for its acquisition of the townhouse. There is no evidence to suggest that Building Co is involved in any arrangement intended

[8] This example assumes a valuation has been made that complies with a Determination by the Commissioner under subsection 75-10(3).

to produce an outcome contrary to the policy of the legislation in relation to the supply of the townhouse.

44. As the other conditions in paragraph 4 above are satisfied, the Commissioner would accept that GST may be accounted for as if the margin scheme would apply. That is, the Commissioner would accept that Building Co's GST liability would be nil.

Example 3: genuine mistake that the supplier was not required to be registered for GST when the supply was made

45. In September 2000 a non-profit entity, whose aim was to provide low-rent housing to the community, purchased a block of land for $99,000 from a developer who applied the margin scheme to calculate the GST on the supply to the non-profit entity. The non-profit entity constructed a home on the land and rented it out to tenants for use as their private home. As the non-profit entity's turnover was below the registration turnover threshold, ($100,000 before 1 July 2007 and $150,000 from 1 July 2007)[9], it chose not to register for GST.

46. The non-profit entity set up an unrelated enterprise in February 2004. This lead to an increase in the turnover of the non-profit entity.

47. In March 2004 the non-profit entity sold the house and land to a first home buyer, who was not registered for GST, for its market value of $330,000. As the non-profit entity had previously chosen not to register for GST, it believed it was not liable to pay GST on the sale of the property. As a result, it did not consider whether to apply the margin scheme to the sale at or before the time it made the supply.

48. Due to its increasing turnover, the non-profit entity registered for GST from May 2004.

49. It was subsequently discovered that the non-profit entity exceeded the registration turnover threshold in February 2004 rather than in May 2004. As such, the non-profit entity was required to be registered for GST from February 2004.

50. Therefore, the sale of the house and land in March 2004 was a taxable supply. The non-profit entity would be liable for GST of 1/11th of the full sale price for the property, being $30,000 (1/11th of $330,000), if the margin scheme could not be applied. If the margin scheme could be applied, the non-profit entity would have been liable for GST of 1/11th of the margin for the supply, being $21,000 (1/11th of [$330,000 - $99,000]).

51. The Commissioner is satisfied that the first home buyer is not likely to become entitled to an input tax credit or decreasing adjustment for its acquisition of the property.

52. As the other conditions in paragraph 4 above are satisfied, the Commissioner would accept that GST may be accounted for as if the margin scheme would apply. That is, the Commissioner would accept that the non-profit entity's GST liability would be satisfied by a payment of $21,000.

[9] Subsection 23-15(2) of the GST Act and A New Tax System (Goods and Services Tax) Regulations 1999 regulation 23-15.02.

subject references	GST Margin scheme Time of choice to apply the margin scheme
legislative references	A New Tax System (Goods and Services Tax) Act 1999 Division 75 A New Tax System (Goods and Services Tax) Act 1999 Division 129 A New Tax System (Goods and Services Tax) Act 1999 Subdivision 9-C A New Tax System (Goods and Services Tax) Act 1999 section 11-20 Tax Administration Act 1953 section 36 Tax Administration Act 1953 section 39 Tax Administration Act 1953 subsection 62(2)
related public rulings	GSTR 2000/21; GSTR 2005/D3; GSTR 2005/D4; Fact Sheets: Nat 8680; 8682; 13320;
related practice statements	PSLA 2005/15
case references	*Federal Commissioner of Taxation v. Asiamet (No.1) Resources Pty Ltd* (2004) 137 FCR 146; [2004] FCAFC 73.
Other references	Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998* paragraph 6.100
file references	Files 04/18100; 05/277; 05/12051.
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Date issued	4 October 2005
Date of effect	1 July 2000
Other Business Lines consulted	OCTC - Admin B&PT CoE Operations - Debt & Lodgement LB&I, SB, SPR, PTAX, EXC, SNC.
Amendment history	**16 October 2007:** Change the GST registration turnover threshold for non-profit entity from $100,000 to $150,000 as specified by regulation 23-15.02. **25 February 2008:** Contact details updated **15 September 2009:** Contact officer details updated