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# Review of Legal Framework for the Administration of the GST



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**KPMG**

# Outline

- Introduction
- Issues and recommendations

# Introduction

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# Outline

- Introduction

- Issues and recommendations

# Issues & recommendations

1. Uncertainty from drafting
2. Flexibility in compliance
3. Financial services
4. Fringe benefits
5. Non-residents
6. Vouchers
7. GST administrative law issues
8. Property
9. Grouping

# Uncertainties from drafting

- Taxable supplies
- Creditable purpose
- Enterprise

# Taxable supplies

- “in connection with” vs “for” – Reliance Carpets, e.g.,
  - The busker – Tolsma principle
  - Composite or mixed supplies
    - Card Protection Plan – common sense view
  - Subsidies / loyalty
  - BOOT arrangements
- Unable to adopt overseas experience
  - GSTR 2001/8
- *Recommendation*
  - Adopt EU approach
    - Terminology “for”?
    - Preamble?

# Uncertainties from drafting

- Taxable supplies
- Creditable purpose
- Enterprise



# Creditable purpose

- Section 11-15, positive and negative tests
  - Structure from ITAA97, section 8-1
  - Intended to provide relief for business inputs to non-input taxed activity
- Legislative effectiveness problematic
  - Capital raising costs
  - Mergers and acquisitions
  - Employee accommodation
- *Recommendation*
  - Redraft to provide for relief from input tax costs on:
    - (taxable) enterprise activities
    - exports, Government, charities etc

# Uncertainties from drafting

- Taxable supplies
- Creditable purpose
- Enterprise

# Enterprise definition

- Uncertain scope
  - Stone's case
  - Non-profit bodies
  - Holding companies (see later)
  - “in the form of”
  - ABN interaction
- *Recommendation*
  - Redraft to make boundaries certain
  - Allow holding companies to register to group

# Issues & recommendations

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# Flexibility in compliance

- Act is “rule” driven – adding to complexity, risk and compliance costs

- Option to tax

- “Proper taxpayer”

- Tax invoices / RCTIs

- Attribution

- Correcting errors

- Special accounting methods

- Voluntary reverse charge

# Option to tax

- Issues
  - Complexity and compliance costs in determining tax status of transactions
    - Mixed supplies
    - Residential (or part thereof)
    - Fee based financial supplies
    - GST-free education, health and medical (e.g. reports to employer)
- *Recommendation*
  - Allow an option to tax with agreement of both parties

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# Proper taxpayer

- Law determines entity with obligation / entitlement
  - No general power for another to pay or act
    - But, incapacitated entities, resident agents, representative members, 153-B, mortgagee in possession, joint venture operators
  - Compliance costs and complexity in accounting
    - Accrued revenues / expenses in change in business / grouping
    - Non-residents
    - Paying agents
    - Cash flow
- *Recommendation*
  - General power to agree / nominate another entity to pay or claim
    - Where appropriate to do so for ease of compliance and administration



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# Tax Invoices / RCTIs (1)

- Onerous rules
- Complex determinations
  - S 29-70
  - RCTIs
    - Limited operation / written agreements
- High cost of compliance and risk for strict non-compliance
- Legal effect - substantiation – unlike EU
- Too detailed to be capable of ready compliance

# Tax Invoices / RCTIs (2)

- Requirements are too detailed
  - Wrong addressee
  - Progressive supplies
  - Lost or destroyed
  - Limited scope of RCTIs
  - Written agreement for RCTIs
  - Subsection 29-10(3) vs 29-70 determination
- *Recommendation*
  - General discretion to waive
    - See S. 900-195 of ITAA 97 and S. 123B of FBTAA
      - Self assessed
    - See W124 re ITAA 36 substantiation provisions

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# Attribution – GST accounting

- Div 29 rules proxy for accruals basis
  - Ss29-25(2) determination for ease of compliance
- Lack of flexibility in rules and determination
  - High cost of compliance / risk
- Recommendation
  - Broad discretion to GST account in accordance with commercial accounting

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# Correcting errors

- Limited adjustments under Div 19
  - Change in nature of previous transactions
    - Allows correction in current period
- No legislative provisions to correct mistakes / omissions
  - Revise previous BASs
- *Recommendation*
  - Supplementary return at taxpayer's option
    - Include aggregate of mistakes identified to date
    - Special rules for interest or penalties

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# Special accounting methods

- High compliance costs for transaction by transaction accounting

- Non-enterprise / input taxed use of acquisitions

- General insurance decreasing adjustments

- 50% / 75% rules for charities

# Non-enterprise / input taxed use of each acquisition - issues

- Section 11-15 – to the extent that ...
- Div 129 – adjust each year for “actual application”
  - Subject to time limits
- Div 130 – private or domestic application
- Div 131 – annual for small business
- Div 132 – ITCs refreshed on sale of asset
  - Only financial private or domestic
  - No time limit
- Div 138 – cancelled registration

# Non-enterprise / input taxed use – *Recommendation*

- Policy?
  - Deny ITCs to the extent acquisition used up (“consumed”) for non-enterprise / input taxed purposes – timing only at issue
    - Must refresh ITCs to the extent of taxable sale
- Legislative approach
  - Principle based drafting
    - Intended use upfront, adjust each year to reflect likely consumption over life time.
  - Agreed formula, safe harbour, average, arbitrary percentage on annual basis both upfront and ongoing

# Special accounting methods

- High compliance costs for transaction by transaction accounting
  - Non-enterprise / input taxed use of acquisitions
  - General insurance decreasing adjustments
  - 50% / 75% rules for charities

# General Insurance - issues

- The policy underpinning the general insurance provisions in Australia is to collect GST on the margin of the part of the insurers' business that insures end consumers.
- The general insurance provisions of the GST law are particularly complex:
  - the difficulties of calculating decreasing adjustments on a claim by claim basis based on the input tax credit entitlement ("ITCE") of the insured; and
  - identifying the Division 11 and Division 78 distinction where there are transactions between service providers, the insurer and the insured.

# General Insurance - *Recommendation*

- A GST registered insurer's entitlement to a DA for a tax period be calculated as:
  - 1/11th of the total claim settlement payments made during that period (net of excesses received and recoveries) x proportion of total insureds that are GST registered,
  - where the proportion of total insureds that are GST registered is a fraction that is either:
    - determined by each insurer for its own GST calculations based on:
      - statistics collected and maintained by the insurer; or
      - a method that is approved by the Commissioner (this is language similar to the way that input tax credits are determined in NZ for the B2B zero-rate of financial services); or
      - for all general insurers (i.e., a global rate) determined by the Commissioner / Treasurer based on statistical information in a way similar to that used for average ITCE for monopoly CTP insurers.
  - The rate would be set on an annual basis and could be different for each class of insurance (similar to the safe harbour for excess adjustments).

# Special accounting methods

- High compliance costs for transaction by transaction accounting
  - Non-enterprise / input taxed use of acquisitions
  - General insurance decreasing adjustments
  - 50% / 75% rules for charities

# Charities etc – Nominal consideration

- Section 38-150 requires analysis of consideration for each supply
  - 75% / 50% of market value; or
  - 75% / 50% of “cost”.
- Commissioner allows pooling of costs
- *Recommendation*
  - Legislative authority for Commissioner’s approach
  - An option for annual calculation of proportion of of supplies vs costs.
    - KPMG submission to Asst. Treasurer of 27 May 2008



# Flexibility in compliance

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# Voluntary reverse charge

- Supply of going concerns
  - GST-free for simplicity and cash flow burden
- Issues
  - Going concern limitation
    - Definitional limitation to going concern
    - Uncertainty as to scope and practical operation
    - Div 135 – GST-free + claw back
  - Margin scheme
- *Recommendation*
  - Voluntary reverse charge for sale of substantial assets of a business
    - Going concern or not.

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# Financial services - issues

- Complex, legalistic regulations
- Not responsive to change in environment
- Definition of transaction (for exemption from tax) + activity (for limitation of input tax relief)
- Lack of neutrality, international consistency, ease of interpretation
  - Particularly where input tax denial is at issue
    - “acquisition supply”
- Apportionment and change of use
- Scope and role of RITC regime
  - Outsourced processing
  - Advisory vs facilitation

# Financial services - *recommendation*

- Policy and legislative review to ensure that
  - the treatment of financial transactions; and
  - costs incurred in carrying them out,  
is clear, simple, efficient, neutral, internationally competitive, effective and capable of ready compliance
- Address:
  - Exemption and input tax relief issues separately
  - Capital raising, borrowing, buy-backs, employee share schemes
  - Acquisition supplies
    - Merger and acquisition, investment vs trading
  - Interests in partnership and trusts
  - Distinction between fees and underlying financial transaction
  - Proper definition of security / derivatives / guarantee / indemnity / managed investment scheme / underwriting / ADI
  - Purpose and definition of RCTIs
    - Trustee fees, arranging, commissions

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# Fringe Benefits

- FBT complex – simplification sought from Henry
- Gross up FBT taxable value if employer entitled to input tax credit for acquisition of benefit to collect additional FBT on account of GST
  - GST creditable benefit – s149A
    - Buy vs build vs separate
- Complexity, inefficiency and incidence
- *Recommendation* – NZ approach
  - Taxable value included as deemed GST supply on GST return in tax period in which FBT return is lodged

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# Non-residents

- Issues
  - Inclusion of non-residents in GST compliance
    - For refunds
    - Subcontracting onshore
  - Certainty of GST obligations for exported services (Ss 38-190(3)).
- *Recommendation*
  - Fiscal representative for Non-residents
  - If supplier not established in Australia
    - Supplies to NR GST-free
    - NR not required to register
    - Supplies by NR reverse charged

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# Vouchers

- Issues
  - Over taxation if sold at discount
  - Antiquated definition in modern economy
  - Design fails to address needs
- *Recommendation*
  - Option for taxable supply at price paid throughout distribution chain
    - No consideration on redemption
  - Special accounting method on redemption where necessary for GST-free etc

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# GST administrative law issues

- Rulings
- Penalties & GIC

# Rulings

## Issues:

- No ability to object to GST private rulings – leads to convoluted processes for review
- Uncertainty about what constitutes reliance upon private ruling
- Limited scope of “reviewable indirect tax decisions”

## *Recommendation*

- Align GST admin rules with income tax admin rules – may need to deem BAS to be an ‘assessment’. This leads to:
  - Right to object and appeal private rulings;
  - Ability to rely upon a private ruling;
  - Ability to obtain private ruling in relation to valuation issues;
- Ensure right to challenge refusal to pay a refund as a “reviewable indirect tax decision”, so as to enable review by AAT or Federal Court (i.e. not just via ADJR action)

# GST administrative law issues

- Rulings
- Penalties & GIC

# Penalties and GIC

## Issues:

- Concept of “shortfall amount” in penalties regime is too onerous in GST:
  - Timing errors result in penalties of gross amount of shortfall, not time value;
  - Repetition of transactions subject to harsh penalties – 1 error rather than several
- GIC does not take into account differences in GST regime, and discretions are exercised inflexibly or with only very limited ability for external review (i.e. ADJR Act)

## *Recommendation*

- Introduce SIC for pre-audit period – align with income tax
- Default position of full remission of GIC for revenue neutral transactions



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# Property

- Residential premises
- Margin scheme
- Retirement villages

# Residential premises - issues

- Definitional issues for “residential premises” are proving to be problematic, is it:
  - physical characteristics only; or
  - intended use (objective or subjective)
- Strata titled hotel rooms – cascade of tax, favours form over substance
- Partitions – GST payable but no cash to pay, 2 separate taxing points, margin scheme confusion, valuation issues, inconsistent with stamp duty and income tax
- Mortgagee sales (Div 105) or sales by liquidators, administrators (Div 147) – ATO gets a priority

# Residential premises - *recommendation*

- Define “residential premises” by reference to physical characteristics alone – removes intended use and subjectivity
- Strata titled hotel rooms – should be taxable when leased, not input taxed
- Partitions – should not be subject to GST (does not affect tax base, only timing)
- Mortgagees and liquidators, administrators should not be personally liable
- Remove ATO priority over secured creditors

# Property

- Residential premises
- Margin scheme
- Retirement villages

# Margin scheme

- Several historical problems:
  - Unclear valuation criteria – largely fixed;
  - Choice v written agreement – largely fixed;
  - Use of 1 July 2000 valuations – less prevalent
- Some problems still remain:
  - Need to exclude value added before becoming registered for GST (consistent with income tax rules – CGT event K4) – allow valuation rule upon becoming registered or required to be, even where property acquired post 1 July 2000
  - Inappropriate outcomes where property sold is different from property acquired as a result of encumbrance or similar affectation to land

# Property

- Residential premises
- Margin scheme
- Retirement villages

# Retirement villages - issues

- Disjointed approach, with mixture of:
  - GST-free (aged care, serviced apartments and charities);
  - input taxed (ILUs in retirement village); and
  - taxable (use of some communal facilities)
- Difficulty in assessing GST liability on sale of retirement village (does it include assumption of resident loans or not), as well as treatment of deferred management fees (DMFs)
- Provisions drafted on piecemeal basis and focus on what is supplied to resident – very difficult to assess ITC entitlements
- Provisions may not be achieving intended outcomes for residents in need – e.g. serviced apartments which do not qualify as being GST-free due to physical layout of village rather than needs of resident



# Retirement villages - *recommendation*

- Recognise that complexity of GST treatment of retirement villages arises from different legal forms of what is supplied, and mix of C'th / State regulation
- GST-free serviced apartment accommodation should be based on needs of resident only, not on whether there is a 'common corridor' in village
- Create specific provisions that treat as input taxed all sales and leases of accommodation and services in RVs, where consideration provided by way of DMF, interest-free loan, share of capital gain or recurrent charges etc.

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# Grouping

## Issues:

- Retrospective grouping
- Inability to register most holding companies
- Part period changes to GST group
- Clean exit rule for GST groups
- Ability to check GST grouping – externally or with ATO

## *Recommendation*

- Distinguish between disallowing retrospective grouping from ATO systems perspective and technical/practical issues
- Adopt NZ approach to GST ‘registration’ and ‘grouping’ for holding companies
- Consider appropriate administrative approach to part-periods
- Introduction of a clean exit rule for GST – similar to income tax approach
- Make it easier to confirm the GST grouping currently held in ATO systems

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