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

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PS LA 2005/2 (GA)

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SUBJECT:	**Goods and services tax and time of choice to apply the margin scheme**
PURPOSE:	**To explain when we may accept that an entity, which did not choose to apply the margin scheme to work out the goods and services tax (GST) on a taxable supply of real property until after it made the supply, may account for GST as if the margin scheme applies.**

TABLE OF CONTENTS **Paragraph**

STATEMENT **1**

EXPLANATION **6**

Legislative context 6

Time of choice to apply the margin scheme – our view 13

Genuine mistakes 14

Examples 30

Example 1: genuine mistake that the supply is GST-free 31

Example 2: genuine mistake that the supply is not taxable – pre-1 July 2000 contract 38

Example 3: genuine mistake that the supplier is not required to be registered for GST when the supply is made 45

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. This Practice Statement sets out the limited circumstances when we 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.

4. Those limited circumstances are where we are satisfied that:

   - The supplier did not choose to apply the margin scheme until after it made the supply due to a genuine mistake.
   - 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.
   - The recipient of the supply does not, and is not likely to have, an entitlement to an input tax credit (ITC) or a decreasing adjustment in relation to its acquisition of the real property.
   - The price for the supply was not agreed by the parties on the basis that GST would be one-eleventh of the consideration for the supply.
   - 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 of this Practice Statement 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*, unless otherwise indicated.

7. Normally, GST is calculated as one-eleventh of the consideration for a taxable supply, in accordance with Subdivision 9-C. However, if GST is calculated

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[1] Law Administration Practice Statement PS LA 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* sets out the circumstances in which the ATO may exercise the Commissioner's discretion to extend the time in which an agreement in writing must be made to apply the margin scheme.

[2] *Commissioner of Taxation v Asiamet (No. 1) Resources Pty Limited* [2004] FCAFC 73.

[3] See, for example, sections 36 and 39 of the *Taxation Administration Act 1953*.

under the margin scheme for a taxable supply of real property, the GST payable is one-eleventh 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.

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 ITCs 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 – our view

13. It is our 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 choose not to apply the margin scheme before 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 one-eleventh of the selling price.

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[4] Paragraph 6.100 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.
[5] Section 11-20.
[6] Section 75-20.
[7] Goods and Services Tax Rulings GSTR 2000/21 *Goods and services tax: the margin scheme for supplies of real property held prior to 1 July 2000*, GSTR 2006/7 *Goods and services tax: how the margin scheme applies to a supply of real property made on or after 1 December 2005 that was acquired or held before 1 July 2000* and GSTR 2006/8 *Goods and services tax: the margin scheme for supplies of real property acquired on or after 1 July 2000*, as well as GST and the margin scheme, outline our views regarding how the circumstances in a 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.

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

- the supply of real property was a taxable supply (see Examples 1 and 2 of this Practice Statement), or
- the supplier was required to be registered for GST when the supply was made (see Example 3 of this Practice Statement).

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.

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, our 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, we consider that there are circumstances in which, consistent with good administration of the GST legislation, it may be accepted that GST is 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, we cannot allow GST to be accounted for in this 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 us consistent with the duty to administer the legislation.

20. We are also mindful that any decision of this kind should not affect the position of the recipient. Therefore, we 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 ITC.

21. Therefore, while each matter will need to be considered by reference to the facts and circumstances of the case, we will, in the limited circumstances set out at paragraph 4 of this Practice Statement, 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. This 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. Furthermore, we 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 ITC for its acquisition of the real property. This would result in a claim for an ITC greater 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 ITC, 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 ITC 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 we are satisfied that the recipient is

not entitled, and not likely to become entitled, to an ITC for its acquisition of the real property.

24. We considered merely limiting this to cases where the recipient is not likely to become entitled to an ITC 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 we are satisfied that the recipient is not likely to become entitled to a decreasing adjustment in relation to its acquisition of the real property.

25. We therefore expect 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 ITC, 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 us that the recipient is not likely to become entitled to an ITC 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 one-eleventh of the consideration is payable, to obtain a windfall by accounting for GST as if the margin scheme applies. Therefore, this Practice Statement does not apply if the parties agreed on the price for the supply on the basis that GST would be one-eleventh of the consideration.

27. As the purpose of this 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 us by or on behalf of the supplier. The written request should contain sufficient detail for us to determine whether the requirements in paragraph 4 of this Practice Statement 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 110-50(2) of Schedule 1 to the *Taxation 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 Our Charter.

Examples

30. Paragraphs 31 to 52 of this Practice Statement set out 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 is GST-free

31. *In January 2002, Farmer Joe acquires farm land for $440,000 from a supplier that is not registered or required to be registered for GST. He registers for GST and begins running the farm.*

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

33. *Farmer Joe mistakenly believes he is entitled to treat the sale of his farm land as GST-free under the farm land exemptions in the A New Tax System (Goods and Services Tax) Act 1999. As a result, he does not choose to apply the margin scheme to the sale of the farm land at or before the time he makes the supply to the retired couple.*

34. *It is 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 is therefore liable for GST of one-eleventh of the sale price for the farm land, being $48,000 ((1 ÷ 11) × $528,000).*

35. *If Farmer Joe had applied the margin scheme, he would have been liable for GST of one-eleventh of the margin for the supply, being $8,000 ((1 ÷ 11) × ($528,000 − $440,000)).*

36. *The retired couple who purchased the property are not registered for GST and do not carry on any enterprise. We are satisfied that the retired couple is unlikely to become entitled to an ITC or decreasing adjustment for their acquisition of the property. There is no reference to GST being calculated as one-eleventh of the selling price in the contract for the sale of the property.*

37. *As the other conditions in paragraph 4 of this Practice Statement are satisfied, we accept that GST may be accounted for as if the margin scheme applies. That is, we accept that Farmer Joe's GST liability is satisfied by a payment of $8,000.*

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

38. *Building Co purchases vacant land in September 1999.*

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

40. *Building Co makes a taxable supply and is entitled to choose to apply the margin scheme to calculate the GST on the supply. However, because the contract is executed in June 2000 before the commencement of GST, Building Co mistakenly believe that the supply is not subject to GST. Consequently, it does not consider the calculation of GST and therefore does not choose to apply the margin scheme. GST is therefore payable on the full consideration for the supply, rather than the margin. As the contract is executed a few days before 1 July 2000, the margin is nil.* [8]

41. *Therefore, Building Co is liable for GST of one-eleventh of the full sale price for the supply under the normal rules, being $25,000 ((1 ÷ 11) × $275,000).*

42. *If Building Co applies the margin scheme, it is liable for GST of one-eleventh of the margin for the supply, being nil ((1 ÷ 11) × ($275,000 − 275,000)).*

43. *As the purchaser is not registered for GST and purchases the townhouse as an investment property for renting to tenants for use as a residential premises,*

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

we are satisfied that the purchaser is not likely to become entitled to an ITC or decreasing adjustment for its acquisition of the townhouse. There is no evidence to suggest that Building Co is involved in any arrangement intended 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 of this Practice Statement are satisfied, we accept that GST may be accounted for as if the margin scheme will apply. That is, we accept that Building Co's GST liability is nil.*

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

45. *In September 2000, a not-for-profit entity (whose aim is to provide low-rent housing to the community) purchases a block of land for $99,000 from a developer who applies the margin scheme to calculate the GST on the supply to the not-for-profit entity. The not-for-profit entity constructs a home on the land and rents it out to tenants for use as residential premises. As the not-for-profit entity's turnover is below the registration turnover threshold ($100,000 before 1 July 2007 and $150,000 from 1 July 2007)[9], it chooses not to register for GST.*

46. *The not-for-profit entity sets up an unrelated enterprise in February 2004. This leads to an increase in the turnover of the not-for-profit entity.*

47. *In March 2004, the not-for-profit entity sells the house and land to a first-home buyer (who is not registered for GST) for its market value of $330,000. As the not-for-profit entity has previously chosen not to register for GST, it believes it is not liable to pay GST on the sale of the property. As a result, it does not consider whether to apply the margin scheme to the sale at or before the time it makes the supply.*

48. *Due to its increasing turnover, the not-for-profit entity registers for GST from May 2004.*

49. *It subsequently discovers that the not-for-profit entity exceeds the registration turnover threshold in February 2004, rather than in May 2004. As such, the not-for-profit entity is required to be registered for GST from February 2004.*

50. *Therefore, the sale of the house and land in March 2004 is a taxable supply. The not-for-profit entity is liable for GST of one-eleventh of the full sale price for the property, being $30,000 ((1 ÷ 11) × $330,000), if the margin scheme is not applied. If the margin scheme is applied, the not-for-profit entity is liable for GST of one-eleventh of the margin for the supply, being $21,000 ((1 ÷ 11) × ($330,000 − $99,000)).*

51. *We are satisfied that the first-home buyer is not likely to become entitled to an ITC or decreasing adjustment for its acquisition of the property.*

52. *As the other conditions in paragraph 4 of this Practice Statement are satisfied, we accept that GST may be accounted for as if the margin scheme would apply. That is, we accept that the not-for-profit entity's GST liability is satisfied by a payment of $21,000.*

[9] Subsection 23-15(2), and section 23-15.02 of the *A New Tax System (Goods and Services Tax) Regulations 2019*.

Amendment history

5 September 2024

Part	Comment
Throughout	Content checked for technical accuracy and currency. Updated to apply current ATO style and accessibility guidelines.

14 April 2014

Part	Comment
Footnote 7 and references	Removed fact sheets (8680, 8682, 13320), replaced with GSTR 2006/7 and Margin scheme – made easy (NAT 73740).
Subject references	Replace with 'GST margin scheme'.
Contact details	Updated.

7 November 2012

Part	Comment
Generally	Updated to current corporate publication style.
Paragraph 29	Reference to 'subsection 62(2)' updated to 'subsection 110-50(2) of Schedule 1'.

15 September 2009

Part	Comment
Contact details	Updated.

25 February 2008

Part	Comment
Contact details	Updated.

16 October 2007

Part	Comment
Paragraph 45	Change the GST registration turnover threshold for not-for-profit entity from $100,000 to $150,000 as specified by regulation 23-15.02.

References

Legislative references	ANTS(GST)A 1999 Subdiv 9-C ANTS(GST)A 1999 23-15 ANTS(GST)A 1999 Div 75 ANTS(GST)A 1999 75-5(1) ANTS(GST)A 1999 75-10(2) ANTS(GST)A 1999 75-10(3) ANTS(GST)A 1999 75-20 ANTS(GST)A 1999 Div 129 ANTS(GST)A 1999 11-20 ANTS(GST)R 2019 23-15.02 TAA 1953 36 TAA 1953 39 TAA 1953 Sch 1 110-50(2) Tax Laws Amendment (2005 Measures No. 2) Act 2005
Related public rulings	GSTR 2000/21 GSTR 2006/7 GSTR 2006/8
Related practice statements	PS LA 2005/15
Case references	Commissioner of Taxation v Asiamet (No. 1) Resources Pty Limited [2004] FCAFC 73; 137 FCR 146; 2004 ATC 4303; 55 ATR 239; [2004] ALMD 4224
Other references	Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998 GST and the margin scheme Our Charter
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