Minerals Council of Australia

26 September 2008

Review of the legal framework for the administration of GST
Board of Taxation
c/- the Treasury
Langton Crescent
PARKES ACT 2600

Private and Confidential

Dear Sir/Madam

Review of the Legal Framework for the Administration of GST

The Minerals Council of Australia (MCA) welcomes the opportunity to comment on the Board of Taxation's (BOT's) discussion paper on the Review of the Legal Framework for the Administration of Goods and Services Tax (GST) ("the Discussion Paper").

Our detailed comments in relation to the Discussion Paper are contained in this report. The recommendations on page 3 of this report summarise our main comments.

Should you have any questions regarding the above please do not hesitate to contact me on (02) 6233 0630.

Yours sincerely

Brendan Pearson

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MINERALS COUNCIL OF AUSTRALIA

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

Response to Issues Paper

SEPTEMBER 2008

Contents

1. Summary/Recommendations

In response to the BOT's request for submissions as part of its ***Review of the Legal Framework for the Administration of Goods and Services Tax*** the MCA has considered a number of possible policy and interpretative issues that, in its view, require modification or amendment. These are set out in the body of this submission as well as being summarised below.

The MCA is of the opinion that there are currently a number of GST technical interpretative and compliance matters (both legislative and policy) that create commercial risks and increased compliance costs beyond what should reasonably be borne in administration of taxpayers' GST obligations. The Australian judicial system has clearly stated that the Australian GST laws should be interpreted and applied as a practical business tax. Such an interpretation is, in the MCA's view, a clear message that the law should not create or impose artificial obligations that extend outside of commercial business processes and operations unless there is specific reasons to do so and the GST laws specifically requires them. As a result, the MCA is of the view that a number of amendments to the GST laws and administration of those laws should be endorsed to allow the reporting of GST to be more aligned with the accounting principles as espoused by the Australian Accounting Standard Board (AASB) at least for certain specific transactions.

Alignment of the GST treatment of transactions with the general accounting principles has the potential to streamline the GST compliance process for taxpayers, across a broad range of industries. Where the GST treatment of a transaction aligns with general accounting principles it could streamline GST compliance in addition to providing an audit trail for both taxpayers and the Australian Taxation Office (ATO).

One specific transaction that has been identified by the MCA where GST reporting should be given greater alignment with the accounting principles is in relation to arrangements known as Parts Exchange ('**PEX**') programs. This part of the submission deals specifically with the impact on these transactions of questions 1.11, 1.14, 1.15, 1.17, 4.11 & 4.12 of the issues paper released by the BOT in July 2008. At present, the current process for accounting for GST on these transactions creates significant additional GST compliance costs for MCA members with little or no benefit to the overall integrity of the GST compliance regime. It is estimated that full compliance with the ATO's interpretation of the law in relation to PEX programs would cost the mining industry and its suppliers many millions of dollars.

In this regard, to minimise GST compliance costs the MCA would propose that the GST treatment of the PEX transactions should be aligned with the accounting treatment in the situations set out below. Such an approach would be similar to the position adopted in the UK. That is:

- where the exchange of reconditioned articles for similar but unserviceable articles as an integral part of a repair or reconditioning service arrangement is a regular part of the supplier's business, then the supplier is making a single supply of a reconditioning service and the exchange of the parts is merely incidental to the dominant supply of the service (ie a composite supply); and

- where the parts exchange occurs merely as a one off transaction, or where the recipient of the exchange parts is either not registered for GST purposes, or not entitled to a full input tax credit, then the transaction must be treated as two supplies of goods (ie a mixed supply).

To facilitate the above solution the GST Act should be amended to give the Commissioner broader discretionary powers similar to those provided to HMRC under the UK Vat Act.

In addition to the greater alignment of the GST reporting requirements with the accounting principles, the MCA would like to make the following submissions in response to the specific questions raised by the BOT in its Issues paper.

Question 1.4

Do foreign entities find the process of registration, cancelling registration, refunding and remission of GST easy to comply with? If not, how can the process be simplified and

improved? Are there any anomalies that exist? If so, what changes are required to address them?

- Where an offshore entity is part of the same corporate group as an Australian entity, the GST registration requirements should be simplified. This could be achieved by allowing the proof of identify requirements to be satisfied by a certificate of registration from the jurisdiction of its incorporation and a certification of affiliation with an Australian entity that is already GST registered together with a consent from the public officer of the Australian entity to act on behalf of the overseas entity.

- Where an overseas entity, with no Australian associates, wishes to register for Australian GST the proof of identify requirements as part of the registration process should be satisfied through proof of registration with a foreign revenue authority (eg HMRC in the UK). Similarly, where the foreign revenue authority requires the registration of an individual as public officer, director, or similar, then the ATO should accept the foreign resident in lieu of the Australian public officer.

- The turnover threshold test should be modified so that in the event that an entity only makes GST-free supplies, it has an election as to whether or not it registers for GST. By dispensing with compulsory GST Registration where an entity's only supplies are GST-free, it will allow that entity to balance the benefit of obtaining input tax credits against the compliance costs associated with registering merely to recover them.

Question 1.7

Do the tax invoice, recipient created tax invoice and adjustment provisions operate effectively to minimise anomalies or compliance costs? If not, in what way should they be modified?

- The requirement for parties to enter into a written RCTI agreement prior to issuing RCTIs should be removed. Rather the Commissioner could merely require the relevant agreement and acknowledgements be contained on the RCTI itself.

Question 1.12 & 1.13

Are any changes desirable to the legal framework for the administration of the GST to ensure that refunds of GST are paid as soon as possible, consistent with maintaining the integrity of the GST system? If so, what changes should be made?

Do the rules concerning monthly, quarterly and annual tax periods operate effectively? Do they correspond sufficiently with the reporting periods that apply for other reporting purposes? If not, how should they be modified?

- Entities should be entitled to instruct the ATO (on an annual basis) that other liabilities should not be offset against GST refund amounts unless the taxpayer does not have a good record of payment compliance. Should the ATO be concerned about the impact on the integrity of the revenue collection, it should have the power to automatically offset such amounts, but only where the taxpayer has a poor compliance history and there is good reason for the ATO to have concerns as to the recoverability of amounts technically overpaid through the GST refund mechanism.

- Introduce a system that isolates JV liability and payable balances from other taxation obligations for that ABN (ie the JV Operator) on the basis that the JV amounts may not belong to the owner of the ABN and should therefore not be offset with other liabilities..

- If the taxpayer has a good compliance history of paying taxation liabilities on or before the due date, then the Commissioner should not allocate or transfer refunds or credits to other RBA accounts.

- If the Commissioner is to allocate a refund or credit to a RBA debt of another JV or the JV operator then he must transfer it directly to that RBA account per section 8AAZLA, for only then is the Commissioner required to offset per subsection 2 (and should provide information on where the credit originated from).

Question 2.4

Do the rules for:

- **Forming, operating, altering and dissolving a GST group, a GST religious group, a GST joint venture and a GST branch; and**
- **Reporting their GST liabilities and entitlements;**
- **achieve an appropriate balance between providing flexibility, minimising compliance costs and ensuring the integrity of the GST system? If not, how should they be modified?**

- The requirements in sections 48-85(3) and 51-85(1) that GST groups and GST JVs (respectively) be formed and altered (including the de-grouping of an entity) only from the first day of a tax period should be removed. This will allow taxpayers to ascertain the most appropriate date on which they should form a GST group or GST JV, taking into account the legal, contractual, commercial and GST compliance imperatives.
- Allow GST JV participants an ability to elect to have product sales reported by the JV operator on behalf of the JV participant's for GST purposes only. The election could be incorporated in the JV registration form and reviewed by the ATO as part of the registration process.

Question 2.5

Do the current arrangements for the timing of entry into and exit from GST groups, and accounting for GST liabilities upon entry into and exit from GST groups, operate effectively? If not, what changes are appropriate to improve their operation whilst minimising compliance costs?

- The formation and dissolution of GST groups should be allowed at any time, particularly where the joining member has been formed during the tax period in which it is looking to join the GST group, or where the departing member falls outside the minimum requirements for it to be a member of the GST group during a tax period.

Question 2.13

Does the financial acquisitions threshold operate effectively and minimise compliance costs for affected taxpayers? If not, what changes should be made to simplify it and reduce compliance costs?

- Replace the $50,000 FAT threshold test in section 189-5(1)(a) with a differential test determined by total entity or GST group turnover, or only have the 10% test.
  - It is recommended that the relevant thresholds should be along the following lines:
    - GST turnover of less than $100m – current FAT threshold;
    - GST turnover between $100m and $500m – FAT threshold of $250,000;
    - GST turnover between $500m and $1b – FAT threshold $500,000;
    - GST turnover of over $1b- FAT threshold of $1m .

Question 3.3

Are the adjustment threshold amounts, the number of thresholds and the timing of adjustments appropriate? Do they reflect an appropriate balance between accuracy and compliance costs? If not, how could they be modified?

- A de minimus threshold should be introduced so that it is not necessary to monitor every low value asset for the periods set out in section 129-20, particularly where there is a relatively low portion of non-creditable usage.

- It is recommended that the relevant adjustment thresholds in section 129-20(3) should be along the following lines:

GST exclusive value	Number of adjustment periods
Less than $20,000	Nil
$20,000 to $200,000	2
$200,000 to $1,000,000	4
Over $1,000,000	6

- The dollar value of the adjustment thresholds in section 129-20 should be linked to CPI to ensure that the real value of the limits is maintained.

Question 3.7

Does the process of correcting GST mistakes encourage taxpayers to accurately determine their liability, whilst imposing the lowest practical compliance costs? Is there a need to change the operation of the law with regard to correcting GST mistakes to meet the above objectives? If so, what changes should be made?

- The correction limits should be enshrined in legislation, either the GST Act, or Taxation Administration Act 1953 (TAA).

- The dollar value of the correction limits should be linked to the CPI or some other indexation process or reviewed on a regular basis to ensure that the real value of the limits are maintained.

- The time period available to all entities to fix any GST mistakes should be extended to 18 months, consistent with the current limit for entities with an annual turnover of less than $20m.

- Increase the dollar value correction limits as follows:

Annual Turnover	***Correction Limits***
Less than $20m	*Less than $15,000*
$20m to less than $100m	*Less than $30,000*
$100m to less than $500m	*Less than $100,000*
$500m to less than $1b	*Less than $500,000*
$1b and over	*Less than $1m*

Question 4.12

Are the current GIC arrangements in the legal framework for the administration of the GST working effectively in the context of the GST as a transaction-based tax, including their application to receive neutral transactions, cases involving documentation issues and where GST has been paid by the wrong entity? Are any changes to the current GIC arrangements with regard to the GST desirable?

- Where a revenue neutral error occurs in a transaction between GST registered associates that are both entitled to full input tax credits, the entities should merely be required to disclose the error to the ATO, without necessarily having to quantify and rectify the past transactions.

- Where a revenue neutral error is identified, the base rate of GIC should be imposed rather than the full GIC. Entities should then be entitled to argue for a reduction in the base rate based on guidelines similar to the current PS LA 2008/9.

- The Commissioner should remit the interest charge completely where there has been no loss of primary tax to the revenue unless the taxpayer has a poor compliance history.

2. Reconditioned Parts

The major issue that the MCA would like to bring to the attention of the the BOT relates to the transaction arrangements known as the Parts Exchange (‘PEX’) programs. This part of the submission deals specifically with the impact on these transactions of questions 1.11, 1.14, 1.15, 1.17, 4.11 & 4.12 of the issues paper released by the BOT in July 2008.

PEX programs between inter alia, mining entities and repairers generally involve the mining entity contracting with a repairer to assess and repair inoperative plant or equipment. This is done against a background of the mining entity’s requirement for full time, around the clock operations and the costs of having key plant and equipment out of service for any length of time. It also generally applies to types of plant and equipment that would take some time to repair if done on site, or withdrawn from service and then replaced only once repaired or reconditioned.

In an effort to minimise down time, the mining entity will generally agree that the repairer will replace the inoperative parts with an identical, but operative part to the extent that it is not feasible for it to effect the required repairs immediately while on-site.

Whilst there are various intricacies to the basic concept of the PEX arrangements, they all have the following broad characteristics:

► The repairer provides a replacement part to the mining company to repair the inoperative plant or equipment (*the replacement supply*);

► The mining entity provides the inoperative part to the repairer (*the inoperative part supply*)

► The repairer assesses, and where economic to do so, repairs and reconditions the inoperative part to ‘*as new*’ condition;

► The repairer bills the mining entity for the repair and reconditioning work, calculated based on the price net of the value of the replacement supply and the inoperative part supply; and

► The repairer carries out the necessary repair work and holds the reconditioned part in its inventory until another identical or functionally equivalent part breaks down (the reconditioned part may not necessarily be provided to the original owner of the part).

In short, the repairer will typically hold a ‘stock’ of certain basic machinery that requires such repairs so that it is in a position to provide the service to the mining entities immediately that it is required to do so. This ‘stock’ will be made up of similar capacity or functionally equivalent parts that are either fully reconditioned to ‘as new’ condition, or those that are in various stages of repair to that condition.

The fact that the replacement part is not swapped back for the original once the repair to the original has been effected is merely a recognition of the impracticalities of stopping the mining process a second time to effect the swap for a second time.

These PEX arrangements also save the mining entities the cost of holding immense, and expensive, stocks of ‘spare’ parts in the event that such a swap is necessary – instead moving that responsibility to the entity tasked with carrying out the reconditioning services. It, in turn will, as a cost saving measure, not restrict the application of stocks of reconditioned parts to specific mining entities, but will use them as required to replace under similar arrangements, functionally equivalent units wherever they may be needed.

2.1 Current concerns with the treatment of PEX programs

Commercially and practically, the mining entities involved in the PEX arrangements consider that a repair of the inoperative part of its plant or equipment has been undertaken and in their accounts they have typically recorded a single expense, say as a repair or maintenance expense. This is a practice that pre-dates the introduction of GST by many years.

From a GST perspective it is understood that the ATO's view (after over two years of discussion with MCA, repairers and others) is that the practice described above reflects two discrete but connected GST supplies, namely the supply of the reconditioned part by the Supplier (ie *the replacement supply*), and the supply by the mining entity of the inoperative part, (the *inoperative part supply*).

The industry has reluctantly accepted the ATO's view that the PEX arrangements involve two supplies of goods, rather than a single supply or repair services by the repairer. This has been done on the basis that it has not, to date, been able to convince the ATO of the merits of the practical treatment afforded to these types of supplies prior to the inception of GST. Nor has the ATO taken cognisance of the costs for mining entities associated with re-configuring their accounting systems from the form taken to date. As a result the mining entities are currently required to issue a tax invoice to the repairers and report the PEX transaction both a supply and acquisition in their BAS. Most mining companies repairers are yet to configure their system to do this, due to the continuing dialogue with the ATO on this matter. Such dialogue was recently discontinued due to an apparent reluctance by the ATO to negotiate on their position.

In order to simplify the documentation process, and in recognition of the fact that the repairer is the entity that is typically in possession of all the relevant facts to facilitate the determination of the value of the services provided to the mining entities, the mining entities and the respective repairers have discussed entering into various Recipient Created Tax Invoice (RCTI) agreements. Under these agreements the repairer would issue a joint tax invoice/RCTI to the mining entity on determination of the value of the respective parts (ie the reconditioned/as new part, and the returned inoperative part that is to be reconditioned).

Under the position currently adopted by the ATO the mining entities are expected to report the 'sale' of the inoperative part in G1 (supplies) of their BAS and the 'acquisition' of the replacement part at G11 of their BAS despite the fact that typically their accounting systems are set up to record merely the 'net' figure, being merely the cost of the repair service.

It has been estimated by one mining company that the compliance costs of having to separate the two supplies could equate to 1.5 full time equivalent (FTE) persons for one entity alone. This is therefore a major cost impost for MCA members and one that provides no change to GST revenues, nor provides any valuable statistical data. This cost is merely the cost of ongoing compliance and does not take into account the many millions of dollars that the mining companies and the suppliers would incur in changing their systems.

2.2 Relevant GST legislation

Central to the current treatment of transactions under the PEX program is the ATO's interpretation of section 9-10(1) which states that '… *a supply is any form of supply whatsoever.'* Section 9-10(2) goes on to provide a non-exhaustive list of supplies, and includes, inter alia: '…

(a) *a supply of goods;*

(b) *a supply of services;*

…

(h) *any combination of any 2 or more of the matters referred to in paragraphs (a) to (g). …'*

However, in the public ruling, *GSTR 2001/8 - apportioning the consideration for a supply that includes taxable and non-taxable parts*, the Commissioner states that it is necessary to analyse the whole transaction to ascertain the appropriate GST treatment:

> *'… 19. Where a transaction comprises a bundle of features and acts,* ***you must consider all of the circumstances of the transaction to ascertain its essential character****. You also need to consider the effect the GST Act has on the supply or any of its individual parts. You can then determine whether the transaction is a mixed supply because it has separately identifiable parts that the GST Act treats as taxable and non-taxable, or whether it is a composite supply because* ***one part of the supply should be regarded as being the dominant part****, with the other parts being integral, ancillary or incidental to that dominant part. …'*. [emphasis added]

The MCA would argue that on analysing the PEX arrangements, the dominant commercial purpose of the transaction is to restore the larger piece of plant or equipment, which is being affected by the non-operating equipment, to operation in the shortest time available. To do so, in its view, this requires the repair of the plant or equipment, which will require that the part that is inoperative is either repaired on site if it is possible to do this cost and time effectively, or is removed and replaced by an equivalent part where an immediate repair is not an option. Although the detail of the various PEX arrangements differs, it could potentially be considered that the swapping of title to the inoperative part for an identical, but operative part is merely integral or incidental to the overarching repair services. This is the practical business effect of the transaction undertaken and the way that the mining industry and their suppliers have treated such matters for decades.

Whilst the MCA acknowledges that the scope of the BOT's current review does not extend to dealing with the technical interpretation of the GST law, it is submitted that the law as it currently stands can and should be interpreted and administered to reflect the business effect of the transaction. Further, we consider that the practicalities of the transactions affected are such that the position that has been adopted and utilised by the mining industry since well before GST was introduced should be adopted for the following reasons:

- ► this would save the mining industry the substantial costs that will be associated with both changing their accounting procedures to accommodate the accounting information requirements that are being required by the ATO's proposed procedures. This is particularly true in a situation where both parties are GST-registered, and both parties have, until this issue was brought to their attention, been accounting for GST on the transaction in a manner which has resulted in no loss of revenue to the ATO and is unlikely to create a risk to the integrity of the GST system in the future;

- ► this would reflect a practical solution to the an industry wide situation without the need for legislative change in that it would merely be recognising the existence of a supply that commercially undertaken to effect the repair of a larger piece of plant or equipment;

- ► it would reflect the fact that, in accordance with commentary in various courts dealing with the GST Law, it should be dealt with as a '*practical business tax with respect to elements of commerce* ' (per Stone J in Sterling Guardian Pty Ltd V FCT 2005] FCA 1166); and

- ► it would avoid a situation where there could potentially be conflicting characterisation of the GST law as it applies to PEX arrangements (eg composite v mixed supplies).

2.3 Implications for MCA members

In the event that the MCA's proposition is accepted, it should be noted that regardless of whether the PEX arrangements are treated as a single composite supply of services, or two mixed supplies of goods, there will be no change in the quantum of net GST being collected by the ATO, merely a change to the way in which the transactions are documented (ie tax invoices) and reported in the BASs of the participants.

As alluded to above, the mining entities currently would have a level of difficulty in complying with the ATO's requirement that it report a sale and acquisition under the PEX programs. This difficulty arises, in part, from the difference in treatment of the PEX transactions for accounting and GST purposes. As noted, most companies in the mining industry do not currently treat the transactions in accordance with the ATO interpretation.

Specifically, for accounting purposes, the mining entities are required by the accounting standards (in particular *AASB 116 – Property Plant and Equipment*) to report the net cost of the transaction as a repair in their books. When a part is replaced, the mining entity will not adjust the value of its asset in its books, regardless of the depreciation of the asset up to that time.

Accordingly, the accounting systems adopted by the mining entities have, in the past been set up either merely to show the amount (ie the net repair cost), or if two transactions are recorded, the 'sale' transaction will be recorded as a 'negative acquisition' rather than a 'sale' in effect reducing the cost of the new part by the value of the old part. As such, the supply of the part to the repairer for repair, does not get reported through the accounting system either as 'sundry income' or as the sale of fixed assets.

For the mining entities to identify, separate and amend the PEX transactions to comply with the ATO's reporting requirements will be an expensive and time consuming process. For example, in addition to the accounting program complexities associated with changing charts of accounts in complex systems, so that the transactions may be isolated and reported, a MCA member has anticipated (at a high level) that it could be required that it employ approximately 1.5 additional FTE employees for one of its sites, on an ongoing basis, solely to report the PEX transactions in accordance with the ATO's directives. The alternative for MCA members is to have their accounting systems amended to automatically allow the disparate reporting of these entries. Such a modification could cost members within the industry several million dollars for no practical benefit to the industry, or compliance risk reduction to the ATO.

The quantum of the cost to the mining entities reflects the volume and value of such transactions, for example, one repairer has estimated that it has approximately $32 million worth of rotable spares on its books at any one time.

Such costly compliance administration measures will result in no additional net revenue being collected by the ATO. Nor will it provide the ATO with any meaningful statistical details for purposes of enhancing its ability to assess the risks associated with the compliance of the industry. If anything, the decision to continue to require such a change in reporting processes would have the potential to significantly distort the ATO's ability to data match between the tax return, BASs and financial reports prepared by the mining entities.

2.4 Treatment in other jurisdictions

It is useful to review the treatment afforded in other jurisdictions in order to establish the lessons that can be taken and applied in the situation identified.

2.4.1 United Kingdom (UK)

The UK Value Added Tax Act 1994 (UK VAT Act) recognises that a strict legalistic application of the VAT law to some transactions can give rise to nonsense results or additional compliance costs. Accordingly the UK VAT Act provides flexibility in such situations whereby Her Majesty's Revenue & Customs (HMRC) is able to exercise a level of discretion around certain supplies to ensure a more practical outcome. In particular, section 5(2) allows various supplies to be treated in different ways when considered appropriate (i.e. supply of goods can be treated as a supply of services and vice versa). HMRC has exercised its discretion in dealing with PEX type transactions and has made a determination to adopt a practical approach to dealing with such transactions. This discretion is contained at section 8.6 in its publication '*The VAT* Guide' (UK VAT Notice 700), and states that:

- where an entity [the repairer] frequently exchanges reconditioned articles for similar but unserviceable articles then the entity is providing a **reconditioning service**;
- however, where an entity makes such a supply on a one-off basis, then the transaction must be treated as a parts exchange (ie as **two separate supplies of goods**).

Such an approach would be a reasonable and practical solution in recognising the distinction between the composite supply being made in the first instance and the separated supplies that are being made in the second, and ensures that compliance costs for industries (such as the mining industry) where such arrangements are a regular feature are minimised.

2.4.2 United States of America

The MCA is also aware that question as to whether a PEX arrangement in the computer industry was a single supply of repair services or two supplies of goods was considered by the United States of America (US) Court of Appeals (*Hewlett-Packard Company and subsidiaries v The United States* [76 AFTR 2d 95-7809]). The case involved whether the pool of spares held by Hewlett-Packard's subsidiary (HP) was trading stock. The facts of the arrangements between HP and its customers were very similar to the PEX program, with the major difference being that HP's customers were not always aware that a computer part had been replaced with a new part.

In order to determine that the parts held by HP were not trading stock the Court relied on the finding that HP:

> '…*does not furnish the rotable spares to the customer in exchange for or to receive the purchase price. Instead, it does so to enable it to* ***provide better service****, ie, to avoid the additional computer downtime…'* (at 20) [our emphasis].

The Court went on to comment that:

'… *In the present case, as we have shown, both [HP] and its customers had the same item before and after the replacement, the only difference being the substitution of a functioning part for a non-functioning one in the customer's computer.*'

2.5 Conclusion

The positions adopted by both the UK and the US demonstrate that PEX type arrangements may not necessarily fall neatly within the view adopted by the ATO. As such, the MCA considers that compliance requirements imposed by the ATO are overly onerous given the 'revenue neutral' nature of these arrangements and the international technical positions of such arrangements.

Regardless of the correct technical interpretation of the transaction underlying the PEX arrangements, the MCA considers that there is an appreciable benefit in allowing the mining entities to merely report a single acquisition on its BAS.

Even if it is determined that the correct technical interpretation of the GST law is that two separate supplies are made under the PEX arrangements, merely reporting a single 'acquisition' in its BAS for the net transaction value will not impact on the revenue, nor the statistical data collected by the ATO. The issue of granting the Commissioner such discretionary powers was one of the issues the Tax Design Review Panel recommended for further examination in its report titled '*Better Tax Design and Implementation*' which was delivered to the Assistant Treasurer on 30 April 2008.

2.6 Recommendation

To minimise compliance cost for participants, whilst protecting the integrity of the revenue, the MCA proposes that for administrative purposes a position similar to that adopted in the UK be adopted for Australian GST purposes. That is:

- **where the exchange of reconditioned articles for similar but unserviceable articles is a regular part of the supplier's business, then the supplier is making a single supply of a reconditioning service and the exchange of the parts is merely incidental to the dominant supply of the service (ie a composite supply);**

- **where the parts exchange is merely a one off transaction, then the transaction must be treated as two supplies of goods (ie a mixed supply).**

The MCA believes that such a solution would be consistent with the primary intention that the GST is a practical business tax, and would help to minimise compliance costs not only for its members, but also other industries where PEX type arrangements occur. To facilitate the above solution the GST Act should be amended to give the Commissioner broader discretionary powers similar to those provided to HMRC under the UK Vat Act.

Alternatively, where it is not possible to treat the PEX arrangements in the manner described above, the MCA recommends that where the appropriate documentation requirements are met, ie both the repairer and mining entity issue tax invoices for their respective supplies (or the repairer issues both a tax invoice and RCTI), the mining entities should be granted an administrative concession to only report a single net (acquisition) transaction in its BAS.

3. Basic Administrative Rules

3.1 Question 1.4

Do foreign entities find the process of registration, cancelling registration, refunding and remission of GST easy to comply with? If not, how can the process be simplified and improved? Are there any anomalies that exist? If so, what changes are required to address them?

Background

It has been the experience of MCA members that the process of registering an entity that carries on an enterprise in Australia where it is either a foreign registered entity or does not have an Australian public officer (ie all directors are domiciled overseas) is unnecessarily cumbersome and onerous. Specific concerns include that:

- The current requirements still specify that an Australian domiciled public officer to be nominated, and for that they be responsible for authorising the registration. This is the case even where the jurisdiction in which the entity is incorporated may not require a person to hold a position equivalent to that of a public officer.

- Many foreign entities that are impacted by this requirement are part of a larger corporate group, which also consists of Australian entities. In practice, it is often the Australian entity that will prepare the Business Activity Statement (BAS) and take care of the Australian GST requirements on behalf of the foreign entity.

- In some cases, the only supplies made in 'connection with Australia' by the overseas entity that create the requirement for it to register for Australian GST purposes are 'GST-free' supplies. Although there is no requirement for these entities to remit GST on any supplies (as they are GST-free), the GST Act requires these entities to be registered. This is on the basis that the 'current GST turnover' test in section 188-15 (and indeed the 'projected GST turnover' test in section 188-20) does not provide for the exclusion of GST-free supplies where they are the only supplies that are connected with Australia.

Whilst the MCA acknowledges that the ATO has taken some steps to simplify the registration process for the foreign entities, the registration requirements are still unnecessarily burdensome and create what should be avoidable complexity and compliance costs.

Discussion / the basis for the MCA's concerns

Requirement for a 'public officer'

As identified above, in undergoing the process required to register for GST, problems arise for foreign entities (including those with a related entity in Australia) that do not have Australian office holders. The underlying reason for this is that while a 'public officer' is required to represent a taxpayer for income tax purposes (per section 252(1) of the *Income Tax Assessment Act 1936* (ITAA36), there is no corresponding requirement in the GST Act, or the *A New Tax System (Australian Business Number) Act 1999* (ABN Act). Rather, an application for registration, or variation/cancellation, for ABN purposes only needs to be signed by the '*person lodging it* [the application] *on your behalf*' (section 20 of the ABN Act).

Whilst the Commissioner acknowledges that there is no requirement for a public officer to be nominated for GST or ABN purposes, this is not applied practically in relation to the online ABN/GST registration process. In particular it is not currently possible to register for an ABN/GST online without including details of a public officer. Rather, a manual registration form needs to be completed and posted to the ATO, delaying the whole registration process.

The MCA acknowledges that it is necessary for the ATO to verify the identity and bona fides of any ABN/GST registrants. However, where these foreign entities are members of a broader corporate group that may even include local GST registrants, there should be recognition by the

ATO of the bona fides of the foreign registrant. This should particularly be the case where the foreign entity otherwise required to register in Australia is already recognised by a foreign revenue authority. It should be possible to streamline the registration process for such entities by seeking proof of registration of, and confirmation of the registered offices of the foreign registrant in the foreign jurisdiction. If there are concerns surrounding the level of scrutiny applied to registration processes in foreign jurisdictions, the proposal referred to above could be limited to entities registered in relatively comparable taxing regimes to Australia such as those jurisdictions listed in Schedule 10 of the ITAA36 Regulations as being ‘Listed Countries’ or ‘Section 404 Countries’.

Requirement to register where only GST-free supplies made

In addition to the above concern, the requirement for an entity that only makes GST-free supplies to register for GST purposes arguably creates unnecessary compliance costs for minimal/no benefit to either the entity (as it may be entitled to minimal input tax credits in Australia) or the ATO.

A possible solution here would be to alter the definition of the turnover threshold to remove the ‘requirement’ to register for entities that only make GST-free supplies, and replace this with an ‘entitlement’ to do so. The MCA considers that such a change to the turnover threshold may not be necessary if the process of registering foreign entities is simplified as discussed above. However, there are some instances where such a change would be considered beneficial in any event, and would allow entities to make a commercial decision as to whether they should register for Australian GST, without adversely impacting on the GST revenues.

Recommendation 1.4.1- Where an entity is part of the same corporate group as an Australian entity, the GST registration requirements should be simplified so that the proof of identify requirements may be satisfied by a certificate of registration from the jurisdiction of incorporation and certification of affiliation with an Australian entity that is already GST registered, together with a consent from the public officer of the Australian entity to act on behalf of the overseas entity, to allow registration of the offshore entity.

Recommendation 1.4.2 – Where an overseas entity, with no Australian associates, wishes to register for Australian GST, the proof of identify requirements as part of the registration process should be satisfied through proof of registration with a foreign revenue authority (eg HMRC in the UK). Similarly, where the foreign revenue authority requires the registration of an individual as public officer, director (or similar) then the ATO should accept the foreign resident in lieu of the Australian public officer.

Recommendation 1.4.3- The turnover threshold could be modified so that in the event that an entity only makes GST-free supplies, it has a choice as to whether or not it registers for GST. By dispensing with compulsory GST Registration where an entity’s only supplies are GST-free it will allow that entity to balance the benefit of obtaining input tax credits against the compliance costs associated with registering to recover them.

3.2 Question 1.7

Do the tax invoice, recipient created tax invoice and adjustment provisions operate effectively to minimise anomalies or compliance costs? If not, in what way should they be modified?

Background

The recipient created tax invoice (RCTI) provisions were included in the GST Act to facilitate circumstances where the supplier does not know the value (or volume) of the supply until the recipient has determined the value (paragraph 7.5 of the Explanatory Memorandum (EM) to the GST Bill). In order to facilitate the issuing of RCTIs, section 29-70(3) of the GST Act allows the Commissioner to determine in what circumstances a RCTI may be issued.

Currently, the Commissioner has made a range of Legislative Determinations detailing circumstances where a RCTI may be issued. The Commissioner’s original Legislative Determinations were attached to ‘*GSTR 2001/10 - recipient created tax invoices*’. These detailed the requirements that must be satisfied before a RCTI can be issued (and are replicated in subsequent RCTI Determinations). One of the key requirements is that the supplier and recipient enter into a written agreement which stipulates, inter alia, the specific supplies to which the agreement relates. This requirement to identify specific supplies to which the RCTI agreement relates is considered by the MCA to be superfluous to minimum practical compliance requirements where both parties are acting at arm's length and is administratively unwieldy.

Discussion

Requiring the agreement to identify specific supplies to which an RCTI will be issued can cause administrative complexities where the supplier makes various supplies to the purchaser, some of which may not be known at the time of entering into the RCTI agreement. In relation to this issue, MCA members believe that there is the potential for the parties to inadvertently breach the RCTI rules where the supplies are limited by the RCTI agreement. It further creates a concern that there is a potential blurring of the certainty of treatment of transactions as between the parties in that one party may seek to rely on the RCTI agreement while the other party considers that a particular supply falls outside the boundary of that agreement (by virtue of the type of supplies identified) and then is at risk of proceeding to issue a tax invoice for the same supply.

Another of many possible examples where these requirements could impose an additional compliance burden on taxpayers for no additional integrity benefit is where a supplier and recipient agree that the recipient will issue a RCTI for goods supplied after the recipient measures the quality and quantity of the goods. However, after the RCTI agreement is concluded, the parties may agree that the supplier will also deliver the goods to the customer and charge for the delivery on a per tonne basis. Once again, the value of the supplier's supply of the goods is determined by the recipient, so the recipient merely adds an extra line item to the RCTI for the delivery service.

In such a situation, however, the recipient has technically **overclaimed input tax credits** as it does not have a valid tax invoice to support its input tax credit claim. That is because the RCTI agreement does not specifically cover the supply of the delivery services, rather it only relates to the goods being supplied.

In this scenario neither party intended to breach their GST obligations and the additional supply by the supplier clearly falls within the intended operation of the RCTI provisions. However, to comply with their obligations both parties would need to identify and constantly be alert to the limit of the existing RCTI agreement, and enter into a new or amended agreement. Neither party is intending to, or likely to derive a benefit that is not essentially in accordance with commercial relationship that is intended to be covered by the RCTI agreement. However, there is technical non-compliance and an exposure for the taxpayers involved.

The problem could be addressed by removing the requirement for the parties to enter into a written RCTI agreement. If entities wish to transact with others under RCTI arrangements, a simple acknowledgement on the RCTI should be sufficient. In that way, the supplier and recipient could acknowledge and agree to the same things as they currently do under the agreement by reference to the relevant Legislative Determination issued by the Commissioner. This could reduce the administrative burden that RCTI arrangements place on entities.

The mere agreement by the parties to enter into the RCTI regime for the supplier's supplies should be sufficient to satisfy the Commissioner that the integrity of the GST documentation requirements is not breached. The entities can then manage (at their own discretion) what is in and out of scope of the RCTI agreement.

Recommendation 1.7.1- Eliminate the requirement for parties to enter into a written RCTI agreement. Rather the Commissioner could merely require the relevant agreement and acknowledgements be contained on the RCTI.

3.3 Questions 1.12 & 1.13

Question 1.12: Are any changes desirable to the legal framework for the administration of the GST to ensure that refunds of GST are paid as soon as possible, consistent with maintaining the integrity of the GST system? If so, what changes should be made?

Question 1.13: Do the rules concerning monthly, quarterly and annual tax periods operate effectively? Do they correspond sufficiently with the reporting periods that apply for other reporting purposes? If not, how should they be modified?

The MCA wish to comment on both questions 1.12 and 1.13 below.

Background

MCA members have been detrimentally affected on occasions where the ATO's administration of the running balance account (RBA) has netted off balances on a taxpayer's running balance in a manner that has created difficulties for the taxpayer.

In such situation, the application of the netting off procedure with the ATO's refund policies have:

- adversely impacted a taxpayer's cashflow as a result of having a GST refund reduced to set off against a liability which the taxpayer has already arranged to pay in accordance with the due date requirement, with the result that there is a double payment of the liability and a need to obtain a subsequent refund; and

- adversely impacted the ability of entities acting in multiple capacities, such as a joint venture (JV) operators, to appropriately manage the GST obligations of its various roles, including instances where refunds for one role have been applied against liabilities arising from other roles.

Discussion

Running balance account (RBA) refunds

In accordance with Chapter 72 of the ATO Receivables Policy, the ATO automatically applies a net refund due from a BAS (called a 'net GST refund' for simplicity). Ordinarily an automatic offset may be seen as a positive action on behalf of the ATO. However, if applied without regard to taxpayers' circumstances, this automatic offset policy may impact on refunds and payments in respect of Fuel Tax Credits (FTCs), PAYG withholding and instalment payments, and Fringe Benefit Tax (FBT) which may be automatically processed and paid by taxpayers.

Whilst the MCA understands the reasoning behind the policy, it is concerned that the policy has some unintended implications that can lead to taxpayers effectively paying a tax liability twice. Specifically, certain MCA members have found this to be the case when their weekly excise returns and payment coincide with the lodgement of a BAS where the BAS has a net refund.

Given the weekly nature of the excise payments, mining entities will generally prepare the excise returns and arrange payment (electronically) at the same time. In the experience of MCA members it can take up to a week after payment for the payment to be applied to the taxpayer's account. During that time, in processing the BAS, and prior to releasing the resulting refund, the taxpayer's account shows a liability for the unallocated excise payment against which the GST refund is reduced prior to being refunded. As a result the taxpayer has effectively been forced into a position of having double paid the excise amount.

This would not be a concern if an alteration to the refund amount then occurred automatically in the same way that the set off had occurred. However, MCA members have found that recovery of the amount of tax 'double paid' through no fault of the taxpayer can be a time consuming manual process.

Recommendation 1.13.1- Entities should be entitled to instruct the ATO (on an annual basis) that other liabilities should not be offset against GST refund amounts unless the taxpayer does not have a good record of payment compliance. Should the ATO be

concerned about the impact on the integrity of the revenue collection, it should have the power to automatically offset such amounts, but only where the taxpayer has a poor compliance history and there is good reason for the ATO to have concerns as to the recoverability of amounts technically overpaid through the GST refund mechanism.

Application of JV refunds

JVs are very prevalent operating vehicles in the mining industry, as they allow the pooling of resources for the maximum benefit for the parties.

Under the GST Act, a JV is recognised as a separate GST entity, per section 184-1 and are dealt with under the specific GST rules set out in Division 51.

The requirements for a JV operator are included in the GST rules pertaining to JVs. From a practical perspective, when registered, the JV is registered as a sub-entity of the JV operator. That is, the JV's ABN is derived from the JV operator's ABN, for example if the JV operator's ABN is 99 888 777 666, then the JV's ABN will be 99 888 777 666 **002**. It is quite possible, and indeed often encountered that an entity might be the JV operator for a number of different JV's without necessarily being a member of the JV itself, resulting in it being responsible for the GST accounting for each of those JV's.

The JV operator is also responsible for calculating and reporting the JV's GST obligations (section 51-50), paying GST on any supplies made by the JV (section 51-30), claiming input tax credits for the JV (section 51-35) and making any adjustments (section 51-40).

Due to the nature of JVs, the output from the JV is sold by the participants, not the JV, resulting in the JV not making any significant taxable supplies JV operators are therefore nearly always in a GST refund position. For mining JVs the GST refund can be several million dollars per month. The refund relates to activities undertaken by the JV on behalf of the JV participants (and not the JV operator, unless it is also a JV participant).

The experience of MCA members is that the ATO applies the JV's refund to any tax liabilities owing by the JV operator (including those belonging to other JVs for which the operator may also be the JV operator for).

The Commissioner's position on the application of JV refunds is found in the minutes from the National Taxation Liaison Group (NTLG), issue NTLG-GST0815/16. In the minutes, the Commissioner comments that Division 3 of Part IIB of the TAA, **requires** him to reduce a net GST refund due to a JV by any tax liabilities of the JV operator. This position has been adopted on the basis that the JV operator, not the JV participants, is entitled to any GST refund due to the JV (per section 51-35 of the GST Act).

Current JV process

Under the current process adopted by the Commissioner, the JV operator submits a separate BAS for each GST JV and the Commissioner establishes a separate RBA for each GST JV pursuant to section 8AAZC(4) of the TAA, unless an election is made to consolidate multiple GST JVs.

Under Division 3 of Part IIB of the TAA the Commissioner is ***permitted*** (not required) to offset the credits against debts owing using one of the following methods:

Section 8AAZLA Method 1

*(1) The Commissioner **may**, in the manner he or she determines, allocate the amount to **an RBA of the entity** or, if the entity is a member of an RBA group, to an RBA of another member of the group*

*(2) The Commissioner **must then** also apply the amount against the following kinds of debts (if there are any):*

*(a) tax debts that have been allocated to **that RBA**;*

(b) general interest charge on such tax debts.

(3) To the extent that the amount is not applied under subsection (2), it gives rise to an excess non-RBA credit in favour of the entity that:

(a) is equal to the part of the amount that is not applied; and

(b) relates to the RBA to which the amount was allocated.

Section 8AAZLB Method 2

*(1) The Commissioner **may**, in the manner he or she determines, apply the amount against **a non-RBA tax debt** of the entity or, if the entity is a members of an RBA group, against a non-RBA tax debt of another member of the group.*

(2) If the non-RBA tax debt is:

a. A tax debt that has been allocated to an RBA; or

b. General interest charge on such a tax debt;

*The Commissioner **must** then also allocate the amount to that RBA.*

(3) To the extent that the amount is not applied under subsection (1), it gives rise to an excess non-RBA credit in favour of the entity that is equal to the part of the amount that is not applied.

(4) The excess non-RBA credit relates to the RBA (if any) that the Commissioner determines and the balance of that RBA is adjusted in the entity's favour by the amount of that credit

(5) If the non-RBA tax debt mentioned in subsection (1) has been allocated to 2 or more RBAs, the Commissioner must allocate the amount applied between those RBAs in the proportions in which the tax debt was allocated.
[emphasis added]

In relation to GST JVs, a GST refund allocated to the RBA of a GST JV is often transferred by the ATO to a second RBA (which is also attributed to the JV operator) to offset another taxation liability (eg FBT) that will become due and payable at a future date. The taxation liability is often triggered in the ATO's system by the concurrent lodgement of the BAS (or Instalment Activity Statement) containing that liability.

In NTLG Issue 13.21 paragraph 14 the Commissioner states that he considers that it is mandatory to offset, per 8AAZLA (1) and (2). However we note that the word **'may'** is used in subsection (1). Therefore there does not appear to be a mandatory requirement for the Commissioner to offset such debts, but rather there appears to be a discretionary power that once exercised **must be** applied in a particular way.

Therefore, given that the tax payer is required to manage its affairs in such a way that it ensures that payments are made on the due date, where it has a good record of making such payments by the due date, it should not have its refunds taken to pay the debts of other entities that are not yet due.

To address these concerns, the Commissioner should allow JV balances to be isolated from the JV operator on the basis that the amounts may not belong to the owner of the ABN and should therefore not be offset with other liabilities of the ABN holder.

Recommendation 1.13.1 - introduce a system that isolates JV liability and payable balances from other taxation obligations for that ABN (ie the JV Operator) on the basis that the JV amounts may not belong to the owner of the ABN and should therefore not be offset with other liabilities.

Recommendation 1.13.2 - If the taxpayer has a good compliance history of paying taxation liabilities on or before the due date, then the Commissioner should not allocate or transfer refunds or credits to other RBA accounts.

Recommendation 1.13.3 - If the Commissioner is to allocate a refund or credit to a RBA debt of another JV or the JV operator then he must transfer it directly to that RBA account per section 8AAZLA, for only then is the Commissioner **required** ***to offset per subsection 2 of Section 8AAZLB Method 1 (and should provide information on where the credit originated from).***

4. Other Rules

4.1 Question 2.4

Do the rules for:

- **Forming, operating, altering and dissolving a GST group, a GST religious group, a GST joint venture and a GST branch; and**
- **Reporting their GST liabilities and entitlements;**
- **achieve an appropriate balance between providing flexibility, minimising compliance costs and ensuring the integrity of the GST system? If not, how should they be modified?**

The MCA separately deals with the various aspects of the question below.

4.1.1 Forming and altering a GST group or JV

Background

The MCA considers that the requirement for formation and alteration of a GST JV or GST group to occur on the first day of a tax period creates unnecessary complexity for the JV participants and GST group members. This is particularly the case when a JV is legally formed or altered during a month. Restricting the dates on which a GST entity can be registered can lead to inconsistencies between the legal creation and commercial and practical operation of a JV, or GST group, and the GST treatment of the same. It further creates the high risk or errors occurring with respect to transactions between entities that alter their status as to when a GST group or GST JV exists and when this is not the case.

Section 48-85(3) requires that the date of effect of the formation or change to a GST group must occur on the first day of a tax period, whilst section 51-85(1) contains similar requirements for GST JVs.

Further, when an entity leaves a GST group (due to group restructure or divestment meaning that the entity no longer meets the membership requirements) such changes very seldom occur on the last day of a tax period. As such, the GST de-grouping currently must occur from the beginning of the tax period in which the entity leaves the GST group. This results in a period where the formerly grouped entity is not a member of the GST group, but is still a member of the same corporate group. This can create significant compliance issues whereby transactions between former group members are not appropriately classified as being taxable due to the change in GST grouping status. There are also instances where due to confidentiality requirements transaction processing staff are not aware of the divestment prior to it actually occurring. Again, this can lead to inadvertent GST shortfall amounts and additional compliance costs to identify transactions and reclassify them correctly.

Discussion

The restrictions noted above on the commencement date for GST groups or JVs can lead to additional and unnecessary compliance costs for taxpayers.

By way of example, Company A, Company B and Company C own a mining tenement equally and have formed an unincorporated JV to conduct the mining activities. A, B and C register the JV as a GST JV and appoint Z as the JV operator.

On 3 September C sells its 33.3% stake in the mining tenement to Company D. From 3 September the JV is carried on by A (33.3%), B (33%) and D (33.3%). From this date, C will cease to be involved in the JV, and D will assume all its rights and obligations.

However, from a GST perspective, section 51-85(1) will not allow the JV operator to update the JV GST registration until 1 October. Commercially and legally, D cannot be added to the JV until it actually accedes to the JV, thereby ruling out a change from 1 September, but C will remain a member of the GST JV, and will thereby continue to bear a share of the GST obligations even though commercially and contractually it is no longer a participant in the JV. Alternatively, C could depart from the GST JV prior to leaving the commercial JV, and create additional compliance issues for the whole of September.

Further, given the JV operator is generally remunerated for carrying on the mining operations on behalf of the JV participants, this is an outcome of it making supplies of services to each of the JV participants. The JV provisions in the GST Act contemplate such a scenario and section 51-30(2) specifically excludes supplies by the JV operator to the JV participants from being a taxable supply.

However, in the example provided above, the new JV participant (D) will not be a member of the GST JV until 1 October (at the earliest). Accordingly, it is likely that the JV operator (Z) will be making taxable supplies to D from 3 September to 30 September. The MCA believes that such an outcome is inconsistent with the stated objective of the GST Act, being a practical business tax, and has the potential to give rise to additional compliance costs, and the unnecessary risk of error, for the JV operator and also the participants.

Similar issues arise for GST groups particularly where a new entity is formed (or acquired) mid month and it starts trading immediately. As a result of the fact that it is prevented from registering as part of the GST Group from the outset, all members of the existing GST group will need to consider whether their supplies are taxable or out-of-scope. Once again, this creates additional compliance costs and the unnecessary additional risk of error for businesses and can lead to entities inadvertently failing to comply with their GST obligations.

The MCA considers that a new entity that complies with all the requirements for it to be a member of the GST group or GST JV from the outset should be entitled to join a GST group or form part of a GST JV from the date of incorporation, acquisition or entering into the JV agreement.

Recommendation 2.4.1- the requirements in sections 48-85(3) and 51-85(1) that GST groups and GST JVs (respectively) be formed and altered (including the degrouping of an entity) only from the first day of a tax period be removed. This will allow taxpayers to ascertain the most appropriate date on which they should form a GST group or GST JV, taking into account the legal, contractual, commercial and GST compliance imperatives.

4.1.2 JV reporting

Background

As the Commissioner noted in *GSTR 2004/2 - What is a joint venture for GST purposes?*, a key component of a JV is that the participants will share in the '… *product, or output rather than sale proceeds or profits … '* (paragraph 11). Accordingly, the sale of products is currently reported by the JV participants in their respective BASs rather than in the JV BAS. However, for some JVs notwithstanding the legal ownership of the products, a common marketing/sales company purchases the product from the JV participants for on sale.

Where a joint sales company acquires the products from the JV participants, the JV participants may suffer a significant GST cashflow shortfall as a result of having to remit a large amount of GST, without receiving compensating input tax credits on acquisitions (ie input tax credits on costs are claimed by the JV). Further, in some instances the JV participant may not receive all the information it requires to prepare its BAS prior to the 21st of the following month.

Discussion

For some JVs, particularly where the participants have agreed to sell the output to a single marketing company, reporting sales and remitting any GST (where the sales are not export sales), can impose an additional compliance burden on both the participant, some of who have very limited presence in Australia, and the JV operator who is required to provide additional information to the participants.

In some circumstances, the GST compliance obligations of the JV participants could be greatly simplified by allowing the sale of the product made by the JV participant to be reported on the JV BAS and not on the JV participant's BAS. To avoid doubt, **the reporting of JV sales in this way would be relevant for GST purposes only and should not impact on the legal sale of the product by the JV participant**. Section 51-30(1) requires that the JV operator report sales made *on behalf of* a JV participant. However, it is the MCA's experience that the ATO does not generally accept that the JV operator will make supplies on behalf of the participants.

The MCA understands that the Commissioner is reluctant to allow JV operators to report sales made on behalf of the JV participants because the Commissioner does not consider that such sales are '*in the course of activities for which the joint venture was entered into*'. The Commissioner's views on this issue are set out in *GSTR 2004/3 – Arrangements of the kind described in Taxpayer Alert TA 2004/2: Avoidance of GST on the sale of new residential premises'*. Specifically, one of the arguments advanced by the Commissioner in GSTR 2004/3 was that the '*the resale of premises by a participant is not part of the specified purpose of design, building or maintenance of residential or commercial premises*' (paragraph 26).

In such a situation, the Commissioner has concluded that the sale of premises is not part of the approved purpose of a 'property' JV.

However, the MCA considers that approved purpose for mining JVs and 'property' JVs can be distinguished such that the Commissioner's views as set out above would not be correct in light of the legislation applying to mining and exploration activities. The MCA is therefore of the view that the GST Act arguably already permits the sale of minerals to be included as part of the approved purpose for a mining JV. Specifically, the GST Act allows a GST JV to be formed when:

> *[T]he joint venture is a joint venture for the exploration or* ***exploitation*** *of *mineral deposits, or for a purpose specified in the regulations*; [section 51-5(a)] [emphasis added]

The GST Regulations specify that a 'property' JV may be formed where it meets the following specified purpose:

> *[D]esign, or building, or maintenance, of residential or commercial premises;* [Regulation 51-5.01(1)(f)]

In comparing the two approved purposes for which a JV may be formed, we note that the approved purpose for 'mining' JVs appears to be broader than the approved purpose of 'property' JVs. The MCA considers that the meaning of 'exploitation' is potentially broad enough to include product sales made by the JV operator or related sale company on behalf of the JV participants (ie legally sold by the JV participants).

It is also worth noting that GSTR 2004/3 was issued by the Commissioner in response to concerns that there were instances certain members of the property industry may have been attempting to derive a GST benefit.

In the mining industry, allowing the JV operator and participants to elect that the JV operator report GST on product sales does not alter the net GST position to the revenue. Rather, allowing the JV operator to report sales by the JV participants merely simplifies the reporting obligations of the participants, reduces the number of refunds that are currently paid out to JV Operators (due to there being minimal taxable supplies that are able to be offset against costs incurred by the JV operator for the JV), and could also assist the ATO to monitor sales and ensure that the appropriate amount of GST is being paid.

Agreeing to allow the JV to report the sale of the output (the sale still occurring on behalf of the participants) would not be without precedent. In particular, the ATO has previously accepted, in *PS LA 2007/2 (GA) – GST joint venture operators in the Mining Industry*, that to simplify the GST reporting of non-product sales (eg scrap sales) the JV should report and pay GST instead of the JV participants.

The ability for a GST JV to report and account for GST on product sales should be optional, or available to JV participants via election, as in some JVs the price at which the participants sell their respective portions of product is commercially sensitive.

Recommendation 2.4.2- allow GST JV participants an ability to elect to have product sales reported by the JV operator on behalf of the JV participant's for GST purposes only. The election could be incorporated in the JV registration form and reviewed by the ATO as part of the registration process.

4.2 Question 2.5

Do the current arrangements for the timing of entry into and exit from GST groups, and accounting for GST liabilities upon entry into and exit from GST groups, operate effectively? If not, what changes are appropriate to improve their operation whilst minimising compliance costs?

The MCA has addressed this issue as part of our response to question 2.4 in section 4.1.1 above.

Recommendation 2.5.1- allow for the formation and dissolution of GST groups at any time, particularly where the joining member has been formed during the tax period in which it is looking to join the GST group, or the departing member falls outside the minimum requirements for it to be a member of the GST group during a tax period.

4.3 Question 2.13

Does the financial acquisitions threshold operate effectively and minimise compliance costs for affected taxpayers? If not, what changes should be made to simplify it and reduce compliance costs?

Background

The current FAT test applies on the basis of the actual acquisitions in the current month and previous 11 months (current test); and separately to acquisitions made in the current month and those expected to be made in the following 11 months. As a result, there is a concern that a large one-off transactions in one month could conceivably lead to an entity breaching the FAT for a substantial period of time – far in excess of a period that would be reasonable in light of the fact that there is a breach in only one month.

Discussion

The MCA considers that the current FAT test is extremely onerous for large enterprises and GST groups. In particular the $50,000 worth of GST test is too low to provide a meaningful safe-harbour or concession. Rather, the inclusion of the $50,000 test can significantly increase the compliance costs of the MCA's members who make some input taxed supplies, where the vast majority of its supplies are either taxable or GST-free. However, due to the sheer size of the entities, the $50,000 criteria can be consumed very rapidly. Rather, the $50,000 threshold appears to unduly favour small and medium entities that may make a relatively higher percentage of financial supplies, but due to their smaller overall size are still entitled to claim full input tax credits.

Even when an entity does not exceed the FAT, the time, effort and cost to monitor compliance with the FAT on a regular basis, particularly in a large corporate group with multiple operating entities, is excessive.

The MCA is aware of some circumstances were the compliance requirements for monitoring the FAT results in entities finding it more cost effective to make a choice to deny themselves input tax credits for costs associated with making financial supplies purely because it is too onerous to monitor whether or not it exceeds the FAT (particularly the requirement to project the next 11 months transactions). Whether or not the FAT is actually breached, it can be extremely difficult to configure accounting systems and reports to monitor the FAT automatically, and therefore the compliance burden is often considered to outweigh the benefit of receiving any additional credits, as it all needs to be done manually.

The MCA considers that there are a number of options that should be considered to make the FAT regime achieve the intended outcome in a more effective manner. These include:

- Removing the $50,000 threshold, leaving only the 10% test; or
- Replacing the $50,000 test with a sliding de minimus test amount depending on the organisation's turnover; and
- Having a differential test amount for GST Group situations – bearing in mind that it appears inequitable for a multi-billion dollar group with a substantial number of subsidiaries and JV's to be limited to the same threshold as a single small entity. In part, this inequity could be addressed by having a differential test based on graduated turnover thresholds, or only having the 10% test.

Recommendation 2.13.1 –Replace the $50,000 FAT threshold test in section 189-5(1)(a) with a differential test determined by total entity or GST group turnover, or only have the 10% test.

- ***It is recommended that the relevant thresholds should be along the following lines:***
  - ***GST turnover of less than $100m – current FAT threshold;***
  - ***GST turnover between $100m and $500m – FAT threshold of $250,000;***
  - ***GST turnover between $500m and $1b – FAT threshold $500,000;***
  - ***GST turnover of over $1b- FAT threshold of $1m .***

5. Subsequent Events

5.1 Question 3.3

Are the adjustment threshold amounts, the number of thresholds and the timing of adjustments appropriate? Do they reflect an appropriate balance between accuracy and compliance costs? If not, how could they be modified?

Background

The current adjustment limits arising as a result of a changing of use between creditable and non-creditable purposes for acquisitions that are not used for business finance are extremely low. These create significant compliance costs for entities even where they make minimal input taxed supplies. For example in accordance with section 129-20(3)(b), the actual use of an item on which just $600 GST was paid (ie a purchase price of $6,600) needs to be monitored and assessed for up to 6 years (ie 5 adjustment periods).

For MCA members that only make a small portion of input taxed supplies, relative to their total turnover, tracking, monitoring and assessing the ongoing use of thousands of acquisitions of relatively low value, over a number of years creates a significant compliance burden.

Discussion

MCA members largely make two kinds of input taxed supplies, residential accommodation (often on or near remote mine sites) and financial supplies (as discussed in section 4.3 dealing with the FAT). Both these supplies form only a small portion of the value and volume of the supplies made by the enterprise being carried on by the mining companies. However, due to the special rules surrounding this aspect of the business entities are required to spend a disproportionate amount of time and resources to ensure compliance with their GST obligations in these areas.

By way of example, where a mining entity builds (through contractors) a house to be used for employee accommodation, all input tax credits are disallowed. After a period of time, the mining entity may do some repairs to the house. The materials for the repairs could be taken from a standard stock held by the mining entity. Depending on the value of the materials, it will have to make an adjustment at that time to repay input tax credits it has previously claimed on the acquisition of those materials.

Often if an employee wants to buy the house, it could sell it to the employee within 5 years (ie it will be a taxable supply of new residential premises). The mining company will then be required to make further adjustments to reclaim input tax credits. However the amount reclaimed will be determined in accordance with when each acquisition was made, how much it cost and when the sale took place. Often, due to the complexity of such calculations entities and the resources required to deal with it, the entity may forgo the adjustment.

The adjustment provisions should not impose undue burden on entities, out of proportion to the value of the supplies involved, and need to be reviewed. Consideration should be given to introducing a de minimus mechanism (similar to the FAT) which could be applied to a class of acquisitions (eg residential accommodation, financial acquisitions).

The MCA also notes that the adjustment values are fixed in the legislation and have not been adjusted since the commencement of GST in 2000. The adjustment thresholds should be kept relevant and appropriate in real terms and should be reviewed on a regular basis.

Recommendation 3.3.1- a de minimus threshold should be introduced so that it is not necessary to monitor every low value asset for the extended periods set out in section 129-20, particularly where there is a relatively low portion of non-creditable usage.

Recommendation 3.3.2 – the value of the adjustment thresholds in section 129-20 should be increased.

- ***It is recommended that the relevant adjustment thresholds in section 129-20(3) should be along the following lines:***

GST exclusive value	*Number of adjustment periods*
Less than $20,000	*Nil*
$20,000 to $200,000	*2*
$200,000 to $1,000,000	*4*
Over $1,000,000	*6*

Recommendation 3.3.3 – the dollar value of the adjustment thresholds in section 129-20 should be linked to CPI to ensure that the real value of the limits is maintained.

5.2 Question 3.7

Does the process of correcting GST mistakes encourage taxpayers to accurately determine their liability, whilst imposing the lowest practical compliance costs? Is there a need to change the operation of the law with regard to correcting GST mistakes to meet the above objectives? If so, what changes should be made?

Background

The GST Act requires that any and all errors that impact on the net amount of GST payable, or claimable, for a tax period be fixed in that tax period. However, in the guide '*Correcting GST Mistakes*' (NAT 4700-07.2004) the Commissioner has granted taxpayers a concession allowing taxpayers to correct certain errors in their next BAS where those errors meet the limits set in the guide.

The correction limits that apply to an entity depend on the size of the entity involved. For example a large entity with a turnover of over $1billion is allowed to correct mistakes with a GST value of up to $300,000 within a period of three months after the original BAS. At the other end of the scale, entities with a turnover of less than $20m have 18 months to correct mistakes of up to $5,000 worth of GST.

Discussion

For entities with an annual turnover in excess of $20m, the time limit to correct any mistakes is only three-months. This timeframe is generally not practical in a large organisation. Particularly, given that GST is a transaction tax, where an error is identified, a process is generally adopted to ascertain whether other similar errors have been made. This process can take some time as it must necessarily be sequenced within the schedule of other on-going compliance activities, and will be subject to staff availability and priorities. The three month limit on BAS corrections can therefore act as a disincentive to entities to undertaking detailed analysis of its transactions with the purpose of ensuring that when an error is identified it is fully investigated and fixed and steps taken to prevent a repetition.

Further, many entities undertake periodic reviews of their GST compliance, either on an annual or rolling basis. Such reviews are generally accepted as part of a good GST risk management process.

The MCA understands both anecdotally and also from its members' experience that the day-to-day transactions are generally correctly treated for GST purposes. However, it is abnormal transactions where errors inadvertently arise (either one-off, or non-core transactions). For larger entities in particular, the dollar value of any such GST errors that may arise from these transaction can easily exceed the correction threshold, notwithstanding that the GST error may only represent a small portion of the entity's total GST obligations for a period. To this end, it is impractical, and imposes a disproportionate burden on the entity, to correct each BAS that may be affected by such an error. Rather, it would be more practical to increase the correction limits to allow the error to be corrected in the next BAS.

The MCA also notes that the correction limits have not been adjusted since their introduction in 2004. To ensure that the limits remain relevant and appropriate in real terms they should be reviewed on a regular basis.

Recommendation 3.7.1 – enshrine the correction limits in legislation, either the GST Act, or Taxation Administration Act 1953 (TAA).

Recommendation 3.7.2 – review correction limits on a regular basis or link the dollar value of the correction limits to CPI to ensure that the real value of the limits are maintained.

Recommendation 3.7.3 - extend the time period available to all entities to fix any GST mistakes to 18 months, consistent with the current limit for entities with an annual turnover of less than $20m.

Recommendation 3.7.4- increase the dollar value correction limit as follows:

Annual Turnover	***Correction Limits***
Less than $20m	*Less than $15,000*
$20m to less than $100m	*Less than $30,000*
$100m to less than $500m	*Less than $100,000*
$500m to less than $1b	*Less than $500,000*
$1b and over	*Less than $1m*

6. GST Administrative Environment

6.1 Question 4.12

Are the current GIC arrangements in the legal framework for the administration of the GST working effectively in the context of the GST as a transaction-based tax, including their application to receive neutral transactions, cases involving documentation issues and where GST has been paid by the wrong entity? Are any changes to the current GIC arrangements with regard to the GST desirable?

Background

Since the ATO has released its practice statement on revenue neutral corrections (PS LA 2008/9), MCA members have found it significantly easier to negotiate an acceptable outcome where an error is made that does not impact on the revenue. However, there are still numerous instances where significant time and resources have to be dedicated to negotiating with the ATO to have GIC remitted, even to the base rate, despite there being no loss to the revenue.

Discussion

Particular areas of concern for MCA members involve transactions between corporate group members (that are not GST grouped), and any closely related JVs. For example, it is not uncommon for the same participants to be members of more than one JV, and for the JVs to share equipment, support staff and other administrative functions. Whilst every attempt is made to ensure that GST is reported and claimed in the appropriate entities, some transactions are inevitably treated incorrectly, or missed.

Many of the transactions arise wholly within the same corporate structure, and provide no advantage to any party. In these instances the ATO still insists on the disclosure, quantification, and rectification of the errors. Notwithstanding the Commissioner typically remits GIC in this circumstance, significant internal, and sometimes external, resources are devoted to an exercise with little practical benefit, being the quantification and rectification of a GST neutral mistake.

Under the current guidelines in PS LA 2008/9, taxpayers are still required to demonstrate to the Commissioner that the GIC rate should be reduced. Particularly for revenue neutral transactions, it would be more equitable if the base rate of interest was imposed, rather than the full GIC.

The reason for this is that by lowering the rate of interest applying in such revenue neutral transactions, the financial impact on entities will be reduced. In particular if only the base rate was imposed (other than in cases of reckless disregard for the taxpayer's compliance obligations) this will tend to remove some incentive for the taxpayers to 'challenge' the imposition of the interest by the Commissioner or look for other offsetting 'savings' to reduce the negative impact of the error in question. Further, by reducing the cost of the interest to an entity, when compared with the cost of challenging the Commissioner's findings, entities would be more inclined to fix the error, pay the interest and move on, rather than tying up significant internal and ATO resources in relation to the amount of interest payable.

Finally, the Commissioner should be encouraged to apply the discretion available to him as espoused in PSLA 2008/9 to remit the interest charge completely where there has been no loss of primary tax to the revenue. That is, when ascertaining whether an error is 'revenue neutral' the Commissioner should disregard any timing difference that may arise between attribution date and the date of receipt of a tax invoice.

Recommendation 4.15.1- where a revenue neutral error occurs in a transaction between associates, then the entities should merely be required to disclose the error to the ATO, without necessarily having to quantify and rectify the past transactions.

Recommendation 4.15.2 – where a revenue neutral error is identified, the base rate of GIC should be imposed rather than the full GIC. Entities should then be entitled to argue for a reduction in the base rate based on guidelines similar to the current PS LA 2008/9.

Recommendation 4.15.3 – the Commissioner should remit the interest charge completely where there has been no loss of primary tax to the revenue unless the taxpayer has a poor compliance history.