



Australian Government

The Board of Taxation

REVIEW OF THE LEGAL FRAMEWORK FOR THE ADMINISTRATION OF THE GOODS AND SERVICES TAX

A report to the Assistant Treasurer and Minister for
Competition Policy and Consumer Affairs

the **board** of **taxation**
www.taxboard.gov.au

The Board of Taxation
December 2008

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FOREWORD

The Board of Taxation is pleased to submit this report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs following its review of the legal framework for the administration of the goods and services tax (GST).

The Board established a Working Group, chaired by Mr Eric Mayne, to conduct the review. The Board conducted extensive consultation with stakeholders and received assistance from officials from the Treasury, the Australian Taxation Office and an Expert Panel comprising nine GST taxation advisers chosen for their expertise. The Board would like to thank all of those who so readily contributed to assist the Board in conducting the review.

This is the first review undertaken of the GST since its introduction in 2000. While overall the Board has found that the GST is operating effectively, there are some aspects of the tax that impose unnecessarily high compliance costs on taxpayers. The Board has made a number of recommendations that will make an important contribution towards reducing these costs as well as simplifying the administration of the GST.

On behalf of the Board, it is with great pleasure that we submit this report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs.

R F E Warburton AO
Chairman, Board of Taxation

E Mayne
Chairman of the Board's Working Group

EXECUTIVE SUMMARY

On 11 June 2008, the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon Chris Bowen MP, asked the Board of Taxation to undertake a review of the legal framework for the administration of the goods and services tax (GST) and to report its recommendations to the Government by the end of December 2008.

Following the announcement of the review, the Board released an issues paper that posed a number of questions to assist taxpayers in identifying possible improvements to GST administration. The Board received 57 written submissions in response to the issues paper.

The Board held public consultations in Sydney, Brisbane, Melbourne, Darwin and Perth to obtain public views and opinions.¹ The Board also met with representatives of the States and Territories and sought the views of small businesses through small business forums convened by the Commissioner of Taxation.

After over eight years of operation, the GST system overall is operating effectively and achieving its policy objectives. Businesses generally have a good level of awareness of their obligations under the GST law.

However, following consideration of the submissions made to the review, the Board is of the view that a number of opportunities exist to reduce compliance costs and to streamline and improve the operation of the legal framework for the administration of the GST and remove anomalies in its operation.

The consultation has raised 90 issues where taxpayers thought the current approach was too complex, too costly or not properly achieving its intended aims. In responding to these issues, the Board has made 36 substantive recommendations and 10 recommendations for technical amendments. Of the other 44 issues raised, 21 were out of scope of the terms of reference of the review. No change is recommended for the remaining 23 issues as the Board is of the view that the current law provides the most appropriate outcome.

This report puts forward the Board's final recommendations to the Government for consideration. These recommendations represent the Board's considered views on the key issues and recommendations obtained from the consultations, submissions and

1 The Board also proposed to hold a regional public consultation in Albury, however as there was no interest from stakeholders it did not proceed.

input from the Treasury, the Australian Taxation Office and the Expert Panel. A complete listing of the recommendations is included in Appendix A.

The GST is a transaction-based multi-stage tax that imposes obligations on registered suppliers and recipients to account for and remit GST and an entitlement to claim input tax credits throughout each stage of the supply chain. Accordingly, some level of compliance costs will inevitably fall on these entities. However, it is important that the GST law does not impose unnecessary or excessive compliance costs on businesses.

Compliance costs generally refer to the incremental burden that businesses bear in complying with regulation. They are additional to the costs otherwise incurred in running their business.² Compliance costs include, but are not limited to, the costs of: acquiring the necessary knowledge of the tax system; compiling records; dealing with the Tax Office; evaluating the effectiveness of alternative transactions or methods of complying with the law; and collecting and remitting taxes.³

Administering and complying with the tax law imposes a cost on the community. The resources required to deal with these costs could be better utilised in productive ways that add to the output of the Australian economy.⁴

Excessive compliance costs and complexity in the law that is imposed on taxpayers can also detract from their ability to comply with the law, particularly for those taxpayers who have more limited access to professional advice or assistance.

In the Board's earlier issues paper⁵, it noted that the legal framework for the administration of the GST could be described as comprising the following parts:

- the basic administrative rules such as registration, records, payment, reporting and accounting;
- other rules including those for entities, grouping, joint ventures, branches, tax law partnerships and small businesses;
- subsequent events such as adjustments, correcting mistakes and refunds of over and underpayments; and
- the GST administrative environment including rulings, period of review and general interest charge.

2 Board of Taxation, *Scoping study of small business tax compliance costs*, December 2007 <http://www.taxboard.gov.au/content/scoping/downloads/scoping.pdf>.

3 Australian Treasury, *Australia's future tax system, Architecture of Australia's tax and transfer system*, page 305.

4 Tracy Oliver and Scott Bartley, 2005, 'Tax system complexity and compliance costs – some theoretical considerations' *Economic Roundup*, Winter page 55.

5 Board of Taxation, July 2008, *Review of the Legal Framework for the Administration of the Goods and Services Tax Issues Paper*, page 6.

In framing its recommendations for changes to the legal framework for the administration of the GST, the Board has sought to address issues raised in submissions and consultations in the following ways:

- recommending changes to the law that either:
 - alter the existing policy; or
 - are consistent with existing policy;
- recommending further reviews by the Government, of those areas where there was insufficient time during this review for the Board to develop specific recommendations. Some of these would involve a change to existing policy;
- recommending that the Commissioner address issues administratively without a change to the law;
- not recommending any change to the law where the Board considers the current law provides the most appropriate outcome; and
- not recommending any change to the law where the issues raised are outside the terms of reference of the review. However in a few key instances, the Board has made recommendations that the Government should consider amending the law.

Therefore, the Board's report is structured into three parts.

Part A contains a number of recommendations that seek to modify and improve the current administrative framework of the GST. This reflects the Board's view that some changes are necessary that alter the *policy* of the legal framework for the administration of the GST. That is, the recommendations suggest changes to the rules themselves or that further work be undertaken that may result in a change to policy.

For example, the Board's recommendation to modify the GST adjustment provisions proposes a new set of rules. The Board became aware that significant compliance costs are imposed on taxpayers under the adjustment provisions (that is, where GST paid or input tax credits claimed in earlier tax periods need to be adjusted to reflect changed circumstances). Evidence provided to the Board indicated that, because of these costs, compliance with this requirement of the GST law is mixed. The Board considers that reform to the adjustment provisions will reduce compliance costs for taxpayers and encourage better compliance.

Part B of the report contains recommendations that retain the policy of the existing framework for the administration of the GST but seek to streamline the existing rules and remove anomalies.

For example, the Board's recommendations concerning the GST grouping rules are consistent with the established framework and policy intent of these provisions. The recommendations seek to streamline and simplify the operation of the law and reduce a range of current anomalies that exist.

A number of the Board's recommendations are designed to achieve greater standardisation between the income tax and the GST regimes. Greater standardisation assists in reducing compliance costs for taxpayers because common rules can be applied to different taxes. This prevents the need for separate rules to be understood and applied.

In particular, a number of the Board's recommendations are intended to achieve this standardisation by applying income tax self assessment principles to the GST law.⁶ These recommendations include:

- applying the income tax rulings system (with some modifications) to the GST;
- in-principle support of the adoption of the income tax shortfall interest regime; and
- the process by which liabilities and entitlements are created should be more closely aligned to the income tax assessment provisions.

Part C contains status quo and out-of-scope issues.

Consistent with its terms of reference, the Board has sought to ensure that the impact of its recommendations on other indirect taxes that share common administrative provisions has also been taken into account, and where appropriate, changes to the wine equalisation tax, luxury car tax and fuel tax credits regimes have also been recommended. For example, the Board has recommended that the income tax rulings regime also be adopted for the purposes of the luxury car tax and the wine equalisation tax.

The Board considers that there is a need to review several areas of the GST law with a view to reducing their complexity and introducing more principle-based rules, while maintaining the scope of their existing policy intent. In particular, this is the case for the margin scheme and the definition of what is a financial supply. In the time available to undertake the review, it has not been possible to develop the detailed principles that should apply, but the Board recommends that further reviews be undertaken.

6 These were implemented in the income tax law by the *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 1) 2005* and the *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 2) 2005*.

Finally, the Board considers that the existing treatment of cross-border transactions and the extent to which non-residents have obligations under the GST system warrant further examination. Accordingly, the Government may wish to undertake a review of this area of the GST law.

The Government requested that the Board's recommendations be broadly revenue-neutral. The Board notes that there will be some net cost to revenue if all of the recommendations included in this report are implemented. However, the Board considers that, taken as a package, its recommendations will achieve a significant overall reduction in compliance costs imposed on taxpayers and that these savings need to be weighed against the cost to revenue.

However, the Board appreciates that in implementing its recommendations, the Government will need to have regard to other competing priorities. Accordingly, the Government may prefer to implement firstly the recommendations that do not have a significant cost to revenue and then secondly the other recommendations as fiscal conditions allow and against competing priorities.

CHAPTER 1: INTRODUCTION

CHAPTER 1.1: BACKGROUND

1.1.1 The GST was introduced on 1 July 2000. This review of the legal framework for the administration of the GST is the first review undertaken of the GST's operation. It is intended to identify ways in which the administration can operate better and reduce compliance costs for taxpayers, particularly small businesses.

1.1.2 The GST is a broad-based, multi-stage, indirect tax that aims to tax final private consumption in Australia at a rate of 10 per cent. It is broad-based as it applies to supplies of most goods and services. It is an indirect tax and although it is imposed on entities that carry on an enterprise, the GST is intended to be imposed on transactions involving the supply of goods and services to consumers and unregistered entities, by being passed on in the price of goods and services.

1.1.3 The Board's report is structured into three key parts:

- Part A: Improving the administrative framework for the GST;
- Part B: Streamlining the GST law and removing anomalies; and
- Part C: Status quo and out of scope issues.

1.1.4 The report contains 46 recommendations that seek to modify and improve the legal framework for the administration of the GST. These represent recommendations for substantive changes in administration of the GST and also recommendations which involve a technical amendment.

1.1.5 A number of issues raised were outside the terms of reference of this review. For the remaining issues examined by the Board, it considered that the best approach was to maintain the status quo as this provides the most appropriate outcome.

1.1.6 A complete list of the recommendations is included at Appendix A.

CHAPTER 1.2: REVIEW'S TERMS OF REFERENCE

1.2.1 On 11 June 2008, the Government announced that it had asked the Board of Taxation to undertake a review of the legal framework for the administration of the goods and services tax.

1.2.2 The review replaced the Board's review of the application of the income tax self assessment principles to other taxes administered by the Taxation Commissioner, including the GST. These issues, as they relate to the GST, are included in this review. Where appropriate, the Board has also recommended some changes to the administration of other indirect taxes.

1.2.3 In conducting the review, the Board was asked to:

- consult with stakeholders on the basis of a discussion paper, including small and large businesses, professional bodies, State and Territory governments and regional representatives;
- report to the Government on the merits of proposed changes to the legal framework for the administration of the goods and services tax by the end of December 2008;
- focus on streamlining and improving the operation of the GST, reducing compliance costs, and removing anomalies;
- not extend the review to the rate of the GST, the scope of goods and services that are subject to GST or the effectiveness of the Commissioner of Taxation in administering the GST law;
- ensure the recommendations are broadly revenue-neutral;
- examine areas including rulings, the period of review, the general interest charge, and the Government's BAS Easy proposal; and
- have regard to the design features of the GST as a multi-stage value added tax and ensure that any possible changes do not undermine the integrity of the GST.

1.2.4 The complete terms of reference are set out in Appendix D.

CHAPTER 1.3: THE REVIEW TEAM

1.3.1 The Board of Taxation is an independent, non-statutory body established to advise government on various aspects of the Australian taxation system (refer Appendix E for the Charter of the Board of Taxation).

1.3.2 The Board appointed a Working Group of its members to work on the review. The Working Group comprised Eric Mayne (Chair of the Working Group), Richard Warburton AO, Chris Jordan AO and Curt Rendall.

1.3.3 The Board also appointed an Expert Panel which consisted of GST taxation advisors chosen for their expertise to assist with the review. They are:

- Stephen Baxter (Associate Director, Indirect Tax Consulting Group);
- Frank Brody (Partner, Mallesons Stephen Jaques Lawyers);
- Carlo Cercone (Manager, Indirect Taxes, Telstra Corporation Limited);
- Ken Claughton (Director, Tax Consulting, Pitcher Partners Advisors Proprietary Limited);
- Michael Evans (Partner, KPMG);
- John McIntosh (Principal, The Charities Advisory Service);
- Rebecca Millar (Senior Lecturer, University of Sydney);
- Jim Murray (Director Tax Services, Grant Thornton); and
- Mark West (Partner, McCullough Robertson Lawyers).

1.3.4 The Expert Panel members assisted the Board with technical and practical advice on the key issues and recommendations and the technical content of this report. The Board appreciates their valuable contribution.

1.3.5 Members of the Board's Secretariat who project managed the review were Ms Christine Barron, Secretary of the Board of Taxation, and Ms Anne Millward, a secondee to the Board's Secretariat from the private sector.

1.3.6 In addition, the Board consulted extensively with the Treasury and the Tax Office. The Board would in particular like to thank Mr Phil Bignell, Tax Specialist, Indirect Tax Division from the Treasury and Mr Matthew Bambrick, Assistant Commissioner, Goods and Services Tax from the Australian Taxation Office and their respective teams for their contribution to this review and the report.

CHAPTER 1.4: REVIEW PROCESSES

1.4.1 The Board has consulted widely in developing the recommendations in this report. The Board's consultation processes involved:

- the development of an issues paper⁷;
- holding consultation meetings⁸;
- inviting written submissions to assist with the review⁹;
- meeting with representatives from the States and Territories to brief them on the progress of the review;
- regular meetings with the Expert Panel to obtain their views on the issues paper, the key issues and recommendations, and this report; and
- attending Australian Tax Office small business forums to discuss the review.

ISSUES PAPER

1.4.2 The Board developed an issues paper to facilitate public consultation. It was released on 18 July 2008.¹⁰

1.4.3 The issues paper provided an overview of the legal framework for the administration of the GST.

1.4.4 For the purposes of the issues paper, the legal framework was divided into four parts:

- basic administrative rules;
- other rules;

7 The Issues Paper is available on the Board of Taxation website

http://www.taxboard.gov.au/content/GST_administration_review/index.asp.

8 Summaries of the consultations are available on the Board of Taxation website at

http://www.taxboard.gov.au/content/gst_legal_framework_review.asp.

9 Submissions that are public are available on the Board of taxation website at

http://www.taxboard.gov.au/content/GST_administration_review/submissions/index.asp.

10 A copy of the Issues Paper is available to download from

http://www.taxboard.gov.au/content/GST_administration_review/index.asp.

- rules relating to subsequent events; and
- the GST administrative environment.

1.4.5 The issues paper included a series of questions to assist stakeholders in preparing submissions. Submissions were also sought on other issues related to the legal framework for the administration of the GST, including identifying areas that do not work as well as they could and making suggestions for changes.

PUBLIC CONSULTATION MEETINGS

1.4.6 The Board held extensive consultations with stakeholders in August 2008. Consultation meetings were held in Sydney, Brisbane, Melbourne, Darwin and Perth.¹¹

1.4.7 The meetings provided an opportunity to discuss the issues canvassed in the issues paper in more detail.¹²

SUBMISSIONS

1.4.8 The Board requested written submissions on the review of the legal framework for the administration of the GST by 15 September 2008. The Board received 57 submissions, 38 of which are available to the public and can be obtained from the Board of Taxation's website.

1.4.9 Appendix C contains a list of the parties who provided submissions and agreed to have their submissions made public.¹³

1.4.10 The Board thanks all parties that provided submissions and appreciates the effort and time taken by these parties in putting forward their issues and proposing recommendations.

11 The Board also proposed holding a regional public consultation in Albury, however as there was no interest from stakeholders it did not proceed.

12 A summary of the key issues from each consultation meeting is available at http://www.taxboard.gov.au/content/gst_legal_framework_review.asp.

13 Copies of public submissions made to the Board are available at http://www.taxboard.gov.au/content/GST_administration_review/submissions/index.asp.

PART A: IMPROVING THE ADMINISTRATIVE FRAMEWORK OF THE GST

CHAPTER 2: ACCOUNTING FOR GST

CHAPTER 2.1: SMALL BUSINESSES

EXISTING LAW AND PRACTICE

2.1.1 There are approximately 2.5 million small businesses with turnover below \$2 million operating in Australia. They represent around 96 per cent of businesses in the revenue system. Approximately 2.2 million of them are registered for GST.¹⁴

2.1.2 All entities registered for GST must lodge periodic GST returns in a form approved by the Commissioner of Taxation (the Commissioner). This periodic reporting of GST liability is made through the business activity statement (BAS). The BAS is used not only for GST, but also to report luxury car tax (LCT), wine equalisation tax (WET), fringe benefits tax (FBT) instalments, pay-as-you-go (PAYG) withholding and income tax instalments and fuel tax credits.

2.1.3 The GST contains a number of provisions designed to reduce the compliance costs of preparing and lodging a BAS for small businesses, including simplified accounting methods, allowing some businesses to account for GST on an annual basis and allowing GST to be calculated annually and paid in quarterly instalments.

Simplified accounting methods

2.1.4 The GST law currently allows the Commissioner to create simplified accounting methods (SAMs), that are aimed at assisting entities carrying on an enterprise with less than \$2 million in turnover that have a mix of GST-free and taxable transactions.

2.1.5 SAMs were initially introduced to make it easier for small food retailers who buy and sell taxable and GST-free products (mixed products), or who buy mixed products and sell only taxable products, to account for GST. They were originally intended to reduce the compliance burden on small businesses with inadequate point-of-sale equipment. Since 2007, the Commissioner has had the power to develop

14 Australian Taxation Office, *Compliance Program 2006-07*, Commonwealth of Australia, 2006, p 15.

SAMs for all entities with mixed transactions and with an annual turnover of less than \$2 million.

2.1.6 There are five simplified SAMs to choose from, depending on turnover, the nature of the business, and the nature of the point-of-sale equipment. These methods help entities work out the information they need to correctly complete the GST section of their BAS.

2.1.7 However, they can only be applied to sales and/or purchases of trading stock. If entities decide to use a SAM, they still need to separately consider other sales (such as non-stock or capital items) and expenses (such as rent, phone and any capital items) when they complete their BAS.

2.1.8 In relation to SAMs, the Tax Office has advised the Board that according to its recent analysis:

- small businesses have a low level of understanding of SAMs;
- approximately half of SAM users are continuing to use their tax agents for BAS preparation;
- the majority of SAM users have turnover below \$500,000; and
- the take-up rate for SAMs within the food industry is between 5 and 7.5 per cent.

Streamlined reporting

2.1.9 Taxpayers with a turnover of less than \$20 million can lodge their BAS quarterly, rather than monthly.

2.1.10 Taxpayers with turnover under \$2 million who lodge quarterly, have the option of making their GST payments on the basis of a simple remittance form and later lodging a more detailed annual information report. This is referred to as the streamlined reporting option.

2.1.11 The Tax Office has advised the Board that the take-up rate for this reporting option is around 2 per cent.

GST annual return and instalment

2.1.12 Another of the existing concessions available to small business taxpayers is quarterly instalments. Under this option the Commissioner calculates the quarterly instalment amount for each small business taxpayer, based on the previously reconciled amount, and notifies the small business taxpayer of its quarterly instalments. The taxpayer then remits that amount to the Tax Office.

2.1.13 The instalment amount is based on data from the individual business and calculated by the Tax Office. Taxpayers using the instalment method lodge a GST return, which is due by the date their business income tax return is due. Their GST is then reconciled at the time they lodge their income tax return. That is, they determine their GST for the year and reconcile that with the instalments already paid.

2.1.14 To be eligible for GST instalments, a taxpayer must have a GST lodgment record of at least four months and not be in a net refund position. That is, they must remit more GST than they claim in input tax credits.

2.1.15 The Tax Office has advised the Board that the take-up rate for this reporting option is around 8 per cent of eligible taxpayers.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

2.1.16 The need for simpler and lower compliance cost options for small businesses was raised in a number of submissions and at the Board consultation sessions held during August 2008:

It is important for the GST system to have procedures enabling simpler and lower cost compliance for small businesses. In addition to the benefits to taxpayers it is suggested that such procedures reduce ATO administration. [ICAA]

2.1.17 The low take-up of SAMs was noted, and in part attributed to the limited ability for taxpayers to access SAMs. Suggestions were made that:

- all small businesses that meet the threshold test should be entitled to elect to apply a simplified reporting and payment method rather than have an arrangement, as currently exists under SAMs, where the Commissioner must first make a determination as to which types of small businesses may apply the reporting concession;
- methods should be available for all small business taxpayers which are in the relevant industries and who fall below the turnover thresholds; and
- current SAMs apply on too narrow a basis.

2.1.18 The lack of a lodgment and payment option prior to completion of a tax period was also raised in consultation.

Proposed BAS Easy method

2.1.19 Prior to its election, the Government proposed BAS Easy¹⁵ which sought to reduce the complexity of GST calculations for small businesses and to minimise their reporting requirements for GST.

2.1.20 The Hon Dr Craig Emerson MP, the Minister for Small Business, Independent Contractors and the Service Economy, when announcing BAS Easy in April 2007 suggested:

... it should be possible to adopt some simple rules that greatly reduce the record-keeping requirements of the BAS without affecting GST revenues. If an option were developed that greatly reduced the GST compliance burden, small business owners and independent contractors could spend less time and expense completing the BAS and paying bookkeepers, leaving them more time to grow their businesses and spend with their families.¹⁶

2.1.21 Under the BAS Easy proposal, SAMs would be extended to all small businesses including those without GST-free transactions (for example, tradespeople and independent contractors). They could elect to apply an agreed ratio to taxable sales, in order to determine the net amount of GST payable or refundable. The ratio would be determined according to either the business norms method (a ratio calculated by the Tax Office on the basis of an industry average) or the snapshot method (a ratio determined by the taxpayer based on two part-year periods). Examples of both methods were included in the Board's July 2008 issues paper.¹⁷

2.1.22 While the current SAMs are similar to the BAS Easy proposal, they are more limited as they only assist entities which have a mix of GST-free and taxable transactions, and can only be applied to sales and/or purchases of trading stock, not other outlays such as rent and consumables.

2.1.23 The BAS Easy business norms proposal is a type of flat-rate scheme. The OECD's *Consumption Tax Trends 2006* notes that other countries are also introducing flat rate schemes:

Countries have developed a range of instruments aimed directly or indirectly at alleviating compliance burden on SMEs. Several countries operate flat-rate schemes that allow small firms to apply a simple flat-rate percentage (calculated by industry

15 Emerson C, *BAS Easy: a proposed option for completing your BAS in a few minutes*, 19 April 2007 <http://www.craigemersonmp.com/files/bas-easy-policy-19-april-2007.pdf>.

16 Emerson C, *BAS Easy: a proposed option for completing your BAS in a few minutes*, 19 April 2007 <http://www.craigemersonmp.com/files/bas-easy-policy-19-april-2007.pdf>.

17 Board of Taxation, *Review of the legal framework for the administration of the Goods and Services Tax Issues Paper*, July 2008. http://www.taxboard.gov.au/content/GST_administration_review/downloads/Review_Legal_Framework_Admin_GST.pdf.

sector) to their turnover instead of recording and accounting for VAT on each individual sale and purchase. These schemes can be open to all sectors or limited to a few.¹⁸

2.1.24 The UK VAT flat-rate scheme¹⁹ applies if annual turnover is less than £150,000.

- Small businesses pay a flat rate percentage of turnover as value-added tax (VAT). The percentage depends on the trade sector, and is less than the standard VAT rate because it takes into account not reclaiming VAT on purchases. Percentages ranged between five and 15 per cent, when the standard rate was 17.5 per cent.²⁰
- Taxpayers still need to show a VAT amount on each sales invoice, but they do not need to record how much VAT is charged on every sale, nor need to record the VAT paid on every purchase. Invoices issued by small businesses using the UK VAT flat-rate scheme, however, display VAT at the normal rate for goods or services of that type.

2.1.25 The Canadian Quick Method²¹ is available for small businesses with turnover up to C\$200,000.

- Small businesses calculate their net tax remittance by multiplying their total GST-included taxable supplies made in Canada by a prescribed Quick Method remittance rate (2.5 per cent or 5 per cent, compared with the standard rate of 5 per cent).
- Taxpayers cannot claim input tax credits on most of their purchases when they use this method, so the part of the tax that they keep accounts for the approximate value of the input tax credits they would otherwise have claimed.
- There are a number of exceptions as to who can use the Quick Method, including accountants, lawyers, and listed financial institutions.
- The cost to revenue of the Quick Method of accounting was C\$245 million in 2005.²²

18 OECD 2006, *Consumption Tax Trends: VAT/GST and Excise Rates, Trends and Administration Issues* page 88.

19 <http://www.hmrc.gov.uk/vat/account-flat.htm>.

20 A temporary 2.5 per cent cut in VAT was announced in November 2008.

21 <http://www.cra-arc.gc.ca/E/pub/gp/rc4058/rc4058-08e.pdf>.

22 Department of Finance (Canada) 2007, *Goods and Services Tax Expenditure of Tax Expenditures and Evaluations*, page 35 http://www.fin.gc.ca/taxexp/2007/taxexp07_3e.html#table3.

2.1.26 Benefits of BAS Easy were recognised in submissions and consultation:

The NIA recognizes that the BAS Easy proposal is aimed at reducing compliance costs for small business. Overall, the NIA provides in principle support for the proposal. One of the benefits of BAS Easy is that it will make it easier for micro enterprises to operate without employing bookkeepers/accountants for purposes of BAS preparation. The micro businesses however will generally still need this type of support for purposes of income/company tax compliance. This should increase the GST compliance rate by reducing costs in some cases. [NIA]

The adoption of BAS Easy measures for new businesses is a sound concept and will go a long way to assisting some types of small businesses (for example, in the retail industry) in a practical and effective manner. [HIA]

The BAS Easy proposals are likely to be a useful addition or improvement to the existing methods. [ICAA]

2.1.27 A number of submissions made the point that the proposed BAS Easy has advantages over the existing SAMs:

It should be noted that the take up rate of SAMs by taxpayers has thus far been very low It would be preferable if the proposed BAS Easy approach could be more widely targeted to allow for greater take up by businesses. [NIA]

The [SAM] prohibition from using the methods because the entity has adequate point of sale equipment is counterproductive and should be removed. To prevent entities from using concessional methods because their systems are good seems to have no merit. [ICAA]

2.1.28 In addition to reducing compliance costs for small businesses, the opportunity for the non-profit sector to access BAS Easy was supported in consultation.

2.1.29 Concerns raised in both submissions and consultation sessions, about the proposed BAS Easy included:

I am concerned that the introduction of the proposals will add even more complexity and uncertainty to an already complex system. [GMA Tax]

In practice, the Institute sees considerable difficulties in fine tuning the industry categories precisely enough to ensure ratios are realistic and/or attractive to adopt. Considerable resources may be required from the ATO to both fine tune the industry categories and calculate the business norms. [ICAA]

... concerns that BAS Easy will lead to a significant loss in revenue to Australian governments and will introduce inequities into the taxation system The snapshot method is based on the premise that a ratio determined over two periods of four weeks will give an accurate estimate of a business's future GST obligation. There is no study

to validate this ... businesses will naturally choose snapshot periods that result in the most beneficial ratio. Furthermore, it is inevitable that many businesses will legitimately manipulate the ratio by various methods businesses that behave legally and ethically will be placed at a competitive disadvantage ... [Martin Tuor]

... it cannot be said that business activity that is carried on within a particular segment of the industry is comparable between operators who carry on business within that segment (howsoever described) To take a simple example, a painter may be required to include the cost of paint in the contract price for one job and yet be required to omit it for another. This is not uncommon, especially where the client is a builder who prefers to source all of the building materials that are required for a particular job. [HIA]

... it would be inappropriate for new building businesses to adopt such an approach, as it may hinder rather than help such a business ... a new business in this industry may be lulled into a false sense of security as to the progress of their business when applying a ratio ... this measure may result in owners and operators of new building businesses failing to pay adequate attention to the actual progress of their new business. [HIA]

No matter what simplified accounting methods are available, the Institute perceives that their take up will be limited. Most entities have already implemented GST systems which enable them to accurately record and report sales and purchases. Such entities are unlikely to abandon accurate GST calculation for the uncertain GST result of simplified methods unless the methods can be clearly demonstrated to substantially reduce compliance costs. [ICAA]

2.1.30 Other concerns raised with the Board during consultation sessions included:

- the difficulty of applying a ratio to the turnover of small businesses that have large seasonal variations in turnover, and the fact that the ratio may disadvantage those with seasonal fluctuations;
- once in the system, businesses cannot easily calculate GST they would have paid if they have stopped keeping those records; and
- the need to consider how BAS Easy would fit with income tax.

2.1.31 One submission suggested if BAS Easy were to proceed, further work on the method would be required:

Clarification is required as to the circumstances in which the Commissioner will review the average ratio under the snapshot method;

Some indicative criteria is required to provide guidance on what constitutes a significant change in the nature of the business which will necessitate a recalculation of the average ratio determined under the snapshot method;

Benchmark ratios applied under the business norm method should only be determined by the Commissioner in consultation with professional industry associations and members of the professional accounting bodies to ensure that any average ratio reflects typical commercial practice in the relevant business category;

Entities electing to use BAS Easy should be alerted to the need to separately account for capital sales and purchases as any related input tax credits are expressly excluded from the BAS Easy method; and

Entities should be reminded to retain all records (including tax invoices) especially as an average ratio under the snapshot method may be potentially subject to review by the ATO. [CPA]

2.1.32 Support was expressed for making the business norms method available for businesses in their first year of operation only. It was thought that this would both limit the possibility that the ratio would not accurately reflect the true business ratio, and limit the adverse impacts on GST revenue.

BAS Easy needs to be made very easy for small business/micro business. [Sydney consultation session]

Existing concessions

2.1.33 Submissions identified a number of problems with the other existing small business concessions. Feedback was received on the variety of current small business concessions, and submissions recommended streamlining and simplifying them.

Each of six different concessions is established through separate Divisions in the legislation. Each of the Divisions includes lengthy administrative rules for eligibility, making the relevant election, date of effect of the election, revocation, date of effect of revocation, timing, period of effect, Commissioner's powers and other compliance matters. Most of the rules are similar for each concession within the same threshold. Yet the threshold for each concession has a different label. [ICAA]

2.1.34 One submission suggested BAS Easy should have the same \$2 million turnover test as other GST concessions.

FINDINGS

2.1.35 From both its work on this review and the *Scoping study of small business tax compliance costs* of December 2007²³, the Board has found some concern with the BAS among small businesses:

While concerns about completing Business Activity Statements appear to be gradually decreasing over time as businesses become familiar with the requirements, the BAS is still regarded as the most annoying and time consuming tax compliance requirement for small businesses. The degree of the concern varies from business to business. [Finding 28]

2.1.36 However, the Board also noted in that study that the introduction of the GST and the BAS has improved record keeping practices among some small businesses. This has enhanced the operation of those businesses.

*Feedback on the compliance issues with the GST suggests that while the transitional compliance costs associated with the introduction of the tax in 2000 were significant, many businesses are now more accustomed to the tax and accept that the record keeping discipline it imposes assists in the general running of their business.*²⁴

2.1.37 That said, the Board supports a simplified reporting system for small businesses. The benefits would be in terms of decreased compliance costs, and allowing start-up businesses to concentrate on their business. The Board notes that a number of overseas countries operate such reporting systems.

2.1.38 However, the Board has a number of concerns with BAS Easy as it was originally proposed:

- It would remove the need for clients to record all transactions to determine GST liability, so over a period of time, it could contribute to a reduction in the quality of record keeping by small businesses.
- New small businesses are often in a net refund position. Under the proposed BAS Easy business norms method, they would pay GST quarterly on the basis of an industry ratio. This ratio is based on all businesses in their industry, not just new businesses, thus there is the possibility of new small businesses paying too much tax. Even if a norm is developed for start-ups there are likely to be variations among businesses that could result in the norm being too high for some businesses.

23 Board of Taxation, *Scoping study of small business tax compliance costs*, December 2007 <http://www.taxboard.gov.au/content/scoping/downloads/scoping.pdf>.

24 Board of Taxation, *Scoping study of small business tax compliance costs*, December 2007 <http://www.taxboard.gov.au/content/scoping/downloads/scoping.pdf> paragraph 9.26.

- A similar problem could exist for other businesses if the GST they would have paid, if they had continued to lodge a quarterly BAS, was lower than the GST they would pay using the industry ratio. This is more likely for businesses that have large fluctuations over time in sales and purchases.
- One of the main reasons for introducing BAS Easy is the reduction in compliance costs. However, it is possible that businesses will continue to calculate their GST payable, in order to see whether BAS Easy is advantageous for them and results in a reduction in their GST payable. This would have two implications:
 - businesses would not have a reduction in compliance costs; and
 - there would be a cost to the revenue.
- Over time the data on which business norms ratios were calculated would deteriorate, as entities using business norms would have to be excluded from the data set upon which the business norm was determined, thus skewing the resultant calculation of the norm for that industry.
- In terms of the snapshot method, it is possible that businesses would select snapshot periods which gave them the most advantageous result, which would lead to a reduction in the revenue.

2.1.39 The Board is also concerned about offering another change to reporting. From both its work on this review and the *Scoping study of small business tax compliance costs* of December 2007²⁵, the Board has found businesses consider the BAS should not be subject to further change as they are now familiar with it and any change would add to their compliance costs.

Alternative proposal

2.1.40 Rather than implementing BAS Easy as originally proposed, the Board recommends an alternative option be pursued.

2.1.41 One of the existing concessions available for small businesses is quarterly instalments, where the Commissioner calculates and notifies the small business of its quarterly instalment amount. The GST is then reconciled at the same time as the income tax return is lodged. One of the conditions for entering the quarterly instalments system is that the small business taxpayer not be in a net refund position, that is, it must remit more GST than it claims in input tax credits.

25 Board of Taxation, *Scoping study of small business tax compliance costs*, December 2007 <http://www.taxboard.gov.au/content/scoping/downloads/scoping.pdf>.

2.1.42 The Board is of the view that the quarterly instalment option should be extended to apply to all small businesses, including those which are in a net refund position. Taxpayers in a net refund position would get an instalment refund.

2.1.43 Taxpayers who had previously used the reporting by instalments option are not able to use that method as they move to a net refund position. The Tax Office advised the Board that in its experience, taxpayers choose a particular GST reporting cycle and stay with that cycle from year to year.

2.1.44 In 2008, more than 6,000 taxpayers who had previously used the reporting by instalments option moved to a net refund position and so were not able to use the reporting by instalments option any longer. Given that taxpayers tend to stay with a reporting cycle from year to year, it is likely that many of the 6,000 taxpayers who had moved into a net refund position would have remained on the instalments option if they could have.

2.1.45 When completing the quarterly BAS, the Tax Office could pre-populate the instalment amount on the taxpayer's BAS as is done with the current instalment option and the taxpayer would then remit that amount, or receive a refund.

2.1.46 Taxpayers would reconcile the GST at the same time as they completed their income tax return. Any change to the total amount of GST to be paid or to be refunded compared with that already paid or refunded through instalments would be calculated at the time of reconciliation.

2.1.47 For small businesses whose GST net amount fluctuates significantly between years, the Board recommends an option to vary their instalment amount, which is available to taxpayers under the current instalment system and under income tax. This will assist taxpayers to manage their GST and help to ensure that they do not end up with a debt at the time of reconciliation.

2.1.48 The Board is of the view that newly commenced small businesses should be able to access a simplified method to calculate their net tax for GST purposes, right from the time they register for GST. However, when a business first starts, the Tax Office does not hold sufficient information on it to be able to issue an instalment amount.

2.1.49 Rather than basing an instalment on the individual businesses' past records, a percentage to be applied to businesses' total sales could be determined by the Tax Office on an industry basis. One option would be to calculate the percentage for the 19 ANZSIC statistical information divisional industry codes.

2.1.50 When completing its quarterly BAS, the small business taxpayer would simply multiply its quarterly total sales by the ratio relevant to its industry to work out its GST payable. It would then remit this amount to the Tax Office. New small business could do this from when they start until the end of their first full income tax year.

Hence, some taxpayers may continue on the set percentage for some part of their second year of operation.

2.1.51 The small business would do an annual reconciliation at the same time it lodged its income tax return. In later years these businesses could opt into the instalment option. Consideration would need to be given to the appropriate time at which charitable organisations and similar entities that are not required to lodge income tax returns would need to prepare an annual reconciliation.

2.1.52 This enhanced instalment option would achieve the aim of reducing compliance costs for small businesses, making the BAS easier and quicker to fill out with a simplified calculation method. Taxpayers would not need to calculate a ratio and then have to apply a percentage to their total sales in a quarter and pay that amount. In the first year, the ratio would be industry-based and calculated by the Tax Office. In later years, the Tax Office would notify the taxpayers of an amount to pay, or a refund, every quarter.

2.1.53 The Board advocates the enhanced instalment option being an optional concession, and available to businesses and non profits with annual turnover below \$2 million.

2.1.54 The Board considers an enhanced instalment option provides a number of advantages over BAS Easy. It would:

- have lower compliance costs because taxpayers would:
 - only have to examine their invoices when doing their annual reconciliation (which would be timed to align with the lodgment of their income tax return, which already requires examination of their invoices); and
 - not be required to calculate ratios from snapshots of their business and then apply those ratios to their turnover. Instead, the Tax Office would notify the small business of the ratio it would apply to total sales (for start-ups), or provide the instalment amount or refund;
- promote good record keeping practices, because taxpayers would still issue and keep tax invoices;
- apply to all small businesses and also the not-for-profit sector (not just those industries with mixed supplies and purchases);
- have a lower cost to revenue as there may only be a timing impact on revenue, because of the annual reconciliation;
- particularly help start-ups;

- introduce a concession that would be available to all small businesses (including non-profits), and would provide opportunities to streamline existing concessions, including simplified accounting methods and streamline the option of reporting;
- provide a reconciliation mechanism which:
 - ensures the correct amount of tax is paid;
 - removes the need for businesses to continue to calculate their GST payable in order to see whether BAS Easy is advantageous for them, thereby receiving a genuine reduction in compliance costs;
 - minimises the risk of ratio or industry shopping. The industry average would only be used in the first year, with a later reconciliation to the actual amount when the business completes its income tax return. After that it is the reconciliation from which the next year's instalment payments or refunds are calculated by the Tax Office; and
- retain the integrity of Tax Office data.

2.1.55 The diagram below sets out how this simpler BAS method for reporting GST would work.



2.1.56 The Board recognises however that the proposed simpler BAS method will not appeal to *all* new small businesses. It will be necessary for eligible businesses to evaluate the impact of choosing to apply the proposed method. The method may not, for example, be appropriate for entities with large seasonal fluctuations in turnover.

Recommendation 1: Simpler BAS method for reporting GST

The GST law should be amended to provide for a simpler BAS method for reporting GST by having:

- a business norm percentage applying for start-ups; and
- an expanded instalment option available to all businesses and not-for-profit organisations with a turnover less than \$2 million. This would apply after their first year of operation, including for those in a net refund position.

In both cases, a reconciliation would be undertaken to coincide with the timing of the lodgment of the income tax return.

GST annual return and instalment

2.1.57 Expanding access to the instalment method to those in a net refund position would fix another issue with the instalment method.

2.1.58 The existing legislation in relation to paying GST by instalments is very specific on how to determine if a taxpayer is in a net refund position. If followed literally, it would cause problems in the administration of GST instalments. To avoid problems, the Commissioner has adopted a more flexible administrative practice in this regard.

2.1.59 In the absence of a simplified BAS method expanding access to the instalment method to those in a net refund position, the Board is of the view that, as with similar provisions (such as how the amount that will be paid in each instalment is calculated), this part of the legislation could just state the principles rather than being specific.

Recommendation 2: Net refund position

If the recommendation for a simpler BAS method for reporting GST is not accepted, the degree of detail in the legislation to determine whether a taxpayer is in a net refund position should be removed and replaced with more principled rules.

Streamlining other concessions

2.1.60 If a simplified BAS method is implemented, the Board is of the view that the current arrangements with SAMs should be monitored, to see how they interact with the simplified BAS method and whether any changes are required, and subsequently whether they are still necessary.

2.1.61 Small business taxpayers currently have access to another option for completing the BAS: they can choose to calculate GST quarterly and report annually. This streamlined reporting option has had a relatively low take-up.

2.1.62 The Board is of the opinion that more choices can lead to confusion among taxpayers and if a simplified BAS method were implemented, the streamlined reporting option could be removed, simplifying the GST reporting system for small business.

Recommendation 3: Streamline BAS reporting concessions

If a simplified BAS method is implemented, current reporting concessions should be reviewed.

GST returns

2.1.63 Concerns were raised in consultation about boxes on the BAS which do not relate to GST liability, such as the information sought on the capital/revenue distinction. Some taxpayers proposed changes to the BAS including aligning it more to the income tax return.

2.1.64 The Board, in its *Scoping study of small business tax compliance costs* December 2007 report²⁶ found that businesses believe the BAS should not be subject to further change as they are now familiar with the BAS and any change would add to their compliance costs. The Board has not heard argument in this review that alter this view.

Tax periods

2.1.65 Two issues were raised during consultation in relation to tax periods:

- taxpayers reporting on a quarterly basis may switch at any time to a monthly basis, but taxpayers on a monthly basis must remain on this basis for 12 months before changing; and
- while entities have the option of lodging monthly BAS statements, only those below a turnover threshold are able to lodge quarterly.

26 Board of Taxation, *Scoping study of small business tax compliance costs*, December 2007 <http://www.taxboard.gov.au/content/scoping/downloads/scoping.pdf>.

2.1.66 In both cases, the Board is of the view that the current law is appropriate. It is only businesses with an annual turnover in excess of \$20 million that are required to report monthly. Additionally, the Commissioner currently has a discretion to allow an entity that has been reporting on a monthly basis for less than 12 months to change to quarterly reporting.

CHAPTER 2.2: ADJUSTMENTS

EXISTING LAW AND PRACTICE

2.2.1 An entity's liability for GST is attributed to a specific tax period, which may be a month, a quarter or a year. In each tax period, the entity must determine the GST attributable as a result of any supplies it has made and deduct any input tax credits it may claim as a result of its acquisitions or importations that are attributable to the tax period.

2.2.2 However, after an entity has finalised its reporting for a tax period by lodging a BAS, it is possible for events to occur that change relevant features of a transaction included in that BAS. This may make it necessary to adjust the amount of GST paid or the amount of input tax credits claimed on a previous BAS. This adjustment will generally be attributed to the tax period when the taxpayer becomes aware of the need for an adjustment.

2.2.3 The GST law contains a number of adjustment provisions. These provisions provide a mechanism to allow changes to be made to the amount of GST paid on taxable supplies or input tax credits claimed in a previous tax period. These adjustments are not made in the original BAS but are reflected in a later BAS, in order to reduce the compliance costs of entities.

Change in creditable purpose

2.2.4 Taxpayers claim input tax credits based on the extent of their creditable purpose when they made the acquisition or importation. They may later use the acquisition or importation in a different way to what was originally intended, such as greater private use of a vehicle. The GST change of use rules provide an adjustment for such changes if the GST exclusive value of the acquisition or importation exceeds certain thresholds.

2.2.5 A \$1,000 threshold applies to acquisitions and importations that do not relate to business finance.²⁷ No adjustments are required for acquisitions and importations under this amount. A larger threshold of \$10,000 exists for acquisitions and importations that do relate to business finance.²⁸

27 An acquisition will relate to business finance where the acquisition is in connection with financial supplies and has no element of private or domestic use.

28 Section 129-10 of the GST Act.

2.2.6 For acquisitions over these thresholds, taxpayers must make an annual calculation of their use of the acquisition for 1, 2, 5 or 10 years depending on the value of the acquisition. Taxpayers are then required to calculate the adjustment based on this use.

Cessation of registration and other anomalies

2.2.7 The GST law contains special rules relating to the treatment of amounts of GST and input tax credits that have not been attributed for entities that account on a cash basis when an entity ceases to be registered.

2.2.8 It also provides for an adjustment if an entity's registration is cancelled and immediately before the cancellation takes effect, the entity's assets include anything for which it was entitled to an input tax credit. Essentially, the increasing adjustment repays a portion of the input tax credits claimed for assets that will now be consumed privately.

2.2.9 As in the case of other adjustments provided for in the GST law, the adjustments for cessation of registration and the related attribution rules are intended to ensure the correct amount of GST is collected on value added.

Third-party payments

2.2.10 The GST law provides for adjustments when there is an event which has the effect of:

- cancelling a supply or acquisition, for example, returning defective goods to the supplier;
- changing the consideration for a supply or acquisition, for example, volume rebates; or
- causing a supply or acquisition to become, or stop being, a taxable supply or creditable acquisition, for example, goods supplied for export which are not exported within the required timeframe cease to be GST-free.

2.2.11 These provisions apply where a supplier pays a rebate to the recipient of the supply. However, if the supplier pays a rebate to an entity further along the supply chain (a third party), an adjustment does not arise. For example, no adjustment is available where a manufacturer pays a rebate to a final consumer, rather than the wholesaler or retailer to which the manufacturer supplies the goods.

Pre-registration

2.2.12 The GST law enables input tax credits to arise for certain pre-establishment costs for companies. It also allows for adjustments to reflect the GST borne on certain assets acquired prior to registration. However, these rules only allow for an adjustment in relation to trading stock or stock for use as raw materials that was acquired before an entity was registered and which is later used in carrying on its GST registered enterprise.

Adjustments for going concerns and farm land

2.2.13 A number of matters relevant to adjustments for going concerns and farm land supplied for farming are dealt with in Chapter 7.2.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

2.2.14 Adjustments were raised as an issue at each of the consultation sessions which the Board held during August 2008. A large number of submissions also raised adjustment issues. Taxpayers view adjustments as an unnecessarily burdensome area of the GST law.

This is one of the most problematic areas of the GST legislation.... [PWC]

2.2.15 While particular concern was expressed about adjustments for changes in creditable purpose, there were also a number of other matters that were frequently raised. These are considered in more detail below.

Adjustments for changes in use

2.2.16 At consultation sessions, the change in use rules were frequently raised. They were considered to be excessively onerous, and to result in significant compliance difficulties for businesses. Several submissions suggested that fully complying with obligations under this law was not possible for many taxpayers.

...very few (if any) taxpayers are able to meet their compliance obligations under this Division unless significant costs are incurred. [CTA]

2.2.17 Particular concerns were raised in relation to property and construction activities.

2.2.18 In submissions, views were expressed about the change in use rules imposing significant burdens. Taxpayers considered they were required to track too many acquisitions for too long. Further, there were also too many different periods and thresholds for acquisitions, rendering record-keeping and accounting excessively complex (the need to classify acquisitions into acquisitions related to business finance and other acquisitions was especially criticised). Finally, submissions considered that

the required calculations are often difficult and the record-keeping onerous (especially given that in some circumstances it may be required for up to 15 years).

... we submit that the thresholds contained within Division 129 are too complex and too low. [Greenwood and Freehills]

Complexity arises due to:

- the low dollar value threshold to which the provisions apply*
- the varying 'adjustment periods' that apply depending on the dollar value thresholds*
- the wide ambit of the Division... [IFSA]*

2.2.19 Concerns were raised in both consultation sessions and submissions that anecdotally, it appears that many taxpayers ignore these provisions.

It is reasonable to argue that very few (if any) taxpayers are, aware of, or able to meet their full compliance obligations under this Division. [IFSA]

The complexity, inflexibility and illogical operation of the current adjustment regime leads, in particular, to Division 129 & Division 132 being two of the most misunderstood and poorly complied with GST provisions. [ICAA]

Adjustments for cessation of registration

2.2.20 Concern was also expressed in public consultation and submissions about the requirements for adjustments upon cessation of registration. Several parties considered that there were problems in the way the provisions applied to adjustments upon the cessation of registration.

2.2.21 Alternatively, an entity operating an enterprise that principally involves activities in another jurisdiction may choose to deregister as it is no longer making any supplies connected with Australia. This entity would be subject to increasing adjustments on assets even where these assets have been transferred to its overseas enterprise activities in what is in substance an export.

2.2.22 Submissions also highlighted technical issues in relation to attribution under the cessation of registration provisions and their interaction with other adjustment provisions.

Adjustments and third-party payments

2.2.23 The issue of adjustment for payments to third parties was also raised in submissions.

2.2.24 The view was put that the adjustment provisions fail to reflect the commercial reality of transactions by not considering related payments to third parties that effectively alter the consideration provided for the supply.

2.2.25 Submissions considered that the law in this area can be complex due to the difficulties in determining if a payment is characterised as:

- a payment to a third party that falls outside the operation of the GST; or
- consideration for a supply, in which case the supply may be taxable.

Adjustments for pre-registration

2.2.26 The issue of the treatment of acquisitions prior to registration was also brought to the attention of the Board. Input tax credits can arise for certain pre-establishment costs for companies. Adjustments can arise in relation to trading stock acquired prior to registration. However, there is no provision to allow an adjustment or input tax credit for acquisitions of goods, such as capital acquisitions, other than trading stock or stock for use as raw materials.

2.2.27 The view was put that adjustments for acquisitions prior to registration should be available wherever they would be required upon cessation of registration.

Meaning of *apply* and *application*

2.2.28 In both public consultation sessions and in submissions, concern was expressed about the meaning of *apply* and *application* in the GST change in use provisions and elsewhere in the GST Act. This was largely in the context of their interaction with the rules regarding residential property and new residential property.

2.2.29 A number of submissions suggested clarification was required, with some proposing wholesale revision of the law in this area.

Most of the anomalies would be removed if Division 129 provided for an adjustment (if applicable) based on any variations in the intended use of the thing that was acquired. In other words, compare intention at the time of acquisition with intention at the time of the review. [CPA]

Other issues raised in submissions

2.2.30 One submission requested that a bad debt adjustment only be available upon writing off the debt. The author recommended removal of the obligation to make an adjustment when an amount is 12 months overdue.

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2.2.31 Given the level of concern expressed about adjustments, the Board regards this area as one in which there is significant room to improve the administrative framework of the GST, reduce compliance costs and improve compliance.

2.2.32 The underlying objective of the adjustment provisions, to ensure that taxpayers bear the appropriate amount of tax when changes occur after they have paid GST or claimed input tax credits, should be achieved with a system that is less burdensome for taxpayers.

Adjustments for changes in use

2.2.33 The Board considers that there is significant room to improve GST rules relating to adjustments for changes in use. The present law is overly complex, having too many differing thresholds and drawing a generally unhelpful distinction between business finance and other types of activity. The periods over which adjustments are to be made often are excessive. Moreover, there is often insufficient consistency between the compliance obligations created by various GST provisions dealing with change in use as well as in similar rules in other areas of the tax law.

2.2.34 The Board gave consideration to amendments to the GST law which would allow change of use adjustments to be made that the Commissioner considered to be fair and reasonable. In the Board's view, however, it was considered that this would create uncertainty for taxpayers and impose compliance costs for affected taxpayers in determining how to fulfil their obligations.

2.2.35 The adjustment mechanism could be significantly improved by redesigning the existing system.

2.2.36 The Board considers thresholds should be raised and the length and number of adjustment periods reduced for adjustments. For example, adopting a single \$100,000 threshold, with all acquisitions below this threshold being subject to two adjustment periods and all above being subject to five, would substantially lessen the compliance burden for taxpayers. The existing de minimis threshold under which no adjustment is required would be retained.

2.2.37 There should be adjustment periods over 10 years for real property, recognising that interests in real property are generally of significant value with ongoing economic benefits being derived.

2.2.38 Adjustment periods should also be aligned, to the extent possible, with the date for lodgment of the taxpayers' income tax returns. This would reduce the period over which adjustments are required, simplify the timing of adjustments and allow use of information already gathered for income tax returns.

2.2.39 All provisions relevant to adjustments should be integrated into a coherent set of provisions dealing comprehensively with all of the relevant law.

2.2.40 Rules should also be introduced to simplify the calculation of adjustments. Private use adjustments should be explicitly linked to the extent of private use for income tax. Combined with the alignment of adjustment periods with the lodgment period, the proposals should ensure affected taxpayers only need to perform minimal GST specific calculations.

2.2.41 Adjustments in relation to input taxed use should only occur where there is a significant change in use (perhaps a change of more than 10 per cent from the intended or prior use). This will eliminate the need for calculations and paperwork presently associated with minor shifts in activity.

2.2.42 Adopting the recommended changes to adjustments for change in use will significantly simplify the obligations of most businesses. Taxpayers will need to make fewer adjustments, and will only be required to track a smaller proportion of assets over shorter periods. The number of differing value thresholds and adjustment periods will also be reduced. This will ensure there will be fewer acquisition categories that taxpayers will need to be aware of in relation to adjustments.

2.2.43 These changes should remove excessive complexity from the law and significantly reduce the compliance burden for taxpayers. They will also ensure that records are not required to be kept for excessive periods.

2.2.44 The Board notes that elsewhere it has generally considered changes to thresholds to be out of scope of the terms of reference for the review because they would result in changes in the treatment of supplies. As the changes to the adjustment thresholds do not alter the GST treatment of any supplies and are broadly revenue-neutral, it considers that they are within scope.

Recommendation 4: Adjustments for changes in use

The GST law should be amended to provide that higher thresholds, together with fewer and shorter adjustment periods, should apply for adjustments (for example, two years for acquisitions less than \$100,000, five years for those over \$100,000, and ten years for real property). Where possible, the existing provisions should be consolidated within the GST law and aligned with other relevant rules elsewhere in the tax system.

Adjustments for private use should be explicitly aligned with the percentage of private use for income tax purposes. Adjustments for input taxed use should only occur where the change in use is significant (for example, greater than 10 per cent change in use).

Adjustments for cessation of registration

2.2.45 The Board considers the adjustment on cessation of a non-resident's registration currently causes an inappropriate additional tax burden.

2.2.46 The Board recommends that this adjustment not apply where a non-resident has acquired an asset in carrying on their enterprise, claimed an input taxed credit then subsequently exported the goods to use in their enterprise operated overseas. Currently the only way a non-resident can avoid this additional tax burden is to remain registered for GST.

2.2.47 The Board also notes that there are some anomalies in the rules governing the attribution of amounts upon cessation of registration. This may also result in unequal or inappropriate outcomes in certain specific circumstances. For example, the existing rules do not provide any special treatment for taxpayers who account on an accruals basis. This can lead to taxpayers not being entitled to an input tax credit if they cease registration before they hold a tax invoice.

2.2.48 The Board considers that the Government should remove these anomalies by way of technical amendments to the law.

Recommendation 5: Adjustments for cessation of registration

Taxpayers should not be required to make adjustments in relation to goods in the event that they deregister, provided the goods are effectively exported and used in the non-Australian enterprise.

Technical amendments should be made to the provisions relating to attribution and entitlement upon cessation of registration to ensure consistent and appropriate treatment of all taxpayers.

Adjustments for manufacturers' rebates

2.2.49 Views were also expressed that it was not appropriate that payments to third parties that impacted on the price of supplies of goods or services did not result in adjustment events.

2.2.50 The Board agrees that adjustments should be available in these circumstances, reflecting the true economic outcomes of the transaction.

2.2.51 The Board considers that the payer and third party (where registered or required to be registered) should have an adjustment for manufacturers' rebates where a manufacturer provides a cash back payment to a customer who purchased the manufacturer's product from a retailer, so that the payment made to the third party effectively reduces the price for the payer's taxable supply and the cost of the acquisition for the third party.

Example — manufacturers' rebates

Hoa, a manufacturer and wholesaler of widgets, sells widgets to Yasmine, a retailer, at \$55 each. Assuming no inputs, her net value added is \$55. Assuming she is registered for GST, she pays \$5.

However, Hoa also pays a rebate of \$11 to entities that purchase widgets from Yasmine. Hence, when Thomas purchases a widget, Hoa's total value added in the transaction is \$44 (\$55 from the purchase by Yasmine less the \$11 paid to Thomas).

Under the proposed change, Hoa would have an adjustment for making this payment (where it was not consideration for a taxable supply). This would reduce her GST liability to \$4, reflecting her net economic position following the transaction.

If Thomas is also registered for GST and makes a creditable acquisition, he will also have an adjustment. His liability will increase by \$1, reflecting the true economic cost of the widget to him.

There is no adjustment for Yasmine in these circumstances, because she is unaffected by the payment from Hoa.

Recommendation 6: Adjustments for manufacturers' rebates

The GST law should be amended to ensure that adjustments for manufacturers' rebates, which in effect change the price of a transaction, result in adjustments for the payer and the third party, reflecting the economic outcomes of the transaction.

Definition of *apply* and *application*

2.2.52 The Board notes that the Tax Office has recently published a new interpretative decision (ATO ID 2008/114) revising its view in the context of property development. The Board considers it prudent to allow time to see if this view addresses the practical concerns raised in consultation and submissions in relation to the adjustment and property provisions of the GST law. In light of this the Board considers that legislative change is not required at this time.

2.2.53 However, a number of related technical issues with the present provisions and the definition of *apply* and *application* have also been brought to the attention of the Board. The Board considers that technical amendments should be made to the provisions to remove anomalies and reduce uncertainty in relation to the use and meaning of these terms.

Recommendation 7: Technical amendment — adjustments

The GST law should be amended to ensure consistency and certainty in the use of the terms *apply* and *application* in the adjustment provisions.

Bad debt provisions

2.2.54 The Board considers the current GST law in relation to bad debt adjustments should not be amended.

2.2.55 Providing bad debt adjustments only once the debt was written off would require the taxpayer to notify a debtor that the debt was not to be pursued. The Board does not consider that this would be desirable or appropriate.

2.2.56 The Board considers that the present rules provide certainty and clarity. The existing rule requiring adjustments after 12 months allows the supplier to adjust without the need to notify a recipient who has not paid. It also automatically means that after 12 months the recipient who accounts on a non-cash basis will have an adjustment. It would be commercially undesirable to require entities to declare debts would not be pursued in order to obtain relief. It would also be poor policy to effectively mandate relief to debtors in these circumstances.

Adjustments and pre-registration acquisitions

2.2.57 The Board considers that there should be a broader entitlement to adjustments for things acquired before an entity was registered for GST and which are later used in carrying on its GST registered enterprise. This would be subject to a decline in entitlement to input tax credits for assets that have been used for non-creditable purposes. This would be consistent with the treatment under income tax. Currently adjustments for pre-registration acquisitions are only available for trading stock, stock for use as raw materials and certain pre-establishment costs for companies. No entitlement would be available for outlays that have been fully consumed prior to registration.

2.2.58 This would ensure that there is no embedded tax included in the cost of supplies as a result of pre-registration acquisitions.

2.2.59 The interaction of adjustments for pre-registration acquisitions with the margin scheme and the change in use adjustment provisions would need to be considered.

Recommendation 8: Adjustments for pre-registration acquisitions

The GST law should be amended to allow an entitlement for an adjustment to the extent of the remaining economic value for things acquired before an entity was registered for GST. The amendment should not apply to adjustments that are already available.

CHAPTER 2.3: ACCOUNTING FOR TRANSACTIONS

EXISTING LAW AND PRACTICE

Tax invoices

2.3.1 Where the value of the taxable supply exceeds \$75, the recipient must hold a valid tax invoice in order to claim the input tax credit.

2.3.2 Information that must be contained in a tax invoice is quite prescriptive. A tax invoice must set out the ABN of the entity that issues it and the price for the supply; and it must be in the *approved form* and contain such other information as the GST Regulations specify. Different information is required depending on whether the total amount including GST payable for the supply is more or less than \$1,000.

2.3.3 The Commissioner has a discretion to treat as a tax invoice a particular document that is not a tax invoice. This discretion is intended to avoid denying input tax credits or placing a further burden to obtain additional documents on taxpayers who hold a document that substantially complies with the requirements, where the entitlement to the input tax credit is otherwise verified.

Recipient-created tax invoices (RCTI)

2.3.4 Tax invoices are normally issued by suppliers. Tax invoices demonstrate that the supply was treated as a taxable supply by the supplier and show the amount of GST. Recipients can issue the tax invoice instead of the supplier in some circumstances, such as where it is the recipient that determines the price of the supply and would therefore have to tell the supplier what that price was and the GST on it instead of the usual process undertaken by suppliers.

2.3.5 The Commissioner determines in what circumstances RCTIs can be used and what requirements have to be met. A current requirement is that the supplier and the recipient have agreed to use RCTIs and, broadly, that the agreement states what supplies they will be used for.

Tax invoices and attribution

Claiming input tax credits in a current or later period

2.3.6 The GST law provides that if a tax invoice is not held in the period for which an input tax credit would be attributable, the input tax credit is instead attributable to the first period in which a GST return is lodged at the time when a tax invoice is held.

2.3.7 However if a taxpayer does not claim that credit in that period, they can choose when to later claim the credit. The taxpayer can claim the credit in any later tax period of their choice provided they have not previously included that amount in the calculation of a net amount of an earlier tax period.

2.3.8 Arguably, the law applies such that if the taxpayer did hold a tax invoice in an earlier tax period and they failed to claim the credit in that period, they would be required to revise the BAS for that earlier tax period to include the input tax credit rather than being able to attribute it to the later tax period.

2.3.9 Currently, the Commissioner is administering this attribution rule on the basis that taxpayers can claim the credit in a later period.

Adjustment notes

2.3.10 An adjustment note is issued when there is an adjustment event, which is broadly an event which changes the supplier's GST liability or acquirer's input tax credit entitlement.

2.3.11 If an adjustment has the effect of reducing GST or increasing an input tax credit entitlement by more than \$50, the entity cannot attribute the adjustment to a tax period unless it holds an adjustment note²⁹ at the time it lodges its return for the tax period in which the adjustment is attributed.

Contra transactions

2.3.12 A supply is a taxable supply if, among other things, it is made for consideration. This includes non-monetary consideration. Hence, a supply can be consideration for another supply, such as a sporting team supplying advertising to a sporting goods supplier in exchange for sporting goods. This means that each supply is consideration for the other supply – the supply of the advertising is consideration for the supply of the sporting goods and the supply of the sporting goods is consideration for the supply of the advertising. GST is charged on the value of supplies, including non-monetary value. Non-monetary consideration therefore needs to be valued to determine the amount of GST to account for, and the amount of input tax credit the recipient can account for. Hence, the supplier of the advertising has to determine its market value, and the supplier of the sporting goods in turn has to determine their market value.

2.3.13 A tax invoice is required before the entitlement to input tax credits for a creditable acquisition can be accounted for. A supplier of a taxable supply is required to issue a tax invoice, if requested, for all taxable supplies with a value over \$75.

²⁹ An adjustment note sets out the change to the amount of GST payable, and other information including the details of the parties to the transaction and the reason for the adjustment.

2.3.14 Hence, even if the advertising and the sporting goods have the same market value and the amount of GST and input tax credit each party accounts for will net off, each party will have to account for both GST and input tax credits and issue a tax invoice.

Option to tax

2.3.15 The GST law does not generally provide taxpayers with the option to elect to treat supplies that would be GST-free as taxable.

2.3.16 However, taxpayers may opt to treat certain supplies of medical aids and appliances, as well as certain other health goods that would otherwise be GST-free, as taxable supplies. To exercise this option, the supplier and recipient must agree that the supply should be treated as a taxable supply.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

Tax invoices

2.3.17 Submissions highlighted that the current regulatory regime for tax invoices and its enforcement cause uncertainty and imposes compliance costs and tax costs on business.

If the rigorous rules introduced by regulation and determination are enforced, it imposes actual costs on business by way of risk, compliance costs, GIC and penalties... The amended rules should provide greater flexibility to achieve the outcome that input tax credits should be claimable if a taxpayer can show sufficient evidence that a creditable acquisition has been made. [ICAA]

The number of items which are not subject to GST seems to be generating more and more mixed invoices and it is these which cause most confusion and take most time in processing. [Software Developers Consultative Group]

2.3.18 Many submissions recommended that the current threshold for tax invoices be increased to reduce the burden on small businesses issuing tax invoices on minor items.

Recipient-created tax invoices

2.3.19 Some submissions noted that complying with the RCTI provisions is very onerous. For example, before parties can use RCTIs it is necessary for the supplier and recipient to first enter into a written agreement. An agreement requires the types of supplies to be stipulated. However, over time the supplies change, requiring a new agreement.

The requirement for whole industries refraining from using RCTI until the Commissioner issues an RCTI determination is cumbersome and unnecessary. It is recommended that RCTI arrangements should be available to all entities. It is also recommended that other measures be introduced to reduce risk to the revenue, including reverse charging the liability and introduce certain general compliance conditions based on which the Commissioner could exercise a discretion to disallow it for applicants with a poor compliance history. [ICAA]

Tax invoices and attribution

2.3.20 A number of submissions commented that the GST input tax credit attribution rules do not allow input tax credits to be claimed in the original tax period to which they were attributable if a tax invoice was not available in the original period. Instead, the GST law attributes them to a later period. There are circumstances where businesses would prefer the attribution to occur back to the period the transaction occurred, for example to avoid GIC being imposed on a separate understatement of GST in that period.

The requirement to keep Tax Invoices for the purposes of attribution pursuant to Division 29 of the Act (and Regulations) is unnecessarily onerous and costly for large businesses, which deal with the processing of many thousands of invoices daily. [ABA]

2.3.21 Some submissions called for a closer alignment between attribution rules and commercial accounting practice. They suggested that the GST attribution rules (separately from the rules for tax invoices) should be relaxed as it would assist in addressing other issues including barter transactions and hire purchase. In particular, these submissions proposed that GST accounting be matched with the appropriate period for commercial accounting purposes. This would be achieved by providing the Commissioner with a broader discretion to apply more flexible attribution rules in a range of situations.

Adjustment notes

2.3.22 A number of submissions observed that adjustment notes are not commonly issued by smaller businesses and that the requirement for adjustment notes creates compliance costs for all businesses.

Whilst taxpayers have established and reviewed systems and processes for the purpose of issuing tax invoices, it has added a further layer of complexity in ensuring that systems can also generate adjustment notes ... It is submitted that the requirement for adjustment notes has created unnecessary further compliance obligations and costs. [PCA]

2.3.23 A number of submissions suggested that the adjustment note threshold should be increased, at least so that it is consistent with the threshold at which a tax invoice must be held.

Contra transactions

2.3.24 One issue frequently raised in public consultation and by submissions was the treatment of contra transactions (that is, exchanges of goods between businesses where no money changes hands).

2.3.25 Many submissions suggested that these transactions should receive special treatment, due to the fact that they are revenue-neutral and difficulties can arise in properly reporting and valuing the transaction.

For large business, the compliance cost of having to manually produce Tax Invoices and record the relevant entries solely for GST purposes is significant, and in light of the fact that most result in no net revenue gain, unwarranted. Also significant is the time and resources required to value the relevant supplies, particularly where one or both sides of the arrangement involve the granting of rights. [CTA]

2.3.26 Some submissions suggested that taxpayers should be able to treat revenue-neutral contra transactions as GST-free. In particular, it was proposed that the Commissioner should be able to deem business-to-business contra transactions, where both parties would be fully entitled to input tax credits, as GST-free, or alternatively, that taxpayers should be able, by mutual agreement, to treat contra transactions that would be fully creditable to both parties as GST-free.

2.3.27 Other submissions suggested instead reducing or eliminating reporting requirements for these transactions.

... we submit that registered businesses which undertake barter transactions of the type described above should be relieved from the obligations to issue tax invoices and take the transactions into account when compiling their BAS where the contra supplies are taxable supplies and give rise to a full input tax credit for both parties. [ICAA]

Option to tax

2.3.28 In some types of transactions, it may not always be clear whether and to what extent GST may apply. This may occur when the status of the transaction depends on factors that are not known or not within the control of the taxpayer.

2.3.29 A number of submissions also raised the issue of transactions between businesses where there is ambiguity about whether supplies might be taxable or GST-free. It was suggested that it would be simpler for all parties for taxpayers to be able to agree to treat supplies as taxable where it is not possible at the time of supply to determine the extent to which a supply is taxable, as is presently the case for medical aids and appliances.

FINDINGS

Tax invoices

2.3.30 The Board considers that making it easier to allow other documents to be treated as tax invoices in some circumstances would reduce difficulties experienced by taxpayers seeking tax invoices from suppliers, including non-resident suppliers, and address the current requirement to obtain a replacement if there are minor errors in the tax invoice.

2.3.31 Currently, taxpayers are required to seek the agreement of the Commissioner in order to treat other documents as the basis for their input tax credit claim where the invoice provided to them by the supplier does not meet all requirements of a tax invoice. The Board considers this is an unnecessarily high burden to place on taxpayers and the Tax Office. Taxpayers should be able to use other documentation to establish an entitlement to an input tax credit where there are only minor errors or omissions in the invoice provided to them.

2.3.32 This option would, in the Board's view, provide greater flexibility in claiming input tax credits as long as a taxpayer can show sufficient evidence that a creditable acquisition has been made. It would reduce compliance costs, as businesses would not need to seek an amended tax invoice to prove that a creditable acquisition has been made.

2.3.33 Taxpayers also currently incur compliance costs where no tax invoice is provided to them by the supplier but other documentation is available to substantiate the supply and the nature of the transaction. The Board considers that where a taxpayer makes all reasonable efforts to get a tax invoice, but cannot, then they should be able to treat another document as a tax invoice, provided they notify the Tax Office. The Commissioner would set out the circumstances in which he would need to be informed of the failure of the supplier to issue a tax invoice.

2.3.34 The integrity of the GST system would be maintained as recipients would still need to make reasonable efforts to obtain a tax invoice, where one has not been provided, and the Tax Office would be advised of cases where there is a disagreement between supplier and recipient over the GST status of a supply.

Recommendation 9: Tax invoices

Where a tax invoice is not regarded as valid for minor reasons, taxpayers should not be required to seek a valid tax invoice from the supplier, where they have other documents that confirm the GST treatment of the supply and the amount of GST. This option should be available to taxpayers without first seeking the agreement of the Commissioner.

Where a taxpayer makes all reasonable efforts to obtain a tax invoice, but cannot, they can treat another suitable document as a tax invoice, provided they notify the Commissioner, and meet any other requirements as determined by the Commissioner.

Recipient-created tax invoices

2.3.35 The Tax Office has informed the Board that it is currently consulting with industry to find solutions for these issues. The Board considers it appropriate that this process be completed before any consideration is given to whether the law needs to be amended.

Tax invoices and attribution

2.3.36 The Board considers that relaxing the current attribution rules to allow alignment with commercial accounting practice would lessen both certainty and fairness between taxpayers. This is due to the wide disparity between how entities account commercially between small and large taxpayers and across different industries. Such alignment would also raise integrity concerns by lessening the certainty of a fixed point at which tax is due to be paid. A relaxation of attribution rules also has the potential to allow extended deferral of GST liability and the bringing forward of the recognition of input tax credits.

2.3.37 Given the risks in providing more flexible GST attribution rules or aligning them with commercial accounting practice, the Board considers that the current law provides the most appropriate outcome.

2.3.38 Although the Board does not recommend changing the attribution rules, it does see benefit in making technical amendments to them to clarify that an input tax credit can be claimed in a later tax period even though the relevant tax invoice was first held in an earlier period.

2.3.39 Allowing an entity to attribute input tax credits to a later tax period is a concession to relieve compliance costs where an input tax credit entitlement has been overlooked (and thereby operates as a mechanism to relieve compliance costs in correcting mistakes). However, under the current law this flexibility may not apply

where a taxpayer forgot to claim the input tax credit in the period they first held a tax invoice.

2.3.40 The Board considers that this technical amendment would clarify the operation of the attribution rules by allowing attribution to occur in a later period even when the tax invoice was held in an earlier period. However, attribution to a later period will be subject to a four-year time limit for refunds (refer to the recommendation relating to unlimited time to claim input tax credits discussed in Chapter 3.3).

Recommendation 10: Technical amendment — tax invoices and attribution

The GST law should be amended to clarify that an input tax credit can be claimed in a later tax period even though the relevant tax invoice was first held in an earlier period.

Adjustment notes

2.3.41 The Board recognises that adjustment notes are a general requirement under international VAT systems and their retention preserves the integrity of the present GST system. However, the Board has been told that not all taxpayers fully comply with adjustment note requirements. Increasing the threshold at which an adjustment note must be held from \$50 to \$75 may result in smaller businesses, which may not be issuing adjustment notes, being more likely to fall under the threshold.

2.3.42 The threshold has remained unchanged since its introduction in 2000. Increasing the threshold will ensure that it does not decline in value in real terms.

2.3.43 The Board notes that elsewhere it has generally considered changes to thresholds out of scope due to resulting changes in the treatment of supplies and significant revenue impacts. As changing the adjustment note threshold does not alter the GST treatment of any supplies and is broadly revenue-neutral, the Board considers the change within scope of the terms of reference for the review.

Recommendation 11: Adjustment notes

The threshold at which an adjustment note must be held should be increased from \$50 to \$75.

Contra transactions

2.3.44 The Board considers that it is a fundamental feature of a multi-stage value added tax that it is imposed on all taxable supplies at every stage of the production chain. Relief for business inputs is provided by means of entitlements to credit for tax borne on tax inputs rather than by exemptions from tax, with documentation and reporting required to verify availability of credits.

2.3.45 The Board does not consider that it is appropriate to exempt certain transactions from these basic requirements. It acknowledges that accounting for 'contra' or barter transactions may create particular burdens for taxpayers without any net revenue implications. However, all business-to-business taxable supplies for which full input tax credits are available are similarly revenue-neutral. Compliance and risk burdens would also result from any solution that provided special reporting or tax treatment for contra transactions based on the status of the other party to the transaction. Taxpayers would need to obtain and rely upon information about the credit entitlement of other parties. Further, any suspension of reporting requirements would result in additional complexity in the event of adjustments being required, such as where there is a change in use of the acquisition. Therefore, the Board considers that the current law provides the most appropriate outcome.

2.3.46 The Board notes that of comparable jurisdictions, only Canada provides any form of special relief to barter transactions. The Canadian provisions are very limited in scope, only applying to exchanges of trading stock of the same class or kind. This approach would not address most of the issues raised in submissions.

Option to tax

2.3.47 The Board notes that in some types of transactions, it may not always be possible to know at the time of issuing a tax invoice the extent to which GST may apply. This may occur when the status of the transaction depends on factors that are not known or are not within the control of the taxpayer.

2.3.48 Such uncertainty generates considerable compliance costs for taxpayers. It also increases the costs of administration for the Tax Office.

2.3.49 The Board considers that where registered businesses are parties to transactions that are partially taxable and the recipient would be entitled to full input tax credits on the taxable component of the supply, they should have the option to treat such transactions as fully taxable. This should only occur by mutual agreement where it is not possible to know at the time of issuing a tax invoice the extent to which the supply is taxable. This option to tax would not apply where part or all of the supply is input taxed.

2.3.50 The Board is of the view that this option will enable the significant costs associated with compliance in such ambiguous transactions to be reduced. Further, it will do so without compromising the principles of the GST as a multi-stage value-added tax.

Recommendation 12: Business-to-business transactions

For supplies where it is not possible to know at the time of entering into a transaction the extent to which it is taxable, registered parties should by mutual agreement be allowed the option to treat the transaction as fully taxable. This should not apply to a supply where a part or all of it is an input taxed supply.

CHAPTER 2.4: CORRECTING GST MISTAKES

EXISTING LAW AND PRACTICE

2.4.1 Mistakes in relation to a net amount for a tax period made in an earlier BAS statement generally need to be corrected by revising the earlier BAS. However, in certain circumstances, the GST legislation does allow mistakes to be corrected by taking them into account in the BAS immediately following the BAS in which the mistake was made. This is of limited use to most taxpayers.

2.4.2 To reduce taxpayers' compliance costs associated with revising earlier BAS, the Commissioner allows entities to correct certain GST, wine equalisation tax, luxury car tax and fuel tax credit mistakes in a later BAS. The corrections allowed to be made to the later BAS are set out in the *Correcting GST Mistakes* fact sheet and the *Fuel Tax Credit – making adjustments and correcting mistakes* fact sheet.

2.4.3 The ability to correct an earlier error in a later BAS is subject to limits. An entity with an annual turnover of less than \$20 million has a correction limit of less than \$5,000 and a time limit in which to make corrections of up to 18 months. An entity with an annual turnover over \$1 billion has a correction limit of less than \$300,000 and a time limit of up to three months.

2.4.4 Where errors fall outside the limits specified in the fact sheet, these must be corrected by revising the earlier BAS. Some simple revisions may be lodged by telephone, but in most cases taxpayers must contact the Tax Office and ask that the BAS requiring revision be returned to them. The taxpayer makes the revisions and then the BAS is resubmitted. Sometimes multiple BAS forms will require adjustment.

2.4.5 The general interest charge applies to both corrections which result in an increased GST liability and which fall outside the time and correction limits specified in the fact sheet.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

2.4.6 A number of submissions argued that the compliance costs of correcting mistakes are very onerous. A number suggested that the thresholds for correcting mistakes on the current BAS should be increased and without penalty while others suggested that it should be possible to put everything in the current BAS rather than amending a past BAS, even if a penalty applies.

For larger entities in particular, the dollar value of any such GST errors that may arise from these transaction can easily exceed the correction threshold, notwithstanding that the GST error may only represent a small portion of the entity's total GST obligations for a period. To this end, it is impractical, and imposes a disproportionate burden on the entity, to correct each BAS that may be affected by such an error. Rather, it would be more practical to increase the correction limits to allow the error to be corrected in the next BAS. [Minerals Council of Australia]

The BAS should include a label to disclose all adjustments in excess of the Commissioner's limits. In the alternative, these limits should be increased significantly for large corporations with a turnover in excess of \$100 million. [ABA]

...the process of correcting mistakes in BAS is cumbersome, costly and unnecessarily complex. The Institute recommends that errors in BAS be corrected by the submission of a supplementary BAS containing all errors for previous tax periods. The law should provide for appropriate penalties and GIC according to the nature of the omission (if applicable), bearing in mind that in the nature of a VAT, much of the tax paid is not a tax base issue because it might have been credited in any event. [ICAA]

FINDINGS

2.4.7 The current threshold that applies to correcting mistakes is not set out in the law, but is an administrative approach approved by the Commissioner of Taxation. Any changes to the threshold would therefore need to be made independently by the Commissioner, or be set out in the law. The Board is not disposed to recommend that a threshold be introduced into the law.

2.4.8 It is appropriate that taxpayers compensate the revenue in situations where GST has not been paid at the time it was payable and taxpayers have enjoyed the use of those funds since that time. Further, GST is a multi-stage value-added tax intended to be collected on transactions between registered businesses and on supplies to final consumers. GIC is applicable when there is incorrect GST treatment of business-to-business transactions.³⁰

2.4.9 However, the Board considers that there could be significant compliance cost benefits if the BAS form were redesigned or a supplementary BAS form developed which would allow taxpayers to correct those mistakes falling outside the existing thresholds without having to revise a previous BAS. Such a form would enable calculation by the Tax Office of the amount of GIC (or other interest charges and penalties) that would be payable on any shortfall reported, with taxpayers simply

³⁰ The Board is making a recommendation in relation to the shortfall interest charge; see Chapter 3.1. The chapter also addresses the application of interest charges to revenue neutral transactions.

being required to insert on the BAS the relevant dates and amounts and any other relevant information.

2.4.10 This should result in significant compliance cost savings for taxpayers, but is likely to require Tax Office BAS processing systems changes before it could be implemented. Stakeholders, including small businesses, should be involved in the design of the form to ensure the best possible outcome in terms of reducing compliance costs.

2.4.11 The Board considers there could be savings for taxpayers if they were able to self assess their interest charge liability in relation to correcting mistakes. Therefore, the Board is of the view that taxpayers should be entitled to calculate their own interest charge liability.

Recommendation 13: Correcting GST mistakes

Taxpayers should be able to correct all GST and other indirect tax mistakes through the current BAS or a supplementary BAS, without altering the requirement for taxpayers to pay the general interest charge, or other interest charges and penalties, where these would currently apply.

Taxpayers should also be able to self assess their interest charge liability when correcting GST mistakes.

CHAPTER 2.5: ENTITLEMENT TO INPUT TAX CREDITS

EXISTING LAW AND PRACTICE

2.5.1 Input tax credits are an essential part of ensuring that the GST generally only applies to the value added by registered taxpayers. While taxpayers are liable to tax on the supplies they make, they are also entitled to input tax credits for any tax borne on their acquisitions.

2.5.2 Input tax credits are generally only available to the extent acquisitions are made for a creditable purpose. Acquisitions are not considered to be made for a creditable purpose to the extent that they relate to an input taxed supply, such as a financial supply.

Apportionment

2.5.3 If a supply is partly taxable and partly GST-free, for example a supply of travel insurance covering both domestic and international travel, the consideration for the supply needs to be apportioned between the taxable and GST-free components to allow the correct amount of GST to be calculated.

2.5.4 Where a supply is made that is a combination of separately identifiable taxable and non-taxable parts, taxpayers need to identify the taxable part of the supply. Then they can apportion the consideration for the supply and work out the GST payable on the taxable part of the supply.

Multi-party transactions

2.5.5 The GST rules about entitlement to and attribution of input tax credits are on the basis there are two parties to a transaction.

2.5.6 Recipients are entitled to input tax credits if, among other things, they acquire the taxable supply and pay, or are liable to pay, the consideration for the supply. Where the recipient neither provides consideration nor is liable to provide consideration for a supply, then it is not entitled to an input tax credit.

2.5.7 Multi-party transactions involve at least three parties. They commonly arise when an entity contracts with a supplier to provide a supply to a third entity. As these transactions involve issues that cannot arise in two-party transactions, the entitlement and attribution rules for GST are often less clear in their application.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

Input tax credits and extent of creditable purpose

2.5.8 Several submissions expressed concerns about the compliance costs for financial supply providers in determining the extent to which they are able to obtain input tax credits for general expenses. It was argued that the present system often results in excessive complexity and compliance costs.

There is a considerable amount of uncertainty around the "extent of creditable purpose", resulting in a great deal of taxpayer and tax administrator time spent in vetting and reviewing methodologies, at considerable cost. [ABA]

2.5.9 These submissions proposed that the law be amended to specify a default apportionment methodology which entities would be able to elect to use in place of undertaking a specific calculation.

2.5.10 A few submissions also raised the issue of classification in the context of supplies between registered entities where it is not possible to ascertain if or to what degree a supply is GST-free.

Multi-party transactions

2.5.11 A number of submissions also raised the GST treatment of transactions involving more than two parties.

2.5.12 There are circumstances in which input tax credits will not be available in multi-party transactions, due to the operation of the entitlement and attribution rules.

2.5.13 This can occur where a party acquires a supply, but is not liable to pay for it because another party to the transaction is liable to provide and does provide the consideration for the supply, in which case neither party is then entitled to an input tax credit.

2.5.14 This may also occur where the recipient of a supply accounts on the cash basis, because they must provide consideration before they can attribute their input tax credit. If in a multi-party transaction the recipient does not provide the full consideration, they will not be able to attribute the input tax credit to the extent that they have not paid for the supply. This is the case even though the recipient may be liable to pay for the supply (with that liability met by someone else's payment, such as under a guarantee or indemnity) and may therefore be entitled to an input tax credit.

Where a transaction involves three parties – a supplier, a recipient of the supply and a payer (that is, the provider of the consideration to the supplier) the current requirements of section 11-5 become restrictive ... [CTA]

2.5.15 Concern was also expressed in relation to certain provisions of the GST Act relating to GST-free supplies of ambulance services. It was suggested that the wording of these provisions means that they can only apply where the service is provided directly to the patient. This has the consequence that certain supplies of ambulance services that are provided to other parties, such as inter-hospital transfers of patients, may be taxable.

FINDINGS

Input tax credits and extent of creditable purpose

2.5.16 The Board considers that the present rules on apportionment are appropriate. The existing provisions allow taxpayers wide flexibility to adopt any methodology that accurately reflects the extent to which their acquisitions relate to financial supplies. In practice, this amounts to any method that is fair and reasonable.

2.5.17 Allowing taxpayers a default method would only result in a change where there were some doubts if the method proposed would be fair and reasonable in the circumstances of the taxpayer. While providing certainty in borderline cases may be of some advantage, the Board does not regard it as appropriate for taxpayers to claim input tax credits on a basis that does not properly reflect the extent of creditable purpose.

2.5.18 Further, given the variety of financial institutions and the complexity of their activities it is unlikely that a single methodology would be universally appropriate for apportionment. Significant variations in activities and extent of creditable purpose would likely exist even within a single sector. Providing a single method would give a competitive advantage to those who would benefit from accessing it and would disadvantage those for whom it was not appropriate.

Multi-party transactions

2.5.19 The Board regards the present treatment of multi-party transactions as problematic.

2.5.20 It is a basic principle of value-added taxes that there should be no net tax borne by registered entities acting in the course of their enterprise (other than input taxed supplies). Although input tax credits are denied in multi-party transactions in quite limited circumstances, the present treatment of some multi-party transactions departs from this general principle. Instead, the only reason for the denial appears to stem from the technical operation of the GST law.

2.5.21 The Board notes that while it is clear that there should be an entitlement to an input tax credit, it is less clear to whom this entitlement should be available. It is also not clear how this situation should be dealt with in the context of the GST

administration rules , especially as they relate to matters such as the provision of a tax invoice, and what steps might be needed to prevent abuse through double claiming or inappropriate transfers of entitlement. The Board understands that there is no common general solution in other jurisdictions to the issue around multi-party transactions.

2.5.22 The Board is of the view that the time available for its consideration of this matter has not been sufficient for it to develop a detailed option that would resolve this issue.

2.5.23 Given this, the Board considers that this area should be further investigated by the Government, with a view to developing an amendment to eliminate unrecoverable tax in multi-party transactions.

2.5.24 The issue relating to multi-party transactions of ambulance services and the GST-free concessions was not within the scope of the review. Any change in this area would involve an alteration in the extent to which GST-free treatment was made available.

Recommendation 14: Multi-party transactions

The Board considers that it is important that the Government further examine the treatment of multi-party transactions in order to eliminate unrecoverable tax. The Government should have regard to overseas work in this area.

CHAPTER 2.6: VOUCHERS

VOUCHERS

EXISTING LAW AND PRACTICE

2.6.1 Supplies of *face value vouchers* are not taxable. Supplies on redemption of the voucher are subject to the general rules for taxable supplies with the consideration being the amount for which the voucher is redeemed, or, if fully redeemed, the face value of the voucher plus any additional consideration.

2.6.2 The taxing point of vouchers is deferred until redemption because some vouchers can be redeemed for both taxable and GST-free supplies and it is not known at the time the voucher is supplied what proportion of taxable supplies it will be redeemed for, and hence how much GST to account for.

2.6.3 If a voucher is redeemed for both taxable and GST-free items, such as a mixed basket of groceries, and tax is accounted for on the redemption, the correct apportionment between GST-free and taxable supplies is possible.

2.6.4 However, if a voucher is sold through a distribution chain, it may be sold by the supplier at a discount on its face value. When a customer redeems the voucher for its face value with the supplier, tax is charged by reference to the face value. The supplier will only have received the discounted price, and not the face value, from its initial sale to the start of the distribution chain.

Example

Sally's department store sells \$1,100 worth of gift vouchers to Easy Money, a credit card company, for \$900. Easy Money uses the gift vouchers as part of its customer rewards program. Under the current GST law, when the vouchers are redeemed, Sally's department store must account for GST on the \$1,100 face value of the gift vouchers and not the \$900 actually paid for them by Easy Money. This results in a GST amount of \$100 (1/11th of \$1,100) being accounted for, as apposed to \$81.82 (1/11th of \$900). In effect, Sally's department store has accounted for GST at a rate of 11.1 per cent ($\$100/\900×100), instead of the GST rate of 10 per cent.

2.6.5 Broadly speaking, the bad debt provisions do not apply to the sale of vouchers. Generally, a supplier is entitled to an adjustment when it does not receive all of the consideration for a supply it has made. That is, it has a bad debt. Similarly, the

recipient of the supply is obliged to make an increasing adjustment when the debt is written off. This is not the case for vouchers.

2.6.6 There are additional special rules in relation to vouchers that are phone cards. Specifically, prepaid phone cards and facilities are included in the definition of a voucher. A prepaid phone card or facility is itself defined as any article or facility supplied for the sole purpose of enabling the owner, on a prepaid basis, to use telephone or like services, or to acquire things facilitated by telephone or like services.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

2.6.7 A number of submissions raised concerns with the complex operation of the vouchers provisions. Many submissions called for the law to be amended, removed completely, or be optional.

2.6.8 The submissions suggested that the vouchers provisions often cause GST to be remitted at a rate greater than 10 per cent. This arises because the consideration for the voucher is treated as its face value. However, when the voucher is sold at a discount (as is often the case in business-to-business transactions), GST equal to 1/11th of the face value of the voucher must still be accounted for. In effect, the supplier of the voucher accounts for GST at a rate greater than 10 per cent of the value of supply.

Major retail stores sell 'gift vouchers' at a discount to its face value, particularly to loyalty program operators. These stores are required to account for GST on the face value of the voucher even though no one in the commercial chain paid that amount for the voucher. This is clearly inconsistent with the nature of a GST being a tax on final private consumption commensurate with the amount paid (or payable) by the consumer for the goods and services consumed. [PWC]

2.6.9 Another issue raised in submissions is that some forms of vouchers are excluded from the GST definition, specifically:

- vouchers that have more than one function;
- vouchers that permit the owner a discount on the price of the goods or services; and
- vouchers that entitle the owner to a specific good or service.

2.6.10 As such, these vouchers are taxed when sold, as opposed to when they are redeemed for goods or services.

2.6.11 Submissions considered that this can result in the potential for two vouchers that offer similar functions to be taxed differently.

A voucher that entitles the holder to a discount off the price of the goods and services and a voucher that entitles the holder to specific goods and services are generally not covered by Division 100. As such these 'non Division 100 vouchers' are taxed on supply and not on redemption.

This raises the issue of neutrality. Two 'vouchers' with similar features may have a different GST result. [PWC]

FINDINGS

2.6.12 The Board's view is that the current rules are not keeping pace with the variety of vouchers that are available in the market place. For example, in some instances, vouchers may represent or be equivalent to financial supplies, with many vouchers now being rechargeable.

2.6.13 The Board notes that the GST treatment of vouchers is a complex area, which other countries are also grappling with to determine the right approach. The European Commission Directorate General Taxation and Customs Union recently conducted a public consultation on the value-added tax treatment of vouchers. Its consultation raised similar concerns to those raised in this review; namely, the definition of vouchers and the payment of value added tax on the voucher's face value.

2.6.14 The Board also notes that no submissions presented a workable solution. The Board considers that the appropriate taxation treatment of vouchers should be reviewed following the finalisation of the review.

2.6.15 The Board considers that the voucher provisions for telecommunication suppliers are working appropriately. This follows the amendment to the vouchers definition to specifically include prepaid phone cards and facilities.

Recommendation 15: Vouchers

The Government should undertake a review of the Australian GST vouchers regime, having regard to overseas work in this area, including that undertaken by the European Union, with a view to developing a simpler system with lower compliance costs.

CHAPTER 3: REVIEW OF SELF ASSESSMENT — APPLICATION TO INDIRECT TAXES

CHAPTER 3.1: GENERAL INTEREST CHARGE AND SHORTFALL INTEREST CHARGE

EXISTING LAW AND PRACTICE

3.1.1 If any amount of indirect tax (GST, wine equalisation tax, luxury car tax or fuel tax credits) remains unpaid after the time by which it was due to be paid, then general interest charge (GIC) applies to that amount until it is paid.

3.1.2 The Commissioner has the power to remit all or part of the GIC. Broadly, where a person is liable to pay the GIC because an amount remains unpaid after it was due, the Commissioner may remit all or a part of the GIC:

- if the delay in payment was not due to an act or omission of the taxpayer, or if the delay in payment was due to an act or omission of the taxpayer, but having regard to the circumstances it would be fair and reasonable to remit all or a part of the GIC and the taxpayer has taken reasonable action to mitigate the circumstances; or
- if there are special circumstances which would make it fair and reasonable to remit all or part of the GIC.

Business-to-business transactions and GIC remission

3.1.3 The GST is a multi-stage value-added tax. GST is intended to be collected on transactions between registered businesses and on supplies to final consumers. The GIC is applicable when there is an underpayment of GST or an over-claim of input tax credits because of the incorrect GST treatment of a transaction, whether it is a business-to-business transaction or a business-to-consumer transaction.

3.1.4 Nonetheless, the Commissioner has a policy in relation to GIC remission for the shortfall period where the practical effect of correcting an error in a business-to-business transaction is revenue-neutral.

3.1.5 The Commissioner's Law Administration Practice Statement PS LA 2008/9 sets out the current policy on full or partial remission of GIC imposed for the shortfall period for:

- corrections that are revenue-neutral, regardless of whether the corrections are taxpayer-initiated or identified through a Tax Office audit; and
- the GIC that accrues on a shortfall amount during the shortfall period, but not GIC for late payment after the shortfall period.

3.1.6 In general, the Practice Statement provides for remission of GIC to the base 90-day bank bill rate for revenue-neutral corrections. However, the Practice Statement provides for remission in full where the taxpayer can show:

- no comparative benefit has been derived from the error;
- GST on a transaction has been accounted for in the correct period but by the wrong entity; or
- an input tax credit has been claimed but by the wrong entity.

3.1.7 A number of situations have been identified where the corrections of errors have a neutral effect on primary GST revenue – that is they are *revenue-neutral*. These are:

- where a supplier fails to include GST in the price of a taxable supply made to a recipient who would have been entitled to claim a full input tax credit if they were issued with a valid tax invoice;
- where the wrong entity accounts for the GST or claims an input tax credit, which may occur with associated entities under a joint venture or similar type of partnership arrangement, or an agency arrangement;
- where entities transact with each other as if they were members of a GST group when they are not members of the same group (for example, because one is not eligible to be a member of the group); and
- where a transaction has taken place involving equal and offsetting primary GST amounts, but the Commissioner declines to exercise his discretion to treat a document as a tax invoice or adjustment note.

Shortfall period

3.1.8 The shortfall period is the period between when an error is made and when it is corrected (by submitting a revised BAS for the relevant period). Where the correction leads to an increase in the GST payable or a decrease in the input tax credit claimable,

the GIC is imposed on this amount for the shortfall period. The GIC continues to accrue after the shortfall period until the debt is paid.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

3.1.9 The GIC was raised as an issue at some of the consultation sessions which the Board held during August 2008. In addition, a large number of submissions highlighted the fact that the (lower) shortfall interest charge (SIC) that applies to income tax shortfalls is not available in relation to GST related shortfalls. Many taxpayers regard the GIC as too high in certain circumstances, particularly where there is no net loss of revenue.

... the policy underpinning GIC (that being to compensate the government for the time value of money) demands that GIC not apply where a tax shortfall results in no net disadvantage to the revenue. [CTA]

We therefore support the adoption of a default position of fully remitting the GIC on adjustments that involve no net loss to the revenue, as suggested in the Inspector-General of Taxation's recent review of the ATO's administration of GST audits. This would include, but not be limited to wash transactions, cases involving documentation issues and cases where GST has been paid by the wrong entity. [CTA]

In relation to the need for a specific penalty to support a default GIC position, although we recognise taxpayers are obliged to maintain a certain standard of care, we believe the existing uniform penalty regime as set out in the TAA is sufficient to address any undesirable taxpayer behaviour [CTA]

However, where a supplier is unable to recover underpayments or overpayments of GST, payment of that tax by the supplier would itself act as a penalty and as such should be taken into account when determining what, if any SIC or GIC should apply. This is particularly the case given the windfall gain that accrues to the Commissioner in such cases. [CTA]

The reasoning behind the adoption of the SIC for income tax (that it is inappropriate to charge the full uplift to encourage prompt payment before the taxpayer is notified of their additional liability) applies equally to GST. As such, the CTA strongly supports the extension of the SIC to GST shortfall amounts attributable to periods prior to a taxpayer becoming aware of that shortfall. [CTA]

A lower rate of GIC, akin to the SIC, should apply in respect of the period prior to the Commissioner notifying the taxpayer of an unpaid net amount or amount of indirect tax, or of a reduced input tax credit entitlement in respect of a particular tax period, where prior to notification the taxpayer was not aware of any unpaid amount remaining outstanding. [TIA]

GIC applying to business-to-business taxable transactions which were treated as GST-free transactions

3.1.10 This situation arises when audit activity results in supplies which had been treated as GST-free being identified as taxable supplies. Submissions suggested it is inappropriate that the GIC and penalties be imposed on the supplier in situations where the recipient was a registered entity entitled to input tax credits for these transactions and there was consequently no net loss of revenue.

The GST is designed to have a self-policing element and an audit trail. We accept and understand that this was a deliberate policy choice. If business-to-business transactions were meant to be ignored, we could have had a retail sales tax or an 'additive' GST. But we do not, so business-to-business transactions matter.

Nevertheless, if the effect on primary GST revenue is neutral there is little need to compensate the revenue for the time value of money. The imposition of any GIC in these circumstances is penal in nature. Remission in full is therefore in principle generally warranted. To do otherwise is inequitable. [PWC].

... the default position should be that it is inappropriate to apply any GIC to business-to-business transactions that are revenue-neutral as the revenue has not suffered any time value of money loss. [TIA]

Other GIC issues

3.1.11 Submissions raised that there are circumstances in which GIC remission should be broadened. The following areas were raised in the submissions:

- The current remission guidelines should take into account changes in other taxes. For example, if in the one period there is a reduction in fringe benefits tax liability and an increase in GST, GIC is imposed on the increase in GST and yet the overall tax liability is unchanged.
- A supplier is penalised when there is irrecoverable GST. For example a supplier must bear the full cost of the GST and GIC where the purchaser is no longer in business or refuses to pay the additional GST.

FINDINGS

Shortfall interest charge

3.1.12 The SIC has also been introduced into the income tax law. From the 2004-05 income year, a taxpayer whose income tax assessment is amended so as to increase their tax liability incurs the SIC rather than the GIC on the shortfall amount during the shortfall period. That is, the SIC applies on a daily compounding basis from the due date for payment of the earlier, understated assessment to the day before the notice of

the amended assessment is issued. There is a gap (21 days) between the issue of the notice of the amended assessment and the new due date — this is an interest-free period. The higher GIC then accrues on any amount not paid by the new due date.

3.1.13 The SIC was introduced because the GIC includes an interest rate generally higher than commercial borrowing alternatives, to discourage use of the revenue as a source of finance, plus an additional premium to encourage prompt payment. However, in pre-amendment *shortfall* cases, taxpayers are usually unaware of their debts. Consequently they are unable to respond to this incentive premium. The SIC therefore applies in lieu of the GIC for the period before assessments are amended.

3.1.14 The SIC is set at the 90-day bank bill rate plus three percentage points, four percentage points lower than the GIC. The circumstances in which a taxpayer will be liable for the SIC are set out in the *Taxation Administration Act 1953* (TAA). The SIC (like the GIC) is tax deductible.

3.1.15 The SIC does not apply in a GST context. The GST system applies GIC to all debts. GIC payments in respect of GST liabilities are included in the GST revenue paid to the States and Territories.

3.1.16 The Board considers that there is a reasonable conceptual case for a lower rate of interest in some circumstances. These include where the taxpayer is not able to respond to the *incentive to pay* incorporated in the GIC because they are unaware of the shortfall.

3.1.17 The Board also notes that the running balance account system established by the TAA, used by the Tax Office to manage taxpayer liabilities arising from those taxes reported on the BAS (GST, luxury car tax, wine equalisation tax, fuel tax credits, PAYG withholding, instalments on income tax and fringe benefits tax instalments), limits the flexibility of applying different interest rate arrangements to different taxes. It also notes that, at present, when the SIC applies in the income tax context, it requires manual calculation on the part of the Tax Office. As part of the broader re-design of its accounting systems, the Tax Office is developing a system to automate calculation of the SIC in relation to income tax in most cases. The automated calculation of the SIC could in future be extended to other taxes including those reported on the BAS.

3.1.18 The Board therefore considers that in future it may be feasible to apply SIC to GST (and the other BAS-reported tax) shortfall amounts in circumstances similar to those applying in the income tax law:

- Shortfalls arising from underpayment of GST prior to the issue of an assessment following a Tax Office audit, or prior to the submission of a revised BAS by the taxpayer identifying a shortfall, would attract the SIC prior to the identification and processing of the shortfall.

- Once the shortfall has been processed, either through an assessment or a revised BAS, the GIC would apply prospectively.

3.1.19 Overpayments of GST refunds do not have a specific parallel in income tax. The Board is of the view that there are two possible approaches to the treatment.

- The first is to treat overpayments of GST refunds symmetrically with underpayments of GST liabilities, that is, SIC is charged on the amount overpaid until an assessment is made or a revised BAS is submitted and GIC is charged thereafter.
- The second is to charge GIC on all overpaid refund amounts from the time the overpayment arises, regardless of whether they have been identified and processed.

3.1.20 The GIC (plus any applicable penalties) would continue to apply in the following circumstances:

- late lodgment of a BAS or failure to pay the identified liability by the due date for payment;
- an underpayment of GST or an over claimed refund has been identified either by the taxpayer or through an audit and has been processed, but the outstanding amount has not been paid.

3.1.21 In such a model, penalties would be applied where appropriate and the current range of remissions would continue to be applicable.

3.1.22 By applying the SIC to BAS-reported taxes in the same way it applies to income tax and postponing its introduction until an automated system is available, the administrative costs of such a change would be considerably reduced.

3.1.23 Whilst applying SIC to BAS-reported taxes would not reduce the time taken to comply with these taxes, it would reduce the financial cost to taxpayers of inadvertent errors.

Recommendation 16: Shortfall interest charge

A shortfall interest charge (SIC) should apply to the GST and other taxes reported on the BAS, including luxury car tax, wine equalisation tax and fuel tax credits.

GIC applying to business-to-business taxable transactions which were treated as GST-free transactions

3.1.24 The Inspector-General of Taxation's *Report on the Tax Office's administration of GST audits for large taxpayers* (released on 11 June 2008) recommended that the

Government consult with the community on the need for legislative changes which have the effect of requiring or allowing the Tax Office to:

- adopt a default position of fully remitting the GIC in GST audit cases which result in adjustments that involve no net loss to the revenue, such as wash transactions, cases involving documentation issues and cases where GST has been paid by the wrong entity; and
- where warranted, address any undesirable behaviour on the part of the relevant taxpayer in relation to failing to account for GST on such transactions through a form of penalty.

3.1.25 The Tax Office response contained in the report stated:

The Tax Office is currently considering its policy and practices in relation to circumstances where remission of GIC might be appropriate in GST audit cases involving revenue-neutral adjustments and has now issued a draft practice statement for community consultation.³¹

3.1.26 The Board noted advice from the Tax Office that under Practice Statement Law Administration PS LA 2008/9 (GST revenue-neutral corrections) the Commissioner now remits or partially remits GIC on some revenue-neutral transactions.

3.1.27 The Board considers that no change is warranted to current practice concerning the application of GIC to business-to-business taxable transactions which were treated as GST-free transactions (subject to the earlier recommendation proposing the adoption of a SIC). The existing Tax Office remissions policy provides an appropriate balance between maintaining the integrity of the GST system, and not imposing excessive interest charges on taxpayers that have acted honestly in seeking to fulfil their GST obligations. Further concessions could have the potential to undermine the operation of the GST as a multi-stage value-added tax.

3.1.28 The Board therefore considers that the current law and the existing Tax Office remissions policy provide the most appropriate outcome.

Other GIC remission issues

3.1.29 The Board considers the current law imposing GIC for shortfalls relating to each tax is appropriate. This reflects that separate returns are lodged for different taxes and encourages entities to account correctly for each tax that applies to them.

31 http://www.igt.gov.au/content/reports/GST_audits/GST_audits_large_taxpayers.pdf.

3.1.30 The Board considers that the broadening of the GIC remission for irrecoverable GST relates to general tax administration and can currently be taken into account by the Commissioner.

CHAPTER 3.2: RULINGS

EXISTING LAW AND PRACTICE

3.2.1 Rulings are a formal mechanism through which the Tax Office provides advice to taxpayers on the interpretation of the laws administered by the Commissioner.

3.2.2 In 2005, a new advice and rulings regime for income tax (and other taxes including the Medicare levy, fringe benefits tax, withholding tax and net fuel amounts) was created in response to the recommendations from the Report on Aspects of Income Tax Self Assessment (RoSA). The RoSA rulings regime was incorporated into the *TAA*.

3.2.3 Unlike income tax, there is no legislated rulings regime for GST, wine equalisation tax and luxury car tax. Rather, the Commissioner issues rulings under the power of general administration and there is a provision in the *TAA* about relying on rulings.

3.2.4 The *TAA* provides that if a taxpayer underpays a net amount of indirect tax (including GST) because they have relied upon an indirect tax ruling the Commissioner gave to them, and which the Commissioner has subsequently changed, the net amount is not payable. The same rule applies in cases where the Commissioner has overpaid a taxpayer – the overpaid amount is deemed to have been payable in full.

3.2.5 The practical impact is that in these circumstances taxpayers are relieved of the obligation to pay indirect tax that would otherwise have been payable, or to repay money to the Commissioner where, for example, the Commissioner has overpaid a refund.

3.2.6 The Commissioner can disregard the above rule if a taxpayer misled him in giving the earlier ruling that led to the underpayment or overpaid refund.

3.2.7 The existing GST rulings provisions also apply to wine equalisation tax and luxury car tax. There is alignment between GST rules and wine equalisation tax and luxury car tax rules, and in particular, wine equalisation tax and luxury car tax amounts form part of an entity's net amount.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

3.2.8 Rulings were raised at each of the consultation sessions which the Board held during August 2008. Submissions highlighted a number of issues.

3.2.9 The problems which arise from not having an express legislative framework for GST rulings include:

- no framework setting out taxpayers' rights and obligations;
- no formal review rights;
- the intended scope of the Commissioner's powers is unclear;
- what is regarded as a public ruling is very broad, resulting in most published material being treated as a public ruling;
- only the applicant for a private ruling can rely on it; and
- there is uncertainty about whether a taxpayer has to demonstrate actual reliance on a ruling.

No express legislative framework

3.2.10 The GST law does not contain a comprehensive rulings regime, such as that which applies to income tax. Instead GST (and luxury car tax and wine equalisation tax) rulings are issued under the Commissioner's power of general administration of indirect tax laws. The only place where GST rulings are mentioned is a single section in the TAA. This section had its origin in the rulings provision of the former sales tax system. The current provision does not establish a rulings system; it only enables a taxpayer to rely on the Commissioner's interpretation in cases where the Commissioner has altered a previous ruling.

No formal review rights

3.2.11 Many submissions and consultation sessions raised the issue that with no express legislative framework, there are no formal review rights for taxpayers where they are dissatisfied with a decision made by the Commissioner in a ruling issued to them. Currently, a taxpayer that does not agree with the view expressed in a private ruling may request an assessment of their net amount for the relevant tax period and object to that assessment.

There is no formal right of review to GST private rulings. This is an impediment to the GST private ruling system achieving its purpose. Because private rulings are not reviewable decisions businesses usually only seek private rulings when confident that the private ruling will confirm their view on the application of the GST law to a transaction. Accordingly, the GST private ruling system does not, in practice, assist businesses to gain certainty as to the GST treatment of intended transactions which raise difficult GST issues. [IFSA]

3.2.12 As a result of the lack of formal review rights, submissions considered that the current system:

- is ineffective, inefficient and costly for both taxpayers and the Tax Office;
- potentially results in inequitable and inconsistent treatment between taxpayers;
- fails to provide certainty;
- can act as a discouragement to seeking a ruling, as taxpayers may only seek private rulings when they are confident that the ruling will confirm their view on the application of the GST law to a transaction; and
- leads to the need for additional processes for review (where a taxpayer has to request an assessment and then object to that assessment).

Where a private ruling application is made on a joint income tax and GST issue (for example, for clarification regarding whether an entity has a permanent establishment in Australia), two different regimes apply to the ruling which can lead to the absurd result of having certainty about one tax position but not the other.’ [Minter Ellison]

3.2.13 A large number of submissions supported taxpayers being able to object to a private ruling, and amending the law to provide formal review rights in respect of private GST rulings. This was seen as a means of supporting taxpayers in a self assessment environment.

In our view the government should amend the GST law to provide formal review rights in respect of private GST rulings, especially in relation to proposed transactions. The simplest path is to extend the private binding ruling regime to GST. [PWC]

3.2.14 Another submission suggested the ability to formally object to a GST private ruling may improve the quality and transparency of GST private rulings issued.

Intended scope of the Commissioner’s powers is unclear

3.2.15 The Commissioner makes class³² and product³³ rulings in relation to other taxes, but there is no express provision as to whether the Commissioner is able to issue class and product rulings for GST.

3.2.16 Submissions called for the legal framework to be altered to specifically provide for the issuing of GST product or class rulings.

32 A class of persons could be employees of a business, shareholders of a company or recipients of a particular government grant or subsidy.

33 A product is an arrangement in which a number of taxpayers enter into substantially the same transaction with an entity or group of entities, for example, managed investment schemes like agribusiness or film schemes.

The Institute considers that a broader range of taxpayers ought to be able to rely on rulings under the indirect tax system and, as such, supports a broader concept of binding ruling – perhaps similar to class or product rulings. [ICAA]

3.2.17 The suggestion was made that class rulings could be particularly useful in addressing food classification issues.

3.2.18 Calls were made for the issue of more class rulings and fewer private rulings. It was suggested that this could minimise distortions in the GST as a two-party transaction tax.

3.2.19 It was noted that it is unclear whether the Commissioner can refer a valuation to a valuer if the making of a private ruling requires the value of something to be determined. Valuations are required for the margin scheme. This is to be contrasted with the current income tax regime, where, as part of making a private ruling, if something needs to be valued the Commissioner can refer that valuation to a valuer. The Commissioner can charge an amount to the applicant in accordance with the regulations (although no regulations have been made for this purpose at present).

What is regarded as a public ruling is very broad

3.2.20 The term *indirect tax ruling* is defined broadly and includes all advice given or published by the Commissioner in relation to a GST law. This means that, for GST purposes, fact sheets, guides or other products published by the Commissioner constitute public rulings.

3.2.21 As a result, there is no scope within the existing regime for the Commissioner to publish simplified general advice without it being classified as a public ruling binding in relation to all entities, and therefore providing taxpayers with the maximum possible protection (from primary tax, penalties and interest).

3.2.22 Consequently, although every attempt is made within the existing framework to provide tailored advice that is easy to understand, all GST related advice published by the Commissioner is drafted in a manner that seeks to keep the risk of conveying a different legal meaning at a bare minimum, reflecting the advice's status as a public ruling binding in relation to all entities. This undermines the provision of simple advice and increases the complexity of advice given.

3.2.23 The income tax regime provides the Commissioner with the flexibility to issue advice which does not constitute a binding ruling. This advice provides taxpayers with protection from penalties and interest, but not primary tax. Additionally, the income tax regime provides the flexibility for non-binding advice, labelled as such, to be published to assist taxpayers. The flexibility under the income tax regime allows the Commissioner to develop a range of products to meet the needs of different taxpayers or classes of taxpayers. For example, the Commissioner can issue class rulings that are targeted at and apply only to new small businesses.

Only the applicant can rely on a ruling

3.2.24 As GST is a transaction-based tax, it is not only the party obtaining the ruling but the obligations and entitlements of two parties which are affected by a particular transaction.

3.2.25 Submissions raised the issue that GST private rulings only give protection to the taxpayer to whom the ruling is specifically issued. Suppliers that rely on the rulings of their suppliers or recipients do not share in the protection of these rulings.

Where a third party in the supply chain has an identical fact pattern to the entity that has obtained the private indirect tax ruling, the Commissioner should also be bound by his position in the ruling where the third party has acted consistently with the private indirect tax ruling. [TIA]

3.2.26 Many submissions suggested that suppliers are in the best position to provide the detailed information necessary for classification of their products, and they recommended that retailers and wholesalers should be able to rely on private rulings issued by the Tax Office to their suppliers.

... it is physically impossible to obtain rulings on the full range of products that we sell. We are not in a position to submit samples for all products, nor can we provide the technical information on products that is only available to suppliers for example formulation. [Woolworths]

Uncertainty about whether a taxpayer has to demonstrate actual reliance on a ruling

3.2.27 Submissions noted that there is uncertainty about whether a taxpayer has to demonstrate actual reliance on a ruling. On a literal reading of the law, a taxpayer must actually rely on a GST ruling in order to receive protection from the ruling.

3.2.28 Thus, on a literal reading, the fact that a taxpayer may act in accordance with the view expressed in a ruling is not in itself sufficient. For example, merely lodging a BAS which happens to be the same as it would have been if the ruling had been relied on would not be enough to demonstrate reliance on the ruling on a literal reading.

3.2.29 Under the income tax regime, a taxpayer receives protection from a ruling if it acts or omits to act in accordance with the ruling, irrespective of whether it is actually aware that the ruling exists. The taxpayer need not *rely* on the ruling within the ordinary meaning of the word and, thus, the problems associated with having to demonstrate reliance do not arise.

3.2.30 Submissions suggested the current GST law leads to uncertainty about what constitutes reliance upon a private ruling, and requiring a business to demonstrate and retain evidence that it has relied on a public ruling is an unnecessary compliance burden.

3.2.31 A number of submissions recommended giving GST public rulings the same status as income tax public rulings, where there is no need to show positive acts of reliance, or that the ruling has been altered.

FINDINGS

3.2.32 The Board considers adopting the income tax rulings system for GST, luxury car tax and wine equalisation tax would fix a range of issues with the current system.

3.2.33 Adopting the income tax rulings system for these taxes would increase certainty for taxpayers.

3.2.34 The move to the broader rulings regime would address the problems about review rights and reliance, as outlined above.

3.2.35 Introducing an express legislative framework would also allow for other types of rulings such as product or class rulings to be issued. For example, the Commissioner could issue a class ruling that only applied to new small businesses.

3.2.36 The Board notes that a consequence of adopting the income tax ruling system for GST, luxury car tax and wine equalisation tax is that the range of documents that are considered to be public rulings would be reduced. This would enable the Commissioner to publish simplified, more readily accessible advice that meets the needs of different classes of taxpayers.

3.2.37 Compliance and administrative costs would be reduced by aligning the rulings regime with that applying to other taxes (which include income tax, Medicare levy, fringe benefits tax, franking tax, withholding tax, mining withholding tax, fuel tax credits and petroleum resources rent tax). This reflects that taxpayers and tax professionals would only need to be familiar with a common set of rules.

3.2.38 One part of the broader rulings regime which would not translate well in the indirect tax context is in relation to oral rulings.

- In income tax, the oral rulings regime covers all non-business individuals that are self-preparers unless, in the Commissioner's opinion, the question being asked is complex.
- However, all GST taxpayers are required to be carrying on an enterprise to be registered for GST and could not readily be considered to be non-business taxpayers. Additionally, there is no readily identifiable group in the GST system that has simple tax affairs; notably, entities with low GST turnover do not necessarily have simple tax affairs.

3.2.39 The Board is of the view that a modification to the income tax ruling system would be required to exclude GST from the oral rulings component of the regime. In order to facilitate this outcome, the range of matters on which the Commissioner is not required to provide oral advice should be expanded from *business matters* to *enterprise matters*.

3.2.40 The Government may wish to consider whether the oral ruling system should continue to be offered for other taxes, including income tax. This reflects the Board's understanding that the oral ruling system imposes significant administrative costs compared to the limited use of the system by taxpayers.

3.2.41 There may be a need to address some transitional issues in a move to the broader rulings regime.

Recommendation 17: Rulings

The income tax ruling system should be adopted for GST, luxury car tax and wine equalisation tax, with appropriate modifications including an exception for oral rulings.

The Government may wish to consider whether the oral rulings system should continue to be offered for other taxes, including income tax.

Reliance on rulings issued to the other party to a transaction

3.2.42 The Board notes that, for a recipient to be entitled to an input tax credit for GST it has to satisfy four requirements:

- the thing it acquired is used for a creditable purpose (that is, in carrying on their enterprise);
- the supply to the recipient is a taxable supply;
- the recipient is liable to provide consideration; and
- the recipient is registered.

3.2.43 The recipient will know itself if it meets three of those requirements, however whether the supply to it is a taxable supply is something that only the supplier will have all the necessary information to determine.

3.2.44 In the consultation process, significant concern was raised about the transaction-based nature of the GST and the fact that there are two parties to every transaction, but that currently recipients and suppliers are not able to rely on the rulings issued to the other party.

3.2.45 If the recipient was able to rely on the supplier's ruling in relation to the requirement that the supply to them is a taxable supply, the benefit would be in respect of determining their input tax credit entitlements. The benefit to suppliers who could rely on a private binding ruling issued to their recipient in relation to whether the supply is taxable would be in respect of determining their GST liability on the supply made to the recipient.

3.2.46 The Board is of the view that recipients should be able to rely on a private binding ruling issued to their supplier to determine their input tax credit entitlements, but only where the supplier has agreed to provide the ruling to them. Similarly, suppliers should be entitled to rely on a private binding ruling issued to their recipient in determining their GST liability on the supply made to the recipient that is the subject of the ruling, again, only where the recipient has agreed to provide the ruling to them.

3.2.47 The need to have the recipient or supplier agree to provide the ruling to the other party is designed to address privacy concerns which were raised in consultation sessions.

3.2.48 However, the recipient should not be able to rely on a private ruling issued to the supplier as far as the three other requirements outlined above (creditable purpose, consideration, registration of recipient) are concerned, because those requirements are within its knowledge, not within the knowledge of the supplier.

Example — recipient entitled to rely on supplier's ruling — no on-supply

Peter obtains a private ruling for GST purposes that his supply to Lara is a taxable supply. Peter agrees to provide the ruling to Lara, and Lara relies on it.

Lara uses the acquisition for a creditable purpose (she uses it for the general purpose of carrying on her enterprise, which only makes taxable and GST-free supplies).

Lara claims an input tax credit on her acquisition of the supply from Peter, relying partly on Peter's private ruling. (To show reliance, Lara has to show she was aware of Peter's ruling. This requires Lara to have been provided with Peter's private ruling, by Peter, at the time, not just that there was a ruling which accorded with the way Lara acted.)

Later it is found that Peter's supply was an input taxed supply. Lara is protected from having to repay the input tax credit she claimed, even though the private ruling was to Peter.

Example — recipient entitled to rely on supplier's ruling — on-supply found to be taxable

Elinor obtains a private ruling for GST purposes that her supply to Jasper is taxable. Elinor agrees to provide the ruling to Jasper, and Jasper relies on it.

Jasper claims an input tax credit, relying partly on Elinor's ruling.

Jasper uses what he acquired in the supply from Elinor in making a supply to Bailey. Jasper treats his supply to Bailey as a GST-free supply. Jasper claims an input tax credit on his acquisition from Elinor because he uses it to make what he thinks is a GST-free supply.

Later, it is found that Elinor's supply is an input taxed supply and Jasper's supply is a taxable supply.

Elinor's treatment of her supply to Jasper as taxable is protected as her ruling provides that the supply is taxable. This means that while Elinor does not have the GST she accounted for refunded, she retains the input tax credits she accounted for on the acquisitions related to the supply.

Jasper had no ruling about his supply to Bailey, so Jasper's treatment of the supply as GST-free is not protected.

However, as Jasper had Elinor's private ruling saying her supply to him was a taxable supply, he can rely on that in retaining his input tax credit.

3.2.49 If the recipient does not acquire the supply for a creditable purpose, the fact that they are protected by the supplier's private ruling about the tax status of the supply to them is not determinative of their entitlement to input tax credits. That is, if, say, the recipient uses the thing supplied to them to make an input taxed supply, they are not entitled to input tax credits on the acquisition of the thing because they did not make the acquisition for a creditable purpose. They are still protected by the supplier's private ruling about the tax status of the supply to them, but that is not the only requirement that has to be met for their acquisition to be a creditable acquisition. As they fail one of the other requirements they are not entitled to input tax credits.

Example — recipient entitled to rely on supplier’s ruling — on-supply found to be input taxed

Jessica obtains a private ruling for GST purposes that her supply to Benjamin is taxable. Jessica agrees to provide the ruling to Benjamin.

Benjamin claims an input tax credit, relying partly on Jessica’s ruling.

Benjamin on-supplies the supply from Jessica to Sam. Benjamin treats his supply to Sam as a taxable supply.

Later, it is found that both Jessica’s and Benjamin’s supplies are input taxed supplies. Jessica is protected as her ruling provides that the supply is taxable.

Benjamin had no ruling about his supply to Sam, so Benjamin’s treatment of the supply as taxable is not protected.

Further, as Benjamin is not entitled to an input tax credit on the acquisition because it related to an input taxed supply, Benjamin is denied the input tax credit on his acquisition of Jessica’s supply to him. The basis for denying the input tax credit is not because of the tax status of the supply to Benjamin. Instead it is denied because Benjamin did not acquire the supply for a creditable purpose — one of the three requirements for claiming an input tax credit that is within Benjamin’s knowledge. That is, Jessica’s ruling only protects Benjamin in relation to the tax status of the supply to Benjamin, not in relation to the other three requirements which are within Benjamin’s own knowledge.

3.2.50 The Board is of the view that an entity should only be able to rely on another entity’s private ruling in respect of the tax status of the supply between them. Therefore, the ability of other parties to rely on a private binding ruling would not extend to supplies further down the supply chain or to the inputs of the supplier.

3.2.51 Having regard to the two-party transaction nature of the GST, it is important that asymmetrical outcomes do not arise. Accordingly, the Board considers that where recipients and suppliers agree to rely on the other’s ruling then they should be bound to apply the ruling in the preparation of their BAS, but may object to the other’s ruling.

3.2.52 Some concerns were raised with the Board about whether taxpayers may be coerced into agreeing to rely on and be bound by another taxpayer’s ruling. This may result in a taxpayer assuming they can rely on and are bound by a ruling that may not accurately reflect the facts as they apply to them, meaning that in practical effect, they will not be protected or bound by the ruling.

3.2.53 The application of penalties would need to be considered further in adopting the income tax ruling system for GST, wine equalisation tax and luxury car tax.

3.2.54 The Board notes that if the income tax ruling system is adopted for GST, the Tax Office will be able to issue product and class rulings that will assist in clarifying the GST law for transactions that occur through supply chains.

Recommendation 18: Relying on, and being bound by, private rulings issued to the other party to a supply

Recipients and suppliers should be able to rely on each other's rulings in relation to the tax status of the supply between them, where they agree to provide their rulings to each other for this purpose. Where recipients and suppliers agree to rely on the other's ruling then they should be bound to apply the ruling in the preparation of their BAS, but may object to the other's ruling.

However, this should not extend to supplies in other parts of the supply chain.

CHAPTER 3.3: PERIOD OF REVIEW

EXISTING LAW AND PRACTICE

3.3.1 Taxpayers' tax affairs need to be finalised to provide certainty and reduce compliance costs, such as reducing the need to keep records for long periods. However, this need for finality has to be balanced against the need to maintain the integrity of the GST system, and therefore the collection of the correct amount of tax on the amount of value added in transactions.

3.3.2 The period of review, or the amendment period, is the length of time that the Commissioner can ordinarily take to assess or determine a tax liability, or that taxpayers can ordinarily take to claim a refund or credit. Currently, the period of review for GST is four years and starts when the tax becomes payable, or in the case of a taxpayer claiming a refund or credit, from the end of the tax period (or the date of importation) to which the refund or credit relates.

3.3.3 During the four-year period of review, taxpayers' liabilities and entitlements can be reviewed by both the taxpayer and the Commissioner.

3.3.4 There are exceptions to the GST period of review. The period can be extended through notification by the Commissioner or the taxpayer. The Commissioner has an unlimited period to recover tax avoided by fraud or evasion.

3.3.5 The GST attribution rules provide some flexibility in relation to when a taxpayer may claim an input tax credit.

3.3.6 If a taxpayer does not hold a tax invoice for a creditable acquisition when they give the Commissioner a return for a particular period, the relevant input tax credit is instead attributed to a later period when the taxpayer does hold an invoice.

3.3.7 There is a further rule that is intended to allow taxpayers the flexibility of deferring input tax credit claims they could make to a later period. For example, a taxpayer may overlook an input tax credit entitlement for a particular period; the provision is designed to allow the taxpayer to make the input tax credit claim for a later period, rather than revising its earlier BAS.

3.3.8 It is arguable that the provision only operates if the taxpayer did not hold a tax invoice at the end of the tax period to which the input tax credit would otherwise be attributable. However, the Commissioner administers the law to allow deferral of input tax credit claims regardless of when the tax invoice was first obtained, provided the input tax credit has not been taken into account in an earlier tax period.

3.3.9 The attribution rules can have the effect that there is no time limit for input tax credit claims in certain circumstances.

3.3.10 Lastly, in normal circumstances, a monthly BAS is due 21 days after the end of the tax period, and a quarterly BAS 28 days after the end of the tax period, except for the December quarter BAS which is due one month later than usual.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

3.3.11 Questions have been raised as to whether the four-year period of review strikes the appropriate balance between minimising taxpayers' compliance costs and maintaining the integrity of the GST system in all circumstances.

3.3.12 The possibility of moving to a shorter period of review for categories of supplies such as retail transactions was raised at the Melbourne consultation session hosted by the Board in August 2008.

3.3.13 Some submissions countered this suggestion, advocating that the current four-year period of review be maintained. It was argued that the current four-year period of review provides a good compromise between taxpayers' need for finality, adequate time for the Commissioner to assess businesses' GST compliance and additional time for taxpayers to claim refunds and credits.

3.3.14 The Commissioner proposed to the Board that the period of review be *refreshed* where he reduces the amount of tax payable or increases a refund payable to a taxpayer based on the information provided by the taxpayer (that is, where a credit revision of the original BAS is lodged). This would provide for a further time period (for example, four years) for taxpayers and the Commissioner to review any GST amendment.

3.3.15 Such a refreshed period of review would only apply in relation to the particular revision and would not open the entire BAS to an extended four-year review period. This would align with the approach to time limits for amending income tax assessments.

3.3.16 Some submissions also argued that the existing provisions dealing with the restriction on refunds and the four-year period are uncertain and inadequate. The point was made that under the current law, the Commissioner and taxpayers are able to alter liabilities and entitlement to refunds, four years after the liability or entitlement has arisen.

... the limitations on the Commissioner and the taxpayer should be consistent in applying the 4 year finality rule...the taxpayer should be required to specify the amount of the overpayment, the tax period and the particularity of the overpayment within the 4 year period. [ICAA]

3.3.17 However, the period should not limit refunds arising as a result of an objection, appeal or review.

3.3.18 Consultation also raised some taxpayers' concerns with monthly and quarterly lodgment dates of the BAS. Monthly taxpayers sought an extension for the December quarter (a similar extension to that available to quarterly taxpayers for the December quarter), and quarterly lodgers sought a further extension.

FINDINGS

Length of period of review

3.3.19 The Board notes that under reforms implemented for income tax arising from the Review of Self Assessment, certain taxpayers with simpler tax affairs now have a two-year period of review, while those with more complex affairs retain a four-year period of review. The Board does not consider that it is appropriate for the GST system to have different periods of review, depending on the complexity of the GST affairs of taxpayers.

3.3.20 The Board is of the view that any alignment for GST purposes with the two-year period of review available to certain income taxpayers would cause asymmetric outcomes. This reflects that if one party to a supply has a two-year period of review and the other has a four-year period, then inequalities will arise when adjustments are made or are required, after the end of the two-year period of review, but before the end of the four-year period.

3.3.21 The Board considers that a four-year period of review provides enough time for the Commissioner to conduct compliance activities and for taxpayers to amend their BAS statements, whilst providing certainty and finality for taxpayers.

Refreshing the period of review

3.3.22 Refreshing the period of review for GST in cases where a credit revision of the original BAS is lodged, grants both the taxpayer and the Tax Office additional time to review any GST amendment. The Board considers that there is merit in also extending this to the luxury car tax, wine equalisation tax and fuel tax credits.

3.3.23 Refreshing of the review period could result in certain transactions having up to an eight-year period of review. This is consistent with the income tax system.

Recommendation 19: Period of review

The four-year period of review for the GST, luxury car tax, wine equalisation tax and fuel tax credits should be refreshed in cases where the Commissioner or the taxpayer reduces (or increases) the amount of tax payable or increases (or reduces) a refund payable to a taxpayer based on the information provided by the taxpayer, but only in respect of the particular that led to the review.

Time limit for claiming input tax credits

3.3.24 The Board considers that imposing a definite four-year time limit on the ability to claim input tax credits would align the attribution rules in the GST Act with the time limit on refunds and credits provision in the TAA.

3.3.25 Limiting the period in which input tax credits can be claimed provides certainty for tax administration purposes as well as providing sufficient time for taxpayers to make claims.

Recommendation 20: Limited time to claim input tax credits

The law should be amended to limit claims for input tax credits to a four-year period in line with the time limit on refunds and credits to clarify that a taxpayer can defer input tax credit claims (within these limits) even if they held a tax invoice at the end of the period to which the credit would otherwise be attributable.

Lodgment of BAS

3.3.26 A BAS can only be lodged once the tax period has ended, so that all the activity for that tax period can be reported in that BAS.

3.3.27 The current approach of not having a lodgment and payment option prior to completion of a tax period is the appropriate outcome, as taxpayers are already able to access refunds earlier if they lodge their BAS immediately after the end of a tax period. Refunds are paid in accordance with the Tax Office's service standard, which is within 14 days of lodgment of the BAS, except where refunds are subject to further review.

3.3.28 The Board also notes that the Commissioner can grant lodgment extensions to taxpayers on a case-by-case base. For example, schools may receive an extension because staff are not present during January. The Board is of the view that leaving the discretion with the Commissioner is the appropriate outcome. The alternative of granting a blanket extension is unlikely to be necessary given that large monthly taxpayers have well-developed systems for GST reporting.

CHAPTER 3.4: SELF ASSESSMENT

EXISTING LAW AND PRACTICE

3.4.1 The GST system can be described as *self actuating*. The liability to tax does not depend on an assessment being made and assessments are not routinely issued.

3.4.2 A taxpayer is required to lodge a GST return, known as an activity statement, in respect of each tax period. This is done through the BAS. The taxpayer is liable to pay the *net amount* in respect of the tax period, or is entitled to a refund if the net amount is less than zero. The net amount for GST represents the total of a taxpayer's GST liability, input tax credits and adjustments for a tax period, and is reported to the Commissioner on the BAS. An assessment is not usually issued by the Commissioner when the BAS is lodged.

3.4.3 Wine equalisation tax and luxury car tax are also taken into account in working out the net amount. Wine equalisation tax, luxury car tax and fuel tax credits are also *self actuating*.

3.4.4 The Commissioner may later issue an assessment of the net amount following the conduct of audit activity or if an assessment is requested by the taxpayer, for particular tax periods. An assessment is necessary for a taxpayer to exercise its right to object.

3.4.5 The GST administration system may be contrasted with income tax self assessment, which involves an assessment being made by reference to the return lodged. If self assessment were introduced for GST, an assessment of the net amount would be taken to be made when a BAS was lodged based on the information provided in the BAS.

3.4.6 There are similarities in the practical operation of *self actuating* and *self assessment* systems. But the fact that the GST and income tax administration systems rest on different foundations has led to some divergence in the design of certain aspects of the systems, for example rulings and the process for objecting against notified liabilities.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

3.4.7 Self assessment was not in itself a focus of submissions and consultations. However, a number of other issues were raised in submissions and consultations that could be addressed by harmonising with income tax self assessment.

In the absence of a formal assessment for GST, the objections, four-year limitation and rulings systems for GST would have to be designed in a different way. [ICAA]

FINDINGS

3.4.8 The Board considers that there are a number of advantages to harmonising the GST system with the income tax self assessment system.

Clear distinction between assessment and collection of tax

3.4.9 The Board considers that harmonisation with the income tax self assessment system would result in the GST law containing a clear distinction between provisions concerned with assessment of tax and those concerned with recovery of tax.

3.4.10 The Board is of the view that any harmonisation of the GST system with the income tax self assessment system should not result in a change to the existing arrangements under which the period of review for GST ceases:

- for unpaid amounts, four years after it becomes due and payable; and
- for refunds, four years after the end of the tax period.

3.4.11 The TAA limits the Commissioner from recovering amounts and taxpayers from claiming credits and refunds. These provisions currently apply having regard to certain amounts not being payable, and taxpayers not being entitled to certain refunds or credits.

3.4.12 These provisions do not clearly delineate between the ascertainment of liabilities and entitlements, the time limits to amend established liabilities and entitlements, and the recovery of established liabilities and entitlements. This lack of clarity is a natural consequence of a self acting system. There is also a lack of certainty and consistency in how the GST administration provisions apply to the components that make up the net amount (for example GST and input tax credits) and to the net amount itself.

3.4.13 One consequence is that these provisions could inadvertently extinguish liabilities reported in a BAS within the four-year time limit that remain unpaid after that time limit has expired.

3.4.14 In contrast, comparable provisions in the income tax law clearly delineate between assessment of tax, time limits for amending assessments and recovery of established liabilities.

3.4.15 The Board is of the view that harmonising with the income tax self assessment system would allow for a clear distinction to be made between provisions dealing with

ascertainment of liabilities, time limits for amendments, and recovery of established debts.

Means for addressing issues with the GST administration system

3.4.16 The Board envisages that if the GST law were harmonised with the income tax self assessment system, the following changes would be made:

- There would be unlimited time permitted to recover a debt that was established within the relevant four-year period as is currently the case for income tax.
- The requirement for a notice to be issued by the Commissioner or a taxpayer to extend a period of review (discussed in Chapter 3.3) would not be carried over into a self assessment system. Rather, when a taxpayer lodged their BAS an assessment would be taken to be made.
- An amended assessment would result in a refreshment of the period of review for certain purposes, as occurs with income tax amended assessments.
- A provision would confirm that the validity of an assessment would not be affected by reason of any provision of the law not being complied with.

3.4.17 The Board considers that similar changes should be considered for other indirect taxes that share a common legislative framework with the GST.

Harmonisation to promote comprehension of the tax system

3.4.18 Harmonisation with the income tax self assessment provisions could be achieved either by adopting self assessment for GST or alternatively by addressing the individual issues arising from the current lack of a self assessment regime for GST.

3.4.19 The Board is of the view that harmonising the administration of income tax and GST may have some long-term advantages in terms of assisting taxpayers, tax practitioners and tax administrators with their understanding of the respective systems.

3.4.20 This would decrease the need for advisors and administrators to have specialist knowledge of unique income tax or GST administration provisions and accordingly may lead to a modest reduction in compliance and administrative costs in the longer term.

Design issues with the self assessment system

3.4.21 There are a number of design issues that will need to be addressed if harmonisation with the income tax self assessment provisions occurs. These include the following:

- The administration provisions for GST are shared with other indirect taxes. Accordingly, consideration needs to be given to applying similar changes to other indirect taxes. This would result in income tax and the indirect taxes sharing the same administrative environment.
- Harmonisation with self assessment will give rise to transitional issues. Since assessments will not have been made for prior tax periods, it may be necessary either to deem assessments to have been made for these earlier periods or to retain the existing indirect tax administration provisions for earlier periods.
- The change to a set time limit in which an assessment must be issued, rather than the more flexible option of issuing a notice extending the period of review, may necessitate some changes to the manner in which the Tax Office undertakes compliance activities.
- A separate provision would need to be made for liabilities notified by the Australian Customs Service for importations that are not reported on the BAS.
- There are a limited range of circumstances where an entity that is not registered for GST, and would not ordinarily lodge a BAS, can be liable for GST. The manner in which an assessment system applies in this context would need to be considered.

Recommendation 21: Self assessment

Greater harmonisation should be introduced between the current self actuating system for GST, wine equalisation tax, luxury car tax and fuel tax credits and the income tax system of self assessment.

PART B: STREAMLINING THE GST LAW AND REMOVING ANOMALIES

CHAPTER 4: MARGIN SCHEME

EXISTING LAW AND PRACTICE

4.1.1 For real property, special rules exist that allow taxpayers an alternative means of calculating GST. These rules are known as the margin scheme and are generally used for new residential property developments.

4.1.2 The margin scheme was designed to ensure that GST is payable only on the incremental value added to land by each party in a series of transactions. Under the margin scheme GST generally is payable only on the value added to property on or after 1 July 2000. It levies GST only on the margin by which the value of the property increases each time it is sold by a registered entity on or after 1 July 2000.

4.1.3 Purchasers of real property under the margin scheme cannot claim input tax credits for the acquisition. This is because an input tax credit would offset the GST payable so that GST would effectively not have been collected.

4.1.4 Therefore, taxpayers selling real property generally have the choice of calculating GST under the basic rules (GST is 1/11th of the GST inclusive price) and the purchaser may have an input tax credit entitlement, or under the margin scheme (GST is 1/11th of the margin) with no input tax credit entitlement.

4.1.5 Under the margin scheme, the margin, or value added that is subject to GST, is equal to the difference between the price the property is sold for and:

- if it was acquired before 1 July 2000 – the value of the property as at 1 July 2000 (the valuation method); or
- if it was acquired on or after 1 July 2000 – the price it was acquired for (the consideration method).

Example

Lori is registered for GST and sells property she owned at 1 July 2000.

She sells the property to Pat and uses the margin scheme to work out her GST liability on the sale, which is 1/11th of the difference between the price for which she sells the property to Pat and the value of the property at 1 July 2000.

Pat is also registered for GST. He is not entitled to input tax credits on his purchase of the property.

Pat later sells the property to Dave. Pat uses the margin scheme to work out the amount of GST on the sale, which will be 1/11th of the difference between the price for which he sells the property to Dave and the price for which he bought the property from Lori.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

4.1.6 The application of GST to real property transactions, in particular the margin scheme, was raised as an issue at most of the consultation sessions which the Board held during August 2008. In addition, the majority of submissions raised issues relating to the GST treatment of real property in general, and/or more specifically, the operation of the margin scheme.

4.1.7 Concerns were raised with the complexity and compliance burden arising from the current margin scheme provisions.

The administrative compliance burden imposed on taxpayers in the residential property sector may (for some taxpayers, in certain situations) become more of an impost than the value of the underlying concession afforded by the margin scheme. [PCA]

The policy intent behind Division 75, in the Institute's opinion, is an attempt to allow the vendor of real property to restrict the GST payable on the taxable supplies of real property to the value added since 1 July 2000 in the course of a GST registered enterprise. While the Institute supports this policy, we submit that Division 75 in its current form has serious flaws and fails to achieve the basic rationale behind a margin scheme... [ICAA]

4.1.8 Many stakeholders commented on the extent of problems in this area of the GST law.

... approximately 30 per cent of all GST cases currently in litigation are property related and most of these deal with margin scheme issues 12 public rulings (with two more in draft) have been issued on residential property and margin scheme issues

... the margin scheme provisions, in Division 75, doubled in size after being substantially amended in 2005 and are still the subject of further major amendments. [TIA]

4.1.9 There are also a number of interaction issues with the margin scheme and other GST provisions. For example, in the case of mortgagee sales, some stakeholders noted that it is not clear whether a mortgagee exercising its power of sale is able to use the margin scheme to determine the GST liability on the sale. Further, it is not always clear how the margin scheme applies in the case of supplies of real property in the context of partnerships (see Chapter 7.3 on partnerships).

4.1.10 There are also concerns that the operation of the current margin scheme provisions may mean that the policy intent is not being achieved in some circumstances, or there may be significant compliance issues. For example:

- there is no adjustment for the input tax credit previously denied on an acquisition under the margin scheme where the subsequent supply is not under the margin scheme, however, there are increasing adjustments for the reverse situation;
- in certain circumstances, an increase in land value while property was held by an unregistered entity may be taxed; and
- transfers on partitioning are merely a change of legal interest for no monetary consideration and should be ignored for GST purposes to reduce the compliance burden.

4.1.11 Concerns were also raised about valuations for margin scheme purposes, in particular, that a valuation should not be open to challenge simply because it differs from what the Commissioner considers correct. This difference of itself should not amount to a failure to make the valuation in accordance with recognised professional standards. It was submitted that this approach is necessary to give taxpayers confidence that they will not be subject to retrospective additional GST.

4.1.12 A number of submissions recommended that the margin scheme be given its own review. For example:

Commission a separate review to simplify the margin scheme and the way in which residential property is taxed for GST purposes within the next 12 months. [PCA]

We recommend that this area of GST be subject to a more detailed and comprehensive review aimed at determining the most effective and efficient way to treat residential property for GST purposes without giving rise to the complexities and the lengthy and costly disputes that the current regime has created. [TIA]

... the current margin scheme is overly complex and flawed in its operation. While we support the policy behind the margin scheme and agree with the principle that there should be relief so as to tax the value added to land, we consider that an alternate mechanism is required to effectively achieve this objective. [ICAA]

FINDINGS

4.1.13 While the margin scheme is not an issue for most taxpayers, it is apparent that for those who need to engage with it, it imposes a significant compliance burden.

4.1.14 The Tax Office has advised the Board that litigation relating to the use of the margin scheme is one of the largest categories of litigation in the GST area. This implies that there is a significant level of complexity and uncertainty in the law. This imposes significant compliance costs on taxpayers as well as cost for the Tax Office in administering this area of the law.

4.1.15 The Board understands that, broadly, the policy intent of the margin scheme is to ensure that GST is payable only on the incremental value added to land by each registered party in a series of transactions on or after 1 July 2000. The Board accepts, however, that this intention is not being achieved in some circumstances and that there can also be significant compliance issues in using the margin scheme.

4.1.16 Removing the margin scheme would be outside the terms of reference of the review. However, the Board considers that the policy intent of the margin scheme can be realised in a more effective manner than in the current law. Further, this is within the terms of reference as the objective would be to achieve the same taxation outcomes but with a simpler, more effective approach.

4.1.17 In the time available for this review the Board was not able to develop an approach to redrafting the law to achieve the current policy intent with much less compliance and administrative costs. However, we strongly urge the Government to apply the time and resources required to adequately consider the principles that should underpin a new approach to the law. This should also include consideration of the interaction between the margin scheme and other provisions in the GST law such as real property transactions involving partnerships (see Chapter 7.3 on partnerships).

Recommendation 22: Margin scheme

The Government should undertake a review of the margin scheme, focussing on its effectiveness and efficiency in achieving its policy intent and how it interacts with other provisions in the GST law.

CHAPTER 5: FINANCIAL SUPPLIES

EXISTING LAW AND PRACTICE

5.1.1 Financial supplies are input taxed. This means that enterprises such as financial institutions that make financial supplies do not generally obtain relief for GST incurred on acquisitions that they make that are inputs to such supplies. The GST Regulations set out what are financial supplies. Broadly, this includes: deposit accounts; debt or credit arrangements; mortgages; life insurance; guarantees; credit under hire purchase agreements; securities; and derivatives. Raising equity capital is also within the financial supply regime.

5.1.2 While generally input taxed, in some cases acquisitions relating to financial supplies can attract a reduced input tax credit. Examples include: transaction banking and cash management services; payment and fund transfer services; loans services and credit union services; debt collection services; funds management services; insurance services; and trustee and custodial services.

5.1.3 A lot of businesses make a small proportion of financial supplies, such as allowing payment on terms but charging interest if payment is late. Rather than requiring all businesses to apportion many of their overhead and other general business-related acquisitions between their ordinary taxable supplies and their minor proportion of input taxed supplies, there is a financial acquisition threshold. Broadly, this is calculated against a value of financial acquisitions, or on a proportion of financial acquisitions against other supplies. Below the threshold, no apportionment of input tax credits is required. That is, 100 per cent input taxed credits can be claimed even though they partially relate to making input taxed financial supplies.

5.1.4 The threshold is exceeded if the input tax credits related to making financial acquisitions would exceed the lesser of:

- \$50,000, or such other amount specified in the Regulations; or
- 10 per cent of the total amount of input tax credits to which the taxpayer would be entitled, assuming that all the financial acquisitions made during the preceding 12 months were made solely for a creditable purpose.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

5.1.5 A number of issues relating to financial supplies were raised in consultation and submissions. Some of these related to the financial supplies provisions and their structure and complexity. Others focused on certain specific problems, including:

- the treatment of hire purchase;
- the financial acquisitions threshold; and
- entitlements to input tax credit for capital raising.

Financial supplies provisions — structure and complexity

5.1.6 Several submissions suggested that the design and structure of the provisions of the GST Act relating to financial supplies were cumbersome and complex, resulting in unnecessary compliance burdens for taxpayers.

The Institute considers that, since its inception, there have been many shortcomings with the design, interpretation and administration of the Australian GST law particularly in relation to financial services Many of these negative features arise, not out of the policy of exemption of financial services but from the cumbersome drafting of the law that fails clearly to state the principles concerned and thus allow a purposive construction to give effect to the policy, purpose and objects of the exemption scheme. [ICAA]

5.1.7 Areas that were highlighted as being particularly problematic were the definitions of financial supply and the rules around the availability of reduced input tax credits and other forms of input tax relief.

Eight years on, it would seem appropriate to consider if the RITC provisions are an efficient way of dealing with these difficulties and if they are operating as intended. [TIA]

Hire purchase

5.1.8 Taxpayers accounting on a cash basis who enter hire purchase arrangements are only entitled to input tax credits as and when they make payments, reflecting the nature of the arrangement as, in effect, a sale by instalments. This treatment differs from that of sale and loan arrangements, such as chattel mortgages, for which an immediate input tax credit is available. Hire purchase arrangements also differ from *payment over time* arrangements such as leases for accruals basis taxpayers. Such taxpayers will need to remit GST upfront in hire purchase arrangements, but need only remit GST periodically for leases.

5.1.9 Some parties to the public consultations and a number of submissions expressed concern about the treatment of hire purchase arrangements. It was

considered that the GST treatment of hire purchase transactions compared to other arrangements such as chattel mortgages and the attribution rules for cash and accrual taxpayers, as outlined above, resulted in a tax based distortion.

... the current rules for attribution of GST credits on HP [hire purchase] discriminate against taxpayers paying GST on cash basis as opposed to accrual. ... The effect of the above is to create tax inefficiency and drive taxpayers to use certain finance products over others, purely on the basis of GST attribution. [ABA]

5.1.10 Some submissions also raised the more general issue of mismatches in dealings between taxpayers on different accounting bases. It was felt that in large transactions this can give rise to inappropriate outcomes. Reference was made to the New Zealand system of applying a single accounting basis for transactions over a time and money threshold.

Financial acquisitions threshold

5.1.11 The operation of the financial acquisitions threshold, which permits entities that do not exceed the threshold to claim input tax credits for acquisitions related to financial supplies, was the focus of concern from a large number of taxpayers both in the public consultation sessions the Board held during August 2008 and in submissions.

5.1.12 The general position was that the present test created unworkable burdens for taxpayers, as well as being overly narrow in its application.

In our view, the FAT [financial acquisitions threshold] test as currently drafted, is impractical. To a large extent it is ignored by taxpayers and is a constant matter raised by the Tax Office during audits. [PWC]

5.1.13 Submissions pointed to two particular features of the financial acquisitions threshold that gave rise to many of the problems. These were the thresholds being too low and the requirement to determine prospective and retrospective acquisitions on an ongoing monthly basis.

... it may be observed that the thresholds are too low and the compliance requirements not as practical as they might be. Ironically the FAT exacerbates compliance for businesses that are not engaged in financial supplies. [TIA]

5.1.14 Submissions also suggested the consequences of one-off or occasional transactions could be unduly harsh. In particular, a number of submissions stated the treatment of capital raising by issues of equity that are an input taxed supply was inappropriate, especially by comparison with debt issues.

Also, where a taxpayer conducts mainly taxable activities and is therefore under the FAT, but has a 'one off' M&A or other major financial supply transaction that technically causes it to exceed the FAT, it is onerous and impractical to trace through

the denial of the small amount of additional input tax credits from its normal day to day enterprise that arise as a result ... [CTA]

FINDINGS

Financial supplies provisions — structure and complexity

5.1.15 The Board considers that the present financial supplies provisions are unnecessarily complex. This is especially the case in relation to defining what supplies will be financial supplies and what acquisitions may qualify for reduced input tax credits.

5.1.16 A number of the existing provisions are unclear. Further, the basic structure is overly complex. For a taxpayer to determine the GST consequence of a transaction, they may need to first refer to the list of supplies that are financial supplies, then check the list of supplies which are not financial supplies, consider the application of the provision on incidental financial supplies before finally examining the list of acquisitions that can give rise to reduced input tax credits. Even after this, the taxpayer may also need to consider how the financial acquisitions threshold may apply given their overall activities.

5.1.17 The Board is of the view that the current approach to defining a financial supply is unnecessarily complex. The complexity of the existing provisions, instead of providing certainty and clarity, create ambiguity and uncertainty. The existing complexity adds substantially to taxpayers' costs. It also results in considerable risks, as the appropriate treatment may often be unclear. This burden is also shared with the Tax Office in its administration of the law. The same policy outcome could be achieved with straightforward provisions.

5.1.18 The Board considers the provisions should be examined with a view to restructuring the law (particularly that relating to the definition of financial supplies and the reduced input tax credit provisions) to remove unnecessary complexity and ensure clarity and consistency. The Board is of the view that there is room for reform to substantially reduce the burden the law places on taxpayers, and to do so in a way that is consistent with the underlying policy intent.

Recommendation 23: Financial supplies

The Government should undertake a review of the financial supplies provisions with a view to reducing their complexity and introducing more principled rules, while maintaining the existing policy.

Hire purchase

5.1.19 The treatment of hire purchase involves complex considerations. The Board is of the view that the present GST treatment of hire purchase arrangements is appropriate. It reflects the legal form of the arrangement as a purchase of goods by instalments. Mismatches between purchasers and suppliers that use different methods of accounting are an expected and intended outcome of allowing taxpayers to account on different bases. Finally, it is a necessary consequence of cash accounting that changes to the time of payment or the substance of what is being paid for will alter the time of attribution.

5.1.20 However, the Board also considers that the operation of these accepted principles in the context of equipment finance results in a bias away from hire purchase arrangements for taxpayers using cash accounting, due to the tax advantages of other arrangements. In particular, taxpayers accounting on a cash basis will only be able to claim input tax credits as they make payments under a hire purchase arrangement, whereas they can obtain a full upfront input tax credit if they enter a chattel mortgage arrangement.

5.1.21 Addressing this bias in a principled way is problematic. There is nothing unique about hire purchase arrangements – they are just a prominent example of the general issue of cash accounting for GST disadvantaging arrangements involving payment over time. This could only be addressed by eliminating cash accounting or imposing GST based on economic substance rather than legal form. Both would involve fundamental changes to the tax. The latter is not consistent with the GST being a tax on the value-added tax model or indeed being a transaction-based tax at all.

5.1.22 Given this, the Board considers that there should be no change to the GST treatment of hire purchase arrangements.

5.1.23 While the option of removing cash accounting is not feasible in its entirety, as it would increase compliance costs for many small businesses, the Board is of the view that there is some merit in requiring transactions above a particular value to be accounted for using accrual accounting.

5.1.24 This would avoid the significant cashflow disadvantages and mismatches that can result where taxpayers account for GST using different bases enter payment arrangements for considerable amounts over a lengthy period of time. Given that these transactions will be rare and significant for small business, special accounting treatment would not represent a significant burden. Similar rules have been in place for some time in New Zealand.

5.1.25 If this option were to be adopted, the Board regards it as important to ensure that the thresholds are set at a level that would not disadvantage small business by requiring excessive use of complex accruals rules while also avoiding as much as possible the problems that arise from parties having mismatched accounting periods in

significant transactions (in particular, substantial differences between the date of liability and the date of entitlement). It would also be important to identify the other criteria for excluding transactions for cash accounting and how this measure would affect entities, such as non-profit bodies, that receive extended access to cash accounting.

Recommendation 24: Cash and accrual accounting

The Government should consider the merits of all transactions above a certain value (and meeting other criteria) being accounted for using accruals accounting.

Financial acquisitions threshold

5.1.26 Many of the changes proposed in submissions in relation to the financial acquisitions threshold fell outside the scope of the Board's review. Excluding occasional or once-off transactions or acquisitions related to particular types of supply (such as capital raisings) would involve changing the GST treatment of these types of supply. This would be a change to the scope and extent of what is subject to GST, and as such, beyond the scope of this review. Raising the thresholds or altering the test to allow taxpayers to make the percentage and dollar amount tests alternatives are also excluded as this would involve a change to the treatment of supplies, with significant revenue consequences.

5.1.27 The period of the test and process for calculating the financial acquisitions threshold are within the scope of this review.

5.1.28 The Board regards the present requirement, for taxpayers to consider their acquisitions over the past 12 months, and their likely acquisitions over the next 12 months in every tax period (potentially meaning every month), to be impractical. For taxpayers approaching the boundaries of the threshold, the costs of monitoring past and prospective acquisitions on an ongoing basis can result in considerable compliance costs. In the view of the Board, monthly consideration of acquisitions related to financial supplies over periods up to 24 months is unnecessarily burdensome.

5.1.29 The Board considers that the financial acquisitions threshold should be simplified. The threshold should be considered on an annual rather than an ongoing basis, thus reducing 12 tests to one test.

Recommendation 25: Financial acquisitions threshold

The financial acquisitions threshold should be simplified by reducing the frequency of testing to an annual basis.

CHAPTER 6: NON-RESIDENTS

EXISTING LAW AND PRACTICE

Breadth of Australia's GST law

6.1.1 Australia includes non-residents in the GST system. Non-residents who carry on an enterprise can register for GST and gain relief for GST incurred on acquisitions of goods and services regardless of whether they have any offsetting liability to remit GST to the Tax Office. Refunds of GST to non-residents can only be made through registration (or in limited circumstances under the Tourist Refund Scheme).

6.1.2 In contrast, where non-resident enterprises supply goods or services to which GST applies, they may have an obligation to register for GST and remit to the Tax Office GST on supplies as well as be entitled to claim input tax credits.

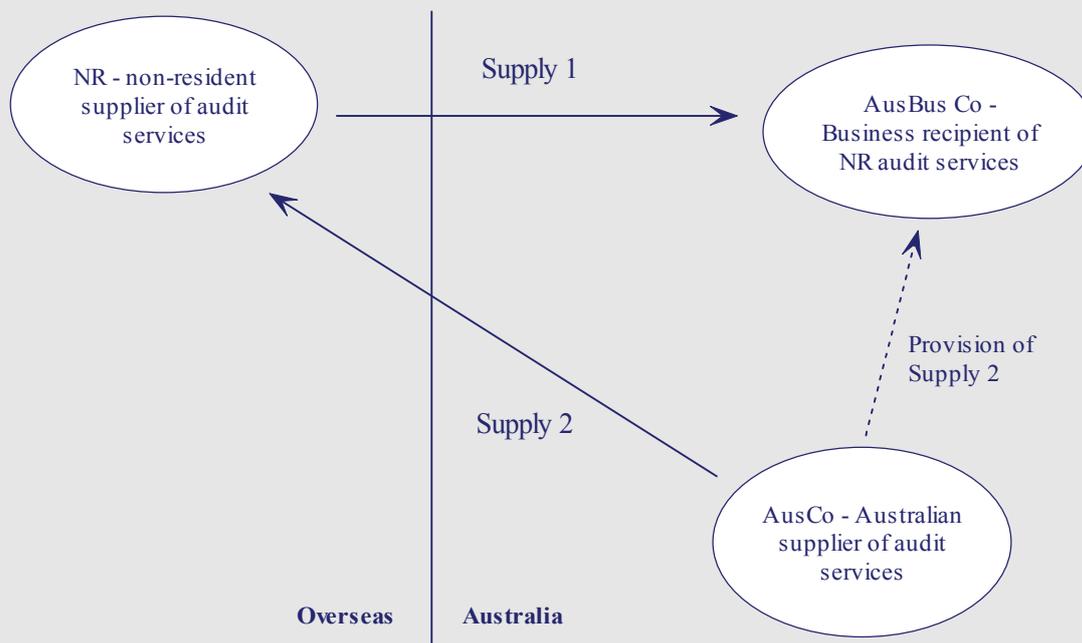
Supply of services and intangibles

6.1.3 One of the conditions of a supply being a taxable supply is that it is connected with Australia. A supply of anything other than goods or real property is connected with Australia where:

- the supply is done in Australia;
- the supplier makes the supply through an enterprise that the supplier carries on in Australia; or
- neither of the above apply and the supply is a supply of a right or option to acquire another thing and the thing would be a supply connected with Australia.

6.1.4 There are a number of GST provisions whereby the supplies of things other than goods or real property that are made to non-residents are GST-free. However, where the supply that is made to the non-resident is provided to another entity in Australia, the supply is taxable.

Example — audit services



AusCo, a subcontractor, is making a taxable supply to the non-resident, NR, because it is providing its supply to the non-resident's customer, AusBus Co.

NR, the non-resident, will be making a supply that is done in Australia, therefore is connected with Australia when it uses AusCo, to carry out its contractual arrangements it has with its Australian customer, AusBus Co. Where the non-resident meets the threshold requirements, this supply will be a taxable supply for which the non resident must remit GST despite having no presence in Australia.

GST-free export of goods

6.1.5 Under certain circumstances in the GST law, goods that are supplied and exported are a GST-free supply for the supplier. This GST-free provision is based on the supplier exporting the goods.

6.1.6 In certain situations where the purchaser exports the goods, the supplier can be treated as having exported the goods from Australia and therefore the supply is GST-free. However, the onus is on the supplier to verify that the goods were exported. Therefore, the supplier in these situations must rely on information given to them by the purchaser.

6.1.7 The definition of Australia in the GST Act does not include any External Territory. Norfolk Island, Cocos & Keeling and Christmas Islands are examples of External Territories.

Reverse charge provisions

6.1.8 The GST law contains two reverse charge provisions whereby the recipient of the supply accounts for the GST on the supply made by the non-resident. Reverse charging applies where:

- the non-resident supplier is making certain taxable supplies and the resident recipient and the non-resident agree that the GST on the supply is accounted for by the resident recipient; or
- the supply by the non-resident is an intangible supply that is not connected with Australia, the recipient is registered for GST and the acquisition by the recipient is not solely for a creditable purpose.

Registration procedures for non-residents

6.1.9 Under the GST legislation, an entity may register for GST if it is carrying on an enterprise or intends to carry on an enterprise.

6.1.10 In order to register, non-residents must provide certain documentation as evidence that they are carrying on the enterprise for which they are seeking GST registration. They are also required to provide evidence of their identity as the non-resident entity, or of their identity as a representative, such as a director, of the non-resident entity.

6.1.11 The requirements for non-residents to establish proof of identity are broadly equivalent to those for residents. All documents must be certified as true copies by an Australian embassy, high commission or consulate, or by a competent authority in the relevant country (if the country has signed the Hague Apostille Convention³⁴) and have these documents Apostille'd.³⁵

6.1.12 Entities that are eligible for an ABN apply for this at the same time as they apply for GST registration. However, non-residents who do not carry on an enterprise in Australia nor make supplies that are connected with Australia are not entitled to an ABN.

Non-resident agency provisions

6.1.13 Where a resident is an agent for a non-resident principal who is registered or required to be registered, and taxable supplies or taxable importations are made by the principal through the agent, then the GST payable on these transactions is payable by the agent and not by the principal.

34 The Hague Convention of 5 October 1961 *Abolishing the Requirement of Legalisation for Foreign Public Documents*.

35 Apostille'd means a type of certification issued by a 'competent authority' designated by the state in which the document was issued.

6.1.14 *Agent* is not a defined term under the GST law and accordingly, common law concepts of the agency relationship are relevant. Under the common law, an agent is a person who is authorised, either expressly or impliedly, by another person to act for that person, the principal, so as to create or affect legal relations between the principal and third parties.

6.1.15 Non-residents that meet the registration threshold are required to be registered even if they are acting through a resident agent. The resident agent also needs to register if they are acting for a non-resident that is registered or required to be registered for GST in Australia. An agent will need to make reasonable inquiries to establish whether the non-resident principal is registered or required to be registered for GST.

GST deferral scheme

6.1.16 Certain importers of goods into Australia can defer their GST liability upon importation until they lodge their next BAS. Broadly, the GST deferral scheme provides for the deferral of payments of amounts of GST on taxable importations.

6.1.17 Entities who lodge their GST returns quarterly (generally, smaller businesses) must elect to lodge monthly and electronically if they want to participate in the GST deferral scheme.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

6.1.18 A large number of issues were raised in public consultation and submissions concerning non-residents and cross-border transactions.

6.1.19 A key concern raised in many submissions and the public consultations was the difficulties faced by non-resident entities wanting to register for GST. The registration information requirements requested by the Tax Office were widely regarded as excessive and difficult to comply with.

6.1.20 Other topics raised in submissions concerned:

- the breadth of Australia's GST law which included many non-residents;
- the non-resident agency provisions being too narrow;
- ABN registration for non-residents;
- small businesses accessing the GST deferral scheme; and
- supplies of goods to External Territories.

Breadth of Australia's GST Law

6.1.21 There were many submissions that raised concerns about the breadth of Australia's GST law, that requires a large number of non-residents to be part of the GST system.

... the Australian GST is over-inclusive of non-residents and needs to be modified to take a more practical approach by using the reverse charge mechanism for supplies by non-resident suppliers who are not established in Australia. In addition, it relies too heavily on a general application of proxies and will inevitably need to move to a greater subdivision of rules to apply specific proxies to particular types of supply. [Rebecca Millar]

6.1.22 Submissions raised concerns that the supplies that are regarded as being connected with Australia are too broad:

... the GST net is being cast unnecessarily wide to capture non-residents with no physical presence in Australia and who are dealing with registered Australian businesses. ... to register and account for Australian GST liabilities and claim back GST credits. This causes a significant compliance burden which seems unnecessary given that there is little or no net effect on the revenue. [ICAA]

The ATO's broad interpretation of section 9-25(5) of the GST Act (the 'connection with Australia' rules for services and intangibles), makes many foreign businesses reluctant to register for Australia's GST ... While this view prevails and the GST law remains in its current form, many foreign businesses will remain outside the GST system, forgoing refunds of GST they would otherwise be entitled to claim. [PWC]

6.1.23 Additionally, submissions were concerned with competitive and compliance cost issues where supplies of intangibles made to non-residents are not GST-free:

The ATO's current interpretation of subsection 38-190(3) as outlined in GSTR 2005/6 is completely at odds with the Government's stated intention regarding non-residents and their participation in the Australian GST system and goes well beyond the purpose of the provision, which was to prevent business to consumer (ie: consumption) expenditure from escaping the GST net.

The outcome of the ATO's approach is a negative one, whichever way you look at it. Corporates are often faced with non-residents who refuse to pay the GST, which results in the corporate having to bear the cost. The other side of this coin is where the added GST impost results in the non-resident sourcing the supply from another offshore market, resulting in lost trade to the Australian economy. Where the non-resident accepts the higher cost but decides not to embark on the process of registration, the price of the Australian service is higher than it would be otherwise, which is clearly an inappropriate outcome. Alternatively, where the non-resident chooses to enter the system, the non-resident, the corporate and the ATO are subject to

additional compliance (and for the ATO, audit) costs, including the onerous POI [proof of identify] requirements mentioned previously. [CTA]

6.1.24 One submission commented on the Tax Office rulings relating to international issues:

As of 4 August 2008, 769 pages of the consolidated versions of the rulings focus on international issues with 543 pages dealing with section 38-190 of the GST Act. The GST Act has been overtaken by the numerous explanations proffered in relation to international issues. [TIA]

Registration procedures for non-residents

6.1.25 A large number of submissions and many of the public consultations raised concerns about the GST registration application procedures for a non-resident. A major complaint was that the registration process was very slow and extremely difficult to comply with.

The proof of identity requirements that are imposed by the ATO when a non-resident applies for GST registration have the result that registration cannot be finalised in less than 4 to 6 weeks. While the ATO generally advises a general registration standard of 28 days the practice is that the registration of an Australian resident entity is generally achieved within 48 hours. [CPA]

6.1.26 The proof of identity requirements include the need for one or more directors to provide identification documents and for these to be appropriately certified and translated. One of the certified identification documents for an overseas non-Australian director must be an overseas birth certificate or passport. Certification must be by an Australian embassy or consulate or by an authorised person under the Hague Apostille Convention (where the document is issued by a country that is a signatory to the Convention). According to submissions:

- it is impractical for directors to obtain certification where there is not an Australian embassy or consulate within reasonable distance. Not all countries (for example Canada) are signatories of the Hague Apostille Convention;
- some directors are unable to hand over their passport for what may be a substantial period of time for it to be certified by the nearest certifying authority; and
- some high-profile directors are uncomfortable disclosing their residential addresses for security reasons.

6.1.27 One submission put it as follows:

The question must be asked: how many Australian businesses would register for GST if there was a requirement that each director present his passport and drivers licence for certification in Canberra? It is submitted that most Australian businesses would be deterred by this requirement and yet the equivalent of this is being required of non-resident companies. [EasyGSTRefunds]

6.1.28 The Australian requirement for non-resident companies to provide certified identification for a resident Australian public officer was criticised in submissions.

6.1.29 Submissions suggested it was inappropriate and difficult to require a company to have an Australian public officer when the company merely purchases goods and services from Australia but has no business presence in Australia or only earns income from property in Australia. While some submissions acknowledged that a public officer was necessary for income tax purposes, in certain circumstances, they argued it was not required for GST purposes for companies whose sole connection with Australia was merely the overseas purchase of Australian goods and services. Some submissions questioned whether there was any legal basis for such a requirement in these cases.

6.1.30 Submissions recognised the procedures need to be balanced to avoid registration for fraudulent reasons, and where the non-residents do not carry on an enterprise.

6.1.31 The GST law requires many non-resident entities to register for GST because they are making taxable supplies or acquiring taxable supplies in carrying on their enterprise, or both. Submissions suggested that given the breadth of the GST law's inclusion of non-residents, the registration procedures should be simplified:

Although we understand the need for the ATO to balance compliance difficulties with the integrity of the system, it is unacceptable to have a system which on one hand actively brings non-resident entities into its net but on the other makes it very difficult and time consuming to have those entities registered. Such a system can materially impact the ability to undertake and complete cross-border transactions as well as discourage compliance with the law as currently interpreted by the ATO. [CTA]

Non-resident agency provisions

6.1.32 One submission regarded the non-resident agency provisions, despite being a revenue protection mechanism, as a means of reducing compliance costs of non-residents. However, the non-resident agency provisions are limited:

Non-residents object to appointing an agent in Australia, since it can increase the risk that the non-resident has a permanent establishment in Australia for income tax. [IFSA]

6.1.33 Several submissions suggested the GST law should allow an Australian entity to be appointed as a representative of a non-resident to take on the GST obligations of the non-resident. One submission recommended a part-solution:

... the Institute recommends that measures be implemented to enable non-residents with no physical establishment in Australia be able to appoint resident Australian entities to account for their tax obligations in their absence In some countries, a fiscal representative must be appointed by any entity that has tax obligations in the jurisdiction but does not have an establishment in the jurisdiction. Once appointed by a person, the fiscal representative takes responsibility for meeting the tax obligations of the non-resident appointing entity. [ICAA]

6.1.34 Other issues concerned the inflexibility of the agency provisions for resident agents who only make acquisitions on behalf of a non-resident. In these instances, the resident agent is only entitled to claim the GST for the non-resident where the non-resident is registered or required to be registered. If the non-resident chooses to register, the non-resident or their resident agent becomes liable for GST on small transactions the non-resident makes that are connected with Australia.

6.1.35 The other compliance issue raised with the non-resident agency provision is that even when the non-resident makes all its supplies and acquisitions through a resident agent, it must still go through the process of registering for GST. In these instances, the resident agent and not the non-resident is responsible for all the GST obligations of the non-resident.

In our view, a non-resident that makes all their supplies and acquisitions through a resident agent should not be required to register for GST. Such GST registration imposes an additional compliance burden on non-residents doing business in Australia for no apparent benefit. [Greenwoods & Freehills]

Refunds to non-resident businesses

6.1.36 There is no direct refund system available to non-resident entities other than through registration or, to a limited extent, the Tourist Refund Scheme:

In our view, a foreign business's entitlement to a refund of Australian GST is an important feature of our GST system However, the mechanism through which foreign businesses can access refunds of Australian GST could be considerably improved if the GST law provided a refund process that resides outside the GST registration process for foreign businesses that are not required to register. [PWC]

6.1.37 Submissions also mentioned that when a non-resident entity registers for GST to claim back GST on taxable supplies made to them, any small supplies made by the non-resident that are connected with Australia will become taxable even when the non-resident would not otherwise have met the registration threshold.

6.1.38 Submissions also raised a concern about the circumstances where no entity is entitled to claim back the GST on a taxable importation. They noted that this can occur when a non-resident with no presence in Australia engages an Australian business as a subcontractor to undertake the local delivery and installation of goods.

6.1.39 It was recommended that the agency provisions in the GST Act should be broad enough that Australian businesses can, in the above circumstances, claim the GST on the creditable importation.

Small businesses accessing the GST deferral scheme

6.1.40 One submission suggested the GST deferral scheme should be more flexible for small businesses. In particular, small businesses should be able to access the cash flow benefits of the GST deferral scheme without incurring the additional compliance costs of lodging monthly rather than quarterly returns.

Export of goods to External Territories³⁶

6.1.41 The issue of residents of External Territories being subject to GST for supplies of goods that are in fact GST-free under the GST law was raised during the consultation period. External Territories are outside of the jurisdiction of the GST. However, since the GST's commencement, residents of External Territories have raised the issue that mainland suppliers on whom they rely do not have mechanisms to allow GST-free sales to residents who ship goods to their External Territory home.

6.1.42 In order for a mainland supplier to treat exported goods as GST-free it needs to be satisfied that the goods were exported. Mainland suppliers may be reluctant to incur this administrative expense.

ABN registration for non-residents

6.1.43 Through public consultations, a concern was raised about whether it was appropriate for a non-resident entity to be denied an ABN when it is registered for GST.

FINDINGS

6.1.44 The Board was surprised by the large number of submissions that raised concerns about the interaction of non-residents with the GST law.

³⁶ External Territory is defined in sub-section 17(pd) of the *Acts Interpretation Act 1901*. It provides that External Territory means a Territory, not being an internal Territory, for the government of which as a Territory provision is made by any Act.

Breadth of Australia's GST Law

6.1.45 The question of whether Australia's GST brings too many non-residents into the GST system goes to the scope and extent to which goods and services are subject to the GST. Many of the possible solutions put forward in submissions involved certain supplies made by or to non-residents no longer being treated as a taxable supply. Changes to the scope and extent of what goods and services are subject to GST are out of scope of this review.

6.1.46 However, the Board considers this is a clear area where there are high compliance costs as well as poor compliance. The GST consequences of international transactions can be complex, particularly for global service contracts. Australia's GST draws in non-residents that play a part in global services agreements where other jurisdictions generally do not. The current law does not appear to be working well.

6.1.47 Other jurisdictions have a variety of approaches to limiting the number of non-residents in their system through, for example, more extensive reverse charge provisions and ignoring many business-to-business transactions.

6.1.48 Whether Australia's approach is appropriate cannot be fully explored within the terms of reference of this review.

6.1.49 However, given the number of submissions that raised issues concerning the compliance costs associated with cross-border transactions, the Board considers that this issue needs to be considered further.

Recommendation 26: Non-residents in Australia's GST system

The Government should consider reviewing the application of the GST to cross-border transactions with a view to simplifying and reducing the number of non-residents in the system.

Registration procedures for non-residents

6.1.50 The Tax Office, in conjunction with the National Tax Liaison Group GST Sub-committee³⁷, sought to streamline the procedures for registration of non-residents. Changes were made in early 2008, including:

- a decrease in the number of directors required to establish proof of identity and an increase from one to two in the number of documents required; and

37 The NTLG GST Sub-committee is a sub-committee of the Tax Office's National Tax Liaison Group which deals with matters that are priorities to the Tax Office and professional associations that relate to: technical issues, compliance, compliance costs and administration issues that relate to GST, luxury car tax and wine equalisation tax.

- an increase in the number of people who can certify a document as a true copy.

6.1.51 However, the Board considers that, in some circumstances, the evidence requirements for registration are still onerous for non-resident entities to meet. These circumstances may include some where the risk to revenue is low. The registration procedure may discourage, inappropriately, some non-resident entities from registering. If registration has not occurred, a non-resident entity carrying on an enterprise cannot claim input tax credits for acquisitions of goods and services from Australia, where those acquisitions are not GST-free. This will result in embedded tax on a business acquisition, contrary to the principles of a GST. This may reduce the likelihood of non-residents sourcing business inputs from Australia. Also, delays in registration mean the ability of non-residents to fully comply with the GST is limited as registration is needed to lodge a BAS.

6.1.52 The Board acknowledges that there are integrity concerns in relation to the registration process, particularly where non-residents are concerned. It is difficult for the Tax Office to exercise an appropriate level of scrutiny over those carrying on enterprises outside Australia compared to those within Australia. This would increase the risks to revenue that fraudulent or unjustified GST refunds will be paid to non-residents compared with residents. Hence, the Board recognises that it is important to be satisfied of the existence of non-resident entities, the identity of their directors and the carrying-on of an enterprise. The Board understands that reducing the registration requirements for non-residents could result in them having lower requirements than residents.

6.1.53 Further, the Board acknowledges that this area concerns the administrative practice of the Commissioner, and hence cannot be fully reviewed within the terms of reference of this review. Nevertheless, since registration is the main means by which entities can gain relief from GST on enterprise acquisitions that are not GST-free, the Board considers that the balance between ease of registration and integrity should be re-examined for certain non-residents. The Board recommends the Tax Office consider further streamlining of registration procedures for non-residents where the risk to revenue appears low.

6.1.54 The Board considers that further streamlining of the registration of non-residents should be considered in the following situations:

- entities joining Australian registered groups, where the representative member is an Australian publicly listed company. However, appropriate identity checks would be required when the entity leaves the group for it to remain registered;
- companies or their subsidiaries listed on a recognised overseas stock exchange ;

- entities that are from countries that have an exchange of information agreement with Australia that covers indirect tax laws, and the revenue body covered by the agreement is able to verify the existence of the entity and that it carries on an enterprise; and
- entities that are from a comparable taxing regime and the relevant revenue authority is able to verify the existence of the entity and that it carries on an enterprise.

Recommendation 27: Registration for non-residents

The Commissioner should consider further streamlining the proof of identity and proof of enterprise requirements for non-residents in the four circumstances in which the Board has identified that the risk to revenue is low.

Non-resident agency provisions

6.1.55 The Board is of the view that the GST agency provisions could be better utilised to reduce the number of non-residents that are drawn into the GST system.

6.1.56 Currently, the non-resident agency provisions are compulsory rather than voluntary and only apply in quite narrow circumstances. The provisions only apply where a non-resident makes supplies, acquisitions or importations through a resident agent and that agent has the authority to create relationships which legally bind the non-resident with third parties.

6.1.57 Non-residents generally do not want to have a resident agent in the context of the current non-resident agency provisions for fear of being seen as having an income tax permanent establishment. However, the structure of the agency provisions in transferring the GST obligations of a non-resident to a taxable presence in Australia is both appealing to non-residents in terms of reduced compliance costs and can be more efficient for tax collection as there is a responsible entity within Australia.

6.1.58 The Board considers that non-resident agency provisions should be broadened to allow an entity, who acts for a non-resident but falls short of being an agent under the current provisions, to apply the features of the provisions. This recommendation would allow a commission agent or a subcontractor who does things on behalf of the non-resident to be responsible for the GST obligations of the non-resident's supplies, acquisitions and importations. The non-resident and the resident entity would both have to agree for the provision to apply.

6.1.59 Consideration would need to be given to the operation of the non-resident agency provisions if a non-resident has two or more Australian resident entities acting for them.

6.1.60 This recommendation would require appropriate integrity measures and these may include:

- the resident entity agreeing to take responsibility for acquisitions, supplies, importations and adjustments of the non-resident even when those supplies are not made through the entity. Input tax credits will not be available to an entity that merely facilitates an importation;
- a surety where appropriate to reduce the risk that there is an uncollectible GST debt; and
- the representative lodging a separate BAS for each non-resident that they have volunteered to act for.

6.1.61 The expansion of the GST agency provisions would reduce the number of non-residents that need to account for GST and allow the Tax Office to gain compliance from an entity that is within Australia's jurisdiction.

6.1.62 Entities that carry out many aspects of the non-resident's supply in Australia but are not common law agents, could by agreement with the non-resident take on the GST responsibilities of the non-resident. This may suit subsidiaries of a non-resident that act in a sub-contracting role or representative entities that have a strong relationship with the non-resident.

6.1.63 Currently, the non-resident agency provisions only apply to common law agents. The expanded agency provision would not of itself mean that the non-resident has a permanent establishment. Hence, with this recommendation, the benefits of the non-resident agency provisions can be accessed without the non-resident's fear of having a permanent establishment for income tax purposes and the consequential income tax implications that arise.

6.1.64 However, some of the integrity measures under this recommendation will have compliance costs. For compliance monitoring, representative entities that fall short of being an agent under the current provisions, would need to lodge a separate BAS for each non-resident that it acts for. Currently, under the non-resident agency provisions, the resident agent includes the non-resident's supplies and acquisitions in its own BAS.

Recommendation 28: Non-resident agency provisions

A resident entity which acts for a non-resident but falls short of being an agent under the current provisions should be able to apply the features of the GST non-resident agency provisions. This may include a commission agent or a sub-contractor who does things on behalf of the non-resident. The non-resident and the resident entity would both have to agree.

6.1.65 The Board also considers that where all the obligations of a non-resident have been transferred to an agent (as per the current provisions) or a representative entity (under the above proposal), it should be unnecessary for the non-resident to register for GST.

6.1.66 The Board recommends that non-residents who are not accountable for their taxable supplies, acquisitions or importations because of the current or expanded agency provisions should no longer have to register for GST.

6.1.67 The non-resident would still need to be regarded as being *registered* or *required to be registered* for all purposes of the GST Act, if it has an agent or representative who is responsible for its GST obligations.

6.1.68 For those resident agents that are currently subject to the non-resident agency provisions, the only change is that the non-resident need not register if the only supplies and acquisitions the non-resident makes are made through the resident agent. While they should not need to register, their non-registration should not affect whether their supplies are taxable or acquisitions are creditable. This would remove the compliance cost of registration, without affecting whether their suppliers and acquisitions are within the GST system. These agents only have to lodge a single BAS that includes their own GST obligations and that of their non resident principal.

Recommendation 29: Non-residents that need to register

Non-residents that do not account for their taxable supplies or importations and their creditable acquisitions or importations because of the current or expanded agency provisions, should no longer have to register for GST.

Refunds to non-resident businesses

6.1.69 Introducing a direct refund system would require integrity checks on every application, whereas currently the registration process forms the main part of the integrity check.

6.1.70 The Board considers the current mechanism of entities needing to register for GST to claim their refund is generally the most appropriate outcome.

6.1.71 The circumstance where no entity is entitled to claim back the GST on the importation, described in the following example, is considered by the Board to be an inappropriate outcome.

Example — where no entity is entitled to the GST on a taxable importation

A non-resident enters into a contract to supply and install equipment to an Australian customer on a delivered duty paid basis.

The non-resident has no presence in Australia and therefore engages an Australian business to fulfil the local obligations of delivery and installation.

The Australian business enters the goods for home consumption (either personally or through a customs agent or a forwarding agent). It then delivers the equipment to the Australian customer and installs the goods at the premises of that customer. The Australian business is a sub-contractor of the non-resident and not an agent.

The Australian business is required to pay the GST on the importation of the equipment because it was the entity that entered the goods for home consumption. However, it is not entitled to claim an input tax credit because it did not cause the goods to be brought to Australia for its own purposes. Furthermore, even if the non-resident reimburses the Australian business for the GST paid at the time of importation, it is not entitled to an input tax credit, because it is not the entity that entered the goods for home consumption and incurred the legal liability to pay GST on the taxable importation.

6.1.72 However, the Board considers that the Australian business in the above example should only be entitled to claim back the GST on importation when it is the responsible entity in the subsequent taxable supply made by the non-resident.

6.1.73 In the above example, the non-resident is making a taxable supply because the non-resident assembles the goods in Australia (through its sub-contractor). The broadening of the non-resident agency provisions (refer recommendation above) should be broad enough to allow the Australian business in this example to claim back the GST on importation on the condition that it takes on the GST obligations of the non-resident.

6.1.74 The Board considers that in a value added tax system such as Australia's GST, the appropriate entity that should be entitled to the creditable importation is either the entity that is responsible for the GST on the subsequent taxable supply, or the recipient, not the facilitator.

Small businesses accessing the GST deferral scheme

6.1.75 The Board notes that the GST deferral scheme is currently only available to monthly remitters. The compliance costs of lodging 12 activity statements, instead of

only four, considerably lessen the attractiveness for small businesses of accessing the GST deferral scheme.

6.1.76 The Government should consider allowing the GST deferral scheme to be extended so that small business taxpayers who want to lodge quarterly can access the scheme. However, this should only extend to small business taxpayers and would not include all entities that are eligible to lodge quarterly. All other requirements of the GST deferral scheme would need to be satisfied, including lodging on-line, paying electronically and having an established track record and good compliance history.

6.1.77 It is expected there would be a reduction in compliance costs for small businesses which currently use the GST deferral scheme as they will now only need to lodge four instead of twelve activity statements. Under the proposal, small business taxpayers who currently use the GST deferral scheme and are lodging monthly are likely to elect to lodge quarterly. It will also encourage other small businesses to use the GST deferral scheme.

6.1.78 The GST deferral scheme currently has integrity measures such as only allowing entities with a good compliance history and also some entities that have been previously revoked to provide a bank guarantee. This proposal will result in a longer period before the GST on a taxable importation and any corresponding creditable importation are reconciled. Accordingly, consideration may need to be given to whether the current integrity measures should be tightened further.

Recommendation 30: GST deferral scheme

The GST deferral scheme should be extended to small business taxpayers which are eligible to lodge quarterly.

All other requirements of the GST deferral scheme would need to be satisfied, including lodging on-line, paying electronically, and having an established track record and good compliance history.

Export of goods to External Territories

6.1.79 Mainland suppliers of goods to External Territories have no incentive to treat supplies as GST-free where the purchaser exports the goods themselves.

6.1.80 When a mainland supplier gives possession of goods to an External Territory resident while the resident is on the mainland, the supplier cannot initially verify that the goods are going to be exported within 60 days. Therefore, initially the supplier is unwilling to supply the goods GST-free. However, if the purchaser goes back to the mainland supplier with the appropriate shipping documents or other paperwork verifying the export, the supplier is then able to adjust how the original supply was

treated. The supplier can refund the GST to the purchaser and then seek a refund of the GST on its next BAS if the relevant transaction has already been accounted for.

6.1.81 However, this is a considerable administrative burden imposed on the supplier. An alternative is to allow GST on these purchases to be refunded under the Tourist Refund Scheme. The Tourist Refund Scheme is currently restricted to situations in which goods are exported from Australia by departing passengers as accompanied baggage. This would expand it for residents of External Territories so that they need only show proof of export.

Recommendation 31: Refund collection system

A system should be introduced under which residents of Australia's External Territories (Norfolk, Cocos & Keeling, and Christmas Islands) can claim refunds under the Tourist Refund Scheme if they can show proof of shipping of exported goods to their External Territory.

ABN registration for non-residents

6.1.82 Where an entity is entitled to GST registration, but not entitled to an ABN, it will be provided with a GST registration number, rather than an ABN, to assist it in meeting its GST obligations.

6.1.83 The issue of a GST registration number as opposed to an ABN can lead to confusion as both registration numbers contain eleven digits.

6.1.84 The GST registration number will not be shown on the Australian Business Register (ABR). Some supplies that are made to a non-resident can be GST-free where the non-resident is not registered or required to be registered. As the non-resident does not have an ABN, it is not possible to check if it is registered for GST.

6.1.85 An ABN can only be issued to a non-resident once it is making supplies that are connected with Australia. Subsequent to GST registration, a non-resident entity may start making taxable supplies and therefore may need to issue tax invoices. This causes a practical problem because until the non-resident applies for and receives an ABN, it will not be able to issue a valid tax invoice. Alternatively, if the non-resident issues a tax invoice listing the GST registration number, which looks like an ABN, the recipient of the supply will not necessarily know that the number is not an ABN.

6.1.86 The practical linkage between GST registration and an ABN in terms of lodging a BAS and the issuing of tax invoices suggests greater symmetry between GST registration and the ABN registration is desirable.

6.1.87 However, a potential solution to allow a non-resident that is entitled to GST registration to automatically qualify for an ABN, would require an amendment to the

ABN legislation. ABN registration has a different purpose to GST registration. ABN registration is recorded on the ABR and facilitates dealings of Australian businesses with Government and with other entities. Non-residents entitled to GST registration but not to an ABN are not an Australian business, and therefore, under the existing policy, should not be entitled to an ABN.

6.1.88 The Board considers this issue is out of scope of the terms of reference for the review because any change would require a change in policy in relation to the ABN legislation. The Board however suggests that this issue be given further consideration by the Government.

CHAPTER 7: ENTITIES

CHAPTER 7.1: GROUPING AND JOINT VENTURES

EXISTING LAW AND PRACTICE

Grouping

7.1.1 Entities which meet certain common ownership and other requirements are able to form a GST group. Transactions between group members are then ignored for GST purposes and transactions of group members outside the group are accounted for by one representative member. The group is effectively treated as a single entity for certain purposes.

7.1.2 The current membership requirements can be complex in application, sometimes making it difficult to determine whether the requirements are met.

Trusts

7.1.3 The membership requirements in the GST Regulations take into account that group structures can involve chains of trusts, or chains with combinations of trusts and companies, ending with the final beneficiary. However, the GST Regulations do not take account of the fact that trusts or companies in the middle of the chain may not be carrying on an enterprise.

Redeemable preference shares

7.1.4 Currently, companies financing their business through redeemable preference shares cannot be members of a GST group.

7.1.5 An issue of redeemable preference shares impacts on the calculation of a company's ownership of another company for GST purposes, particularly the membership requirements for GST groups. Where an issue of redeemable preference shares reduces one company's stake in another company to less than 90 per cent, the membership requirements of a GST group are compromised.

Stapled entities

7.1.6 Stapled entities may not meet the ownership requirements, which means they cannot be part of a GST group.

Timing of formation, alteration or revocation

7.1.7 Currently, entities can only form, alter, or revoke a GST group from the beginning of a tax period (the first day rule), with the exception of entities that pay GST by instalments or report and pay GST annually.

7.1.8 The first day rule means that if a company merger or acquisition occurs during a tax period, the group has to unwind the accounting for transactions treated under the grouping rules back to the start of the tax period, account separately for that tax period, and form a new group.

7.1.9 Similar issues arise with forming and revoking GST groups. That is, if a commercial group forms part way through a tax period, the entities are required to account for GST separately until the start of the next tax period, when a GST group can be formed. For revoking GST groups, the same issue arises, but in reverse. If a commercial group dissolves or changes part way through a tax period, the GST group is revoked at the end of the previous tax period and then each entity has to account for GST separately, meaning that the accounting for GST transactions has to be unwound back to the start of the tax period in which the commercial group is dissolved or changes.

Joint ventures

7.1.10 The optional GST joint venture provisions apply where a joint venture operator makes supplies or acquisitions on behalf of other participants of the joint venture. Rather than requiring each participant to account for GST or input tax credit on their share of the supply or acquisition, the joint venture operator has the entire GST liability and input tax credit entitlements.

7.1.11 As it is the GST joint venture operator that is liable to the entire GST on a supply or entitled to the entire input tax credits on an acquisition it makes on behalf of the other members, any GST refunds arising from those supplies and acquisitions are required to be offset against the GST joint venture operator's other liabilities.

7.1.12 Currently entities can only form, revoke or alter GST joint ventures from the beginning of a tax period.

Applying to the Commissioner for approval

7.1.13 Forming, altering or revoking GST joint ventures has to be done with the approval of the Commissioner, requiring entities to apply to the Commissioner and wait for the Commissioner's decision about whether they meet the requirements set out in the legislation.

Joint and several liability

7.1.14 Each participant in the GST joint venture is jointly and severally liable to pay the GST payable by the joint venture operator.

Religious groups

7.1.15 Certain religious organisations can form a GST religious group with the effect that intra-group transactions are ignored for GST purposes, but the members all lodge separate GST returns. The prerequisites to join such groups are not as strict as the general GST grouping rules recognising the unique size and number of small religious organisations.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

7.1.16 Concerns with the rules governing GST groups were raised at most of the consultation sessions which the Board held during August 2008. At a few sessions, concerns were also raised about GST joint venture rules. In addition, a number of submissions highlighted problems that arise from the application of the GST law to GST groups and GST joint ventures.

GST grouping membership rules

7.1.17 A number of stakeholders claimed that GST grouping membership requirements are complex, inflexible and difficult to apply. They argued that this creates uncertainty, imposes compliance costs on entities and discourages entities from grouping. Some stakeholders were also concerned that the membership rules are too narrow and prevent certain entities that have common ownership and control from grouping for GST purposes.

7.1.18 Stakeholders suggested a range of improvements to the GST grouping rules.

7.1.19 A number of stakeholders suggested clarifying and simplifying the GST grouping rules.

The provisions of the Act and Regulations that prescribe the rules for grouping of trusts and partnerships are extremely difficult and complex to understand. ... The law around grouping of trusts and partnerships for Division 48 need to be redrafted so that:

- It is more plainly worded, and is found in one place

- Each type of entity is treated separately, so there is no overlap in definitions. [ABA]

7.1.20 Stakeholders suggested broadening the membership rules to allow various types of entities to be able to form, or be a part of, a GST group. In particular, some

stakeholders suggested amending the GST law to allow stapled entities, interposed entities used for distribution of benefits, and holding companies which do not carry on an enterprise, to be a part of a GST group. A few stakeholders also suggested that entities forming a consolidation group for income tax purposes should be able to form a GST group with members of the same consolidation group, and that the Commissioner should be given a discretionary power to allow entities to form a GST group in certain situations. Also, a few stakeholders suggested extending the grouping treatment of religious groups to government and other non-profit organisations, and extending the scope of joint venture activities for which entities can form a GST joint venture.

The ability of a trust to form a GST group with another trust or a company is restricted where one of the beneficiaries of the trust is either a company or a trust ('interposed entity') that will not be a member of the GST group, and distributions have been made, or will be made to that interposed entity. [TIA]

... they [the rules for forming a GST group] are also too inflexible to allow economic groups such as stapled entities to form a GST group. [Greenwoods & Freehills]

Where an entity is part of a consolidated group for income tax that entity should be able to form a GST group with members of the same consolidated group ... The Commissioner should have discretion to approve GST groups where a group of entities do not satisfy the membership requirements but have a degree of control and economic association such that it is appropriate under GST policy and economic reality to group the entities for GST purposes. [ICAA]

It is a curious outcome that companies can group for GST purposes on the basis of shares being held by the a common entity (such as a holding company), yet the company holding the shares may not be a member of the GST group because it cannot register for GST purposes. ... We recommend that the GST law be amended to allow a company that has at least a 90 per cent stake in another company that is registered for GST purposes, to be entitled to register for the purposes of being a member of a GST group, even if it may not be conducting an enterprise. [PWC]

7.1.21 It was suggested that the 90 per cent ownership threshold be reduced to 51 per cent. It was claimed that this would significantly reduce administrative difficulties and costs of running the business as one enterprise in the case of associated companies with significant business interests but which are below the current 90 per cent threshold.

Process and consequences of grouping

7.1.22 A number of stakeholders were concerned about the administrative processes and some consequences of grouping. Concerns raised included the process of registration of GST groups, the inability of mid-tax period grouping and de-grouping and the lack of clean exit rules for joint and several liability for entities leaving a GST

group. Stakeholders claimed that these impose unnecessary compliance costs and tax risks on entities, do not take into account commercial realities, and discourage entities from forming GST groups.

7.1.23 Stakeholders suggested a range of improvements to the processes and minimising some negative consequences of grouping.

7.1.24 A few stakeholders suggested allowing simultaneous registration for GST and grouping.

Section 48-5(1)(b) requires that an entity must be registered before it can join a GST group. The ATO's practice in this regard does not permit simultaneous registration and grouping (ie. it does not permit you to become part of a GST group as part of the registration process of an entity). This process is problematic as taxpayers must wait for the GST registration to be approved before it may apply for grouping. [CTA]

7.1.25 Stakeholders also suggested forming, altering and revoking a GST group at any point during a tax period rather than only at the beginning. It was argued that intra-tax period grouping and de-grouping should also be allowed for GST joint ventures. Some stakeholders also suggested that all applications for registration, grouping and de-grouping, should be automatically approved by the Tax Office or self assessed and that this should be done on an electronic basis.

Expand ability to enter or leave a GST group so that any eligible entity can join or leave a GST group at any time. ... The inability to add members to a GST group during a tax period has resulted in additional compliance for taxpayers and also create an unnecessary and inappropriate risk that supplies between the new entity and other members of the GST group could be taxable. [PCA]

At a practical level, all applications for registration and grouping (or de-grouping) should be automatically approved by the ATO rather than being subject to a specific approval process. Taxpayers should have access to a complete electronic commerce interface with the ATO that allows for all registrations, deregistrations and grouping applications to be completed and lodged through a central portal. [Australand Holdings Limited]

7.1.26 Some stakeholders suggested that joint and several liabilities of GST group members should be able to be limited by the use of a tax sharing agreement similar to that applying in the income tax system.

There is a need to overcome current commercial practices that do not permit GST grouping (for example due to views expressed by rating agencies and/or investors) and align the GST rules with income tax, where joint and several liability is able to be restricted by the operation of a tax sharing agreement (that is a concept not available in the GST context). [IFSA]

FINDINGS

GST grouping membership rules

7.1.27 The Board agrees that the GST grouping membership rules are overly complex, difficult to apply, and in some instances do not allow membership of all the entities with commonality of ownership and control to form a group.

7.1.28 The Board was advised by the Treasury that it had previously given consideration to simplifying the grouping rules through a principle-based approach. The Board supports legislative amendments to the GST group membership rules, along the lines of the principle-based rules developed by the Treasury.

- *Principle 1 (the 90 per cent owned group model)* – Companies, partnerships or trusts can group where they are part of a 90 per cent owned group.
 - Carve out from the principle – A non-fixed trust cannot be a subsidiary member of a 90 per cent owned group if any of the recipients of distributions are not members of the GST group, and a partnership cannot be a member of a group unless all of its partners are members of the group.
 - Add-on to the principle – Trusts can be a member of a 90 per cent owned group even if the trustee also makes distributions to a charitable institution, a trustee of a charitable fund, or a gift-deductible entity.
- *Principle 2 (the single family model)* – An individual and one or more family members, and companies, partnerships or trusts can group where the only individuals that hold interests in those entities are the individual or a family member of the individual.
 - Add-on to the principle – Trusts can be a member of a family group even if the trustee of a trust also makes distributions to a charitable institution, a trustee of a charitable fund or a gift-deductible entity.
- *Principle 3 (the multiple family model)* – Companies, partnerships or trusts can group, where they are wholly owned by the same individuals or family members of those individuals.
 - Add on to the principle – A trust can be a member of a multiple family group even if the trustee also makes distributions to a charitable institution, a trustee of a charitable fund, or a gift-deductible entity.

- *Principle 4 (the non-profit model)* – Non-profit bodies can group where they are members of the same non-profit association.

7.1.29 The Board considers that the above principle-based GST group membership rules would enable greater consistency of definitions in the GST grouping provisions, improve the clarity of membership rules and make it easier to determine if the grouping membership requirements are met. They would also broaden the eligibility of entities to group, by allowing stapled and interposed entities that are a part of a group of entities to group with these entities in a GST group under principle 3. The principle-based rules would generally also allow income tax consolidated entities to group.

7.1.30 The Board recognises that the GST grouping rules do not reflect the reality that a holding company – even though it does not carry on an enterprise – is a part of one economic entity. The Board notes that New Zealand amended its GST law in 2006 to allow holding companies to be members of GST groups despite being unregistered for GST purposes, subject to certain conditions.³⁸

7.1.31 The Board, however, notes that one of the principles of the GST system is that only entities carrying on an enterprise can register for GST purposes and claim input tax credits for GST paid on creditable acquisitions. Allowing holding companies that do not carry on an enterprise to group departs from the principle that only entities carrying on an enterprise can register for GST purposes. The Board notes that the enterprise test in the GST law is very broad and holding companies do not have to carry on significant activities to be entitled to register for GST purposes.

7.1.32 The Board recommends that the Government allows holding companies that do not carry on an enterprise to be entitled to register for GST for the purpose of joining a GST group. The Board also considers that once such holding companies leave the GST group, they should not be entitled to continue to be registered for GST purposes unless they are carrying on an enterprise. While such an approach departs from the principle that only entities carrying on an enterprise can register for GST purposes and claim input tax credits, effectively it treats the operation of the group as a whole, recognising that holding companies are also involved in carrying on the enterprise of the group.

7.1.33 The Board does not support reducing the 90 per cent ownership requirement to join a GST group as this would be inconsistent with the existing policy intent of the grouping provisions. The Board also considers that providing the Commissioner with a discretion to approve GST groups in certain circumstances would add to uncertainty and lead to inconsistent outcomes, and is therefore not supported.

38 Under the New Zealand GST law, companies that are not registered for GST are able to join a group registration of companies if the total value of taxable supplies made by the companies, in any 12-month period, to persons outside the group, is at least 75 per cent of the total value of supplies made by the group to other taxpayers.

7.1.34 The Board does not support extending the grouping treatment of religious groups to government and other non-profit organisations. The Board notes that government entities can form a GST group with other government-related entities and non-profit sub-entities can form a GST group. The Board also notes that the GST law currently specifies a large variety of purposes for which entities can form a GST joint venture and thus the Board does not consider there is a need for extending the scope of joint venture activities further.

Process and consequences of grouping

7.1.35 The Board considers that the time taken to be notified by the Commissioner of the approval to group can be lengthy and can result in uncertainty and add to compliance costs prior to approval being given to a group. The Board also agrees that allowing self assessment of eligibility to form or revoke a new GST group would speed up the process. However, the Board also recognises that there are a number of issues that may require further consideration, including a process of dealing with entities that incorrectly self assessed that they have formed a GST group.

7.1.36 The Board considers that taxpayers should be entitled to self assess their eligibility to form a new GST group and revoke an existing GST group by notifying the Commissioner. The Board considers that self assessment should also be extended to forming and revoking GST joint ventures. As far as possible, on-line notification should be provided as an option.

7.1.37 The Board also agrees that allowing formation, alteration and revocation of a GST group only at the beginning of the tax period may delay commercial transactions and increase compliance costs.

7.1.38 The Board therefore supports allowing intra-tax period formation, alteration and revocation of GST groups and GST joint ventures. The proposed reforms would reduce compliance costs and uncertainty, and provide additional flexibility to entities in conducting their businesses.

7.1.39 Finally, the Board accepts stakeholders' concerns that the lack of GST clean exit rules means that an entity may be liable for GST even after it leaves a group, thus leading to uncertainty, increasing compliance costs, potentially negatively impacting on companies' credit ratings, and creating a disincentive for entities to join or form GST groups. The Board notes that entities forming a consolidated group under the income tax law may protect themselves from joint and several liability by entering into tax sharing agreements.

7.1.40 The Board considers that members of a GST group (and GST joint venture) should be entitled to enter into tax sharing arrangements so that members can leave a GST group (or GST joint venture) clear of any GST exposure, subject to safeguards (similar to those for income tax consolidated groups). This could potentially reduce

compliance costs, increase certainty and would be consistent with income tax arrangements.

7.1.41 Finally, the Board notes that consideration will need to be given to the impact of its recommendations on the fuel tax credits legislation, which is linked to the GST grouping and joint venture provisions.

Recommendation 32: Grouping and joint ventures

GST grouping membership rules should be simplified and broadened by replacing the detailed rules with principle-based rules.

Holding companies should be entitled to register and group for GST purposes, despite not carrying on an enterprise. However, they should not be entitled to continue to be registered once they leave the group, unless at that time they are carrying on an enterprise.

Entities should be able to self assess their eligibility to form a GST group and GST joint venture. Where possible, entities should have an option to do so electronically.

Entities should be able to form, alter or revoke a GST group at any time during a tax period, and such arrangements should be extended to GST joint ventures.

Clean exit rules should be introduced to allow entities to leave GST groups or GST joint ventures clear of any GST consequences.

The impact on fuel tax credits would need to be considered.

CHAPTER 7.2: GOING CONCERNS AND FARM LAND

EXISTING LAW AND PRACTICE

7.2.1 Supplies of going concerns (broadly, an operating business) are GST-free if certain conditions are met. Supplies of farm land are also GST-free if certain, different, conditions are met.

7.2.2 The going concern and farm land GST-free rules generally involve business-to-business transactions where, without the benefit of those provisions, and assuming that the supply would otherwise have been a taxable supply and acquired solely for a creditable purpose, the supplier would be liable to GST and the recipient would be entitled to an input tax credit.

7.2.3 Given the recipient of a supply of a going concern will usually be acquiring an operational business, or part of a business, it would be usual for them to be registered or required to be registered for GST. In the case of farm land, as the recipient of the supply of the farm land has to intend that a farming business be carried on, on the land for the supply to be GST-free, generally they will be carrying on an enterprise of farming (at least after they acquire the land) and will therefore generally be registered or required to be registered. Hence, in both cases, the recipient generally would be entitled to an input tax credit were these supplies are subject to GST.

7.2.4 These supplies are given a GST-free status so that the recipient of the supply does not need to finance, and hence bear financing costs for, the potentially large amount of GST that would otherwise be included in the price of the supply, only to later claim that amount as an input tax credit. For example, to acquire a \$10 million going concern, the purchaser would need to finance an additional \$1 million in GST for a total GST inclusive price of \$11 million. The purchaser would therefore bear the substantial finance cost of the GST until they can recover the GST as an input tax credit.

7.2.5 Unlike other GST-free supplies in the GST Act, the GST-free status is not given to provide an exemption from taxing final private consumption. Instead, it is intended to allow a GST exclusive price to be charged in a business-to-business transaction.

7.2.6 When the concessions apply, the normal liability to GST and entitlement to input tax credits do not arise. However, adjustment provisions are intended to make the recipient of the supply liable for an adjustment if they do not acquire the supply solely for a creditable purpose, or do not use the supply solely for a creditable purpose over the adjustment periods.

7.2.7 The intended effect of going concern and farm land adjustment provisions is to produce the same net effect as would arise had the supply been taxable and the recipient been entitled to claim a partial input tax credit. That is, if the recipient would not have been entitled to a full input tax credit, as they did not make the acquisition fully for a creditable purpose under the general rules, they were intended to have an increasing adjustment. In other words, although supplies of going concerns and farm land are GST-free if the relevant conditions are satisfied, the overall intention of the legislation is to reduce compliance costs while still producing the same outcome as if the normal rules had applied to those supplies.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

7.2.8 A number of submissions raised concerns about the complexity and anomalies that the present going concern and farm land provisions can give rise to.

The current requirements imposed under Division 38-J in respect of disposals of businesses (enterprises) as a GST-free going concern are, on occasion, overly burdensome. [Australand Holdings Ltd]

7.2.9 Some stakeholders noted that the going concern provisions are too narrow in their application. That is, the eligibility requirements for the GST-free concession are too strict for what is, more often than not, a transaction that does not result in any net GST revenue.

The aim of the concession "is clearly one of convenience" but this purpose is frustrated by the narrow manner in which it is defined. Consequently, anecdotal evidence suggests that some large businesses are reluctant to use the concession because it is too uncertain and excessively complex. [ICAA]

7.2.10 It was noted in various submissions that there are also deficiencies with the operation of going concern and farm land adjustment provisions which mean that the adjustments do not apply as intended. There can be, depending on the circumstances, over or under-payment of GST and, contrary to the reason for treating the supplies as GST-free, an increase in compliance costs in some circumstances.

...the scope of this provision is too wide and it interacts poorly with other provisions. For example, it is possible for the amount of a Division 135 increasing adjustment to be greater than the aggregate GST liability which would have arisen if the assets of the enterprise had been discretely sold as separate taxable supplies. [IFSA]

7.2.11 Suggestions were made that a better approach to the GST-free concession would be a reverse charge mechanism.

... a more appropriate and elegant mechanism is to adopt a "voluntary reverse charge" to the sale, rather than grant GST-free status and an input tax claw-back mechanisms.

Further, the Institute recommends that a reverse charge be available for supplies of substantial capital assets of a (or a substantial part of) business.’ [ICAA]

7.2.12 Alternative suggestions included that the GST-free going concern and farm land adjustment provisions be amended to overcome the deficiencies in their operation, or that the law be amended so that the GST-free concession is not available in certain circumstances.

An alternative approach would be to remove Division 135 and amend section 38-325 such that the provision is not available where the recipient acquires the assets of the enterprise other than for a creditable purpose. [PCA]

FINDINGS

7.2.13 The Board acknowledges the concerns that the GST-free going concern provision can be too narrow and uncertain in its application despite its intention to relieve a cash flow burden in what are generally business-to-business transactions. The Board notes stakeholder concerns that as a result of the uncertainty, complex contractual arrangements are necessary in order to address the risk of a subsequent finding that a transaction was not in fact eligible for the concession.

7.2.14 Treating transactions of going concerns as GST-free also means that the adjustment provisions do not always operate appropriately to ensure that the correct amount of GST has been paid.

7.2.15 The Board considers there is merit in the proposal that the concession be achieved through a reverse charge mechanism³⁹ rather than as a GST-free supply. The Board notes that New Zealand is currently considering such a proposal.

7.2.16 A reverse charge mechanism would provide the compliance cost savings achieved through reduced financing costs as is currently provided as a result of the supplies being GST-free. However, it would avoid the interactions with the adjustment provisions.

7.2.17 A reverse charge mechanism would shift the obligation to charge GST from the supplier to the recipient. It would require the recipient to be registered, to charge itself GST on the supply and then claim, if entitled to do so, the input tax credit in the same tax period. This would also provide greater certainty for entities involved.

7.2.18 The Board also notes views that a wider range of supplies of going concerns should benefit from the concession. For example, a business may be sold to more than

39 Under a reverse charge mechanism, the recipient of a supply is responsible for remitting GST on the supply that would otherwise be made by the supplier. The recipient is also entitled to claim input tax credits where it has made a creditable acquisition.

one recipient or a purchaser may not require all the assets of an existing enterprise as it may have similar assets of its own. Such transactions can be high value, business to business, yet the concession is not available.

7.2.19 Replacing the current GST-free treatment of going concerns and farm land supplied for farming with a reverse charge mechanism will allow a less strict definition of going concern to be applied. This is because integrity concerns about accessing the concession will be reduced.

7.2.20 The Board recommends that the reverse charge mechanism apply more broadly to supplies involving the sale of businesses. This would include situations in which incidental parts of a business are not sold, for example because the recipient already has the necessary business assets.

7.2.21 The Board notes that the rules relating to GST-free supplies of farm land supplied for farming do not require a recipient of farm land to be registered for GST. However, the Board notes that the current GST-free treatment can produce an anomalous result in that an unregistered recipient could bear less GST in the same circumstances as a registered recipient. A basic design feature of GST as a value-added tax is that, generally, with the exception of input taxed supplies, registered entities do not bear GST and unregistered entities do bear GST.

7.2.22 In particular, if a registered recipient acquires GST-free farm land with the intention that, on the land, a farming business be carried on, but proceeds to use the farm land for private purposes, an adjustment is intended to arise. The registered recipient will thus bear GST because input tax credits are only available to offset GST on business inputs. Where the farm land is used for private purposes, it is not an input to business and no relief from GST should be available.

7.2.23 In contrast, an unregistered recipient in the same situation will not bear GST, as an unregistered recipient will not have a tax period to which an adjustment can be attributed or a net amount to which to add the adjustment. This is despite the fact that it would not, as an unregistered entity, have been entitled to claim an input tax credit had the supply to it been taxable.

7.2.24 The replacement of the GST-free treatment of going concern and farm land supplied for farming with a reverse charge mechanism would mean that a supply of farm land from a registered entity to an unregistered recipient would attract GST. A reverse charge mechanism would only be available to registered entities.

7.2.25 The Government may wish to consider whether the current treatment of GST-free supplies of farm land supplied for farming to unregistered recipients should continue.

Recommendation 33: Reverse charge mechanism

The GST-free concessions for the supply of going concerns and farm land supplied for farming should be removed and replaced with a reverse charge mechanism. The reverse charge mechanism should also be available for a wider range of supplies of going concerns.

Recommendation 34: GST-free farm land supplied for farming

The Government should consider whether the GST-free treatment of farm land supplied for farming to unregistered recipients should continue.

CHAPTER 7.3: PARTNERSHIPS

PARTNERSHIPS

EXISTING LAW AND PRACTICE

General law partnerships

7.3.1 Under general law, a partnership is not an entity. The general law regards the business as being carried on by the persons who are in partnership. The term *partnership* is merely descriptive of the relationship between persons carrying on business with a view to profit.

7.3.2 However, the definition of *entity* under the GST law includes a *partnership* and *partnership* has the same meaning as that given by the income tax law, which includes an association of persons carrying on business as partners.⁴⁰ This means that a general law partnership is an entity for GST purposes.

7.3.3 As a consequence, the GST Act applies to partnership transactions in a manner that does not reflect the general law treatment of those transactions. Further, the GST law does not contain any specific rules to govern matters such as partner-to-partnership transactions or changes in the membership of a partnership.

Tax law partnerships

7.3.4 As the GST law provides that the term *partnership* has the same meaning as that given by the income tax law, a tax law partnership is also an entity for GST purposes.

7.3.5 Tax law partnerships are an association of persons in receipt of ordinary income or statutory income jointly.⁴¹ Tax law partnerships exist for tax purposes only and are not recognised under general law.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

7.3.6 Concerns with the GST treatment of partnerships were raised at a number of the consultation sessions which the Board held during August 2008. In addition, a

40 Section 995-1 of the *Income Tax Assessment Act 1997*.

41 Section 995-1 of the *Income Tax Assessment Act 1997*.

number of submissions highlighted problems that arise from the application of the GST law to partnerships.

7.3.7 Comments by stakeholders suggest that there are issues with both general law partnerships and tax law partnerships.

... it is difficult for taxpayers to accurately determine the GST compliance obligations arising out of partnerships [and] ... this creates undesirable and unacceptable levels of commercial uncertainty for taxpayers ... [ICAA]

General law partnerships

7.3.8 In the absence of many provisions in relation to general law partnerships, the Commissioner has been administering the law in an attempt to achieve a workable approach for taxpayers. However, there is doubt over some of the views expressed in the Commissioner's rulings concerning general law partnerships.

... detailed examination is necessary to ensure that:

- the principles adopted in the various GST rulings concerning partnerships are materially correct and in line with the common law principles on partnerships ... [ICAA]

... ATO views have resulted in inappropriate and inconsistent outcomes. For example, the view that a capital account represents a partner's legal interest in a partnership leads to the incorrect conclusion that this amounts to consideration for a distribution of a partnership asset to a partner. [ICAA]

7.3.9 Stakeholders raised concerns about how to treat supplies made to and by partnerships and how to determine the relevant entity that is making a supply.

The provisions of the GST Act that deem a relationship to be an entity in circumstances where there is no legal entity create confusion about the identification of the entity that is required to be registered for and account for GST. [CPA]

7.3.10 It was also noted that there can be difficulties distinguishing between general law partnerships and tax law partnerships.

The Institute notes that real uncertainties exist as to when a particular relationship between two or more parties constitutes a general law partnership or a tax law partnership. Furthermore, under the ATO rulings concerning partnership, the GST consequences of these two types of partnership differ significantly. [ICAA]

Tax law partnerships

7.3.11 A number of submissions raised concerns with the treatment of tax law partnerships as entities for GST purposes. It was noted that as they are not legal

persons, but instead are a relationship: this gives rise to various problems in applying the GST law to them as entities.

A Tax Law Partnership is an artificial concept. The inclusion of tax law partnerships as an entity raises a number of conceptual difficulties with the application of GST to tax law partnerships, the solutions to which are equally artificial. [IFSA]

Uncertainty and compliance costs

7.3.12 Some submissions noted that it can be difficult to determine whether a tax law partnership exists, who is making the supply, and whether special GST rules apply such as the margin scheme (see Chapter 4 on the margin scheme). There are also issues arising when a tax law partnership is formed or dissolved. Submissions suggested that this can create uncertainty, for example, whether the tax law partnership is entitled to input tax credits for acquisitions it makes in commencing its enterprise, even though at that stage, the co-owners may not yet have been in receipt of income jointly.

The GST Act does not operate clearly or effectively in deeming tax law partnerships to be an entity for GST purposes. The GST Act should ignore tax law partnerships and each co-owner should deal with its own GST payments and compliance. [TIA]

The practical difficulties include determining when something is supplied by the co-owner and when it is supplied by the tax law partnership. ... The answer determines who (if anyone) is liable for the GST, who can claim the credits and impacts on the analysis for special rules such as supplies of a going concern or margin scheme sales. [TIA]

FINDINGS

General law partnerships

7.3.13 There appears to be significant doubt amongst taxpayers about how the GST law applies to general law partnerships, including in relation to supplies between partner and partnership and changes in the constitution of a partnership. The Board recognises that this can lead to uncertainty and can give rise to potential litigation. The Board considers that clarification of the application of the GST law to general law partnerships would assist in providing certainty for such entities.

Recommendation 35: General law partnerships

The GST law should be amended to clarify the treatment of general law partnerships, including in relation to matters such as partner-to-partnership transactions or changes in the membership of a partnership.

Tax law partnerships

7.3.14 The Board recognises the considerable difficulties associated with the deeming of a tax law partnership to be an entity for GST purposes and recommends that the GST treatment of tax law partnerships be examined. In particular, consideration should be given to removing uncertainty about what happens for GST purposes when a tax law partnership commences, when a supply or acquisition is made by the tax law partnership or by a partner, and what the implications are for the dissolution of a tax law partnership.

7.3.15 The Board also considers that the application of the margin scheme to real property transactions by a tax law partnership and its partners is uncertain. This gives rise to increased compliance costs and can also result in inappropriate GST outcomes, including the inability to use the margin scheme or over taxation. As a consequence, the Board considers that the operation of the margin scheme in relation to tax law partnerships, and more generally, partnerships, should be examined as part of the recommended review of the margin scheme (see Chapter 4 on the margin scheme).

7.3.16 The Board notes some stakeholder calls for the removal of tax law partnerships as an entity for GST purposes. Submissions noted that this would significantly reduce compliance costs and address the practical difficulties associated with this area of the GST law. However, the Board considers that removing tax law partnerships from the GST system could create other compliance issues, such as requiring partners to determine their particular share of transactions undertaken jointly and to account for their share separately.

7.3.17 Accordingly, the Board recommends that tax law partnerships remain entities for GST purposes and that the law be amended to clarify the GST treatment of tax law partnerships. Issues that would need to be addressed include the consequences of formation and dissolution of tax law partnerships providing certainty concerning supplies and acquisitions made by tax law partnerships, and how the margin scheme applies to such entities.

Recommendation 36: Tax law partnerships

The GST law should be amended to clarify the treatment of tax law partnerships, including in relation to matters arising when a tax law partnership is formed or dissolved and when it makes a supply or an acquisition.

CHAPTER 7.4: TRUSTS

EXISTING LAW AND PRACTICE

7.4.1 Trusts are entities for GST purposes. The term *trust* is not defined for GST purposes and therefore takes its common law meaning.

Bare trusts and nominee relationships

7.4.2 The Tax Office view is that the legal title to the trust property held by the trustee does not determine who has the GST liabilities and entitlements for supplies and acquisitions.⁴²

7.4.3 If the trustee transfers real property to a third party at the direction of a beneficiary carrying on an enterprise with the asset, the view taken by the Tax Office is that it is the beneficiary that causes the supply to be made in the course of its enterprise. Accordingly, it is the beneficiary that has the GST liabilities and entitlements. Similarly, where the beneficiary makes acquisitions in the course of its enterprise, the beneficiary (not the trustee) has the entitlement to the input tax credits. This is the case even if it is the trustee who provides the consideration to the supplier.

7.4.4 The GST law applies to a very broad range of entities, including trusts.⁴³ However, the GST law does not state whether GST obligations and entitlements accrue to the trustee or to the beneficiary in bare trusts and similar nominee arrangements, where the trustee of the bare trust has either no active duties to perform or only minor active duties, and does not carry on an enterprise for GST purposes.

7.4.5 Typically, in bare trust structures, the beneficiary carries on an enterprise using trust property which is owned by the trustee of the bare trust, but the beneficiary directs and controls absolutely the use of the trust property.

7.4.6 Public Ruling GSTR 2008/3 sets out the Tax Office view where the trust property is real property. However, how bare trusts are treated where they hold other forms of property such as shares has not been dealt with in a public ruling.

Trusts and the ABN register

7.4.7 One way of knowing whether a trust is registered for GST is to access the Australian Business Register (ABR).

42 GST ruling 2008/3 *Goods and services tax: dealings in real property by bare trusts*, paragraphs 40 to 41.

43 Paragraph (g) of section 184-1 of the GST Act.

7.4.8 The *A New Tax System (Australian Business Number) Regulations 1999* (ABN Regulations) prescribes what information about a trust is entered in the ABR.

7.4.9 Trusts are named in the ABR in the general format ‘The Trustee for the XYZ Trust’. This reflects the fact that while the registered entity is the trust, notices may need to be addressed to the legal person who is the trustee at that time.

7.4.10 The ABN regulations⁴⁴ provide that the name of the trustee (or trustees) must be entered in the ABR. However, not all the information about an entity that is contained in the ABR is publicly available.

7.4.11 The Registrar may only make publicly available any details listed in the ABN Act or Regulations.⁴⁵ One of the details not listed is the name of the trustee (or trustees). Therefore, while the name of the trustee (or trustees) is entered in the ABR, the Registrar cannot publish the name of the trustee (or trustees).

Example

Gigi as trustee applies for an ABN for the White Family Trust.

On registration the entity’s name is shown in the ABR as ‘The Trustee for the White Family Trust’.

Gigi’s name is also recorded in the ABR as she is the trustee at the time of registration.

However, Gigi’s name is not publicly available as the Registrar cannot publish the trustee’s name.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

7.4.12 Submissions raised concerns about the term *trust* taking its common law meaning.

The term trust is undefined. A trust; is at law a legal relationship, not an entity. The term trust as it appears in section 184-1(1)(g) is both undefined and unrestricted. Accordingly, the trust entity for GST purposes also includes bare trusts, custodians and nominees. [IFSA]

7.4.13 In addition, submissions observed that this wide definition of trust results in complexity and ambiguity as to whether the trust or the beneficiary is liable for the

44 Subregulation 6(d).

45 Subsection 26(3) of the ABN Act or in Regulation 8 of the ABN Regulations.

GST consequences of transactions, even though the trust entity may not be carrying on an enterprise for GST purposes.

7.4.14 Submissions expressed concern that the GST law does not distinguish between different types of trust and there are doubts about how the GST law applies to bare trusts and similar types of nominee arrangements.

FINDINGS

7.4.15 The Board considers that a key legislative design principle is that terms with an ordinary meaning should not be defined in legislation. Defining such a term could lead to greater complexity in the law, particularly if the same term is defined in different ways in a number of different areas of the law. Therefore, although the meaning of the term *trust* can lead to some interpretative issues, the Board does not recommend defining the term *trust* in the GST Act as the current law provides the most appropriate outcome.

Bare trusts and nominee relationships

7.4.16 The Board notes that the Tax Office has issued a Public Ruling in relation to dealings in real property by a bare trust.⁴⁶ However, the Board considers there are still risks surrounding the uncertainty of the GST liabilities and entitlements of bare trusts. If a court or tribunal were to rule that the trustee makes the supplies and acquisitions, then this would impose significant compliance costs on taxpayers in unwinding transactions, and in some instances taxpayers may face unforeseen tax liabilities. Compliance costs also might be incurred by taxpayers in accounting for transactions differently. Additionally, loss of revenue may occur if the Tax Office is required to refund GST incorrectly remitted by beneficiaries carrying on an enterprise, but is unable to collect GST from the trustee because of the protection given by the Tax Office public ruling.

7.4.17 For these reasons, the Board recommends making a technical amendment to the GST law to reduce uncertainty in relation to the GST liabilities and entitlements of bare trusts.

Recommendation 37: Bare trusts

The GST law should be amended to remove doubt surrounding the GST liabilities and entitlements of bare trusts.

46 Goods and Service Tax Ruling GSTR 2008/3 *Goods and services tax: dealings in real property by bare trusts*.

Trusts and the ABN register

7.4.18 There is an identity problem with trusts. While the trust is the entity, it is the trustee who makes supplies.

7.4.19 A trustee may have many different roles, for all of which the trustee may be entitled to register for GST. It can be difficult to confirm from the ABN register what role the trustee is acting in and whether that role is registered for GST.

7.4.20 The Board considers that this issue is out of scope of the terms of reference for the review because any change would require a change to the ABN legislation. The Board, however, suggests that this issue be given further consideration by the Government to determine whether the ABN register needs to make it clear in which capacity the registration status applies.

CHAPTER 7.5: INCAPACITATED ENTITIES

EXISTING LAW AND PRACTICE

7.5.1 Special rules apply to representatives of incapacitated entities to ensure that the GST liabilities and entitlements of enterprises that have gone into receivership, liquidation or other forms of administration are properly accounted for.

7.5.2 The intended effect of these rules is to reflect that the representative, rather than the incapacitated entity, is carrying on the enterprise. It follows that the representative should be personally liable for GST, entitled to input tax credits and be responsible for any adjustments attributable to the period that it is acting for the incapacitated entity.

7.5.3 However, the existing law does not expressly deem the representative to be making the supplies and acquisitions that are made during its appointment. Equally, the law does not expressly provide that the representative is liable for, or entitled to, the GST consequences that arise during the period it acts for the incapacitated entity.

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

7.5.4 There were a number of submissions that raised concerns with the operation of the GST law in its application to representatives of incapacitated entities. Concerns were also raised about the manner in which other provisions of the GST law operate where a representative has been appointed and where that can give rise to anomalous outcomes.

The current regime for application of GST to insolvency is beset by significant legal uncertainties and compliance problems. [ICAA]

Perceived failure of the law to achieve its objective

7.5.5 There is uncertainty about how the GST law operates to achieve the stated objective of ensuring that the representative is liable for, or entitled to, GST consequences that arise during its appointment.

The most fundamental [question] was whether the insolvency practitioner was personally liable for GST on supplies and adjustment made during the course of appointments. Various representatives of the profession argued that the insolvency practitioner did not have a personal liability because they are acting in the capacity as an agent for the incapacitated entity. Other commentators argued that the scheme of

the legislation, as derived from its structure and explanatory material, was to confer a personal liability upon the representative. [IPAA]

As far as possible, GST liability and input tax credits should attach to the entity (incapacitated entity or representative) that received or issued consideration for the supply or acquisition in question. [IPAA]

Interaction with other GST provisions

7.5.6 The current law may give rise to anomalous outcomes because GST consequences differ. That is, the GST consequences that arise from a transaction undertaken by a representative may not be the same as those that would have arisen had the incapacitated entity undertaken the transaction.

...the GST legislation (and not merely the Commissioner's practice) needs to ensure that any method that the incapacitated entity would have been eligible to use to work out the amount of GST payable on a supply (such as the margin scheme) or the amount of an input tax credit can be used... [IPAA]

7.5.7 These interaction problems can arise in a number of circumstances, including:

- Where a representative uses or on-sells something acquired by the incapacitated entity, the representative may not have access to various special rules, such as the margin scheme or the second-hand goods provisions.
- Where a representative makes a supply to an associate of the incapacitated entity, the associate rules will not apply (as the entity is an associate of the incapacitated entity and not of the representative).
- When a member of a GST group becomes incapacitated part-way through a tax period, the incapacitated entity is removed from the group from the start of the relevant tax period. This gives rise to compliance costs for the group as a whole as during the first part of that tax period, the group would have accounted for GST as though the incapacitated entity was part of the GST group. Among other things, this means that intra-group transactions would have been ignored.

Notification of adjustments

7.5.8 Concerns were raised about the compliance burden imposed by the requirement that representatives notify the Commissioner of increasing adjustments⁴⁷

47 That is, adjustments that increase an entity's net amount (net GST liability) for a tax period.

that arise in relation to transactions undertaken by the incapacitated entity prior to the representative's appointment.⁴⁸

7.5.9 It was also stated that it is inequitable that failure to notify the Commissioner of any increasing adjustment transfers the liability to the representative.

[This regime] imposes an onerous compliance burden and unwarranted liability transfer. [IPAA]

The major compliance issues facing representatives relate to adjustments ... The representative is required to identify and calculate adjustments often in the absence of adequate records kept by the incapacitated entity. [ICAA]

Other issues

7.5.10 There were also a number of other issues raised in relation to the GST administration of an incapacitated entity.

...the GST regime for insolvency [should] be completely redesigned to ... provide more clarity and more flexible compliance arrangements for representatives in respect of registration, liability, GST groups and returns. [ICAA]

7.5.11 Issues raised include:

- A representative of two or more incapacitated entities should be able to elect to lodge one consolidated GST return if the incapacitated entities are members of the same GST group.
- There can be confusion about who is liable for payment of GST when there is more than one representative appointed in respect of an incapacitated entity.
- There are inconsistent rules regarding concluding tax periods, with some types of incapacitated entities currently being assigned concluding tax periods but others are not.
- There is scope for the representative to be liable for GST on a component of a progressive or periodic supply made during its appointment for which the incapacitated entity has received consideration (such as in the form of an advance payment).

48 Under section 147-20 of the GST Act, if the representative provides the Commissioner with a written notice specifying the amount of the adjustment, the incapacitated entity is liable for the adjustment. If, however, the representative fails to provide a written notice, the representative is instead personally liable for the adjustment.

FINDINGS

7.5.12 The Board understands that the Tax Office has been administering the law in relation to representatives of incapacitated entities in a manner that accords with the intended policy. However, the law itself does not provide certainty for incapacitated entities and their representatives, which gives rise to an undesirable level of compliance costs and potential litigation.

7.5.13 The Board recommends legislative amendments to clarify the operation of the law and address compliance concerns. Amendments should ensure that the representative of an incapacitated entity is liable for, or entitled to, the GST consequences that arise from supplies, acquisitions and importations made during its appointment. Further, any GST liability or entitlement should be determined as if the representative was the incapacitated entity so that the GST outcome is the same, regardless of whether the incapacitated entity or the representative is responsible.

7.5.14 Submissions also raised concerns about the requirement for representatives to provide written notification of increasing adjustments to the Tax Office. The Board notes that this requirement assists the Tax Office to quantify the amount that is owed by an incapacitated entity and establish proof of debt. However, the Board acknowledges industry views that the notification requirement can be overly onerous and that compliance costs may be able to be reduced. The Board suggests that consideration be given to ways of reducing compliance costs for representatives in these circumstances.

7.5.15 The Board recognises that there are a number of areas of uncertainty, including registration requirements, tax periods, returns and grouping. The operation of the law in these areas should also be clarified to reduce uncertainty and compliance costs.

7.5.16 The Board notes that the fuel tax law applies to an incapacitated entity and its representative in the same way as the GST applies to them under the GST law. Consistent with the terms of reference for the review, the Board recommends that the implications of any possible changes to GST administration provisions in relation to incapacitated entities be considered for other indirect taxes, including fuel tax.

Recommendation 38: Incapacitated entities

The GST law should be amended to ensure that the representative of an incapacitated entity is responsible for the GST consequences that arise from supplies, acquisitions and importations made during its appointment.

The law should also be amended to make it clear that any GST liability or entitlement should be determined as if the representative was the incapacitated entity.

In amending the law, consideration should be given to the treatment of notification of increasing adjustments, registration requirements, tax periods and returns. Consistent treatment should be considered for other indirect taxes, including fuel tax credits.

CHAPTER 7.6: MULTIPLE ROLES AND THE OFFSETTING OF CREDITS AND DEBITS

EXISTING LAW AND PRACTICE

7.6.1 An entity can have a variety of capacities in which it accounts for GST. These can include in its own capacity as an entity and as a GST joint venture operator.

7.6.2 Under the TAA, a Running Balance Account can be established by the Commissioner for any entity to keep account of the primary tax debts, payments and credits allocated to that Running Balance Account. Entities are required to notify most of their business tax liabilities to the Commissioner by lodging a BAS so that those debts and any credit entitlements and payments made can be all recorded on one running balance account. Those debts, credit entitlements and payments can relate to GST, wine equalisation tax, luxury car tax, PAYG withholding, PAYG instalments, fringe benefits tax instalments, deferred company instalments, and fuel tax law liabilities. Separate accounts are maintained which record other liabilities such as assessed income tax, assessed fringe benefits tax and superannuation liabilities.

7.6.3 Under the current law the credits and Running Balance Account surpluses must be offset against tax debts. However there are three situations where the Commissioner has an option not to do so:

- the tax debt is due but not yet payable and is not a BAS amount (that is, this discretion does not apply where the tax debt is a business activity statement amount),
- there is an arrangement to pay by instalments, or
- the Commissioner has agreed to defer recovery.

Branches

7.6.4 Some entities, for their own administrative convenience, operate through a divisional or branch structure. For instance, they may amalgamate their branch accounts only once a year. Rather than requiring such entities to amalgamate their accounting for GST purposes for each tax period, they are allowed to register their branches separately.

7.6.5 Although GST branches operate for GST purposes as if they are distinct entities, the parent entity bears the legal responsibility for lodging the branches'

returns and making payment. The parent entity is also required to lodge a separate return for activities not included in the returns of its GST branches.

7.6.6 Any credit or Running Balance Account surplus of a GST branch, such as for a GST refund, must be applied against the tax debts of the parent entity (including tax debts relating to other GST branches of the parent entity).

VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

7.6.7 Public consultations held during August 2008 and a number of submissions raised issues associated with refunds being used to offset debts that are due but not yet payable. Submissions stated that it was extremely time consuming and cumbersome to recoup the money.

7.6.8 Through the public consultations, and one submission, the following examples were given of when there is offsetting of a refund against another debt:

- offsetting within the one entity that does not have branches. The entity lodges a BAS early, with the applicable GST to be paid later (but on time), and the debt not yet due is offset against a refund due on another account, for example an account recording the income tax credits and liabilities of the entity;
- offsetting where an entity uses GST branches. A branch lodges its BAS early, with the applicable GST to be paid later (but on time), and the debt not yet due is offset against a refund that would have been payable to another branch of the one entity; and
- offsetting where there is use of a GST joint venture. Where a BAS is lodged and it contains a GST refund and other tax liabilities, the GST refund will be immediately transferred to offset that liability, whether it is currently due or just pending. Accordingly, when the GST joint venture operator has a credit on its account arising from the acquisitions or supplies it has made on behalf of the joint venture participants (under the voluntary joint venture rules, the operator has the liabilities and entitlements on such acquisitions or supplies), that credit can be offset against the debts on the operator's account relating to its activities on its own behalf.

7.6.9 Consultation also raised concerns regarding whether it was appropriate that a GST joint venture operator's role should be mixed in with the running balance account of the same entity's other roles. If the joint venture operators were not operating as a GST joint venture, each joint venture operator would account for its share of the input tax credits or GST in relation to the acquisitions or supplies the joint venture operator makes on their behalf. These joint venture operators are usually entities totally independent of each other. A GST joint venture operator (as opposed to a joint venture

that is a separate entity) may have a client account number with one or more separate client account centres. It may account for GST in its own right in one client account centre and also its GST obligations in relation to the GST joint venture in another client account centre.

FINDINGS

7.6.10 The Board concludes that the offsetting rules for debts and refunds, in their current form, produce inappropriate outcomes that cause significant compliance costs to taxpayers.

7.6.11 The relevant offsetting provisions were introduced in order to prevent entities that have several roles from claiming credits in one capacity while accruing debts in another capacity.

7.6.12 The examples raised in submissions are not examples of situations in which debts are accruing. The Board agrees with the concerns raised in submissions in that any offsetting refunds should not be applied against debts that are not yet overdue.

7.6.13 The Board does not consider that it is appropriate that the role of a GST joint venture operator in its role in accounting for the activities of the GST joint venture should be mixed with the GST joint venture operator's own Running Balance Account.

7.6.14 Currently, any credit or Running Balance Account surplus of the entity that is the GST joint venture operator must be applied against the tax debts of that entity. These debts may relate to a joint venture for which the entity is the joint venture operator, or may be debts of the joint venture operator in relation to its own business activities. This may occur before the due date for payment of the tax debt. Hence, a credit arising in relation to the acquisitions or supplies a joint venture operator has made on behalf of the joint venture participants has to be offset against a tax debt, such as a fringe benefits tax liability, arising from the joint venture operator's other activities.

7.6.15 The Board recommends that the requirement to offset a credit against a business activity statement amount should not apply when that amount is due but not yet payable (that is, it should not be mandatory to offset in this circumstance where the debt is due but not yet payable).

7.6.16 Limiting offsetting debts that are due and payable will remove an administrative irritant for taxpayers. It is expected that the recommendation would reduce compliance costs for taxpayers in reconciling their various roles and recouping the refund where it belongs.

7.6.17 Additionally, the activities of each GST joint venture role that a GST joint venture operator undertakes should be treated separately for Running Balance

Account purposes and also separately from the activities of the GST joint venture operator's own capacity.

Recommendation 39: Running Balance Account

The GST law should be amended so that there is only a requirement to offset a credit against a business activity statement amount when that amount becomes due and payable and not before this time.

Additionally, the activities of each joint venture role that a joint venture operator undertakes, should be treated separately for Running Balance Account purposes, and also separately from the activities of the joint venture operator in its own capacity as an entity.

CHAPTER 7.7: AGENCY RULES

EXISTING LAW AND PRACTICE

7.7.1 The domestic agency provisions⁴⁹ allow the GST on supplies between agents, their principal and third parties to be accounted for in a simpler way.

7.7.2 Under these provisions, certain agents and principals can act by agreement as if:

- supplies and acquisitions made by the principal through the agent are supplies that are made first, from the principal to the agent and then secondly, from the agent to the customer, or
- acquisitions are first made by the agent and then secondly, supplied by the agent to the principal.

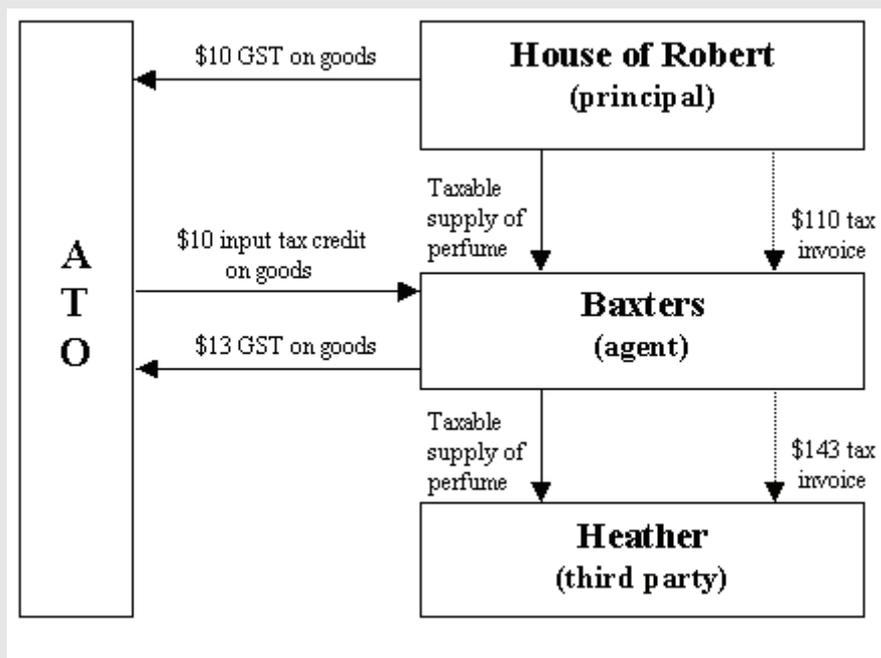
7.7.3 *Agent* is not a defined term in the GST Act and accordingly, common law concepts of the agency relationship are relevant. The GST domestic agency provision therefore only applies to entities that are agents and principals at common law. For commercial law purposes, an agent is a person who is authorised, either expressly or impliedly, by a principal to act for that principal so as to create or affect legal relations between the principal and third parties.

49 Subdivision 153-B of the GST Act.

Example — How the agency provisions apply

The House of Robert (principal) supplies perfume at a price of \$143 (GST inclusive) to Heather (third party) through Baxters (agent). Baxters is entitled to receive a commission of \$33 (GST inclusive) from The House of Robert for the agency service.

If the House of Robert and Baxters enter into an agreement that the GST domestic agency provisions apply, then the outcome is as per the following diagram.



VIEWS RAISED IN SUBMISSIONS AND CONSULTATION SESSIONS

Inflexibility of the domestic agency provisions

7.7.4 Submissions and the public consultations raised the issue of the inflexibility of the domestic agency provisions; for example:

The narrow interpretation of agent causes administrative problems where agency-type arrangements arise and the relationship does not technically meet the GST requirements to be an agent. Common examples are where one party acts as a paying or billing agent for another party and service providers that do not meet the technical interpretation of agents, but perform a similar function. While it would normally be useful to use the simplified agency arrangements in Division 153 for such arrangements (since this would make the GST and commercial arrangements consistent), the narrow interpretation of agents prevents this.

As an example, where a billing agent is used, the entity making the supply must issue the tax invoice for the supply, even though it is normally only the billing agent that issues an invoice to third parties. [IFSA]

Other agency issues

7.7.5 Other agency issues were also raised at public consultation sessions. These included:

- whether the GST on agent fees was being appropriately accounted for under the domestic agency provisions;
- difficulties in distinguishing between acquisitions made as agent for another entity and acquisitions made as part of making a supply to another entity; and
- whether the client or the service provider is entitled to input tax credits.

FINDINGS

Inflexibility of the domestic agency provisions

7.7.6 The Board notes that there is complexity in the current law because of the narrow application of the term agent. The Board supports a broadening of the scope of the domestic agency provisions as a way of reducing the complexity and thereby the compliance costs for parties that act in a similar way to a common law agent.

7.7.7 The domestic agency provisions are too restrictive in that they only reduce compliance costs for entities that are a principal and agent at common law and they do not assist those entities that act in a similar way to principal and agent.

7.7.8 The Board considers that the scope of the domestic agency provisions should be broadened to include representatives that operate in a similar way to, but do not amount to, common law agents, and consideration should be given to simplification of the principles underlying the provision.

7.7.9 This recommendation needs to be considered in conjunction with similar issues within the non-resident agent provisions (described in Chapter 6).

7.7.10 Invoicing and commission agents will no longer have compliance costs associated with dissecting the payments they receive on behalf of a supplier. For example, under the current system an invoicing agent only accounts for GST on their services and yet the amount they receive also includes consideration for the supply made by the entity they are acting for.

Recommendation 40: Domestic agency provisions

The scope of the domestic agency provisions should be broadened to include representatives that operate in a similar way to, but do not amount to, common law agents, such as invoicing and commission agents, and consider simplification of the underlying principles.

Other agency issues

7.7.11 With respect to the other agency issues raised, the Board is of the view that the current law provides the most appropriate outcome.

7.7.12 The domestic agency provisions currently operate correctly and agency fees are being correctly accounted for. In the example above, the agency fee is in effect the difference between the taxable supply of \$143 and the acquisition of \$110, being \$33.

7.7.13 Although it was suggested that taxpayers find it difficult distinguishing between acquisitions made as agent for another entity and acquisitions in making a supply to another entity, the Board considers this is an education issue and that the current law is appropriate.

CHAPTER 8: TECHNICAL AMENDMENTS

8.1.1 There are a number of areas in the GST law where the policy and purpose of the legislation is clear but the words in the law do not clearly reflect that policy.

8.1.2 The Tax Office has identified a number of these areas and advised the Board it has been taking a purposive interpretation of the law where possible. However, as the words do not clearly reflect the policy, there is uncertainty for taxpayers about how the law should apply.

8.1.3 Throughout this report, the Board has recommended a number of technical amendments. These are additional technical amendments, which do not fit specifically with other chapters in this paper.

8.1.4 A complete listing of all the technical amendments the Board recommends is included in the table at the end of this chapter.

GAMBLING: APPLICATION TO NON-RESIDENTS

Existing law

8.1.5 GST applies to gambling, such as in casinos and gaming machines in clubs and hotels, lotteries and raffles.

8.1.6 Some gambling supplies are GST-free, such as, gambling supplies made to non-residents, or supplies of raffles or bingo games by charitable institutions.

8.1.7 Applying GST and input tax credits to individual bets, wagers and prizes would be administratively complex. For example, GST would have to be applied on every spin of a roulette wheel for every covered square on the table.

8.1.8 For this reason, the GST is instead applied as 1/11th of the GST inclusive margin of gambling suppliers, which is intended to have the same net result as applying GST to individual wagers and allowing input tax credits on prizes paid out.

Issue

8.1.9 There are potential anomalies in the treatment of gambling supplies, particularly concerning non-residents. The law needs to be clarified concerning gambling supplies made to non-residents. This would involve clarifying that the

amount bet and any prize money paid out in relation to non-resident GST-free supplies are excluded when calculating the margin on the gambling supply.

Recommendation 41: Technical amendment — gambling

The GST law should be amended to confirm the application of the rules about gambling to non-resident entities.

NET AMOUNT FOR LUXURY CAR TAX AND WINE EQUALISATION TAX

Existing law

8.1.10 The luxury car tax and wine equalisation tax legislation provide that luxury car tax and wine equalisation tax are added to the net amount determined under the GST Act to give a total net amount that becomes due and payable, or which permits the Commissioner to make an assessment of that net amount.

8.1.11 However, the definition of net amount in the GST Act does not expressly recognise the inclusion of luxury car tax and wine equalisation tax in the net amount under the GST law.

Issue

8.1.12 There is a lack of clarity concerning the inclusion of luxury car tax and wine equalisation tax amounts in the net amount for GST purposes.

Recommendation 42: Technical amendment — luxury car tax and wine equalisation tax

The law should be amended to confirm that luxury car tax and wine equalisation tax are part of the net amount that is calculated under the GST Act.

NON-PROFIT SUB-ENTITIES

Existing law

8.1.13 There are a number of concessions available to non-profit entities. These include a higher registration turnover threshold, the ability to account for GST on a cash basis, gifts to non-profit bodies that do not form consideration for a supply, and non-commercial supplies of goods and services by charities (including religious organisations) are GST-free.

8.1.14 Under the GST legislation, certain non-profit organisations with small independent branches (units) have the option of treating their units as if they were separate entities for GST purposes and not a part of the main organisation. A unit will be regarded as independent if it keeps its own accounting records and can be separately identified by the nature of its activities or its location.

8.1.15 Units could include a branch, bar activity, fete, lamington drive or fundraising dinner. This means that, where the unit's annual turnover is less than the \$150,000 turnover threshold, the unit can choose whether it registers for GST or not. The option allows, for instance, small non-profit entities to run certain activities so that no GST is payable on sales.

Issue

8.1.16 While not specifically set out in the law, the Tax Office currently treats non-profit sub-entities in the same way as their parent entity, and thus they can take advantage of those GST concessions.

Recommendation 43: Technical amendment — non-profit sub-entities

The GST law should be amended to ensure that non-profit sub-entities are able to access the same GST concessions as their parent entity.

POWER TO RECOVER OVERPAID REFUNDS

Existing law

8.1.17 Where a GST debt is caused by a reduction in the amount of refund originally paid to the taxpayer (such as where the taxpayer claimed too much refund), the GST law⁵⁰ cannot impose a general interest charge on the debt (which it is intended to do, and does, for underpayments of a liability) because the assessment does not create a liability, but rather results in a reduction of the refund amount.

8.1.18 The Commissioner's practice is to treat these amounts as administrative overpayments⁵¹ and apply GIC from the date of the over claimed refund.⁵²

50 Section 105-80 of Schedule 1 to the TAA.

51 Section 8AAZN of the TAA.

52 Section 8AAZF.

Issue

8.1.19 The provisions in the GST legislation that deal with refunds and payments do not cover over claimed refunds. To overcome this deficiency, the Tax Office has treated over claimed refunds as administrative overpayments paid by mistake which can be recovered.⁵³ However, a recent court decision has raised doubts about the Commissioner's current practice in the recovery of administrative overpayments. Further, this means that there is a different treatment of underpayments of liabilities versus over claimed refunds, leading to a difference in the way GIC applies.

Recommendation 44: Technical amendment — power to recover overpaid refunds

The law should be amended to allow over claimed refunds to be treated as an amount of tax which becomes payable when either refunded to the taxpayer or applied against a tax debt.

REFUNDS — RESTRICTIONS OF THE PAYMENT OF REFUNDS OF OVERPAID GST

Existing law and practice

8.1.20 Under the TAA,⁵⁴ the Commissioner is only required to refund a supplier for overpaid GST if the recipient of the supply is unregistered and the supplier has reimbursed that recipient.

8.1.21 Luxury car tax has its own refund restriction rules. However, there is a question of whether they are sufficient and if so, whether the TAA⁵⁵ needs to address any deficiency in the rules.

8.1.22 There are limitations on the payment of refunds of GST to ensure that the economic burden of the tax falls on the consumer, that business-to-business transactions generally result in a neutral outcome for the revenue, and that there are no windfall gains for suppliers. These limitations are set out in the TAA.⁵⁶ Broadly, the TAA simply provides that the GST need not be refunded to a business if the recipient of their supply is registered or required to be registered.

8.1.23 If a business overpays GST on a sale to a customer, then the GST may be refunded to the business only if the Commissioner is satisfied that business has first

53 Section 8AAZN of the TAA.

54 Paragraph 105-65(1)(c) of Schedule 1 to the TAA.

55 Section 105-65 of Schedule 1 to the TAA.

56 Section 105-65 of Schedule 1 to the TAA.

refunded the overpaid amount to the affected customer. This is because it is the customer who is intended to bear the cost of the GST, and does so because the GST is included in the price they pay. Without this restriction, there is a potential for a windfall gain to arise to businesses that receive the refund of GST as they have not borne the incidence of the tax.

8.1.24 In the case of business-to-business transactions, the Commissioner is not required to refund overpaid GST because the purchasing business is potentially entitled to input tax credits to offset the GST included in the price of its acquisition.

8.1.25 The scope of the refund restriction in relation to scenarios where a supplier could be unjustly enriched has been recently amended by *Tax Laws Amendment (2008 Measures No. 3) Act 2008* in response to deficiencies highlighted in the KAP Motors Case⁵⁷ with effect from 1 July 2008.

Issue

8.1.26 There are several technical issues⁵⁸ that mean the law may not operate comprehensively wherever GST is overpaid.

8.1.27 A number of submissions also expressed concern that it was not possible for suppliers to obtain refunds without first fully refunding GST related amounts to purchasers. The Board considers that the current outcome is appropriate. Taxpayers should not be entitled to a refund unless it is clear that this will not result in them obtaining a windfall profit. Other circumstances can be addressed by the discretion of the Commissioner.

57 *KAP Motors Pty Limited v Commissioner of Taxation* [2008] FCA 159.

58 Section 105-65 of Schedule 1 to the TAA.

Overpaid GST scenarios

8.1.28 The application of the law⁵⁹ currently depends on something being incorrectly treated as a taxable supply.

Example

Entity A makes a taxable supply of real property and calculates the GST on the supply using the margin scheme.

After Entity A lodges its activity statement for the relevant tax period, it recalculates the margin for the supply of the property and finds that it has overpaid GST.

It is uncertain whether the restriction on refund provisions applies. This is because the overpayment does not stem from the incorrect treatment of a supply. The supply was treated as a taxable supply in the past and it remains a taxable supply, it is just that the amount on which GST is calculated has decreased.

8.1.29 Similar concerns arise in the context of mixed supplies, that is, supplies that are partly taxable and partly non-taxable, such as a supply of travel insurance which covers both domestic travel (taxable part) and international travel (GST-free part).

Multiple revisions to an activity statement for over and under payments

8.1.30 An underlying assumption of the restriction on refunds provision appears to be that the taxpayer is entitled to a refund from the Commissioner for a tax period in which they have incorrectly reported some or all of their supplies as taxable supplies.

8.1.31 However, it is possible for a supplier to have understated their net amount while also incorrectly treating some supplies as taxable. That is, overall, after the revision, the taxpayer still owes the Commissioner an amount for the particular tax period.

8.1.32 This would arise when a taxpayer makes a series of revisions for the same tax period such that the underpayments exceed the amount of overpayments or refunds for that tax period.

8.1.33 The restriction on refunds provision may not be operative in these circumstances.

⁵⁹ Section 105-65 of Schedule 1 to the TAA.

Discretionary nature of refund restriction provision

8.1.34 The TAA⁶⁰ provides that the Commissioner *need not* pay a refund in particular circumstances. The Commissioner takes the view that this provides a discretion to allow a refund in circumstances where the Commissioner thinks a refund is appropriate, notwithstanding that another provision of the TAA⁶¹ has not been complied with.

8.1.35 However, this discretion is not clear on the face of the existing legislation. The Explanatory Memorandum to Tax Laws Amendment (2008 Measures No. 3) Bill 2008 states that the Commissioner does have such a discretion, but it is not explicit in the law.

Recommendation 45: Payment of refunds of overpaid GST

The law should be amended to clarify that the Commissioner has a discretion to refund the GST where appropriate.

INTERACTION OF ASSOCIATE PROVISIONS**Existing law and practice**

8.1.36 One of the conditions for a supply being a taxable supply is that it is made for consideration. However, associates can make supplies for no consideration or less than market consideration.

8.1.37 Specific rules provide that if a supply is made to an associate for no consideration, and the associate is not entitled to a full input tax credit, the supply is still a taxable supply with GST payable by reference to the GST inclusive market value of the thing that is transferred. The associate rules ensure that supplies between associates are included in the GST system with an appropriate value.

8.1.38 If a taxable supply is made to an associate for less than market value, and the associate is not entitled to a full input tax credit, GST is charged on the market value of the supply.

8.1.39 Despite not paying any or inadequate consideration, the associate is entitled to an input tax credit to the extent the acquisition is for a creditable purpose.

60 Section 105-65 of Schedule 1 to the TAA.

61 Section 105-65 of Schedule 1 to the TAA.

Issue

8.1.40 The Tax Office raised a technical abnormality with the structure of the associate provisions in that the provision does not adequately interact with other provisions of the GST law such as the input taxed and GST-free supply provisions.

8.1.41 A recent change to the law⁶² addresses this issue for the margin scheme to ensure that transfers to an associate for no consideration are effectively treated as a sale for the purposes of the margin scheme.

Example of a problem with the associate provisions

Where things are transferred from an entity to an associate for no consideration, the supply can nonetheless be a taxable supply with GST payable by reference to the GST inclusive market value of the thing that is transferred.

However, the associate provisions do this without deeming that the supply has been made for consideration that is equal to the GST inclusive market value. This means that these transactions do not qualify for some of the other provisions of the GST Act, such as those that require a sale like the margin scheme or residential premises provisions, or those providing for a GST-free supply of a going concern.

Recommendation 46: Technical amendment — associates

The GST law should be amended to remedy the interaction of the associate provisions and other provisions such as those relating to input taxed and GST-free supplies.

62 *Tax Laws Amendment No 5 Act 2008.*

Summary of technical amendment recommendations

Area	Recommendation	Recommendation Number
Adjustments for cessation of registration	<p>Non-residents should not be required to make adjustments in relation to goods in the event that they deregister, provided that the goods are effectively exported and used in the non-Australian enterprise.</p> <p>Technical amendments should be made to the provisions relating to attribution and entitlement upon cessation of registration to ensure consistent and appropriate treatment of all taxpayers.</p>	5
Adjustments	The GST law should be amended to ensure consistency and certainty in the use of the terms <i>apply</i> and <i>application</i> in the adjustment provisions.	7
Tax invoices and attribution	The GST law should be amended to clarify that an input tax credit can be claimed in a later tax period even though the relevant tax invoice was first held in an earlier period.	10
General law partnerships	The GST law should be amended to clarify the treatment of general law partnerships including in relation to matters such as partner-to-partnership transactions or changes in the membership of a partnership.	35
Bare trusts	The GST law should be amended to the GST law to remove doubt surrounding the GST liabilities and entitlements of bare trusts.	37
Gambling	The GST law should be amended to confirm the application of the rules about gambling to non-resident entities.	41
Luxury car tax and wine equalisation tax	The law should be amended to confirm that luxury car tax and wine equalisation tax are part of the net amount that is calculated under the GST Act.	42
Non-profit sub-entities	The GST law should be amended to ensure that non-profit sub-entities are able to access the same GST concessions as their parent entity.	43
Power to recover overpaid refunds	The law should be amended to allow over claimed refunds to be treated as an amount of tax which became payable when either refunded to the taxpayer or applied against a tax debt.	44
Associates	The GST law should be amended to remedy the interaction of the associate provisions and other provisions such as those relating to input taxed and GST-free supplies.	46

PART C: STATUS QUO AND OUT-OF-SCOPE ISSUES

CHAPTER 9: STATUS QUO AND OUT-OF-SCOPE ISSUES

STATUS QUO AND OUT-OF-SCOPE ISSUES

9.1.1 There are a number of issues raised with the Board which were outside the Board's terms of reference, and thus outside the scope of this review. There were other issues where the Board considers the current law provides the most appropriate outcome, and thus recommended the status quo.

9.1.2 Both out of scope and status quo issues were considered in other chapters of this report. These are additional items, which did not fit specifically with the other chapters in this paper.

9.1.3 A complete listing of all the out of scope and status quo issues are included in the table at the end of this chapter.

ASSOCIATE DEFINITION

Existing law and practice

9.1.4 Under the associate provisions the term *associate* is drawn from income tax law.

View raised in submissions and consultation sessions

9.1.5 Several submissions were concerned that the term associate is defined in the GST Act by reference to section 318 of the *Income Tax Assessment Act 1936*.

The section was introduced in 1991 and was specifically designed for a complex area of the income tax legislation and was never designed to cater for GST and the complexities that arise when income tax definitions are used in a GST context.[IFSA]

9.1.6 The view was raised that the adoption of this quite specific definition from income tax law is not directly relevant to the GST system.

Findings

9.1.7 The Board considers that the current law should remain. GST legislation draws on many definitions as used in the income tax and other acts. The use of

common definitions seeks to assist by reducing tax law complexity and compliance costs.

DIRECTOR PENALTY NOTICES

Existing Law and Practice

9.1.8 Currently, there is no personal liability imposed on the directors of companies that have failed to pay their outstanding GST.

Views raised in submissions

9.1.9 One submission suggested that because directors can be made personally liable for withholding debts, there is an incentive to pay withholding tax debts before GST debts. The submission also suggested director penalty notices should also apply to GST debt.

Findings

9.1.10 The Board considers that providing a priority to GST debts is not desirable unless a similar priority exists for income tax and fringe benefit tax debts. Such a change would be outside the scope of this review.

FLEXIBILITY IN COMPLIANCE

Existing law and practice

9.1.11 The current law provides specific powers for each of the following to nominate others to accept obligations and entitlements under the GST law:

- non-residents (resident agents acting for non-residents);
- GST groups (being the representative member for groups of two or more companies, partnerships or trusts);
- GST joint venture participants (where the joint venture operator has the GST liabilities and entitlements on supplies and acquisitions it makes on behalf of the joint venture participants);
- unincorporated associations (committee of management); and
- non-profit entities (persons responsible for the management).

View raised in submissions and consultation sessions

9.1.12 In a number of submissions and consultation sessions it was suggested that a general power to agree or nominate another entity to pay GST or claim input tax credits should be available.

Findings

9.1.13 The Board considers that the current law provides the most appropriate outcome in most circumstances.

9.1.14 A general power to nominate another entity could result in entities without sufficient assets accounting for the GST obligations of other entities. Taxpayers can also seek assistance from tax professionals to meet their obligations.

9.1.15 However, the Board has made other recommendations in this report that will at least in part address this issue:

- the expansion of the scope of the GST agency provisions in regards to the obligations of non-residents (Division 57 of the GST Act), (details in Chapter 6); and
- the expansion of the domestic agency provisions⁶³ for invoicing agents or similar agents (also covered in the non-resident chapter).

INSURANCE AND THIRD-PARTY STATUS

Existing law and practice

9.1.16 To tax the value added on general insurance, insurers are liable to GST on insurance premiums, and are entitled to input tax credits on any acquisitions related to their general insurance enterprise, including things related to settling insurance claims, such as the purchase of replacement goods or acquiring services such as motor vehicle repairs.

9.1.17 Insurers also make settlements in cash. To correctly tax the value added, there also has to be a GST consequence in relation to cash settlements. As the cash settlement is paid to those insured, the correct GST treatment of a cash settlement depends on the GST status of the insured party, that is, whether the insured party used the insurance in relation to making taxable, input taxed or GST-free supplies.

9.1.18 Hence, the adjustment (like an input tax credit) the insurer is entitled to on a cash settlement depends on the input tax credit entitlement of the insured in relation to

63 Division 153 of the GST Act.

the insurance premium (the insured's input tax credit entitlement depends on what the insured's acquisition of insurance relates to: taxable, input taxed or GST-free supplies.)

View raised in submissions and consultation sessions

9.1.19 There were some suggestions in submissions that this system needed to be reformed as it unnecessarily imposes significant compliance costs and risks to all parties, particularly given the consequential impacts of any breakdown in the process.

Requiring an insurer to "know" the status of another entity places significant dependency and stress on existing business process and relationships and creates unnecessary uncertainty and complexity. This is especially with the current drafting of Section 78-10(2) which provides no protection for insurers if they rely on information provided by the insured which is subsequently demonstrated to be incorrect. [ICA]

9.1.20 The following options were suggested:

- Work with existing legislation, and allow insurers to rely on information provided by insured parties. This would result in the insured party, rather than the insurer being exposed.
- Insurers could be given a different method of calculating their adjustment: a 12-week snapshot whereby an average is used to calculate the adjustment or a government or Tax Office approved average input taxed credit information by portfolio type (business norms) similar to CTP.⁶⁴

Findings

9.1.21 The Board considers that the current law provides the most appropriate outcome because:

- contractual protection can avoid the insurer from being exposed because of incorrect information being received by the insured;
- general insurers already ask for significant information from insureds whereas CTP insurers do not have the same degree of interaction; and
- shifting the burden to the insured party would increase complexity and administrative costs by imposing obligations on significantly greater numbers of taxpayers.

64 Division 79 of the GST Act.

QUARTERLY THRESHOLDS FOR PAYG WITHHOLDING AND GST INSTALMENTS

Existing law and practice

9.1.22 At present entities that withheld more than \$25,000 in the preceding financial year from payments they made, such as salary and wages, are generally required to report and remit their withholding liability on a monthly basis. If a GST registered entity has a GST turnover of \$2 million or less, it may account for GST by quarterly instalments.

View raised in submissions and consultation sessions

9.1.23 A small business representative proposed that the threshold for quarterly remittance of pay as you go (PAYG) withholding amounts should be increased to align with the turnover threshold for quarterly instalments of GST. The effect of the proposal would be to enable small businesses (those with a turnover that does not exceed \$2 million a year) to fulfil their obligations for the two taxes by submitting one BAS and remitting the taxes at the same time.

Findings

9.1.24 The Board notes that the two reporting/remittance thresholds serve different purposes. The PAYG threshold relates to withholding an amount of tax on behalf of employees. It is not appropriate that this amount is treated in the same way as the GST liabilities of the business. Monthly remission ensures that if a business fails to remit the withheld amount, for whatever reason, only one month of withheld amounts are at risk. GST remittance deals with the GST liabilities of the business itself. Quarterly GST remittance for small businesses is considered to provide an appropriate trade-off between the risk to revenue and the reduction in compliance costs.

9.1.25 The Board considers that the current law provides the most appropriate outcome.

REFUNDS AND NOMINATED BANK ACCOUNT

Existing law and practice

9.1.26 The tax law gives the Commissioner a discretion to direct that refunds be *paid to the entity in a different way*. The Commissioner exercises his discretion to direct that electronic refunds be paid into a nominated third-party account when authorised to do so by the entity.

9.1.27 The discretion to make an electronic refund to a nominated third-party account may be exercised where the following criteria are satisfied:

- the overall policy intent⁶⁵ is maintained;
- there is a significant legal relationship between the entity entitled to the refund and the entity (third party) into whose financial institution account it will be paid;
- the nominated account is maintained at an office or branch of a financial institution in Australia;
- the entity entitled to the refund gives the Commissioner a clear authority to pay the refund to the nominated financial institution account; and
- there is a legislative requirement, a standard industry or commercial practice, or a legal reason for the refund to be paid to that third party.

View raised in submissions and consultation sessions

9.1.28 A submission expressed the view that it is inappropriate that refunds can only be paid to a bank account that has the taxpayer's name.

Findings

9.1.29 The Board considers that the current law is appropriate as it already provides a number of options as to how refunds can be paid.

9.1.30 Generally, refunds are paid via an electronic funds transfer to the taxpayer's bank account.

9.1.31 The account nominated must be maintained at a branch or office of the institution that is in Australia.

9.1.32 The payment of refunds into a bank account in the taxpayer's name is a refund system integrity measure.

9.1.33 The Board notes that the account may also be:

- jointly held by the taxpayer with other entities;
- held by their registered tax agent; or
- held by a legal practitioner (that is, a barrister or solicitor) acting as the taxpayer's trustee or executor.

65 of section 8AAZLH of the TAA.

9.1.34 The refund may, however, be paid by cheque or paid into a nominated third-party account when certain criteria are satisfied.⁶⁶

RETROSPECTIVE CANCELLATION AND ENTITY WRONGLY TREATED AS NOT CARRYING ON AN ENTERPRISE

Existing law and practice

9.1.35 The GST law provides that the Commissioner can retrospectively register an entity for GST. Entities registered in this way are taken to have made taxable supplies and creditable acquisitions and importations from the day on which they have been registered.

9.1.36 Also, the Commissioner must retrospectively cancel a registration where the Commissioner establishes that the entity does not carry on an enterprise.

View raised in submissions and consultation sessions

9.1.37 One submission was critical of a circumstance where a taxpayer was disadvantaged when the Tax Office view of whether they were carrying on an enterprise was overturned by a court or tribunal.

Example

The GST registration of an entity was cancelled retrospectively by the Tax Office as the entity was not considered to be carrying on an enterprise. The taxpayer appealed to the Administrative Appeals Tribunal (AAT) on the basis that it was carrying on an enterprise and should be registered for GST. The cancellation was overturned by the AAT.

The entity was then reregistered retrospectively as it argued at the AAT and was now liable to remit GST on supplies made by it during the period of the dispute (that is, from the date on which the registration was cancelled to the date on which the registration was re-instated following the AAT decision in the taxpayer's favour).

However, the entity may not have collected GST from purchasers or remitted GST during this period and it cannot pass on GST to purchasers for transactions that have been completed.

Findings

9.1.38 The Board considers that the particular circumstances of taxpayers in these situations should be addressed by the Tax Office on a case-by-case basis.

66 PS LA 2004/7.

9.1.39 The Board considers that no change in law is required.

THRESHOLDS

Existing law and practice

9.1.40 There are various thresholds for GST, including:

- registration (one general and one for non-profit bodies);
- requirement to use monthly tax periods;
- requirement to lodge GST returns electronically;
- various small business concessions; and
- the financial acquisition threshold.

View raised in submissions and consultation sessions

9.1.41 A submission expressed concern about the number of GST turnover thresholds, and the provisions governing them, thereby making the law extremely complex. The submission suggested that all thresholds be structured on a positive, ascending basis. It was also suggested that threshold levels should be regularly reviewed.

Findings

9.1.42 The Board considers that the current design of the thresholds applies effectively and does not impose excessive compliance costs.

CHARITABLE INSTITUTIONS AND NON-PROFIT BODIES — CALCULATION OF GST-FREE SUPPLIES

Existing law and practice

9.1.43 A supply is GST-free if the supplier is (broadly) a charitable institution or fund, a gift deductible entity or a government school and the supply is for consideration that:

- if the supply is a supply of accommodation — is less than 75 per cent of the GST inclusive *market value* of the supply; or
- if the supply is not a supply of accommodation — is less than 50 per cent of the GST inclusive *market value* of the supply.

9.1.44 In addition, a supply is GST-free if the supplier is (broadly) a charitable institution or fund, a gift deductible entity or a government school and the supply is for consideration that:

- if the supply is a supply of accommodation – is less than 75 per cent of the *cost to the supplier of providing* the accommodation; or
- if the supply is not a supply of accommodation – is less than 75 per cent of the *consideration* the supplier provided, or was liable to provide, for acquiring the thing supplied.

View raised in submissions and consultation sessions

9.1.45 It was suggested in a number of submissions that charitable institutions and similar entities should be entitled to pool acquisitions and related supplies in determining whether supplies are made at less than 75 per cent of the cost of providing them and thus GST-free under the GST law.

9.1.46 It was also suggested that the GST and income tax law should be streamlined to ensure that contributions made to charitable institutions that are income tax deductible as gifts are not treated as consideration for a taxable supply made by the charitable institution to the donor.

9.1.47 Also raised in public consultation was the compliance cost for charities in continually obtaining new valuations for the purposes of determining that supplies made by charitable institutions are GST-free. An option was proposed where existing valuations could be subject to indexation to extend the time period before revised valuations are required.

Findings

9.1.48 It is considered that the proposed change to the pooling method for determining the market value of supplies is an administrative matter for the Commissioner and should not be addressed as part of this review. The Commissioner could consider whether an administrative approach could be adopted to extend the period over which a valuation remains valid if it is indexed annually. The proposed change to reduce the scope of consideration to the extent it relates to contributions that are deductible for income tax purposes, is outside the terms of reference for the review as it would result in a greater range of circumstances in which GST-free treatment would apply.

APPROPRIATIONS

Existing law and practice

9.1.49 The GST law⁶⁷ provides that a payment made by a government-related entity to another government-related entity is not the provision of consideration if the payment is specifically covered by an appropriation under an Australian law.

9.1.50 Public Ruling GSTR 2006/11 on appropriations is the Commissioner's current interpretation of the law. Two earlier public rulings on the topic have been withdrawn.

View raised in submissions and consultation sessions

9.1.51 While this provision was included in the GST Act to specifically exclude government appropriations from GST and to make these transactions administratively simple to calculate their GST status, in practice it has actually increased the complexity of this type of transaction and as such calculating its GST status. This complexity is highlighted by the fact the Tax Office has issued three separate rulings on this issue.

Findings

9.1.52 The Board considers this issue is out of scope of the review because any changes would affect the scope and extent to which goods and services are subject to GST.

ASSOCIATE PROVISIONS AND INCOME TAX LAW

Existing law and practice

9.1.53 Income tax liabilities are based on the GST exclusive amounts. Income tax deductions exclude input tax credit entitlement. Where the associate provisions operate, the amount on which GST is charged, and hence the corresponding input tax credit entitlement, is higher than the actual payment. That is, either there has not actually been an expenditure, or the expenditure is less than the market value on which GST operates.

View raised in submissions and consultation sessions

9.1.54 The Taxation Institute of Australia raised in its submission that the income tax provisions that are aimed at excluding the effect of the GST payable or refundable do not operate effectively, in relation to GST that is payable under the associate provisions.

⁶⁷ Subsection 9-15 (3)(c) of the GST Act.

9.1.55 The Taxation Institute of Australia recommended amendments to ensure the appropriate tax treatment of credits and liabilities arising under the associate provisions in the GST Act.

Findings

9.1.56 The intent of the income tax provisions is to exclude money paid over as GST from being included in assessable income and input tax credits claimed from being allowed as a tax deduction.

9.1.57 The issue of whether the income tax provisions appropriately account for the GST consequences of the associate provisions is out of scope of this review because any amendments, if necessary, would need to be made to the income tax law.

BODY CORPORATE AND SINKING FUNDS

Existing law and practice

9.1.58 Bodies corporate charge levies for various purposes, including to accumulate money in sinking funds to cover future expenses. These levies are consideration for supplies made by the body corporate to its members and are subject to GST.

View raised in submissions and consultation sessions

9.1.59 It was suggested that payments into sinking funds for strata plans should be treated as deposits and not payments to a separate entity and therefore not be subject to GST.

Findings

9.1.60 The Board considers this issue is out of scope of the review because the view proposes a change from taxable treatment to not subject to GST.

FLIGHTS CONNECTING WITH SEA VOYAGES

Existing law and practice

9.1.61 International flights are GST-free. Domestic flights sold as part of the one ticket for an international air journey are also GST-free, as are international sea voyages.

9.1.62 Other transport passengers use to reach the start of the international flight is not GST-free.

9.1.63 The domestic leg of a passenger's sea voyage is GST-free if it is part of the international voyage and is provided by the same supplier.

9.1.64 Domestic flights, or other transport, used to reach the start of the sea voyage are not GST-free.

View raised in submissions and consultation sessions

9.1.65 Domestic flights connected with an international sea voyage are not given the same treatment as domestic flights connected with an international flight when the transport within Australia is part of the ticket for international travel.⁶⁸

9.1.66 It was suggested in the submission that a domestic flight connected with an international sea voyage be given the same treatment as a domestic flight connected with an international flight and be GST-free if the transport within Australia was part of the ticket for international travel.

Findings

9.1.67 The Board considers this issue is out of scope of the review because it is seeking to treat taxable transactions as GST-free.

FORFEITED DEPOSITS

Existing law and practice

9.1.68 Currently, deposits are considered to be provided as part of the consideration for a supply of a good or service. As a result, GST is charged on the deposit if the underlying supply is taxable, even if the purchaser fails to pay the remaining consideration and the deposit is subsequently forfeited.

View raised in submissions and consultation sessions

9.1.69 It was suggested that deposits should be treated as input taxed, similar to financial supplies.

Findings

9.1.70 The Board considers this issue is out of scope of the review because it proposes a change from taxable treatment to input taxed.

68 Section 38-355 of the GST Act.

FRINGE BENEFITS TAX

Existing law and practice

9.1.71 The price of a supply of a fringe benefit is the amount of consideration in the form of the recipient's payment or the recipient's contribution.

9.1.72 Where a taxpayer makes a taxable supply of a fringe benefit, they are only liable for GST to the extent of the consideration payable on the supply in the form of a recipient's payment or the recipient's contribution.

9.1.73 The recipient's payment or the recipient's contribution that reduces the fringe benefits tax taxable value of a fringe benefit is consideration for the supply of that benefit.

9.1.74 Similarly, employee payments made for benefits with no fringe benefits tax value, or that are fringe benefits tax exempt benefits, are also employee consideration for the supply of those benefits

9.1.75 The application of fringe benefits tax takes account of GST.

View raised in submissions and consultation sessions

9.1.76 The fringe benefits tax law takes into account the GST consequences of employee benefits by increasing the amount of fringe benefits tax payable. However, it was suggested that it is more appropriate for this revenue to remain within the GST base. Accordingly, it was submitted that the taxable value should be included as a deemed taxable supply for GST purposes in the tax period in which the fringe benefits tax return is lodged.

Findings

9.1.77 The Board considers this issue is out of scope of the terms of reference for the review because the suggested change would result in a change in the scope and extent of what goods and services are subject to the GST.

INSURANCE AND STAMP DUTY

Existing law and practice

9.1.78 Stamp duty on insurance policies is excluded from the value of the supply of insurance for the purposes of calculating GST.

View raised in submissions and consultation sessions

9.1.79 Small businesses will often not be aware of how this affects their input tax credit entitlement. It was recommended that this exception be removed for minor supplies of insurance (those less than \$1,000 including stamp duty).

Findings

9.1.80 The Board considers this issue is out of scope of the review because the view proposes change to base under which GST is calculated and hence relates to the scope and extent to which goods and services are subject to GST.

PROPERTY AND RESIDENTIAL PREMISES

Existing law and practice

9.1.81 A supply of residential premises (other than commercial residential premises, like hotels etc) by way of sale, lease, hire or licence, is input taxed, but only to the extent to which the premises are to be used predominantly for residential accommodation.

View raised in submissions and consultation sessions

9.1.82 In many instances, the application of the residential premises rules in the GST Act is non-problematic. However, more complex boundary issues arise where residential premises come in and out of the GST registration system, and where residential premises are supplied for non-residential purposes.

9.1.83 A submission considered the Tax Office's view, based only on the physical construction of the premises and not the objective *expected use* of the premises, was flawed.

Findings

9.1.84 The Board considers this issue is out of scope of the terms of reference for the review because any change would result in some existing supplies of residential premises being taxable supplies and some taxable supplies of residential premises being treated as input taxed supplies.

REGISTRATION THRESHOLD AND CHARITIES

Existing law and practice

9.1.85 Entities have to register for GST if their turnover is over the threshold of \$75,000. However, non-profit bodies do not have to register until their turnover is over the threshold of \$150,000 or above.

View raised in submissions and consultation sessions

9.1.86 It was submitted that the compliance costs associated with being registered are greater than the benefit of being registered, such as with university residential colleges that make GST-free non-commercial supplies.

9.1.87 A suggestion was made that there should only be one registration threshold for non-profits, charities and other entities.

Findings

9.1.88 The Board considers this issue is out of scope of the review because changes to the threshold will result in a change to the scope and extent to which goods and services are subject to GST.

REGULAR REVIEWS

Existing law and practice

9.1.89 Not applicable

View raised in submissions and consultation sessions

9.1.90 It was suggested in the consultation process that there is a need to ensure that the GST review process produces meaningful improvements in the administration of GST, and that a process be put in place to deliver ongoing reforms, specifically recommended were:

- a medium-term efficiency dividend;
- an ongoing annual report on the relative competitiveness of our GST system; and
- a follow-up review in three years.

Findings

9.1.91 The Board notes that the Inspector-General of Taxation is able to examine systemic issues of tax administration.

9.1.92 The process for further reviews of the GST law is not within the terms of reference of the Board.

RETIREMENT VILLAGES

Existing law and practice

9.1.93 Retirement villages make a mixture of GST-free, input taxed and taxable supplies to their residents.

View raised in submissions and consultation sessions

9.1.94 A submission recommended retirement villages should be able to treat all sales and leases of accommodation and services in retirement villages as input taxed.

9.1.95 It was also suggested that GST-free serviced apartment accommodation should be based on the care needs of residents only and not whether there is a common corridor.

Findings

9.1.96 The Board considers this issue is out of scope of the review as it relates to the scope and extent to which goods and services are subject to GST.

RUNNING BALANCE ACCOUNTS ADMINISTRATION

Existing law and practice

9.1.97 The Running Balance Account is a mechanism in the TAA to consolidate taxpayer credits and debts from different taxes.

View raised in submissions and consultation sessions

9.1.98 During consultation, large organisations with multiple entities said they spend 3 to 4 days per month on the administration of Running Balance Accounts.

9.1.99 They suggested the refunds provision in the TAA should form an exclusive code for GST related refunds excluding the general Running Balance Account rules.

Findings

9.1.100 The Board considers this issue is out of scope of the review because this issue is a general tax administration issue.

SUPPLIES MADE THROUGH A PERMANENT ESTABLISHMENT

Existing law and practice

9.1.101 Supplies of things other than goods or real property that are done in Australia, or are made through an enterprise the supplier carries on in Australia, are connected with Australia and can be taxable supplies.

9.1.102 An enterprise is carried on in Australia if it is carried on through what is a permanent establishment for income tax purposes, or what would be a permanent establishment but for certain exclusions from the definition of permanent establishment.

View raised in submissions and consultation sessions

9.1.103 The definition of a permanent establishment in the GST law is wider than in the income tax law. This means that activities are likely to be carried on through an enterprise in Australia, requiring registration and GST being payable, when they would not result in income tax.

Findings

9.1.104 The Board considers this issue is out of scope of the review because changes to the permanent establishment definition will affect the scope and extent to which goods and services are subject to GST.

TRANSFER OF PROPERTY BY PARTITION

Existing law and practice

9.1.105 The Commissioner's preliminary view in draft public ruling GSTR 2008/D3 states that under a partition of land by agreement, the transfer or conveyance by each co-owner of their respective interest in the land to be taken by the other co-owners in severalty is a supply.⁶⁹

View raised in submissions and consultation sessions

9.1.106 The issue for GST purposes is whether a partition by agreement where each co-owner's interest remains equal, will result in a supply for GST purposes. Based on the wide definition of supply in the GST Act, partitioning is likely to result in supplies being made between the parties. However, it is merely a change of legal interests for no monetary consideration which is ignored for stamp duty purposes, and recognising it

⁶⁹ As defined in subsection 9-10(1) of the GST Act.

as a supply for GST purposes will create very complex accounting for GST margin scheme sales for little (if any) net revenue.

9.1.107 It was submitted that supplies by way of partition should be ignored for GST purposes and expressly set out as an exclusion to a supply.⁷⁰

Findings

9.1.108 The Board considers this issue is out of scope of the review because taxable transactions would be treated as not subject to GST.

UNCERTAINTY CREATED BY GST DRAFTING

Existing law and practice

9.1.109 The GST law⁷¹ provides that consideration includes any payment, or any act or forbearance, in connection with a supply of anything.

View raised in submissions and consultation sessions

9.1.110 It was submitted that the words *in connection with* in the definition of consideration should be more closely aligned with the approach adopted in the European Union.

9.1.111 It was also submitted that the creditable acquisition rules⁷² do not operate appropriately to allow input tax credit relief for capital raising costs, the costs of mergers and acquisitions and employee accommodation. It was suggested that they be redrafted to provide more broad relief for GST incurred by enterprises, and also acquisitions related to exports, and acquisitions by government and charities.

Findings

9.1.112 The Board considers change from the term *in connection with* is out of scope of the review because it would narrow the scope and extent of what goods and services are subject to the GST. It would also result in fewer circumstances in which amounts would be considered to be consideration in connection with taxable supplies, and hence is a matter relating to the scope and extent to which goods and services are subject to GST.

9.1.113 The Board considers the issue around the creditable acquisition rules is also out of scope of the review because it would broaden the range of creditable

70 As a new sub-paragraph in section 9-10(4) of the GST Act.

71 Subsection 9-15(1) of the GST Act.

72 Section 11-15 of the GST Act.

acquisitions and hence also relates to the scope and extent to which goods and services are subject to GST.

Summary of out of scope and status quo issues

Area	Status quo or out of scope	Chapter reference
Adjustments and bad debts	Status quo	Chapter 2.2 Adjustments
Aligning attribution rules with accounting practice	Status quo	Chapter 2.3 Accounting for transactions
Associate definition	Status quo	This chapter
BAS labels	Status quo	Chapter 2.1 Small businesses
Director penalty notices	Status quo	This chapter
Flexibility in compliance	Status quo	This chapter
GIC applying to business-to-business taxable transactions treated as GST-free	Status quo	Chapter 3.1 General interest charge
Grouping and religious groups	Status quo	Chapter 7.1 Grouping and joint ventures
Input tax credits and extent of creditable purposes — apportionment methods	Status quo	Chapter 2.5 Entitlement to input taxed credits
Insurance and third-party status	Status quo	This chapter
Joint venture — not a separate legal entity	Status quo	Chapter 7.6 Multiple roles and the offsetting of credits and debits
Joint venture — scope of activities	Status quo	Chapter 7.1 Grouping and joint ventures
Lodgment date extensions	Status quo	Chapter 3.3 Period of review
Lodgment of BAS early	Status quo	Chapter 2.1 Small businesses

Summary of out of scope and status quo issues (continued)

Moving from monthly to quarterly tax periods	Status quo	Chapter 2.1 Small businesses
Quarterly thresholds for PAYG withholding and GST instalments	Status quo	This chapter
Refunds and nominated bank account	Status quo	This chapter
Retrospective cancellation and entity wrongly treated as not carrying on an enterprise	Status quo	This chapter
Thresholds	Status quo	This chapter
Trust definition	Status quo	Chapter 7.4 Trusts
Direct refund system for non-residents	Mainly status quo	Chapter 6 Non-residents
Taxable importations and creditable importations	Mainly status quo	Chapter 6 Non-residents
Charitable institutions and non-profit bodies — calculation of GST-free supplies	Status quo and out of scope	This chapter
Appropriations	Out of scope	This chapter
Associate provisions and income tax law	Out of scope	This chapter
Body corporate and sinking funds	Out of scope	This chapter
Breadth of Australia's GST law and non-resident entities	Out of scope	Chapter 6 Non-residents
Entitlement to input tax credit for capital raising	Out of scope	Chapter 5 Financial supplies
Flights connecting with sea voyages	Out of scope	This chapter
Forfeited deposits	Out of scope	This chapter
Fringe benefits tax	Out of scope	This chapter
GIC remission	Out of scope	Chapter 3.1 General interest charge
Insurance and stamp duty	Out of scope	This chapter
Multi-party transactions and ambulance services	Out of scope	Chapter 2.5 Entitlement to input tax credits

Summary of out of scope and status quo issues (continued)

Property and residential premises	Out of scope	This chapter
Recipient created tax invoices	Out of scope	Accounting for transactions
Registration threshold and charities	Out of scope	This chapter
Regular reviews	Out of scope	This chapter
Retirement villages	Out of scope	This chapter
Running balance accounts administration	Out of scope	This chapter
Supplies made through a permanent establishment	Out of scope	This chapter
Transfer of property by partition	Out of scope	This chapter
Uncertainty created by GST drafting	Out of scope	This chapter

GLOSSARY

AAT	Administrative Appeals Tribunal
ABA	Australian Bankers' Association Inc
ABR	Australian Business Register
ABN	Australian Business Number A business identifier which acts as the GST registration number. For a recipient to claim input tax credits, the ABN must normally appear on the supplier's tax invoice.
AFMA	Australian Financial Markets Association
APPEA	Australian Petroleum Production & Exploration Association Limited
BAS	Business Activity Statement Used by businesses to account to the Tax Office for their GST liabilities and credit entitlements.
Board	Board of Taxation A non-statutory advisory body charged with contributing a business and broader community perspective to improving the design of taxation laws and their operation.
CBA	Commonwealth Bank of Australia
CPA	CPA Australia Limited
CTA	Corporate Tax Association
Class rulings	Specific types of public rulings, which aim to provide certainty to participants in similar arrangements and remove the need for individual participants to seek private rulings.
Commissioner	Commissioner of Taxation Parliament has vested responsibility for administering a range of tax and superannuation legislation in the Commissioner of Taxation.
FBT	Fringe Benefits Tax
General law partnership	An association of persons carrying on business as partners.

GIC	<p>General Interest Charge</p> <p>A uniform interest charge imposed where there is a late payment of a tax debt. The rate is worked out using a statutory formula based on the monthly average yield of 90 day Bank Accepted Bills published by the Reserve Bank of Australia plus two uplift factors to discourage use of the revenue for loans and to encourage prompt payment. The rate of GIC, excluding the uplift factors, generally reflects the interest rate charged by financial institutions on unsecured loans and is updated quarterly.</p>
GST	<p>Goods and Services Tax</p>
GST act	<p><i>A New Tax System (Goods and Services Tax) Act 1999</i></p>
GST-free	<p>One of the types of supply that is excluded from being subject to GST.</p> <p>There is no liability for GST on a GST-free supply, but the supplier can claim input tax credits for the GST on its own related acquisitions.</p> <p>The main GST-free items are specified exports, health, food, education, international travel and certain charitable activities.</p>
GST private rulings	<p>Any written ruling or written advice about GST that the Commissioner gives to a particular entity.</p>
GST public rulings	<p>All forms of written advice involving the interpretation of the GST law, other than GST private rulings.</p>
GST regulations	<p><i>A New Tax System (Goods and Services Tax) 1999 Regulations</i></p>
HIA	<p>Housing Industry Association</p>
ICA	<p>Insurance Council of Australia</p>
ICAA	<p>The Institute of Chartered Accountants in Australia</p>
IFSA	<p>Investment & Financial Services Association Limited</p>
IGA	<p><i>Intergovernmental Agreement on the Reform of Commonwealth-State Relations</i></p> <p>The IGA requires the agreement of all the States and Territories to change the GST rate or base.</p>
Indirect tax rulings	<p>Any ruling or advice given or published by the Commissioner in relation to GST, wine equalisation tax and luxury car tax (but not fuel tax)</p>
Indirect taxes	<p>A direct tax is imposed on the person it is intended bear the cost.</p> <p>An indirect tax is a tax whose incidence falls on someone with the intent for them to pass on the cost of the tax, through means such as higher prices, to the persons it is intended bear the cost of the tax.</p> <p>For the purposes of the <i>Taxation Administration Act 1953</i>, indirect taxes are defined to include GST, wine equalisation tax and luxury car tax.</p>

Input taxed supplies	<p>One of the types of supply that is not directly subject to GST.</p> <p>There is no liability for GST on supplies made, and the supplier cannot claim input tax credits for the GST on its own acquisitions.</p> <p>The main input taxed items are financial services and the supply of residential premises.</p>
Intergovernmental Agreement	<p><i>Intergovernmental Agreement on the Reform of Commonwealth-State Relations.</i></p> <p>This exists between the Commonwealth and the States and Territories, and under the agreement, all GST revenue is paid to the States and Territories.</p>
IPA	Insolvency Practitioners Association of Australia
ITAA36	<i>Income Tax Assessment Act 1936</i>
ITAA97	<i>Income Tax Assessment Act 1997</i>
LCT	<p>Luxury car tax</p> <p>Luxury car tax is a tax of 33 per cent imposed on luxury cars. It is generally payable when a car is sold or imported at the retail level. It is in addition to any GST payable.</p>
NARGA	National Association of Retail Grocers of Australia Pty Ltd
NIA	National Institute of Accountants
Partnership	An association of persons (other than a company or a limited partnership) carrying on business as partners, or in receipt of ordinary income or statutory income jointly, or a limited partnership.
PAYG	Pay as you go
PCA	Property Council of Australia
Period of review	<p>For income tax - the period in which the Commissioner can make an amendment to a taxpayer's assessment.</p> <p>There are significant differences between the GST rules and the equivalent income tax provisions (see Chapter 3 for details).</p>
Private ruling (income tax)	A written ruling on the way in which the Commissioner considers a relevant provision applies or would apply to a person in relation to a specified scheme.
Product ruling (income tax)	Specific types of public rulings which aim to provide certainty to participants in similar arrangements and remove the need for individual participants to seek private rulings.
Public ruling	A published written ruling on the way in which the Commissioner considers a relevant provision applies or would apply to entities generally or a class of entities.
RCTI	Recipient-created tax invoice

RoSA	<p>Review of Aspects of Income Tax Self Assessment</p> <p>Recommendations from the 2004 review aimed to improve taxpayer certainty by improving the framework for the Commissioner's advice, reducing exposure to the risk of increased liabilities, and mitigating the penalty and interest consequences of errors made by taxpayers acting in good faith.</p>
RoSA rulings regime	<p>Division 357 of Schedule 1 to the <i>Taxation Administration Act 1953</i> provides a rulings regime which applies to specified taxes, including income tax. This regime does not apply to indirect taxes such as the GST.</p>
SAM	<p>Simplified Accounting Methods</p> <p>The Commissioner can create simplified accounting methods that entities with turnover below \$2 million can choose to apply with a view to reducing their costs of complying with the requirements of the GST.</p>
SIC	<p>Shortfall Interest Charge</p> <p>As a result of the RoSA changes, the SIC replaces the GIC with a charge at a lower rate for the period between when an income tax shortfall amount would originally have been due and when the shortfall is corrected in an amended assessment.</p>
TAA	<p><i>Taxation Administration Act 1953</i></p>
Tax law partnership	<p>An association of persons that is not in business, but that is nevertheless in receipt of ordinary income or statutory income jointly.</p>
Tax Office	<p>The Australian Taxation Office is the Government's principal revenue collection agency. Its role is to manage and shape tax, excise and superannuation systems that fund services for Australians.</p>
Tax periods	<p>For GST they may be monthly, quarterly or annual, depending on the taxpayer's circumstances.</p>
TIA	<p>Taxation Institute of Australia</p>
Wash transaction	<p>Transactions with no net impact on revenue. For example, where supply that is incorrectly treated as not being subject to GST is made to a purchaser who would have been eligible to claim an input tax credit if the supply was treated as taxable.</p>
WET	<p>Wine equalisation tax</p> <p>A value-based tax which is applied to wine consumed in Australia. It applies to assessable dealings with wine (unless an exemption applies) that include wholesale sales, untaxed retail sales and applications to own use. The wine equalisation tax rate is 29 per cent of the wholesale sale value.</p>
VAT	<p>Value-added tax</p>

APPENDIX A: LIST OF RECOMMENDATIONS

Recommendation 1: Simpler BAS method for reporting GST

The GST law should be amended to provide for a simpler BAS method for reporting GST by having:

- a business norm percentage applying for start-ups; and
- an expanded instalment option available to all businesses and not-for-profit organisations with a turnover less than \$2 million. This would apply after their first year of operation, including for those in a net refund position.

In both cases, a reconciliation would be undertaken to coincide with the timing of the lodgment of the income tax return.

Recommendation 2: Net refund position

If the recommendation for a simpler BAS method for reporting GST is not accepted, the degree of detail in the legislation to determine whether a taxpayer is in a net refund position should be removed and replaced with more principled rules.

Recommendation 3: Streamline BAS reporting concessions

If a simplified BAS method is implemented, current reporting concessions should be reviewed.

Recommendation 4: Adjustments for changes in use

The GST law should be amended to provide that higher thresholds, together with fewer and shorter adjustment periods, should apply for adjustments (for example, two years for acquisitions less than \$100,000, five years for those over \$100,000, and ten years for real property). Where possible, the existing provisions should be consolidated within the GST law and aligned with other relevant rules elsewhere in the tax system.

Adjustments for private use should be explicitly aligned with the percentage of private use for income tax purposes. Adjustments for input taxed use should only occur where the change in use is significant (for example, greater than 10 per cent change in use).

Recommendation 5: Adjustments for cessation of registration

Taxpayers should not be required to make adjustments in relation to goods in the event that they deregister, provided the goods are effectively exported and used in the non-Australian enterprise.

Technical amendments should be made to the provisions relating to attribution and entitlement upon cessation of registration to ensure consistent and appropriate treatment of all taxpayers.

Recommendation 6: Adjustments for manufacturers' rebates

The GST law should be amended to ensure that adjustments for manufacturers' rebates, which in effect change the price of a transaction, result in adjustments for the payer and the third party, reflecting the economic outcomes of the transaction.

Recommendation 7: Technical amendment — adjustments

The GST law should be amended to ensure consistency and certainty in the use of the terms *apply* and *application* in the adjustment provisions.

Recommendation 8: Adjustments for pre-registration acquisitions

The GST law should be amended to allow an entitlement for an adjustment to the extent of the remaining economic value for things acquired before an entity was registered for GST. The amendment should not apply to adjustments that are already available.

Recommendation 9: Tax invoices

Where a tax invoice is not regarded as valid for minor reasons, taxpayers should not be required to seek a valid tax invoice from the supplier, where they have other documents that confirm the GST treatment of the supply and the amount of GST. This option should be available to taxpayers without first seeking the agreement of the Commissioner.

Where a taxpayer makes all reasonable efforts to obtain a tax invoice, but cannot, they can treat another suitable document as a tax invoice, provided they notify the Commissioner, and meet any other requirements as determined by the Commissioner.

Recommendation 10: Technical amendment — tax invoices and attribution

The GST law should be amended to clarify that an input tax credit can be claimed in a later tax period even though the relevant tax invoice was first held in an earlier period.

Recommendation 11: Adjustment notes

The threshold at which an adjustment note must be held should be increased from \$50 to \$75.

Recommendation 12: Business-to-business transactions

For supplies where it is not possible to know at the time of entering into a transaction the extent to which it is taxable, registered parties should by mutual agreement be allowed the option to treat the transaction as fully taxable. This should not apply to a supply where a part or all of it is an input taxed supply.

Recommendation 13: Correcting GST mistakes

Taxpayers should be able to correct all GST and other indirect tax mistakes through the current BAS or a supplementary BAS, without altering the requirement for taxpayers to pay the general interest charge, or other interest charges and penalties, where these would currently apply.

Taxpayers should also be able to self assess their interest charge liability when correcting GST mistakes.

Recommendation 14: Multi-party transactions

The Board considers that it is important that the Government further examine the treatment of multi party transactions in order to eliminate unrecoverable tax. The Government should have regard to overseas work in this area.

Recommendation 15: Vouchers

The Government should undertake a review of the Australian GST vouchers regime, having regard to overseas work in this area, including that undertaken by the European Union, with a view to developing a simpler system with lower compliance costs.

Recommendation 16: Shortfall interest charge

A shortfall interest charge (SIC) should apply to the GST and other taxes reported on the BAS, including luxury car tax, wine equalisation tax and fuel tax credits.

Recommendation 17: Rulings

The income tax ruling system should be adopted for GST, luxury car tax and wine equalisation tax, with appropriate modifications including an exception for oral rulings.

The Government may wish to consider whether the oral rulings system should continue to be offered for other taxes, including income tax.

Recommendation 18: Relying on, and being bound by, private rulings issued to the other party to a supply

Recipients and suppliers should be able to rely on each other's rulings in relation to the tax status of the supply between them, where they agree to provide their rulings to each other for this purpose. Where recipients and suppliers agree to rely on the other's ruling then they should be bound to apply the ruling in the preparation of their BAS, but may object to the other's ruling.

However, this should not extend to supplies in other parts of the supply chain.

Recommendation 19: Period of review

The four-year period of review for the GST, luxury car tax, wine equalisation tax and fuel tax credits should be refreshed in cases where the Commissioner or the taxpayer reduces (or increases) the amount of tax payable or increases (or reduces) a refund payable to a taxpayer based on the information provided by the taxpayer, but only in respect of the particular that led to the review.

Recommendation 20: Limited time to claim input tax credits

The law should be amended to limit claims for input tax credits to a four-year period in line with the time limit on refunds and credits provision in the *Taxation Administration Act 1953* and to clarify that a taxpayer can defer input tax credit claims (within these limits) even if they held a tax invoice at the end of the period to which the credit would otherwise be attributable.

Recommendation 21: Self assessment

Greater harmonisation should be introduced between the current self actuating system for GST, wine equalisation tax, luxury car tax and fuel tax credits and the income tax system of self assessment.

Recommendation 22: Margin scheme

The Government should undertake a review of the margin scheme, focussing on its effectiveness and efficiency in achieving its policy intent and how it interacts with other provisions in the GST law.

Recommendation 23: Financial supplies

The Government should undertake a review of the financial supplies provisions with a view to reducing their complexity and introducing more principled rules, while maintaining the existing policy.

Recommendation 24: Cash and accrual accounting

The Government should consider the merits of all transactions above a certain value (and meeting other criteria) being accounted for using accruals accounting.

Recommendation 25: Financial acquisitions threshold

The financial acquisitions threshold should be simplified by reducing the frequency of testing to an annual basis.

Recommendation 26: Non-residents in Australia's GST system.

The Government should consider reviewing the application of the GST to cross-border transactions with a view to simplifying and reducing the number of non-residents in the system.

Recommendation 27: Registration for non-residents

The Commissioner should consider further streamlining the proof of identity and proof of enterprise requirements for non-residents in the four circumstances in which the Board has identified that the risk to revenue is low.

Recommendation 28: Non-resident agency provisions

A resident entity which acts for a non resident but falls short of being an agent under the current provisions should be able to apply the features of the GST non-resident agency provisions. This may include a commission agent or a sub-contractor who does things on behalf of the non-resident. The non-resident and the resident entity would both have to agree.

Recommendation 29: Non-residents that need to register

Non-residents that do not account for their taxable supplies or importations and their creditable acquisitions or importations because of the current or expanded agency provisions, should no longer have to register for GST.

Recommendation 30: GST deferral scheme

The GST deferral scheme should be extended to small business taxpayers which are eligible to lodge quarterly.

All other requirements of the GST deferral scheme would need to be satisfied, including lodging on-line, paying electronically, and having an established track record and good compliance history.

Recommendation 31: Refund collection system

A system should be introduced under which residents of Australia's External Territories (Norfolk, Cocos & Keeling, and Christmas Islands) can claim refunds under the Tourist Refund Scheme if they can show proof of shipping of exported goods to their External Territory.

Recommendation 32: Grouping and GST joint ventures

GST grouping membership rules should be simplified and broadened by replacing the detailed rules with principle-based rules.

Holding companies should be entitled to register and group for GST purposes, despite not carrying on an enterprise. However, they should not be entitled to continue to be registered once they leave the group, unless at that time they are carrying on an enterprise.

Entities should be able to self assess their eligibility to form a GST group and GST joint venture. Where possible, entities should have an option to do so electronically.

Entities should be able to form, alter or revoke a GST group at any time during a tax period, and such arrangements should be extended to GST joint ventures.

Clean exit rules should be introduced to allow entities to leave GST groups or GST joint ventures clear of any GST consequences.

The impact on fuel tax credits would need to be considered.

Recommendation 33: Reverse charge mechanism

The GST-free concessions for the supply of going concerns and farm land supplied for farming should be removed and replaced with a reverse charge mechanism. The reverse charge mechanism should also be available for a wider range of supplies of going concerns.

Recommendation 34: GST-free farm land supplied for farming

The Government should consider whether the GST-free treatment of farm land supplied for farming to unregistered recipients should continue.

Recommendation 35: General law partnerships

The GST law should be amended to clarify the treatment of general law partnerships, including in relation to matters such as partner-to-partnership transactions or changes in the membership of a partnership.

Recommendation 36: Tax law partnerships

The GST law should be amended to clarify the treatment of tax law partnerships, including in relation to matters arising when a tax law partnership is formed or dissolved and when it makes a supply or an acquisition.

Recommendation 37: Bare trusts

The GST law should be amended to remove doubt surrounding the GST liabilities and entitlements of bare trusts.

Recommendation 38: Incapacitated entities

The GST law should be amended to ensure that the representative of an incapacitated entity is responsible for the GST consequences that arise from supplies, acquisitions and importations made during its appointment.

The law should also be amended to make it clear that any GST liability or entitlement should be determined as if the representative was the incapacitated entity.

In amending the law, consideration should be given to the treatment of notification of increasing adjustments, registration requirements, tax periods and returns. Consistent treatment should be considered for other indirect taxes, including fuel tax credits.

Recommendation 39: Running Balance Account

The GST law should be amended so that there is only a requirement to offset a credit against a business activity statement amount when that amount becomes due and payable and not before this time.

Additionally, the activities of each joint venture role that a joint venture operator undertakes, should be treated separately for Running Balance Account purposes, and also separately from the activities of the joint venture operator in its own capacity as an entity.

Recommendation 40: Domestic agency provisions

The scope of the domestic agency provisions should be broadened to include representatives that operate in a similar way to, but do not amount to, common law agents, such as invoicing and commission agents, and consider simplification of the underlying principles.

Recommendation 41: Technical amendment — gambling

The GST law should be amended to confirm the application of the rules about gambling to non-resident entities.

Recommendation 42: Technical amendment — luxury car tax and wine equalisation tax

The law should be amended to confirm that luxury car tax and wine equalisation tax are part of the net amount that is calculated under the GST Act.

Recommendation 43: Technical amendment — non-profit sub-entities

The GST law should be amended to ensure that non-profit sub-entities are able to access the same GST concessions as their parent entity.

Recommendation 44: Technical amendment — power to recover overpaid refunds

The law should be amended to allow over claimed refunds to be treated as an amount of tax which becomes payable when either refunded to the taxpayer or applied against a tax debt.

Recommendation 45: Payment of refunds of overpaid GST

The law should be amended to clarify that the Commissioner has a discretion to refund the GST where appropriate.

Recommendation 46: Technical amendment — associates

The GST law should be amended to remedy the interaction of the associate provisions and other provisions such as those relating to input taxed and GST-free supplies.

APPENDIX B: PRESS RELEASE — GOVERNMENT ANNOUNCEMENT OF REVIEW

Government acts to reduce GST compliance costs for business

The Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Chris Bowen MP, has asked the Board of Taxation to review the legal framework for the administration of the GST, including Labor's BAS Easy.

"This review is another step towards the Government's goal to save business, particularly small business, time and money," Mr Bowen said.

"Simplifying the rules that govern how businesses meet their GST obligations, including calculating their GST liability, will reduce red tape and compliance costs for all businesses.

"I have asked the Board of Taxation to consult with stakeholders, including small and large businesses, professional bodies and State and Territory Governments, and to report back to me by the end of December 2008."

The focus of the review will be on:

- streamlining and improving the operation of the GST;
- reducing compliance costs; and
- removing anomalies.

"The review will not extend to either the rate of the GST or the scope of goods and services that are subject to GST. I have also asked the Board of Taxation to ensure that its recommendations are broadly revenue neutral," Mr Bowen said.

The Board of Taxation had before it a reference to review the application of the income tax self-assessment principles to other taxes administered by the Taxation Commissioner, including the GST.

The Board will instead undertake this review of the legal framework of the GST. The Board's findings on the GST may then inform any consideration of the application of the self-assessment principles to other taxes.

Further information about the Board of Taxation can be found at <http://www.taxboard.gov.au>.

APPENDIX C: LIST OF PUBLIC SUBMISSIONS

Fifty-seven submissions were received. Below are the organisations and individuals which provided submissions that agreed to have their identities and submissions made available to the public.

Association of Heads of Australian University Colleges and Halls Inc

Australand Holdings Limited

Australian Bankers' Association Inc (ABA)

Australian Finance Conference, Australian Equipment Lessors Association and Australian Fleet Lessors Association.

Australian Financial Markets Association (AFMA)

Australian Petroleum Production & Exploration Association Limited (APPEA)

Australian Securitisation Forum

Challenger Financial Group

Commonwealth Bank of Australia (CBA)

Corporate Tax Association (CTA)

CPA Australia (CPA)

Easy GST refunds – Singapore

Ernst and Young

Federal Chamber of Automotive Industries

Freehills

GMA Tax (two submissions made)

Greenwoods & Freehills Pty Ltd

Housing Industry Association (HIA)

Insolvency Practitioners Association of Australia

Insurance Council of Australia (ICA)

Investment & Financial Services Association Ltd (IFSA)

KPMG

Kraal, Dr Diane⁷³

Local Government Association of Queensland Inc

Millar, Rebecca⁷⁴

Minerals Council of Australia

Minter Ellison

National Association of Retail Grocers of Australia Pty Ltd (NARGA)

National Institute of Accountants (NIA)

Northern Beaches Practitioner Tax Discussion Group

PricewaterhouseCoopers

Property Council of Australia (PCA)

Software Developers Consultative Group

Taxation Institute of Australia (TIA)

The Institute of Chartered Accountants in Australia (ICAA)

Tuor, Martin

Woolworths Ltd

73 'GST Apportionment and Industry Superannuation Funds' *Australian GST Journal*, Volume 8, Issue 9 October 2008.

74 Draft paper prepared for the Corporate Law Association Conference 'Commercial Practice in a Global Economy' (organised in conjunction with the Parsons Centre, Sydney University), held on 1 August 2008.

APPENDIX D: TERMS OF REFERENCE

Terms of Reference for Consultation on Review of the Legal Framework for the Administration of GST

The Board of Taxation should consult with relevant stakeholders and report to the Government on the merits of possible changes to the legal framework for the administration of the goods and services tax. The intent of any possible changes should be to reduce compliance costs, to streamline and improve the operation of the GST and remove anomalies in the following areas:

Liabilities and entitlements — as set out in the *Taxation Administration Act 1953* (Tax Administration Act)

For example:

- refunds of overpaid GST
- period of review of GST payable and refunds
- general interest charge
- rulings

Adjustment and entity rules — as set out in the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)

For example:

- adjustments to previously declared GST or input tax credits
- correcting GST mistakes
- tax law partnerships and general law partnerships
- GST grouping
- joint ventures

Accounting for GST — as set out in the GST Act

For example:

- attribution of GST and input tax credits and tax invoice requirements
- tax periods and accounting for GST and calculating GST obligations.

In pursuing the reference, the Board should ensure that its consultations and recommendations focus on the legal framework for the administration of the GST as set out in the TAA and GST Act. Whilst the Board may consider related issues to the above categories consistent with its terms of reference, its work should not extend to the rate of the GST or the scope and extent of what goods and services are subject to the GST. The Board should also not examine questions of the Commissioner of Taxation's effectiveness in administering the GST law as these are subject to separate ongoing review by other statutory office holders.

The Board should have regard to the design features of the GST as a multi-stage value added tax and should also ensure that any possible changes do not undermine the integrity of the GST. In considering any changes to reduce compliance costs to streamline and improve the operation of the GST and remove anomalies, the Board should ensure that its recommendations are broadly revenue neutral. The Board should also consider the implications of any possible changes to GST administration provisions for other indirect taxes that currently share common tax administration provisions in the TAA or the GST Act.

The Board should consult widely with business on the basis of a discussion paper and then undertake targeted consultation with affected taxpayers, including small and large businesses, professional bodies and State and Territory governments. Regional representatives should also be included in the consultations. The Board should report to the Government by the end of December 2008 on the outcome of its consultations and its recommendations.

APPENDIX E: MEMBERS, CHARTER OF THE BOARD OF TAXATION AND CONFLICT OF INTEREST DECLARATION

Members

The members of the Board of Taxation are:

Chairman

Mr Richard F E Warburton AO

Deputy Chairman

Mr Chris Jordan AO

Members

Mr John Emerson AM

Mr Brett Heading

Mr Keith James

Mr Eric Mayne

Mr Curt Rendall

Ex officio members

Mr Michael D'Ascenzo (Commissioner of Taxation)

Dr Ken Henry AC (Secretary to the Treasury)

Mr Peter Quiggin (First Parliamentary Counsel)

Secretariat

Members of the Board's Secretariat who contributed to this report were Ms Christine Barron (Secretary) and Ms Anne Millward.

Charter

Mission

Recognising the Government's responsibility for determining taxation policy and the statutory roles of the Commissioner of Taxation and the Inspector-General of Taxation, the Board's mission is to contribute a business and broader community perspective to improving the design of taxation laws and their operation.

Membership

The Board of Taxation will consist of up to ten members.

Up to seven members of the Board will be appointed by the Treasurer, for a term of up to three years, on the basis of their personal capacity. It is expected that these members will be appointed from within the business and wider community having regard to their ability to contribute at the highest level to the development of the tax system. The Chairman will be appointed by the Treasurer from among these members of the Board. If the Treasurer decides to appoint a Deputy Chairman, he or she will also be appointed from among these members of the Board. Members may be re-appointed.

The Secretary to the Department of the Treasury, the Commissioner of Taxation and the First Parliamentary Counsel will also be members of the Board. Each may be represented by a delegate.

Function

The Board will provide advice to the Treasurer on:

- the quality and effectiveness of tax legislation and the processes for its development, including the processes of community consultation and other aspects of tax design;
- improvements to the general integrity and functioning of the taxation system;
- research and other studies commissioned by the Board on topics approved or referred by the Treasurer; and
- other taxation matters referred to the Board by the Treasurer.

Relationship to Other Boards and Bodies

From time to time the Government or the Treasurer may establish other boards or bodies with set terms of reference to advice on particular aspects of the tax law. The Treasurer will advise the Board on a case-by-case basis of its responsibilities, if any, in respect of issues covered by other boards and bodies.

Report

The Chairman of the Board will report to the Treasurer, at least annually, on the operation of the Board during the year.

Secretariat

The Board will be supported by a secretariat provided by the Treasury, but may engage private sector consultants to assist it with its tasks.

Other

Members will meet regularly during the year as determined by the Board's work programme and priorities.

Non-government members will receive daily sitting fees and allowances to cover travelling and other expenses, at rates in accordance with Remuneration Tribunal determinations for part-time public offices.

The Government will determine an annual budget allocation for the Board.

Conflict of interest declaration

All members of the Board are taxpayers in various capacities. Some members of the Board derive income from director's fees, company dividends, trust distributions or as a member of a partnership.

The Board's practice is to require members who have a material personal interest in a matter before the Board to disclose the interest to the Board and to absent themselves from the Board's discussion of the matter, including the making of a decision, unless otherwise determined by the Chairman (or if the Chairman has the interest, the other members of the Board).

The Board does not regard a member as having a material personal interest in a matter of tax policy that is before the Board merely because the member's personal interest may, in common with other taxpayers or members of the public, be affected by that tax policy or by any relevant Board recommendations.