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Utilising the margin scheme when selling new residential property

When building new residential property with the intention of selling for a profit, the biggest consideration, apart from income tax, is GST.

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Following on from last month, where we discussed the tax consequences of different types of developments, this month we take a more in-depth look at how you can use the ‘Margin Scheme’ to reduce your GST liabilities.

The margin scheme’s been around since the inception of GST but has seen many changes over the years as the ways it can be applied have been redefined. Normally when you sell new (or substantially renovated) residential property you are required to remit one-eleventh of the sale price to the ATO as GST. When you use the margin scheme, the amount of GST you have to remit is reduced to one-eleventh of “the margin”. In this case, the margin is the difference between what you purchased the property for and what you sell it for, it is not your profit margin.

You can use the margin scheme if you purchased the property before July 1, 2000 (the start of GST) or, if purchased after July 1, 2000, from someone that:

- was not registered or required to be registered for GST
- who sold you existing residential premises
- who sold the property to you as part of a GST-free going concern
- who sold you the property using the margin scheme.

You cannot use the margin scheme if when you first purchased the property the sale to you was fully taxable and the margin scheme was not used. In this case the amount of GST included in the price you paid is one-eleventh of the full purchase price.

There are different requirements depending on whether or not you purchased the property pre-GST (July 1, 2000) or post-GST, or if you purchased after December 9, 2008, when the margin scheme was overhauled.

So how does it actually work? Here’s an example:
Ross and Rachel purchased an investment property in 2009 for $450,000 and rented it out. In 2013 they notice that there have been a number of subdivisions in the area and they think this may be something they could do. They speak to the local council and find they can put three townhouses on their block, so they speak to a town planner and an architect to get the ball

rolling. They think they will sell at least one townhouse to help pay for the development, but may end up selling all three.

Rachel, knowing how important it is to get good advice, gives her accountant a call to discuss the tax consequences of selling the townhouses. Her accountant advises her of the income tax consequences of the potential sales then goes on to discuss GST. As Ross and Rachel purchased an existing dwelling they are able to use the margin scheme to calculate the GST on the sales. The accountant goes on to explain that the margin scheme can have a significant impact on their overall profits and gives the following example:

Original purchase price: $450,000. Potential sale price per townhouse: $550,000.
So, per townhouse (in round numbers)*:

	Margin scheme	Full GST
Purchase price	$150,000	$150,000
Build costs	$200,000	$200,000
Sale price	$550,000	$550,000
GST	$36,000	$50,000

* *This calculation does not consider income tax or CGT*

In both cases Ross and Rachel are able to claim the GST credits on their costs associated with the development, as long as they are registered for GST.

Rachel then asks her accountant if there is any situation whereby they would not have to pay GST and is told that GST only applies if the property is sold for the first time within five years of being built.

Ross and Rachel take this information and formulate a plan that involves selling the first townhouse on completion, the second in 12 months and the third in six years, reducing their overall GST payable from a potential $150,000 to $72,000 and spreading their income tax/CGT liabilities as well.

What a great result – it's amazing what planning with all the right information can do!

Pat Mannix and Bec Mackie *have been operating Gatherum-Goss & Assoc for more than seven years and both have extensive experience dealing with tax and structuring advice for investors. For more information, go to* *www.gatherumgoss.com*