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9 September 2008

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

Dear Board Members,

GST - Compliance Issues with GST Groups

In accordance with the 'Review of the Legal Framework for the Administration of the GST' issues paper, released by the Board of Taxation on 18 July 2008, we are pleased to attach on behalf of a number of clients our submission which deals specifically with the ability for related entities to form a GST Group for the purposes of administering the *A New Tax System (Goods and Services Tax) Act 1999* (the "GST Act").

As you will be aware, the legislative requirements for forming and administering GST Groups are contained within Division 48 of the GST Act. The specific legislative requirements in the GST Act are also complemented by regulations contained in Division 48 of the *A New Tax System (Goods and Services Tax) Regulations 1999* (the "GST Regulations"). In this regard we have set out in the attached submission some anomalies with the current legislation which result in compliance issues and increase the compliance burden for a number of our clients.

We would appreciate it if you would take the time to review and consider the issues raised in the submission attached.

If you have any questions regarding the attached, or would like to discuss any aspect of the paper, please do not hesitate to contact me on 03 9655 2718.

Yours sincerely

Brad Miller

Brad Miller
Partner - Indirect Tax

Att.

Compliance Issues with GST Groups

Relevant Legislation

Division 48 of the GST Act, as complemented by Division 48 of the GST Regulations, sets out the requirements that various entities must satisfy in order to form a GST group and take advantage of the ability to effectively 'ignore' transactions between GST group members, and have to prepare and lodge only a single Business Activity Statement. However there are difficulties encountered in trying to apply this legislation to a number of situations, including to entities which have common ownership.

Compliance Issues

Aspects of the GST grouping provisions and regulations in their current form fail to achieve their principal intended objective in relation to specific circumstances which, according to the Explanatory Memorandum to the original A New Tax System (Goods and Services Tax) Bill 1998 was:

> *"6.3 Companies with common ownership....often supply things to, or acquire things from, other members of the group. The company making a taxable supply to another company will generally pay GST on that supply. The other company will generally have an input tax credit for the acquisition. If both companies are owned by the same entity all of these transactions could be viewed as internal with the entity charging itself GST and claiming input tax credits on the same internal transaction. The cost of accounting for intra-group transactions could be reduced by ignoring these transactions for GST. This is what the GST grouping provisions provide."*

Further the Explanatory Memorandum to the *Indirect Tax Legislation Amendment Bill 2000*, which broadened the scope of the application of the GST Grouping provisions stated that the purpose of the GST Grouping provisions is to '*eliminate the administrative and cash-flow costs associated with transactions* ***between related entities***' (emphasis added).

We have set out below an example where the above intention is not achieved, which reflect the anomalies in the operation of the GST grouping provisions of the GST Act and result in administrative compliance burdens for businesses as a result of not being able to take advantage of these provisions. We have also set out similar examples of where "common ownership" exists where entities can take advantage of the grouping provisions, highlighting the inconsistencies in the application of the current legislative provisions.

Companies with Common Ownership

Subsection 48-10(1)(b) of the GST Act specifies that a company satisfies the membership requirements of a GST group if the company is of the same 90% owned group as all other members of the GST group that are also companies. A typical example of where this applies is set out in Slide 1 attached. This slide illustrates the fact that Shareholder A and Shareholder B own a 100% interest in both Y Pty Ltd and Z Pty Ltd.

There are, however, circumstances where companies have common ownership, for example where each is owned by the same shareholders with the same degree of shareholding. However, despite this common ownership, the two companies are not eligible to group for GST purposes under the current legislative provisions as neither company has at least a 90% stake in the other. This example is illustrated in Slide 2 where it can clearly be seen that Shareholder A and Shareholder B hold the same interests in both Y Pty Ltd and Z Pty Ltd.

As Y Pty Ltd and Z Pty Ltd are unable to group under the arrangements illustrated in Slide 2, notwithstanding they satisfy the "common ownership" requirements, GST is levied on the supplies made between the two companies. This results in increased administration and therefore compliance costs to these related entities.

Other examples where related parties can group for GST purposes

While we have not included an exhaustive list of examples of where entities that are commonly owned, in similar arrangements as set out in Slide 2, that are able to group for GST purposes, we have included a couple of examples to illustrate the anomalies contained within the current legislative provisions.

Example 1: 2 Trusts with the same beneficiaries

Slide 3 illustrates this example, where two Trusts with the same beneficiaries can take advantage of the GST Grouping provisions. In this regard, the relevant regulation is Regulation 48-10.03(2)(d) which states that:

> *"the candidate trustee distributes income or capital of the trust, and the trustee of another trust that is a member of the GST group distributes income or capital of the other trust, only to persons who are all family members of the same individual (whether or not other distributions could lawfully be made)."*

That is, where the proposed GST group consists of two trusts distribution to the same beneficiaries, Regulation 48-10.03(2)(d) allows the two trusts to group for GST purposes. This is clearly no different to two companies that have the same shareholders as set out in Slide 2.

Example 2: Company and trust (with the same beneficiaries as the shareholders of the company)

Slide 4 illustrates this example, where a company with shareholders A and B, which are the same beneficiaries of a Trust can take advantage of the GST Grouping provisions. In this regard, the relevant regulation is Regulation 48-10.03(2)(b) and (4) which states that:

> *"(2)(b) the candidate trustee distributes any income or capital of the trust only to beneficiaries that are permitted beneficiaries (whether or not other distributions could lawfully be made:*
> .....
> *(4) For a company that is a member of the GST Group, each representative of a shareholder of the company is also a permitted beneficiary if:*
> > *(a) for a company with 1 shareholder - the beneficiaries of the trust include a representative of the shareholder; and*
> > *(b) for a company with more than 1 shareholder - the beneficiaries of the trust include at least 2 beneficiaries who are representatives of different shareholders."*

That is, where the proposed GST group consists of one trust whose beneficiaries are the same as the shareholders for a company, Regulation 48-10.03(2)(b) and (4) allows the two related entities to group for GST purposes. Again, this is clearly no different to two companies that have the same shareholders as set out in Slide 2.

Recommended Solution

We recommend that the membership requirements for companies at section 48-10(1)(b) be amended to enable related companies with common ownership (i.e. where each company is owned by the same group of shareholders with the same degree of shareholding) to be eligible to form a GST group.

The implementation of the above recommendation will remove the additional compliance burdens for those commonly owned entities that are unable to take advantage of the grouping provisions as they are currently drafted.

Impact on Revenue

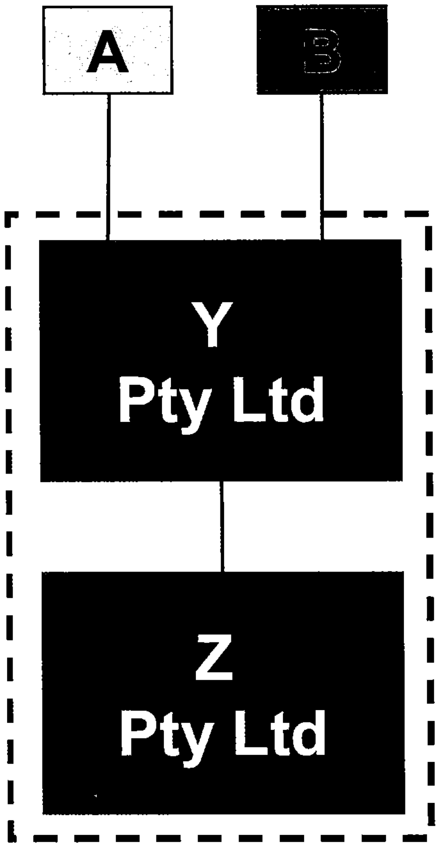
This is an issue that illustrates additional compliance costs because of the inability to take advantage of the grouping provisions. Currently, the supply between one party to another is taxable and therefore one party accounts for the GST liability while the other claims the same GST as an input tax credit, and both parties are required to prepare and lodge a Business Activity Statement. The adoption of the recommendations to alter the grouping provisions to allow such entities to group will result in such transactions not being subject to GST and the requirement to lodge a single Business Activity Statement for the GST Group.

The impact upon revenue should be the similar to that contemplated when the GST Grouping provisions were broadened as part of the changes introduced with *Indirect Tax Legislation Amendment Bill 2000*, which according to the Explanatory Memorandum to that Bill the Government considered would be "Negligible"[1]. In this regard we would anticipate this impact to also be negligible. However, we estimate that the reduction in both administrative time and compliance costs would be considerable.

[1] We also note that the with the introduction of the GST Regulations dealing with GST Groups, and many of the amending Regulations, where the Government has considered any impact of these Regulations on Government Revenue, it has only concluded the impact to be "negligible".

Slide 1

Shareholders



Y and Z can form a GST Group

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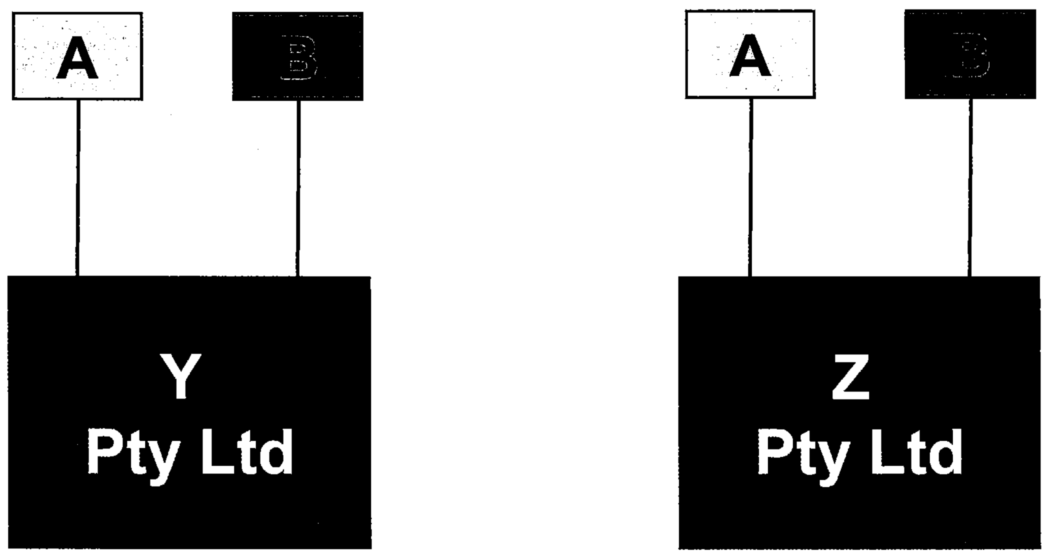
Slide 2

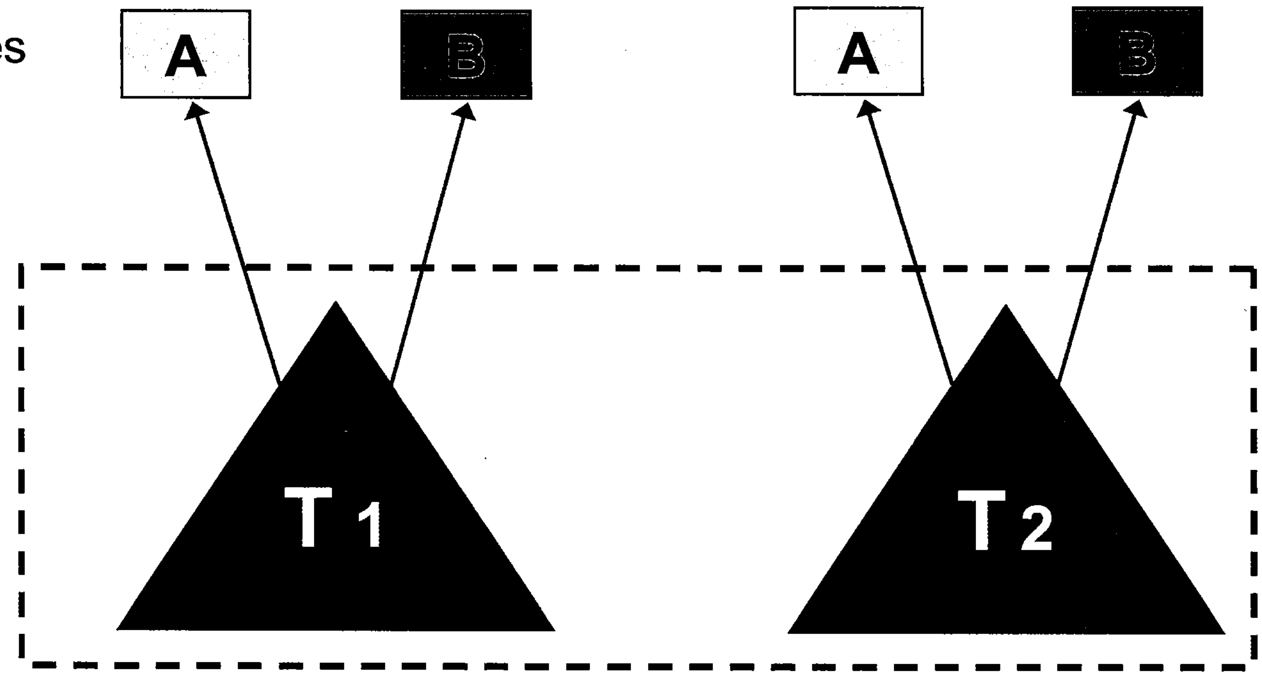
Shareholders



Y and Z unable to group for GST purposes

Slide 3

Beneficiaries



T_1 and T_2 can group for GST purposes

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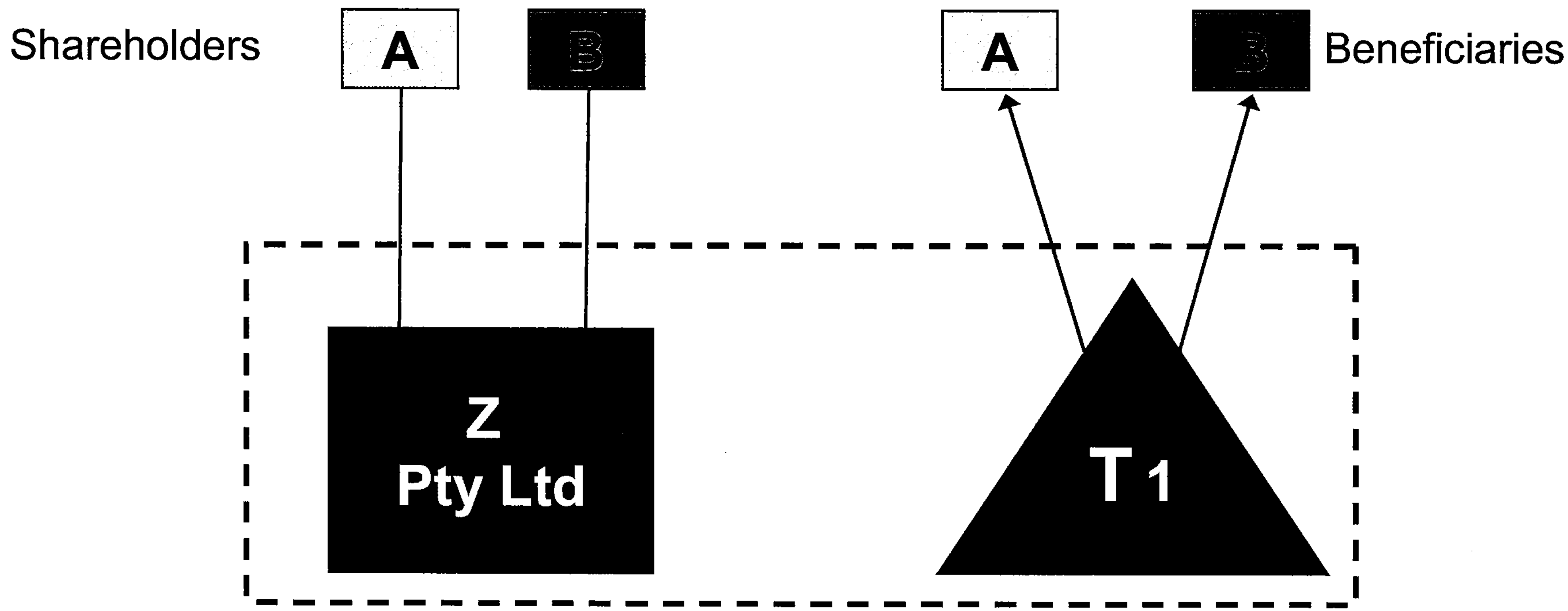
Slide 4



T_1 and Z can group for GST purposes