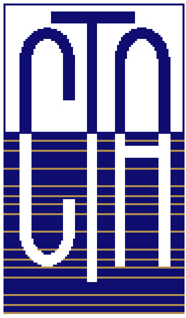

CORPORATE TAX ASSOCIATION of Australia Incorporated

22 September 2008

Review of the Legal Framework for Administration of the GST
Board of Taxation Secretariat
c/- The Treasury
Langton Crescent
PARKES ACT 2600

By email: taxboard@treasury.gov.au

Dear Sir/Madam

Review of the Legal Framework for the Administration of the Goods and Services Tax

The Corporate Tax Association (**CTA**) welcomes the opportunity to provide comments to the Board of Taxation (**the Board**) in its review of the legal framework for the administration of GST.

The Board has stated that the objectives of its review are:

- to reduce compliance costs;
- to streamline and improve the operation of the GST; and
- remove any anomalies in its operation.

It is with these clear objectives in mind that the CTA makes the recommendations set out in the following submission. For ease of reference our concerns and related recommendations are dealt with under the broad headings provided in the Board's Issues Paper of July 2008. All section references in the submission are to the A New Tax System (Goods and Services Tax) Act 1999 unless otherwise stated.

As the Board's review will no doubt reveal, there are several areas of the GST law that are problematic from both an administrative and interpretative perspective. The more obvious of these are Divisions 129, 135 and subsection 38-190(3). Although we have made recommendations in relation to how these areas of the GST law could be improved, further consultation, perhaps in the form of specific industry or issue workshops, should be undertaken to ensure the final recommendations are workable for all impacted taxpayers

We look forward to working with the Board to achieve its aim of an improved and streamlined GST system with less complexity and reduced compliance costs.

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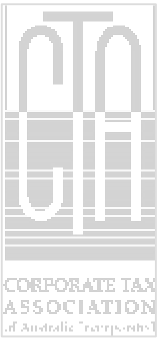


If you have any queries regarding the matters canvassed in this submission, please do not hesitate to contact me on (03) 9600 4411.

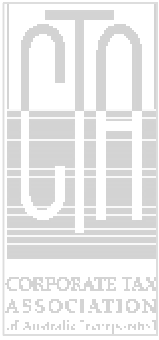
Yours faithfully

Michelle de Niese
Assistant Director

Corporate Tax Association Submission to:

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

September 2008



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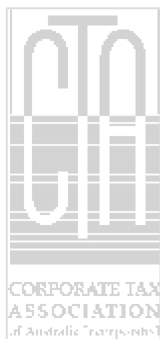


Basic Administrative Rules

Registration

Proof of identity requirements

The Australian Taxation Office (ATO) has adopted a broad interpretation of the provisions of the GST Act which relate to supplies connected with Australia (paragraph 9-25(5)(a)) and the GST treatment of supplies to non-residents (subsection 38-190(3)). Without commenting on the appropriateness of the ATO's interpretation of these provisions, these views have resulted in a system which captures a broad range of supplies to and from non-residents, thereby encouraging (or requiring) non-residents to enter into the GST net to correctly account for their obligations and claim input tax credits.

In the context of such a system, the process of registering a non-resident for GST should be as simple and streamlined as possible, with the view to ensuring cross-border transactions can be undertaken and completed in a timely manner.

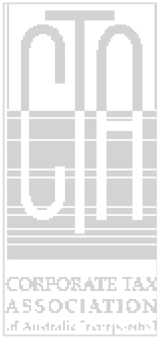
Unfortunately, the registration process for non-residents is far from being simple and streamlined, primarily because of the ATO's proof of identity (POI) documentation requirements.

Although we note that the ATO has recently undertaken a review of its POI requirements for non-residents and has, to a degree, streamlined the level of documentation required for companies listed on a stock exchange, the existing requirements are still far too onerous. Some of the issues encountered by our members on a day to day basis when registering non-residents are:

- difficulties in locating directors and their documentation, particularly when they are in very senior positions in the organisation and located in other parts of the world;
- issues with having the documentation authenticated and translated into English; and
- a reluctance on the part of some countries (perhaps based on cultural issues) to hand over personal documentation.

To add to the frustration, these difficulties are often associated with a company that is a member of a well recognized corporate group, is listed on a foreign stock exchange, is not going to make any taxable supplies or claim input tax credits itself, and will be grouped with an Australian listed GST group.

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.

Recommendation

To this end, and keeping in mind the ATO's need to ensure the authenticity of the non-resident entity and its directors, we recommend that where the entity:

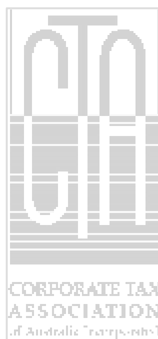
- is listed on an approved stock exchange; or
- is a subsidiary of an entity listed on an approved stock exchange; or
- is grouping with an Australian registered entity that is listed on the Australian stock exchange;

the proof of identity requirements for Australian entities should apply.

Public Officer requirements

In March this year the ATO changed its POI requirements in respect of the 'associate' of a company that is seeking an ABN. Under the new requirements, non-resident entities that apply for GST registration are required to identify an 'Australian resident public officer' before the registration will be processed. There have been several instances since the change in requirements where the ATO has refused to process an application for GST registration lodged on behalf of a non-resident entity until the applicant provides the name and identifying documents (or TFN) of an Australian resident public officer. In respect of many non-resident registrants, this requirement does not seem to have any basis in law. Certainly, the GST legislation sets out requirements for taxpayers to be able to register for GST purposes. However, none of these requirements are that the taxpayer have an Australian resident public officer.

Section 252 of the Income Tax Assessment Act 1936 (**ITAA 36**) requires "every company carrying on business in Australia, or deriving in Australia income from property" to "be represented for the purposes of this Act by a public officer duly appointed....". Further, subsection 444-10 of the Taxation Administration Act 1953 (**TAA 53**) sets out that "the individual who is the public officer of a company for the purposes of the Income Tax Assessment Act 1936 is also the public officer of the company for the purposes of an indirect tax law."
Accordingly, where a non-resident entity is applying for an ABN and/or registering for GST because they 'carry on business in Australia' or 'derive income in Australia from property', it is accepted that a public officer will be needed pursuant to section 252 of the ITAA 36.



However, practical experience is that these entities will be in the significant minority as compared to those applying because they have a GST liability arising out of the far-reaching 'enterprise carried on in Australia' rules in subsection 9-25(5), or because they have a legitimate input tax credit claim but do not have either a business in Australia or derive income in Australia from property.

These registrants very often are only registering because of the 'thing done in Australia' rule in paragraph 9-25(5)(a), or because they conduct an enterprise in Australia under the extended definition of permanent establishment as set out in subsection 9-25(6). By definition, such entities are registering because they are providers of services and they will not 'derive in Australia income from property'. Further, they will not conduct as much as a 'business' in Australia.

Recommendation

We recommend the ATO amend its information requirements so that registrants disclose whether they will fall within section 252 of the ITAA 36, and those that do are then made aware that they will need to appoint an Australian resident public officer, and those that do not are relieved of the additional compliance requirement.

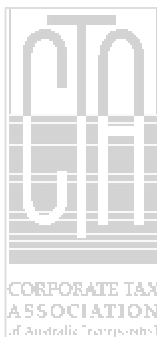
GST treatment of supplies to non-residents

Subsection 38-190(3) seeks to ensure that a supply of something other than goods or real property provided in Australia to an entity that is in Australia is not GST free under item 2 of subsection 38-190(1) by contracting for the supply under an agreement with a non-resident that is outside Australia.
Notwithstanding the above intention, during the introduction of the GST legislation the Government recognised the practical difficulties associated with unnecessarily bringing non-residents businesses into the GST system.

For example, the Explanatory Memorandum to the *Indirect Tax Legislation Amendment Bill 2000* states that:

> *"The Government's policy objective is to ensure that services provided to businesses overseas should not be subject to GST [in the same way that exported goods are GST free]. In addition, the Government wants to ensure it does not unnecessarily draw non-residents into the GST system."*[1]
>
> *"…there are situations where non-residents will make supplies connected with Australia but in many cases will not carry on an enterprise in Australia or have a presence in Australia. This will make*

[1] Paragraph 3.30 of the EM



it difficult for the non-resident to comply with the Australian GST laws or the ATO to enforce the law."[2]

and

"Extending the GST free provisions will keep the overseas entities out of the GST system. This will have compliance benefits for them, as they will not need to become part of the Australian GST, keep records, and lodge returns consistent with the system. It will also be less costly for administrators as they may otherwise, if no change is made, need to examine and possibly audit a wider range of transactions occurring outside Australia."[3]

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 requirements mentioned previously.

Although we understand and accept the need for a provision which prevents 'business to consumer' expenditure from escaping the GST net, the current operation of subsection 38-190(3) goes well beyond achieving this aim, as well as creating unnecessary compliance and audit risks.

In this regard its important to note that subsection 38-190(3) is based on an equivalent provision (subsection 11A(2)) in the New Zealand GST legislation. However, a key distinction between the New Zealand provision and the ATO's interpretation of subsection (3) is the condition that the recipient in New Zealand does not receive the performance of the services in the course of making taxable or exempt supplies. Thus, the equivalent provision in New Zealand only applies where the services supplied are used for domestic or private consumption or in

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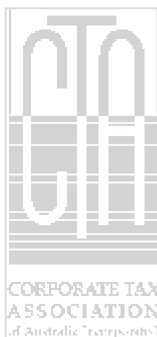
[2] Paragraph 3.32 of the EM
[3] Paragraph 3.38 of the EM



making exempt (input taxed) supplies and as such does not unnecessarily bring non-resident entities into the GST system.

Recommendation

Align the interpretation of subsection 38-190(3) with its New Zealand counterpart so that it doesn't apply (ie: the supply will be GST free) where it is reasonably foreseeable that the thing supplied is provided or is required to be provided to another entity in the course or furtherance of that entity's enterprise.

GST treatment of cross border transactions generally

The concerns raised above are only a small sample of the issues associated with the GST treatment of cross border transactions. We assume that these (and others, such as the overly expansive reach of paragraph 9-25(5)(a)) will be raised with the Board throughout the consultation process.

The overriding concern of the CTA in raising these issues is the unnecessary complexity and compliance costs associated with bringing non-residents into the GST net in circumstances where the non-resident must register in order to claim an input tax credit that would otherwise be claimable by an Australian registered enterprise.

In the context of this concern, we think it appropriate to consider approaches taken in other jurisdictions, most notably:

- The UK system, which only requires non-residents to register and account for GST where they have an establishment in the UK.
- The New Zealand system, which treats supplies to non-residents as GST free unless the entity that consumes that supply in Australia is unable to claim an input tax credit (eg: because it doesn't enjoy the supply in the course or furtherance of an enterprise).

We note that Division 83 of the GST Act was inserted partly in response to taxpayer submissions in relation to the above concerns and the ATO may view this provision as a means of overcoming some of the practical difficulties, including the need to register non-resident suppliers. However, whilst we acknowledge that Division 83 can provide relief in some circumstances, for many corporates its usefulness is limited. Agreeing to meet a third party's tax obligations creates governance risks, and a risky and onerous manual process is usually required to account for the GST on transactions.[4]

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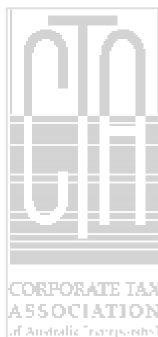
[4] The CTA's recommendation as to how Division 83 may be more practically applied (see the 'Records' section of this submission) should not detract from the above comments regarding its



In any case, adoption of Division 83 does not generally result in any higher or lower net GST liability for a period, as the customer is not required to hold a Tax Invoice to claim an input tax credit that is equal to the liability. Therefore, it seems the ATO would have limited scope to penalise a failure to account for the resulting GST, which raises the question whether the provision has any real practical use. The original proposal put by taxpayers was to adopt a similar system to New Zealand, leaving fully creditable transactions out of the compliance process altogether. This is a sensible approach that achieves a similar outcome without the associated administrative burdens and governance issues.

Recommendation

In looking at the complexities and compliance costs associated with bringing non-residents into the Australian GST net in circumstances where the outcome of the transaction is revenue neutral, we recommend the application of the GST law be limited to:

- non-resident suppliers with a physical presence in Australia; and
- non-resident recipients where the relevant input tax credit would not otherwise be claimable by an Australian registered enterprise (ie: where the transaction would not in effect be a 'wash').

Records

Recipient Created Tax Invoices (RCTIs)

The current stringent compliance framework around RCTIs is untenable and represents an enormous compliance cost for large corporates. The requirement for a recipient to have a written agreement with all suppliers for which an RCTI is issued creates a compliance burden both in respect of having the agreement executed and subsequently storing and maintaining the agreement. Many of our members are required to house many thousands of these agreements. The time and costs associated with creating and maintaining these agreements is substantial. Further, we do not believe that the integrity concerns associated with requiring suppliers to sign an RCTI agreement are relevant at the large end of the market.

With regard to this issue, we note at the GST NTLG sub-committee meeting of November 2007, the ATO indicated that it was seeking feedback on giving recipients the option to embed the written agreement in the RCTI. This option would result in reduced compliance costs and remove the need to maintain and store a separate written agreement. The CTA and other NTLG sub-committee members have provided written feedback indicating support for this option.

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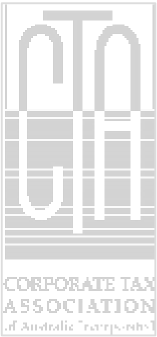
ability to assist in alleviating the broader concerns with the ATO's approach to cross border transactions.



Recommendation

Allow large taxpayers (turnover in excess of $250M) the option to embed the RCTI agreement into the RCTI.

Tax Invoices

The Tax Invoices requirements, when viewed from a purely technical perspective (which the ATO tends to do), are far too prescriptive and need to be relaxed. Strict enforcement of the requirements over the past eight years have resulted in significant compliance costs for large business, as well as exposure to GIC and penalties.

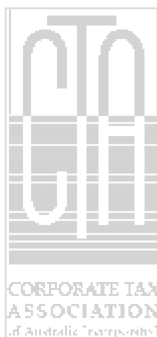
Some examples of where the requirements might be relaxed are:

- The requirement to obtain replacement Tax Invoices when the omissions are due to simple mistakes, such as a vendor omitting an ABN on one of a series of Tax Invoices but including it on the others.
- The requirement to obtain replacement Tax Invoices where the quality of stored copies are poor, due to it being a faxed or a scanned copy.
- The requirement that only the supplier can issue a Tax Invoice, regardless of whether that supplier is part of a GST group.

There are also many instances where Tax Invoices are inherently difficult to obtain, which translates to considerable administrative costs and in some cases, self imposed input tax credit reductions. Some examples are supplies purchased via the internet from Australian registered companies, supplies made by small family-owned landlords for commercial rental properties and supplies purchased via credit card where there are no ATO exemptions.

Although there is an obvious need to ensure suppliers are issuing valid Tax Invoices, the overly prescriptive requirement of section 29-70 and the myriad of regulations and determinations overreach any integrity concerns associated with this risk, particularly in the context of a now mature GST system. Such concerns are now well and truly outweighed by the compliance costs associated with the requirements. The sole focus of the ATO should be on whether or not there is a creditable acquisition rather than on the form of the Tax Invoice, adjustment note or RCTI.

The key purpose of a Tax Invoice is to evidence that the recipient claiming an input tax credit has paid GST to a supplier that is registered for GST and will have a liability to account for it. If this can be demonstrated in an alternative way, it should be acceptable.



Recommendation

Amend the Tax Invoice requirements to provide more flexibility in terms of what will constitute a valid Tax Invoice. As a general proposition, if a Tax Invoice is accepted in good faith, the recipient should be able to rely on it regardless of whether the information contained in the Tax Invoice is correct or not or deficient in some detail(s) that does not impact on the legitimacy of an input tax credit claim.

In the case of large taxpayers (turnover in excess of $250M) mere evidence of payment should be sufficient substantiation for an input tax credit. One way this could be achieved is by widening the Commissioner's discretion under Division 29 so it is aligned with the discretion allowed for the purposes of administering income tax. That is, evidence of payment is sufficient for claiming a tax deduction or input tax credit.

Adjustment note requirements

The adjustment note requirements for GST add significant additional compliance costs to the normal commercial invoice requirements and represent a real revenue risk where a recipient does not make a consequent increasing adjustment to their BAS. We understand these difficulties have been further compounded by the introduction of e-invoice systems, under which purchasers accept responsibility for issuing adjustment notes for some adjustments, while suppliers are responsible for issuing other adjustment notes for the same supply.

Although the effect of these adjustments is revenue neutral, we understand the ATO devotes a decent proportion of its audit activity to verifying them.

Recommendation

Allow suppliers and purchasers the option to agree not to issue adjustment notes where appropriate and simply base their GST liability on the original Tax Invoice. We note that this is the approach adopted under the Canadian GST system. An alternative to this approach would be to allow parties the option to rely on existing Tax Invoice formats to reverse transactions rather than issuing separate adjustment notes.[5]

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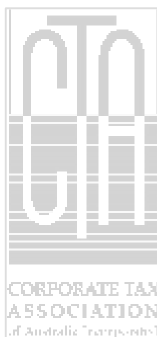
[5] Many suppliers and recipients have developed software at a significant expense to comply with the current requirements. On this basis, any changes made to the adjustment or Tax Invoice requirements should be optional.



Division 83 Agreements

Currently Division 83 Agreements require a party (the recipient) to account for GST and claim an input tax credit for any creditable acquisition. The obligation to account for GST and claim an input tax credit is time consuming and adds unnecessarily to the cost of compliance where the acquisition by the recipient is a fully creditable acquisition, which is almost always the case. There is no cost to the revenue or integrity concerns in these situations, as no Tax Invoice is required to be issued.

Recommendation

Division 83 be amended in line with Division 84. That is, GST related accounting is only required to the extent that any acquisition on which GST is payable is not creditable.

Payment and reporting

Centralisation of ATO functions

The lodgement of BAS and other related GST information is currently recorded and accessed through a variety of different points throughout the ATO. This makes it very difficult for corporates not only to access relevant information, but also to be aware of any information that requires updating.

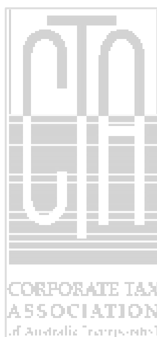
Some functionality is currently available via the ATO's on-line portal, however there are onerous requirements for the application of and issuing of the associated "Electronic Certificate Interfaces" and the range of reporting and viewing options is limited.

Recommendation

The nominated GST group representative to have access to a group portal similar to the Tax Agent Portal. This would assist in the management of GST group members; provide a central location for preparing, lodging and viewing BASs, as well as providing a single point of contact for arranging payments and reviewing account balances. Any such system should ideally allow all GST administrative tasks to be completed online (eg: GST payments, grouping and registration requests).

Offsetting of credits

Where a BAS or IAS is lodged early with the ATO and payment is not made until the due date (a later date), the ATO in the interim sets off the debt (not yet due) with a refund due on another account. The corporate later pays the liability on time as intended, effectively doubling up payment. Although this itself is not an issue,



the taxpayer must then chase the funds which have been offset against the liability owed by the taxpayer, which is an extremely time consuming and cumbersome exercise.

Recommendation

Although we understand this offsetting mechanism is a design feature of the running balance account, the fact that it is a commonly occurring administrative issue and consumes significant time and resources, we thought it appropriate to raise the issue in the context of this review. As such, we recommend the ATO's systems be modified such that offsets are not made until the relevant payment date has expired.

Accounting

The operation of subsection 29-10(4)

Subsection 29-10(4) was inserted into the GST law to overcome the following issue:

> *"As the law currently stands, an entity is required to attribute an input tax credit to the first tax period in which it holds a Tax Invoice. There may be situations where an entity does not became aware that it holds a Tax Invoice in respect of a creditable acquisition until after it has lodged its GST return for the tax period....In these situations the entity is unable to claim their entitlement to the input tax credit in the next tax period but must instead lodge an amended GST return for the tax period in which it should have claimed the input tax credit."*[6]

Thus the original purpose for its introduction was to ease the administrative burden on taxpayers so that they did not have to amend a previous activity statement each time they discovered a Tax Invoice that had not been attributed to the correct tax period.

Despite this provision being introduced to assist taxpayers, disadvantages arise where an activity statement is amended (either voluntarily or as a result of an audit) to increase the GST payable and there are corresponding input tax credits that would offset in whole or part the amount of GST payable if those input tax credits were allowed to be attributed to the same period. The ATO's view is that the GST payable must be attributed to the prior period and that the increase in input tax credits must be attributed to the next activity statement to be lodged, as directed under subsection 29-10(4). This means that GIC and penalties may (unfairly) arise on a GST payable amount despite the existence of valid offsetting input tax credits.

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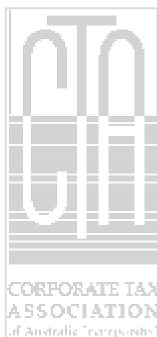
[6] Paragraphs 6.7 and 6.8 of the EM to Taxation Laws Amendments Bill (No 8) 2000



Although the practical value of allowing taxpayers to claim input tax credits in a later period to the period in which the Tax Invoice is first held is appreciated, taxpayers should have the option of amending activity statements for increases in input tax credits claimed so as to avoid any unfair exposure to GIC and penalties.

Recommendation

Sub-section 29-10(4) be amended to allow taxpayers the option of amending activity statements for increases in input tax credits claimed so as to avoid any unfair exposure to GIC.

Alignment with commercial accounting practices

The GST accounting methods are not as closely aligned with commercial accounting practices as they could be. In some cases, transactions appear on the opposite of the BAS (eg: as a negative supply in G1 or a negative expense in G11). This would typically come about in the on-charge of certain expenses (for example, where a company initially incurs some remediation costs which gets coded into an Expense Account). When a portion of the cost is on-charged to another entity, the accounting would usually be a reduction in the same Expense General Ledger (GL) account. Because it is an expense account, it cannot be coded with a "taxable supply" code but with a negative "creditable acquisition" code. The document that gets issued would be a negative adjustment note.

Ultimately, the net amount is the same, but instead of showing the on-charge as a taxable supply in G1, it is sitting as a negative G11 (ie. increasing adjustment). Currently, the only way to address this is to create new GL accounts or use other "revenue" GL accounts to ensure a Tax Invoice issued. However, taxpayers cannot override the accounting treatment unless a separate accounts / systems is created for GST purposes only.

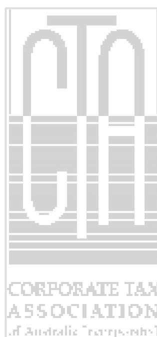
Recommendation

The ATO to accept the GST recording to follow the accounting treatment in such circumstances as outlined above (ie: where there is no revenue loss for the ATO and the taxpayer's net amount remains the same).

Contra transactions

The requirement to issue Tax Invoices in relation to contra transactions is a significant administrative burden for large corporates and has been the subject of intense and fruitless consultation for many years. Over this period, discussions with the ATO, Treasury and CTA members on the matter have confirmed that although there are some limited circumstances in which contra transactions impact on net GST revenue, the vast majority of them are revenue neutral, as they involve both a taxable supply and a creditable acquisition.

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.

Because the vast majority of these transactions occur outside a company's accounting systems, the required documentation and the GST consequences have to be produced manually. This makes it very difficult for companies to comply with the attribution rules, which in turn creates a potential exposure to penalties and GIC, and in our view leads to unproductive and undesirable ATO audit behaviour.

Also, many of the contra transactions large corporates undertake are with customers who are not large corporates, and who therefore do not understand the GST requirements. Where corporates issue contra Tax Invoices in these circumstances, they often need to also explain to the customer why they are doing it, what they need to do in return etc, which then becomes quite a time consuming process. On many occasions, corporates have to follow up and remind customers to issue them with their Tax Invoice so that the corporate doesn't end up paying GST on its side of the transaction and be unable to claim an input tax credit on their side of the transaction.

Adding to compliance difficulties is the fact that many supplies of goods and services in the course of commercial activities fall outside what most people would consider to be supplies for consideration, but may arguably be caught in the GST net as an exchange of supplies between two parties. For example, a recipient may allow a supplier to use equipment or consumables in carrying out contracted services, and may therefore be said to have paid not only money for those services but also provided non-monetary consideration. Food, drinks, lighting or entertainment might be provided for a sporting club function in return for minor acknowledgement of the supplier. There are many instances like these where the supplier and recipient do not agree on the correct GST treatment, making an exchange of Tax Invoices unworkable.

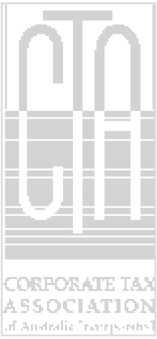
As many and varied as the examples of contra transactions are, they generally have two significant commonalties:

- Accounting for GST on them runs the risk of errors and penalties/GIC exposure.

- Ignoring them where appropriate would avoid such risks.

These increased risks apply equally to the GST revenue, in that where contra transactions are accounted for incorrectly, they could result in over or underpaid GST. The adoption of a more practical approach would therefore benefit the ATO as well as corporates.

Recommendation



Where an arm's length recipient warrants to a supplier that it is fully creditable, and there is no reasonable basis for the supplier to doubt that assertion, the parties should not be required to exchange invoices or to value contra supplies (although they could if they wish). If necessary, such an arrangement could be supported by sufficient information about the contra supplies (such as an internal register) to enable the ATO to verify what has occurred.

The practical difficulties companies face in complying with the attribution rules for these transactions should also be recognised. This could be done by accepting that contra supplies will not always be accounted for in the right period and, in the case of fully creditable recipients, remitting GIC to nil as a matter of course where shortfalls are identified.

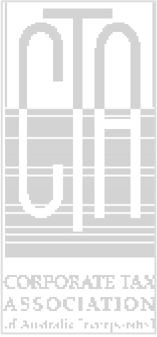
Basic administrative rules – other issues

Commissioner's discretion - revenue neutral transactions

PS LA 2008/9 sets out the ATO's policy in respect of the remission of the GIC imposed for the shortfall period on corrections of transactions where the correction involves equal and offsetting primary GST amounts (ie: a 'wash' transaction'). Although we welcome the Commissioner's views as set out in the Practice Statement, we believe there needs to be further statutory guidance in respect of the matters the Commissioner is required to consider in the context of revenue neutral transactions and the remission of GIC. Given the difficulties associated with anticipating all the circumstances in which the discretion to remit GIC may or may not be exercised, taxpayers should have some indication as to the factors that the Commissioner will take into account in making his determination.

Recommendation

Consideration is given to introducing a specific discretion in regards to GIC and penalties, which requires the Commissioner to consider the cost of compliance and whether the outcome of the correction in question is revenue neutral. In this regard, we note that in our view, 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.



Other Rules

Grouping, joint ventures and branches

Simultaneous registration 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.

Recommendation

For the ATO allow an entity to join a GST group at the same time as it registers for GST. This could be done on the initial GST registration form.

Grouping a holding company

In order for an entity to form part of a GST group the member must be registered for GST. In order to be registered for GST the entity must be carrying on an enterprise. This requirement effectively prohibits holding companies from forming part of a GST group. The same analysis applies to incapacitated entities. Whilst these entities may not carry on an enterprise as defined, there are many instances where inter-company transactions occur. These transactions are unnecessarily onerous to account for on the basis they are outside the GST group.

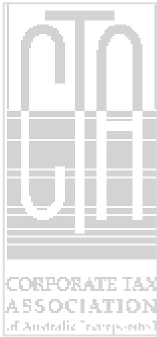
Recommendation

Where a holding company or an incapacitated entity satisfies all of the membership requirements of a GST group other than GST registration, it should be allowed to group with those related entities.

GST grouping part way through a tax period

The ATO currently administers the law such that under the GST grouping provisions entities may be grouped or de-grouped only at the beginning of a tax period. This often results in delays in commercial transactions and increased compliance costs, and is equally relevant to GST joint ventures.

We understand that concerns have been raised with the ATO that if an entity joins or leaves a GST group part way through a tax period, that the representative member of the group would need to lodge a BAS for the period ending on the date of change in the group, and another BAS for the period commencing from the date



of change to the next tax period. We do not have an issue with this outcome as the majority of large taxpayers' accounting systems are sophisticated enough to enable the recording and extracting of information to lodge a BAS for these periods. Further, the ability to lodge a tax statement for a part period already exists in the context of subsidiary members who become part of a consolidated group for income tax purposes part way through an income year.

Recommendation

The ATO allow entities to join or leave a GST group part way through a tax period.

Retrospective GST grouping

Where a group (or indeed a single entity) satisfies the policy rationale behind GST grouping, there is no reason why entities should not be able to form GST groups retrospectively, provided relevant membership requirements are satisfied.

Recommendation

The Commissioner to have the discretion to allow entities to group retrospectively where the policy rationale of GST grouping is met.

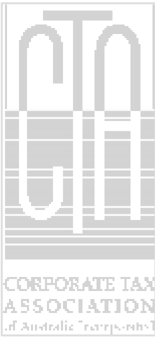
Clean exit provisions for GST

For income tax purposes, an entity may leave a tax consolidated group free of any tax liabilities of the group provided the entity satisfies all of the requirements for a "clean exit". As no such provision applies for entities that leave a GST group, a 'leaving' GST entity may subsequently become liable for additional GST attributable to transactions that took place while it was a member of the GST group.

An example of this problem is where a small company is sold by a large mining or retail group. In this situation, the GST liability of the large mining or retail group is enormous. By contrast, the GST liability and assets of the company sold are very small. Nevertheless, by virtue of the joint and several liability under the GST legislation, the acquirer potentially acquires the liabilities of the whole mining company or retailer group. Entities leaving a GST group should be able to protect themselves from such an outcome, just as entities leaving a consolidated group are able to.

Recommendation

New legislation be introduced to ensure that an entity leaving a GST group will not subsequently become liable to any additional GST which is attributable to transactions while it was a member of the previous GST group. The application of



such a provision should be consistent with the tax consolidation rules on entry and exit from a consolidated group.

Discretion to approve entities for GST grouping where membership requirements not met

There are several circumstances in which entities should be able to join a GST group but are unable to because they do not satisfy the membership requirements. Examples are:

- entities that do not satisfy the 90% control requirement;
- entities that have common ownership (ie: where two companies are owned by the same group of shareholders with the same degree of shareholding); and
- where a company is an incorporated joint venture but one company is nominated as the ‘operator’ and effectively has control.

Such entities should be allowed to group with their related entities where there is a sufficient degree of control and economic association. This would enable transactions to occur between these and grouped entities without the need to account for GST and provide Tax Invoices (which would otherwise not occur under normal accounting practices).

Recommendation

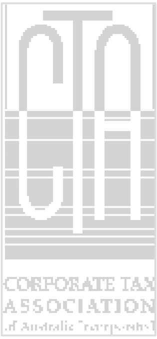
The Commissioner to have the discretion to approve entities for GST grouping where the entity does not satisfy the membership requirements but there is a sufficient degree of control and economic association to warrant a departure from those requirements.

Other rules – other issues

Financial Acquisitions Threshold

The intention of the FAT test is to provide relief for entities making predominantly taxable/GST free supplies from having to identify acquisitions that relate to the insignificant number of financial supplies they make and then having to block the associated input tax credits.

However, the compliance costs associated with determining FAT status (most notably the requirement to undertake a detailed analysis of transactions on a monthly basis) have completely negated any relief the threshold test intended to provide. This is particularly the case for GST groups, who are required to use the same test that applies to single entities, but across an entire GST group.



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 (also see below under "Section 11 generally").

Recommendation

There are several ways in which the FAT test could be improved so that it achieves its intended purpose, the most viable being a combination of the following:

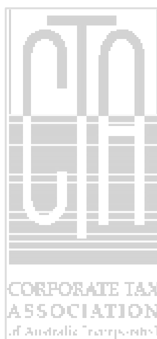
- Changing the threshold requirements to the higher of "$50,000 **or** 10% of the total amount of the input tax credits to which you would be entitled for all acquisitions and imports during that 12 months."
- Allowing corporates to monitor input tax credit denial on a less regular basis, without penalty or interest (eg: on an annual basis, or a reasonable time (say six months) after the conclusion of major M&A projects or once they become public knowledge). In other words, changing the nature of the test to allow it to run for the duration of the particular transaction in question.
- Allowing a higher threshold for GST groups (making appropriate allocation based on the turnover/size of the member entities).
- Allowing non-financial institutions to isolate major transactions outside the normal course of business when measuring the FAT.

Tri-partite arrangements

Section 11 sets out the rules relating to the entitlement to input tax credits of the GST Act. Under these rules, in order to be entitled to an input tax credit in relation to a payment made, requirements under section 11-5 (as well as section 11-15) must be met. Amongst other things, section 11-5 requires that:

- A taxpayer is the recipient of the supply; and
- The taxpayer is liable to provide consideration for any said supply.

Where a transaction involves three parties - a supplier, a recipient of the supply and a payer (ie the provider of the consideration to the supplier) the current requirements of section 11-5 become restrictive to the extent that only the recipient of the supply (who also is generally liable to provide consideration for the supply) meets the section 11-5 criteria and thus only that entity is entitled to claim input tax credits under the GST Act. The payer has no entitlement to claim input tax credits.



In isolation, such an outcome may appear appropriate in order to ensure an entity's entitlement to input tax credits correctly aligns with the contractual liability to provide consideration for the particular supply. However, this requirement creates significant ramifications in business to business transactions where the actual recipient of the supply has entered into arrangements with a third party for that third party to make payments to the supplier - the third party being known as "the payer".

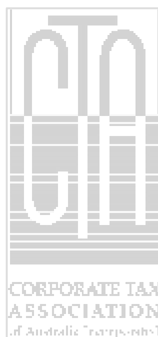
Such arrangements are common – especially in the general insurance industry, as well as other situations such as outsourced administration/management arrangements. The difficulties arise as most taxpayers account for GST on actual transactions supported by records that have been processed by their accounting systems, rather than capturing 'notional' or theoretical transactions. Accordingly, in relation to arrangements involving three parties (such as insurance) the 'true' recipient of the supply (the insured) generally receives no records of the 'transaction' which it has been supplied with, but instead only the payer (the insurer) is invoiced for the supply. As a result, the recipient (the insured) has no source document upon which to calculate its input tax credit entitlement and therefore, no input tax credit claim is recognized in its accounting system. In contrast, the payer (the insurer) is in possession of all relevant source documents (including Tax Invoices), but it is unable to make any claim of input tax credits as it does not satisfy section 11-5 given it is not the 'recipient of the supply' or 'liable to provide consideration to the supplier'.

Once the invoicing process occurs in this way, the ability to ensure GST symmetry is achieved for business to business transactions becomes extremely difficult as the only party that has the legal entitlement to claim input tax credits is the entity that did not receive an invoice.

Recommendation

Easing the requirements of section 11-5 to provide greater flexibility regarding the entity that may claim input tax credits so as the correct economic outcome is achieved. One way this might be done is to ‘deem’ a payer entity (ie the entity that provides the consideration for a supply) to be the recipient of the supply for the purposes of section 11-5 (similar to the deemed relationships under section 153B) provided appropriate integrity measures are satisfied (such as agreement with or notification to the 'true' recipient that this deeming provision has been applied). Another option might be to enable the input tax credit entitlement of one entity to be “transferred” to another entity (similar to the GST grouping provisions) provided appropriate integrity measures are satisfied.

Interpretation of section 11 generally



Corporates that are not financial institutions face large and impractical compliance burdens in calculating input tax credit denial due to the ATO's interpretation of section 11.

Financial institutions that make financial supplies as part of their day-to-day business have usually set up complex standard systems and processes to manage input tax credit denial, apportionment and RITCs.

However, corporates whose businesses are generally taxable, and may often normally be under the FAT, face practical difficulties in complying with sec 11-15 (as interpreted by GSTR 2008/1) to calculate input tax credit denial, particularly for M&A activity.

Determining FAT status, apportionment, RITCs etc on a rolling monthly basis based on "intention" as outlined in the draft is almost impossible, particularly in environments where tax advisers (whether in-house or external) are not privy to information relating to highly confidential M&A projects.

Where the point in time at which input tax credit denial "kicks in" is a clearly identifiable milestone (eg Board approval) this at least provides a reference point. However, with the time of intention very vague and possibly based on the actions and intentions of very senior executives in the company, no clear reference point is available.

This is made worse by the need to (in theory) monitor GST-free financial supplies for the purpose of FAT measurement, even though minimal actual input tax credit denial will result.

Recommendation

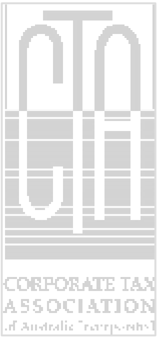
The suggested changes to the FAT test would go a long way to alleviating this concern. Some practical guidance from the ATO (in the absence of the 'Belvedere' example in GSTR 2002/2, which was amended following the finalisation of GSTR 2008/1) would also assist corporates in calculating input tax credit denial.

Subsequent events

Adjustment provisions

Division 129

The purpose of Division 129 is to adjust a taxpayer's net GST amount where the creditable purpose of an acquisition or importation has changed. It would be



difficult to list all the difficulties and complexities associated with this provision. However, there are a few obvious ones:

- 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; and
- the fact that current fixed asset accounting systems do not provide Division 129 solutions

Taking these and the myriad of other concerns and compliance costs associated with Division 129 into account, it is reasonable to state that very few (if any) taxpayers are able to meet their compliance obligations under this Division unless significant costs are incurred.

Recommendation

In view of the need for significant change to this area of the GST law, we recommend Division 129 be redrafted so that it will specifically apply to:

- Goods and real property in excess of $1M
- An adjustment period of 5 years from the time of acquisition or importation.

The Division 129 adjustment could be made once yearly (say by the end of the calendar year) and would effectively allow for an "annual adjustment". This recommendation is roughly aligned with UK VAT system's "capital goods scheme" which has worked well to produce a fair result since 1990.

Division 135

There are numerous problems with the provisions contained within Division 135, mainly in terms of their practical operation. The following is a summary of some of these practical concerns:

- Division 135 is said to apply to adjustments that may be required where going concerns are acquired on a GST-free basis. However, on literal reading of the provisions it is possible to interpret that the Division results in an increasing adjustment in respect of the acquisition of a going concern that is not GST free because section 135-5(1) is not linked to section 38-325(1);

CORPORATE TAX ASSOCIATION

- It is unclear whether the amount of the increasing adjustment is based on a supply price which is the GST inclusive price of things that would have been taxable supplies had the arrangement not been made GST free or some other amount;
- The provision does not specify a particular period of time over which the recipient's intention must be measured;
- Where Division 135 applies to an entity, upon a subsequent disposal of the relevant enterprise there is no decreasing adjustment where the acquired entity is later supplied GST free or taxable; and
- It is not clear in which tax period the increasing adjustment is attributed to.
- The FAT provisions are not linked to Division 135 to ensure that there is no increasing adjustment for a purchaser that meets the FAT and is therefore otherwise not required to deny input tax credits.

These problems should be viewed in the context of the GST free treatment of supplies of going concerns, which is aimed at simplifying the purchase of a business and alleviating related cash flow problems.

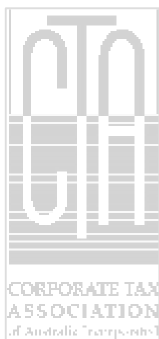
Recommendation

Further consultation on the various concerns with Division 135 needs be undertaken to determine how best to achieve the original intention of Division 135. In our view, and in light of the current problems associated with the Division, the most viable option would be to remove its operation to the extent acquisitions relate to making input taxed supplies.

Correcting GST mistakes

The Correcting GST Mistakes Fact Sheet is aimed at reducing compliance costs for taxpayers where mistakes are made or something is left out of a previous activity statement.

In relation to the correction thresholds (BAS revision guidelines), where a group's annual turnover is in excess of the amounts set out in the Fact Sheet (ie: more than $1B) the correction amount is unreasonable as it represents less than .00003% of turnover. For the thresholds to be of any practical use to large taxpayers, they must be increased. This is particularly the case in relation to taxpayers who are grouped for GST purposes. For example, in the case of a taxpayer who has seven companies, each with a turnover of $1B, each company should have its own individual threshold, regardless of whether those companies are grouped for GST purposes.



The time thresholds should also be reviewed and amended in accordance with the review and amendment of the correction thresholds (ie: where the threshold is increased, the time in which to report errors should also increase). A three month time limit in which to detect and correct errors is completely inadequate for large taxpayers, particularly those with significant M&A activity (where the average M&A project would span between 4 to 9 months).

Notwithstanding that large corporates have robust reporting processes and procedures, given the volume of transactions they manage, the identification and quantification of a GST mistake or mistakes often takes considerable time, energy and resources.

Recommendation

The time and correction thresholds in the Correcting Mistakes Fact Sheet be lifted for large corporates and a cash value carve out be considered for mistakes valued at a nominal amount.

An alternative approach might be to consider the UK approach of adopting a percentage of turnover as the threshold.

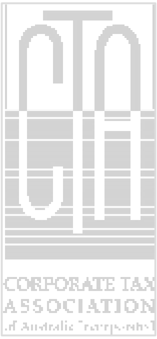
Refunds of overpaid GST

The requirement that a business that has overpaid GST must refund that amount to the customer that has borne the cost of GST before obtaining the refund is unreasonable in circumstances where the supplier is unable to identify the customer. This circumstance is particularly common for retailers, who are clearly unable to identify each of the customers who have purchased a product on which GST has been incorrectly charged. As the law currently operates, such suppliers are unable to claim refunds under section 105-65 of the Tax Administration Act 1953. This in turn results in a windfall gain to the Commissioner at the expense of the customer who paid the tax to the retailer.

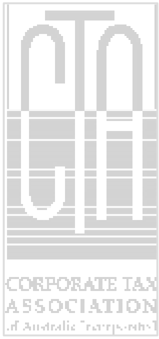
Recommendation

An alternative requirement(s) be considered for those taxpayers who are unable to comply with the current refund requirements as outlined above. One option might be to require a supplier in such circumstances to refund the money by way of a genuine discount on the good for a specified/agreed period. We understand this approach was accepted by the ACCC at the start of GST for the purposes of sec 75AU of the Trade Practices Act.

For example, a retailer sells a GST-free good at $1.10 (inclusive of GST). The retailer sells 1million units over a period of two weeks, therefore overpaying $100k. In order to ‘refund’ this amount, the retailer could sell the product for two



weeks at $0.90 per unit (ie. $1.00 - GST-free price less the GST that was overpaid $0.10). As long as the retailer could demonstrate it sold 1 million units at $0.90, it could demonstrate the GST was effectively refunded to the consumer.



GST Administrative Environment

Rulings

Application of RoSA principles to GST

The CTA supports the initiative to extend the RoSA recommendations to GST where those recommendations are workable within the context of a transactional tax.

Specifically, we support the following:

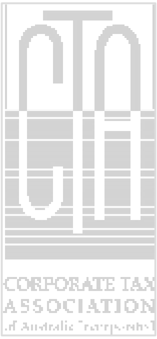
- Indirect tax rulings binding the Commissioner in the same way income tax rulings do. In particular, a taxpayer should no have to demonstrate reliance on a particular ruling or that a particular ruling has been altered in order to rely on it.
- Providing taxpayers with the right to object against private indirect tax rulings where they are dissatisfied with the Commissioner's decision, as well as the right to compel the Commissioner to make a ruling where the Commissioner has delayed in issuing the ruling.
- The concept of 'reasonably arguable position' being available as a defence against shortfall penalties under GST
- Expanding the concept of product and class rulings to GST where appropriate.

Reliance on third party rulings

Due to perceived difficulties with the relevant law, the Commissioner is reluctant to allow retailers to rely on private rulings provided to suppliers notwithstanding that the goods in question are identical in all material respects and that the relevant taxpayers are parties to the same transactions.

Suppliers' private rulings should, in our view, be the starting point in the classification of goods by retailers and wholesalers. Suppliers generally develop, manufacture and market goods and are clearly in the best position to provide detailed and timely information to the Commissioner to assist in the classification of goods.

The continuation of the ATO's position has forced retailers and wholesalers to seek separate private rulings in respect of a broad range of products, particularly foodstuffs. In our view, this is an unnecessary duplication of rulings and



significantly increases the cost of administration for the Commissioner and taxpayers, for no revenue gain.

Recommendation

We believe it is open to the Commissioner to interpret the existing legislation in two alternative ways, either of which will allow reliance on classification rulings by the whole distribution chain. The Commissioner may regard any ruling request for classification by the supplier as an application for all members within the distribution chain. Thus, each entity that sells the product effectively receives a private ruling once the supplier disseminates the ruling throughout the chain. Alternatively, the Commissioner may regard a ruling request by the supplier for the classification of a certain product as a ruling request by more than one entity. It follows that a ruling to the original entity is by definition not a private ruling, but a public ruling on which each entity within the distribution chain may rely.

General interest charge

Revenue neutral transactions

The CTA has made several submissions to both the ATO and Treasury on the issue of GIC and revenue neutral transactions, each raising the point that 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.

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.[7]

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 Tax Administration Act is sufficient to address any undesirable taxpayer behaviour.

Applicability of the SIC to GST

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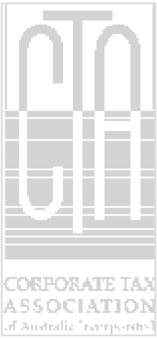
[7] Recommendations 4.2 and 4.2A Review of the Tax Office's administration of GST audits for large taxpayers



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.

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 indeed GIC should apply. This is particularly the case given the windfall gain that accrues to the Commissioner in such cases.

Additional issues

Single Amending BAS

When a taxpayer makes an adjustment (often as part of a voluntary disclosure), the requirement to amend related BASs can result in the need to go back months or years, as well as cover several entities in a corporate group if they are not GST group members. Although the total adjusting payment may be significant, often the individual BAS amendments that comprise the total are minor.

It is an extremely onerous and time consuming task for both business and the ATO to trawl through and amend each BAS. This process also results in the ATO sending out an amendment letter for every entity and every month, sometimes resulting in hundreds of separate pieces of correspondence.

Under the previous sales tax regime, where a voluntary disclosure was made and/or an additional payment was required due to an adjustment as part of the audit process, a “supplementary return” was lodged including the outstanding primary tax and any associated GIC or penalties. This enabled both the ATO and the taxpayer to easily identify and account for the adjustment. GIC could still be appropriately calculated via a spreadsheet summarising the monthly amounts.

Recommendation

A single “Amending BAS” be introduced to cater for adjustments and voluntary disclosures covering a minimum number of periods.

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