

# Purchasing Land: GST or the Margin Scheme?

## Issue in Question

In the sale and purchase of land, a developer is faced with a choice between electing for the Margin Scheme to apply or for the normal course of GST to be calculated over the transaction. The wisest financial option entails an examination of the operation and effect of both tax regimes with specific reference to the unique facts of each transaction.

A general layout describing the mechanism of the GST and the Margin Scheme will be summarized briefly in order to understand their respective advantages.

## GST on Real Property

GST applies to the supply of land in situations which include (but not limited to)

- Sale of new residential property
- Sale of commercial or industrial property
- Sale of vacant land in the course of the developer's enterprise

But not to

- Sale of residential property which is not new or for commercial purposes
- Sale of property as part of a going concern<sup>1</sup>

The normal 10% GST applies to the GST-exclusive purchase price.

## Margin Scheme

The GST Act provides an alternative calculation to the GST on land called the "margin scheme". This scheme allows GST to be calculated on the margin of the supply i.e. the difference between the price paid to acquire the land by the vendor and the purchase price that is to be paid by the purchaser. The normal calculation of GST then applies to that margin rather than to the full purchase price.

The simple formulation can be devised as follows:

$$\begin{aligned} \text{GST (Margin Scheme)} &= 1/10 \times (\text{Price paid by Vendor*} - \text{Price to be paid by Purchaser*}) \\ \text{GST} &= 1/10 \times \text{Price to be paid by Purchaser*} \end{aligned}$$

\*GST-exclusive prices

## Advantages of Electing the Margin Scheme

A brief summary of the advantages:

- a) The purchaser could get a lower sale price
- b) The purchaser is given the choice to elect the margin scheme when selling the land in the future
- c) The purchaser would have to pay less stamp
- d) The purchaser has to pay less interests on the loan to purchase the land
- e) The purchaser would have to pay less capital gains tax

### (a) Lower Sale Price

The GST is calculated based on the full purchase price whereas the margin scheme allows the GST to be calculated only on the margin of the supply<sup>2</sup> which is only a portion of the full purchase price.

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<sup>1</sup> Under a simplistic definition, means supplies that are necessary for the continued operation of an enterprise

<sup>2</sup> The difference between the price paid by the vendor to acquire the land and the purchase price

### (b) Availability of the Margin Scheme in subsequent sale

The margin scheme is not available to the sale of land<sup>3</sup> which was previously acquired using the GST without recourse to the margin scheme. On the other hand, if the vendor elects to apply the margin scheme in the sale of the land, the purchaser would be permitted to choose to apply the margin scheme in a subsequent sale.

### (c) Less Stamp Duty

Stamp duty is charged on a percentage of the GST-inclusive purchase price. The stamp duty payable would be less under the margin scheme because the GST-inclusive purchase price is lower (refer to (a)).

### (d) Less Interests on Loan

Following the lower purchase price, a lower amount of loan would be taken out, resulting in a lower amount over which interest rates apply.

### (e) Less Capital Gains Tax

The purchase price would form part of the cost base of the land for capital gains tax purposes because no GST input tax credit is permitted.

## **Disadvantages of Electing the Margin Scheme**

The margin scheme may be disadvantageous because the purchaser would be unable to claim for a GST input tax credit. Even though the purchase price under the margin scheme may on the surface appear to be lower, a purchaser under the GST would be entitled to an input tax credit which places the purchaser in a better net position in the immediate monetary terms. Once the GST is refunded, the purchaser would have paid the net value equal to the purchase price as opposed to the purchaser under the margin scheme who is unable to get any tax refunds<sup>4</sup>.

## **Conclusion**

Many factors have to be weighed up against one another to determine the best resolution to a particular transaction. The margin scheme may be more advantageous in certain circumstances but not in others, depending on the facts of the situation.

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<sup>3</sup> Only applies to sale on or after 17 March 2005

<sup>4</sup> There are circumstances in which the purchaser of the land is not entitled to GST input tax credits. In this case, the margin scheme would be more appealing.