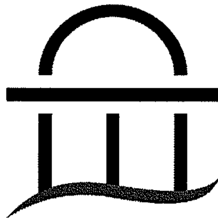

15 September 2008

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

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Dear Christine

Board of Taxation GST Review

Thank you for the opportunity to provide our submission to the Board of Taxation for improving the legal framework and administration of the GST (the GST Review).

The Property Council is the peak body representing the interests of owners and investors in Australia's $320 billion property investment sector. All of our members have a significant interest in ensuring that the administration of the GST is as efficient and effective as possible.

Our members welcome the Government's commitment to streamlining and improving the operation of the GST, reducing compliance costs, and removing anomalies.

Currently, the GST regime creates considerable cost and compliance burdens for taxpayers through:

1) unnecessary administrative complexity;

2) inconsistent provisions for dealing with GST issues; and

3) unclear provisions that are difficult to interpret.

Many of the problems regarding complexity, inconsistency and clarity have been caused by attempts fix specific, perceived flaws in the system which create more issues or result in a "patch-work" of amendments.

GST reform must consider the impact of the changes across the whole GST regime to ensure that complexity is stripped out and replaced by simple, clear rules.

Property Council of Australia – Level 1, 11 Barrack Street, Sydney
Phone: 02 9033 1900 Fax: 02 9033 1966 ABN 13 008 474 422

PROPERTY COUNCIL of Australia

Simplifying the current GST provisions is the easiest way to improve administrative efficiency and reduce compliance costs. In particular, reform needs to include:

1) simplifying the Margin Scheme;

2) clarifying and streamlining the margin scheme valuation rules;

3) clarifying the rules for Division 129 adjustments; and

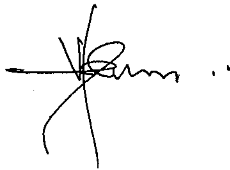
4) cleaning up nuisance issues that unnecessarily burden the industry.

The attached submission outlines our recommendations for improving the GST regime.

We would appreciate the opportunity to discuss them with you further at your convenience.

In the meantime, please do not hesitate to contact me on (02) 9033 1900.

Yours faithfully,



Peter Verwer
Chief Executive
Property Council of Australia

Board of Tax GST Review Submission

Property Council of Australia
September, 2008

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Summary

The Property Council is the peak body representing the interests of owners and investors in Australia's $320 billion property investment sector.

Currently, the GST regime creates considerable cost and compliance burdens for taxpayers through:

1) unnecessary administrative complexity;

2) inconsistent provisions for dealing with GST issues; and

3) unclear provisions that are difficult to interpret.

Many of the problems regarding complexity, inconsistency and clarity have been caused by attempts fix perceived flaws in the system which create more issues or result in a "patch-work" of amendments.

GST reform must consider the impact of the changes across the whole GST regime to ensure that complexity is stripped out and replaced by simple, clear rules.

Simplifying the GST provisions is the easiest way to improve administrative efficiency and reduce compliance costs.

Our recommendations for improving the administration and operation of the GST regime are over the page.

Simplification of the margin scheme

RECOMMENDATION:

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

Valuations – Margin Scheme

RECOMMENDATION:

The GST Act be amended so that margin scheme valuations cannot be challenged by the ATO where:

- the valuation is made by a professional valuer in accordance with accepted valuation principles;
- the valuer complied with the specific requirements set out in the relevant margin scheme valuation determination;
- there has been no evidence of fraud or negligence on the part of the valuer or collusion on the part of the taxpayer; and
- the value is not so extravagantly large or so inadequately small such that the only conclusion is that the valuation is not a professional valuation.

Division 129

RECOMMENDATION:

Creditable application under Dvision 129 needs to be amended to:

- ensure minor applications do not result in old residential premises being treated as new residential premises through interaction with section 40-75;
- clarify what constitutes an acquisition;
- clarify how to treat acquisitions that become a part of another supply;
- re-align quantum thresholds:
    - remove the distinction involving acquisitions that relate to business finance in determining thresholds (i.e. $10,000 vs. $1,000 as a minimum threshold, and $50,000 vs. $5000 as the second threshold, one year versus two years as the number of periods), and retain only the higher monetary thresholds;
    - 5 years as the maximum vs. 10 years;
- clarify whether the application period ends at 31 May or 30 June;

- clarify the treatment of "non-applications" and "non-applications together with applications";
- clarify the adjustment methodology to recognise different uses/ applications for acquisitions that straddle 30 June;
- Clarify whether any acquisitions have only one purpose; and
- Clarify whether a thing has been "applied" if ultimately no supply is made at all.

Division 135 – Going Concern & Farm Land

RECOMMENDATION:

Amend Division 135 to ensure adjustments under the division are consistent with:

- other GST adjustment provisions (such as Division 129); and
- GST provisions that result in taxpayers not being able to claim full GST credits (such as Division 11).

Tax Invoices and Recipients within GST Groups

RECOMMENDATION:

Allow tax invoices to name any entity within a tax group as the recipient to reduce the need to re-issue invoices for technical errors.

The financial acquisitions threshold ("FAT") and s.11-15(5)

RECOMMENDATION:

The FAT should be revised to:

- exclude acquisitions made in the course of the commencement or termination of an enterprise from the definition of "financial acquisition";
- extend the current exclusion for borrowings to any activity associated with raising equity capital;
- amend the period for testing to 6 months retrospectively and 6 months prospectively; and
- increase the threshold to 25% or $100,000.

Transfers on Partitioning

RECOMMENDATION:

Supplies by way of partition should be ignored for GST purposes and expressly set out as an exclusion to "supply" as a new sub-paragraph in section 9-10(4).

Adjustment Provisions: Mirror decreasing adjustment for non-margin scheme sales

RECOMMENDATION:

A new provision should be drafted to allow a decreasing adjustment for the input tax credit previously denied on an acquisition under the margin scheme where the subsequent supply is not under the margin scheme.

Land value increase for an unregistered entity

RECOMMENDATION:

Remove a margin scheme anomaly to ensure all land value increases for a property held by an unregistered entity are not taxed.

Division 129 adjustments and the five year rule for new residential premises

RECOMMENDATION:

The 'five year' period in section 40-75 should be aligned to the "five adjustment periods" in Division 129 to simplify the interaction between the two provisions.

Shortfall Interest Charge (SIC) for GST and symmetry with interest on overpayments

RECOMMENDATION:

A SIC-like charge is more appropriately used where:

- the Commissioner undertakes an audit and determines that the taxpayer has a shortfall amount; and
- the taxpayer voluntarily revises a BAS which creates a shortfall amount from the original BAS submission.

Division 105

RECOMMENDATIONS:

A specific mechanism should be provided in the GST Act which prescribes an "approved form" for the purposes of Division 105.

Furthermore, Division 105 should be clarified such that either:

- a mortgagee is expressly permitted to:
  - apply the margin scheme to a sale of debtor's property for the purpose of calculating the GST payable under Division 105; and
  - elect to obtain and rely on the GST-inclusive market value of real property as at the date on which the debtor acquired the relevant property (as distinct from the consideration for the debtor's acquisition of the property) for the purpose of applying the margin scheme; OR
- Division 105 does not apply to impose GST liability on a mortgagee in the context of residential premises.

AGENCY

RECOMMENDATION:

Allow:

- subdivision 153A and 153B to be used by agents that do not have the ability to bind the principal in contacts (eg invoicing agents); and
- foreign principals to be unregistered for GST where they have a registered Australian agent.

Tax Law Partnership Returns

RECOMMENDATION:

Allow Tax Law Partnerships to account for their share of income and expenses through each partner's own returns without lodging partnership returns.

GST Joint Ventures

RECOMMENDATION:

GST Joint Venture provisions to be expanded to allow any joint venture that is a joint venture for accounting purposes under IFRS to elect to be treated as a joint venture for GST purposes.

Grouping of all staples to be allowed

RECOMMENDATION:

Allow any two or more entities/groups that are stapled to elect to be grouped for GST purposes.

Grouping/degrouped mid tax period to be allowed.

RECOMMENDATION:

Expand ability to enter or leave a GST group so that any eligible entity can join or leave a GST group at any time.

Adjustment Notes

RECOMMENDATION:

Consider abolition/simplification of adjustment note provisions in recognition of the fact that adjustment notes are rarely issued in practice.

Recipient Created Tax Invoices ("RCTIs")

RECOMMENDATION:

RCTIs provisions should be amended to allow the RCTI agreement to be embodied into the relevant tax invoice.

General GST on-line administration

RECOMMENDATION:

Expand on-line access to eliminate written communication.

Barter transactions

RECOMMENDATION:

Remove the requirement to identify and report on barter transactions where no net revenue would be collected from the transaction.

Threshold limits

RECOMMENDATION:

Government should:

1) Increase the current limits on all existing thresholds contained in the GST Law; and

2) Provide regulations to allow Parliament to alter the threshold limits on a periodic basis in-line with changes in the relative economic scale of business activities.

Review of income tax self assessment (ROSA) changes

RECOMMENDATION:

ROSA style initiatives should be investigated and applied to the GST regime.

Terms used in the Submission:

In this submission a reference to the "GST Act" or the "GST Regulations" is a reference to the *A New Tax System (Goods and Services Tax) Act 1999* or the *A New Tax System (Goods and Services Tax) Regulations 1999*, as appropriate.

Property Council Detailed Submission

Simplification of the margin scheme

RECOMMENDATION:

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

The margin scheme is a cornerstone component of Australia's GST Law. Since the introduction of GST, the application of the margin scheme to residential property transactions has without doubt, (and, as intended by Government) benefited purchasers of residential property.

The Property Council believes that the fundamental economics behind providing purchasers of residential property with a tax concession is appropiate and well founded.

Property developers however are currently paying a very high price for this concession. The complexity of the underlying margin scheme laws, compounded by ATO and Australian Courts' interpretations relating to the margin scheme rules, is continuing to grow at a rapid pace and shows no sign of dramatically easing. This is evidenced by the very high number of property-related technical interpretation issues and court cases currently on-foot.

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

The Property Council believes that the application of GST to real property should be re-assessed by the Government in the short to medium term as a part of separate review.

This separate real property review should focus on the key issues relating to the economic 'trade-off' that exists between the legal compliance burden imposed on taxpayers who wish to apply the margin scheme, and the concessionary benefits that flow to end consumers of residential property.

It may be that the outcome of such a review would be recommend to Government a radical change to the way in which residential property is taxed for GST purposes – whilst still retaining the underlying policy intention of a targetted concessionary approach. Alternatively, the outcome of the review may be to implement other (perhaps more subtle) changes to the margin scheme laws that have the effect of minimising – or even eliminating – the current difficulties faced by property developers.

The Property Council believes that the Board should incorporate an over-arching

recommendation to Government that the review be commissioned and carried-out within the next 12 to 18 months.

Given that a review of the fundamental principles surrounding the margin scheme is not within scope of the current review being carried out by the Board, the Property Council considers that a separate review such as the one proposed above is appropriate in order to acknowledge and better understand the very real compliance issues currently faced by property developers.

Valuations – Margin Scheme

RECOMMENDATION:

The GST Act be amended so that margin scheme valuations cannot be challenged by the ATO where:

1) **the valuation is made by a professional valuer in accordance with accepted valuation principles.**

2) **the valuer complied with the specific requirements set out in the relevant margin scheme valuation determination.**

3) **there has been no evidence of fraud or negligence on the part of the valuer or collusion on the part of the taxpayer.**

4) **the value is not so extravagantly large or so inadequately small such that the only conclusion is that the valuation is not a professional valuation.**

This approach is consistent with relevant analogous legal principles drawn from Australian case law commencing with Legal & General Life of Australia Ltd v A Hudson Pty Ltd (1985) 1 NSWLR 314. The approach is necessary to give taxpayers confidence that they will not be subject to retrospective additional margin scheme GST where these principles have been followed.

The Property Council believes that valuations obtained to calculate margin scheme GST liabilities under the GST law should be accepted by the Commissioner
without challenge where the four principles outlined above hold true.

In practical terms the ATO should apply the following question tests to implement the above principles:

- In relation to Margin Scheme Valuation determinations 2000/1 and 2000/2 - "Does the valuation have regard to the matters specified in the determination?" If the answer is yes, the valuation should not be open to challenge. The particular weight or relevance given by the valuer to any particular matter should not be, as a general rule, open to challenge.

- In relation to Margin Scheme determination 2005/3 - "Has the valuer made the valuation in accordance with recognised professional standards, and does the valuation certificate set out the specified matters?"

If the answer is yes, the valuation should not be open to challenge. Simply arriving at a different valuation from what the Commissioner considers correct in and of itself should not amount to a failure to make the valuation in accordance with recognised professional standards.

The Property Council believes that the above approach is consistent with relevant analogous legal principles drawn from Australian case law commencing with Legal & General Life of Australia Ltd v A Hudson Pty Ltd (1985) 1 NSWLR 314. The approach is necessary to give taxpayers confidence that they will not be subject to retrospective additional margin scheme GST where these principles have been followed.

Division 129

RECOMMENDATION:

Creditable application under Dvision 129 needs to be amended to:

1) ensure minor applications do not result in old residential premises being treated as new residential premises through interaction with section 40-75;

2) clarify what constitutes an acquisition;

3) clarify how to treat acquisitions that become a part of another supply;

4) re-align quantum thresholds:

a) remove the distinction involving acquisitions that relate to business finance in determining thresholds (i.e. $10,000 vs. $1,000 as a minimum threshold, and $50,000 vs. $5000 as the second threshold, and one year versus two years as the number of periods) and retain only the higher thresholds.

b) 5 years as the maximum vs 10 years

5) clarify whether the application period ends at 31 May or 30 June.

6) clarify the treatment of "non applications" and "non-applications together with applications".

7) clarify the adjustment methodology to recognise different uses/applications for acquisitions that straddle 30 June.

8) Clarify whether any acquisitions have only one purpose.

9) Clarify whether a thing has been "applied" if ultimately no supply is made at all.

Division 11 requires a taxpayer to make an estimate, or determine its intention, in respect of the extent to which some "thing" has been acquired for a creditable purpose.

Since that determination broadly occurs at the time of making an acquisition, it necessarily can only be based on the intent, or expectations, of the taxpayer at that moment in time. That estimate could be made as a reflection of a particular plan as to how the thing acquired is to be used (eg in accordance with a project plan) or by relying on past usage of similar acquisitions as a basis.

However, the commercial reality that the acquisition could end up being applied differently to the manner that was originally intended is reflected in Division 129, a provision that requires, within a framework, the taxpayer to consider the actual application of the acquisition over set periods of time. Where the (intention based) Division 11 creditable purpose is different to the actual creditable application, then there may be an increasing or decreasing adjustment to the GST claimed. We consider that Division 129 is an appropriate mechanism, but the following matters require legislative, or interpretative, amendments and clarifications.

- On current interpretation, there is a significant risk that even a minor application, for Division 129 purposes, of acquisitions forming part of New Residential Premises to be supplied in taxable or GST free circumstances could inappropriately interact with section 40-75. This could result in residential premises being treated as New Residential Premises (NRP), and therefore being subject to GST, even decades after first occupation, and even where there was a very predominant use in making input taxed supplies (with input tax credits being denied accordingly). This is due to the ATO applying a very restrictive test on what is NRP (i.e. unless used for residential leasing purposes for an unbroken and continuous 5 year period, immediately prior to the sale). This view means that the new ATO view regarding the "application" of a thing for Division 129 purposes (the ATO now accepts that a thing may be acquired both for the purposes of leasing a premises and actively marketing the same premises for sale) may mean that the sale of residential premises can never be an input taxed supply.

- Division 129 applies to a particular "acquisition", provided that the GST exclusive value of that particular acquisition meets specific thresholds. We strongly note the need for greater certainty of exactly what constitutes the "acquisition", so that the consideration connected with that acquisition can be identified to determine the quantum thresholds in Division 129. For example, is 500 bricks of $2.50 each, on a single pallet, 500 acquisitions of less than $1000, or a single acquisition of over $1000? A similar issue arises where "construction services" are acquired in respect of large scale developments, rather than a series of component acquisitions.

- There is need for greater certainty as to how to treat acquisitions that become part of something else which is to be supplied or applied, in determining the application of the acquisition (eg a brick forming part of a house which is applied or supplied, or a part acquired to form part of a vehicle which is then applied or supplied).

- The quantum thresholds, and length of adjustment periods, are too burdensome, and we recommend that the first two thresholds for all acquisitions be aligned with those for business finance acquisitions (eg

$10,000 vs. $1,000 as a minimum threshold, and $50,000 vs. $5000 as the second threshold, and one year versus two years as the number of periods). We also recommend 5 years as the maximum vs. 10 years (bearing in mind that taxpayers are only required to maintain records for GST purposes for five years under provisions in the *Taxation Administration Act 1953*.

- Clarification should be provided as to whether the application period ends at 31 May (31 March for quarterly remitters) vs. 30 June. For example, acquisitions made on 31 May and 1 June will have a different first adjustment period. Such a distinction seems arbitrary and unnecessary and does not align with 30 June periods for tax or accounting purposes. It is submitted that all acquisitions made in the same financial year should have the same first adjustment period.

- Clarification as to the treatment of 'non applications', and 'non applications together with applications' (eg used for a minor purpose, and still available for another intended use even though not applied to that other use, when the application for Division 129 arises).

- The adjustment methodology should also recognise that acquisitions that straddle 30 June may have different uses/applications that are in line with intentions but straddle 30 June (eg seasonal or cycle movements, or temporary business changes occur) should not give rise to adjustments.

- Clarification should be provided as to whether some "things" are only acquired and applied once for the purposes of Division 129 (eg: professional advice).

- Clarification should also be provided as to whether a thing has been "applied" if ultimately no supply is made at all (or alternatively, whether the "thing" should be viewed as an "enterprise cost"). For example, assume advice has been obtained by a retirement village operator in connection with the purchase of an operating retirement village, which will predominately involve input taxed supplies (and credits are denied in respect of the acquisition of the advice accordingly). If the operator ultimately decides not to proceed with the purchase, is a decreasing adjustment available?

Division 135 – Going Concern & Farm Land

RECOMMENDATION:

Amend Division 135 to ensure adjustments under the division are consistent with:

1) other GST adjustment provisions (such as Division 129); and

2) GST provisions that result in taxpayers not being able to claim full GST credits (such as Division 11).

Division 135 provides that the recipient of a going concern or a purchaser of farm land has an increasing adjustment in certain circumstances. The Property Council believes that Division 135 adjustments should be consistent with both the other GST adjustment provisions (such as Division 129) and also the provisions of the

GST law that result in taxpayers not being able to claim full GST credits (such as Division 11). There are various deficiencies in Division 135, as follows:

- A Division 135 adjustment is required even where the subject property or assets being transferred are not taxable (i.e. where the sale of the property or assets is GST-free, input taxed or out of scope). For example, a Division 135 adjustment can arise where existing residential property (which is input taxed) is sold as part of a going concern.

- Unlike Division 11 and Division 129, a Division 135 adjustment can arise even where a taxpayer exceeds the FAT or satisfies section 11-15(3) or 129-50(3).

- A Division 135 adjustment can arise even where the taxpayer meets the borrowing exemption (refer section 11-15(5)).

- Division 135 requires that the adjustment is calculated on a revenue basis. As recognised by the Tax Office in its GST rulings on apportionment (GSTR 2006/3 and GSTR 2006/4), apportioning on a revenue basis does not always result in a fair and reasonable outcome. As an example, many farming businesses enter into agricultural derivatives and make other input taxed supplies. The values of these are often far higher than the other revenue received by the business, leading to a distorted and unreasonable Division 135 adjustment.

- A Division 135 adjustment arises where the supplies made through the enterprise are not GST-free or taxable. Accordingly, where a business makes out of scope supplies (which would normally give rise to a full input tax credit entitlement on acquisitions related to the supplies), the business will nevertheless have a Division 135 adjustment.

- Division 132 does not reference Division 135 adjustments and therefore a Division 132 adjustment can never arise where property or assets that were the subject of a Division 135 adjustment are sold.

- Division 135 references a "supply of a going concern", rather than a supply that is GST-free under section 38-325. Accordingly, a Division 135 adjustment can technically arise even where a business sold as a going concern is treated as taxable for GST purposes.

The Property Council suggests a rewrite of Division 135 to overcome the above issues. An alternative approach would be to remove Division 135 and amend section 38-325 such that the provision is not available where the recipient acquires the assets of the enterprise other than for a creditable purpose.

Tax Invoices and Recipients within GST Groups

RECOMMENDATION:

Allow tax invoices to name any entity within a tax group as the recipient to reduce the need to re-issue invoices for technical errors.

Under GST Regulation 29.70.01(2), if the total amount payable for a supply is $1,000 or more, the tax invoice relating to that supply must contain "the name of the recipient" and "the address or the ABN of the recipient". This regulation still applies where the recipient of the supply is a member of the same GST Group as another entity that has been named on the tax invoice.

An inordinate amount of time can be spent by staff (usually accounts payable staff) checking that the correct recipient's details are contained in the tax invoices received by an entity. If a tax invoice is incorrect, the supplier is asked to reissue the tax invoice , which causes frustration and delays in payment.

These compliance costs can be reduced in circumstances where the recipient of the supply is a member of a GST Group and the entity named on the tax invoice is a member of the same GST group.

Given that only the representative member of a GST Group is entitled to the input tax credits for creditable acquisitions made by each member of the group, it does not matter that the actual recipient's name and details aren't on the tax invoice.

The following amendments to GST Regulation 29-70.01(2) would achieve the desired result:

a) the name of the recipient **or a *member of a *GST Group of which the recipient is a member**;

b) the address or the ABN of the recipient **or a *member of a *GST Group of which the recipient is a member**;

The Property Council's view is that such amendments would not compromise the role that tax invoices play as an integrity measure in the GST system, but would assist in reducing compliance costs.

The financial acquisitions threshold ("FAT") and s.11-15(5)

RECOMMENDATION:

The FAT should be revised to:

1. **exclude acquisitions made in the course of the commencement or termination of an enterprise from the definition of "financial acquisition";**

2. **extend the current exclusion for borrowings to any activity associated with raising equity capital;**

3. **amend the period for testing to 6 months retrospectively and 6 months prospectively; and**

4. **increase the threshold to 25% or $100,000.**

New entities

Certain new entities, including both listed and unlisted property trusts, may not exceed the financial acquisitions threshold ("FAT") in the ordinary course of business. However, these entities may nonetheless initially exceed the FAT because of the initial costs associated with the start-up of the new entity's activities (e.g. costs of professional advice associated with financial supplies involving raising equity, including issuing units). Such entities are precluded from remaining below the FAT for the first 12 months, and are therefore required to consider implementing an appropriate apportionment methodology.

This outcome is inappropriate and highly onerous for taxpayers, particularly in circumstances where such obligations must be undertaken only temporarily (i.e. for a 12-month period). Such an outcome seems to detract from the policy intent of the FAT, which is to enable certain entities that make predominantly taxable supplies to claim full input tax credits without having to undertake a significant apportionment exercise.

12-month testing periods

Furthermore, it is extremely onerous to apply the financial acquisitions threshold test over a 12-month period both retrospectively and prospectively. This creates a significant uncertainty in applying, testing and substantiating the FAT and is most difficult (if not impossible) to apply.

10% / $50,000 threshold

The reference to 10% or $50,000 is extremely low and has not been amended to take account of the development and increasing cost structures for businesses.

The increase of thresholds from $50,000 to $75,000 is not unprecedented in the GST context, whether to take account of inflation or otherwise (e.g. the increase in the registration turnover threshold under section 23-15(1) of the GST Act). Similar reasons should apply for the purpose of revising the FAT.

Accordingly, the FAT should be revised to:

- exclude from the definition of "financial acquisition" in section 189-15 of the GST Act any acquisitions made in the course of the commencement or termination of an enterprise (similar to the wording contained in the definition of "carrying on an enterprise" in section 195-1 of the GST Act). Such acquisitions have a distorting effect in determining whether an entity exceeds the FAT;

- specifically extend the current exclusion for borrowings in the FAT caculations and in s. 11-15(5) to any activity associated with raising equity capital (by way of the provision, acquisition or disposal of an interest in or under securities or otherwise) and derivatives that hedge such borrowings;

- amend the period for testing to 6 months retrospectively and 6 months prospectively; and

- increase the threshold to 25% or $100,000.

Transfers on Partitioning

RECOMMENDATION:

Supplies by way of partition should be ignored for GST purposes and expressly set out as an exclusion to "supply" as a new sub-paragraph in section 9-10(4).

The issue for GST purposes is whether a partition by agreement, where each co-owner's interest remains equal, will result in a supply for GST purposes. Based on the wide definition of "supply" in the GST Act, partitioning is likely to result in supplies being made between the parties[1]. However, it is merely a change of legal interests for no monetary consideration, which is ignored for stamp duty purposes, and recognising it as a supply for GST purposes will create very complex accounting for GST margin scheme sales for little (if any) net revenue.

We submit that supplies by way of partition should be ignored for GST purposes and expressly set out as an exclusion to "supply" as a new sub-paragraph in section 9-10(4).

Partitioning occurs where the joint ownership of real property (i.e. between joint tenants or tenants in common) is terminated by the division of land between the co-owners. The partitioning of land may occur by way of agreement between parties or through a court order. Relevantly for property developers the division of the property where interests remain the same does not give rise to stamp duty (see for example, section 30 of the Duties Act 1997 (NSW)).

By way of example, in a partition a co-owner may start with a 50% interest in the whole land (50% in 100%) and after partitioning ends with a 50% interest in a separately-titled part of the land (100% in 50%).

We submit that ignoring supplies by way of partition for GST purposes would remove the significant complexities for taxpayers particularly in relation to the complicated margin scheme calculations required where:

- there are more than 2 co-owners, more titles, and differently valued interests;
- part of the land is to be supplied under the margin scheme and the other part to be supplied under the normal GST rules;
- the co-owners involve general law partnerships or tax law partnerships; and
- the supplies relate to acquisitions of land by unregistered parties.

[1] which is the preliminary view expressed by the Commissioner in Draft GST Ruling GSTR 2008/D3

Adjustment Provisions: Mirror decreasing adjustment for non-margin scheme sales

RECOMMENDATION:

A new provision should be drafted to allow a decreasing adjustment for the input tax credit previously denied on an acquisition under the margin scheme where the subsequent supply is not under the margin scheme.

An adjustment provision is needed to allow a decreasing adjustment for the input tax credit previously denied on an acquisition under the margin scheme where the subsequent supply is not under the margin scheme. Such a provision would effectively be a mirror to the increasing adjustment provision, section 75-22, inserted in 2005.

We propose that the solution is as simple as a new provision – ie section 75-23 – setting out the entitlement to the increasing adjustment.

Currently an entity is liable for an increasing adjustment (ie. a payment of GST) if it acquires land in a fully taxable supply, claims an input tax credit and later sells the land (or part of it) under the GST margin scheme[2]. This adjustment, effectively repaying the original input tax credit, reflects the policy that no input tax credit is available for land to be sold under the margin scheme to ensure that the aggregate revenue is the GST payable by each land owner on its margin.

However, there is no mirror provision to allow a decreasing adjustment where an entity acquired land under the margin scheme but subsequently sold part or all of the land in a taxable supply (or, potentially, a GST-free supply or a taxable leasing of the land). In these circumstances, there is a cascading of GST on the non-margin scheme supplies, which is contrary to the policy.

The circumstances of acquiring under the margin scheme and later selling or leasing in a taxable or GST-free supply could arise where an entity acquires a site for "mixed use" development, for example:

- a very large tract of land for residential development but which will include a shopping centre;
- a single "mixed use" development such as an apartments, hotel and offices; and
- a retirement village which includes residential living units and GST-free aged care.

[2] The margin scheme is not normally available where the same land is acquired in a fully taxable supply as is being sold, but where the land is acquired and amalgamated with other land that is eligible to be sold under the margin scheme, then the entire amalgamated title is able to be sold under the margin scheme subject to the section 75-22 increasing adjustment.

Land value increase for an unregistered entity

RECOMMENDATION:

Remove a margin scheme anomaly to ensure all land value increases for a property held by an unregistered entity are not taxed.

Currently, the margin scheme provisions of the GST Act do not tax the increase in the value of land held by an unregistered entity – unless and until the entity registers for GST in which case a valuation of the land as at the date of registration is required. However, these provisions, Item 2 of section 75-10(3)(b), only apply if the entity acquired the land before 1 July 2000. If the land is acquired after 1 July 2000 by an unregistered entity, the margin scheme provisions will tax the increase in value of the land while the entity is not registered for GST.

This anomaly can be simply fixed by amending Item 2 of Section 75-10(3) (b) as follows:

> *The supplier acquired the interest, unit or lease before it became*
>
> **registered or *required to be registered*

It is the clear policy of the margin scheme provisions to tax the value added to land by registered entities after 1 July 2000[3].

If an entity held land on 1 July 2000, registers for GST sometime after that date and sells the land under the GST margin scheme, then the "margin" for GST purposes under Item 2 of section 75-10(3)(b) is the difference between the selling price and the value of the land as at the date the entity registered for GST. This ensures the increase (if any) in the value of the land between 1 July 2000 and the date of registration is not subject to GST.

However, an anomaly arises where an unregistered entity acquires land after 1 July 2000, later registers for GST and then sells under the margin scheme. The current wording of Item 2 of section 75-10(3)(b) would not apply to such an entity, as it did not hold the land as at 1 July 2000, so the "margin" for this entity is the difference between its selling price and its purchase price. This means the increase (if any) in the value of the land between the date it was acquired and the date of registration is subject to GST.

This anomalous situation, where the value increase of land held by an unregistered entity is taxed, may arise (and indeed has arisen) where, for example, a 'mum and dad' home owner of a large block decide to use the land in a property development enterprise.

Division 129 adjustments and the five year rule for new residential premises

RECOMMENDATION:

The 'five year' period in section 40-75 should be aligned to the "five adjustment periods" in Division 129 to simplify the interaction between the two provisions.

Currently there is uncertainty and potential mismatch between the five year leasing period in section 40-75 after which sales of new residential premises will not be subject to GST and the adjustment periods in Division 129 which would enable input tax credits to be claimed (or require them to be repaid) depending on whether the sale of residential premises was taxable or not.

The 'five year' period in section 40-75 should be aligned to the "five adjustment periods" in Division 129 to simplify the interaction between the two provisions. Subsection 40-75 both defines new residential premises and provides that premises will not be new residential premises where they have been used to make input taxed supplies for at least five years. We would suggest the 'five year' period in the section 40-75 be aligned with the "five adjustment periods" in Division 129.

In this way:

- if the taxpayer sold the new residential premises within 5 years (i.e. five adjustment periods) then supply of the new residential premises would be a taxable supply and the taxpayer would be entitled to input tax credits to the extent of the revenue received for the sale over the total revenue for the sale and lease of the premises;

- if the residential premises were sold after 5 adjustment periods, the sale would be input taxed and input tax credits repaid under Division 129.

For example, currently if the residential premises are leased for 2 years, and the acquisitions that have gone into the premises are under $5,000, a taxpayer would have a Division 129 adjustment in respect of those acquisitions as, although initially used to produce new residential premises, for two years would have been used to make input taxed supplies.

We would suggest that where new residential premises are being provided or leased, the period within section 40-75 be aligned with the tax periods within Division 129. This would allow:

- clarity to the definition of "...the period of at least 5 years";

- simplification of the interaction between section 40-75 and Division 129; and

- if the thresholds within Division 129 were increased, further simplification would occur for small property developers in determining what adjustments were required where new residential premises were leased to provide cash

[3] Refer Sterling Guardian, Brady King

flow prior to being sold. (Given the current state of the property market within Australia this may remove disincentive for developers to move stock into the rental market as well as simplify their compliance burden).

Shortfall Interest Charge (SIC) for GST and symmetry with interest on overpayments

RECOMMENDATION:

SIC-like charge is more appropriately used where:

1) **the Commissioner undertakes an audit and determines that the taxpayer has a shortfall amount; and**

2) **the taxpayer voluntarily revises a BAS which creates a shortfall amount from the original BAS submission.**

With reference to the Board of Taxation's question 4.15, there are circumstances where a "SIC-like" charge would be much more appropriate for GST than the current GIC regime.

Currently a taxpayer is only liable for shortfall income charge (SIC) where an amount of income tax is payable as a result of an assessment being amended for an income year. The SIC rate on this amended assessment is only 3 percentage points above the base interest rate as compared to the GIC rate which is 7 percentage points above the base interest rate.

Under the Taxpayers' Charter the Commissioner generally considers that most taxpayers act in honest manner, as such, applying a SIC-like charge may be more appropriate than the higher GIC amount. It may show that the Commissioner acknowledges that mistakes can occur, but the Commissioner should not be "out of pocket" from such a mistake.

A "SIC-like" charge could be appropriate in two situations:

1) **where the Commissioner undertakes an audit and determines that the taxpayer has a shortfall amount; and**

2) **where the taxpayer voluntarily revises a BAS which creates a shortfall amount from the original BAS submission.**

Although no assessment would be issued, the charge would apply from the date the original BAS was due, to the date the BAS revision was made.

Where the Commissioner reviews a BAS and determines that the net amount is incorrect, the Commissioner could issue a GST assessment (although this may not necessarily need to be a requirement) and a "SIC-like" charge could apply to the difference between the amount determined by the taxpayer and the amount determined by the Commissioner. This would encourage taxpayer's to correctly determine their GST liability prior to the submission of the BAS.

Like SIC, the charge would apply regardless of whether the taxpayer was liable for an administrative penalty.

Similarly, where the taxpayer voluntarily revises a BAS, if a shortfall amount is created, the charge should apply on that shortfall amount (the taxpayer should still be entitled to request the Commissioner's discretion to remit the charge). Both scenarios would allow the charge to be imposed on shortfall amounts to encourage taxpayers to comply with the provisions of the GST Act as well as encourage GST payments to be made in a timely manner without the punitive higher rate of GIC.

Division 105

RECOMMENDATIONS:

A specific mechanism should be provided in the GST Act which prescribes an "approved form" for the purposes of Division 105.

Furthermore, Division 105 should be clarified such that either:

1) a mortgagee is expressly permitted to:

(a) apply the margin scheme to a sale of debtor's property for the purpose of calculating the GST payable under Division 105; and

(b) elect to obtain and rely on the GST-inclusive market value of real property as at the date on which the debtor acquired the relevant property (as distinct from the consideration for the debtor's acquisition of the property) for the purpose of applying the margin scheme; OR

2) Division 105 does not apply to impose GST liability on a mortgagee in the context of residential premises.

Taxpayers have difficulty with what is required by the term "reasonable information" in section 105-5(3)(b) of the GST Act.

We recommend that there be a specific mechanism in the GST Act which prescribes an "approved form" for the purposes of Division 105, which outlines what sort of information would be regarded as "reasonable" in order to determine whether the supply (if made by the debtor) would have been a taxable supply. Under Division 105 of the GST Act, the supply of property by a mortgagee in possession will be a taxable supply if the supply would have been taxable had the debtor made the supply.

However, the supply is not a taxable supply if:

- the debtor has given a written notice stating that the supply would not have been a taxable supply if the debtor were to make it; or
- if such notice cannot be obtained, the mortgagor believes on the basis of reasonable information that the supply would not have been a taxable supply if the debtor were to make it.

If a written notice cannot be obtained from the debtor, the issue that arises is what constitutes "reasonable information" and, in particular what the ATO regard as reasonable information. Based on our understanding from taxpayers that have been affected, the ATO applies this provision very strictly and the burden of proof for mortgagees in not treating the supply as taxable is extremely high. Further, in our experience, the ability of mortgagees to obtain the requisite information from debtors in these circumstances is limited given the tenuous relationship between the debtor and mortgagee (as the loan is in default).

Furthermore, for supplies that give rise to GST liability for a mortgagee under Division 105, it is unlikely that the mortgagee would have sufficient information for the purpose of applying the margin scheme to any taxable supply.

The policy intent of Division 105 seems to require a mortgagee to account for GST otherwise payable by a debtor. To the extent that a mortgagee is in a better financial position, Division 105 protects the Commissioner's ability to recover GST liability on sales made by a mortgagee and ultimately preserves GST revenue.

However, Division 105 currently requires a mortgagee to account for GST otherwise payable by the debtor (i.e. putting the mortgagee in the shoes of the debtor). Rather, Division 105 goes beyond the policy intent by creating additional GST liability for mortgagees, resulting in a significant unintended and inappropriate increase in GST revenue at the expense of mortgagees.

As a result of the practical and evidentiary obstacles associated with compliance with Division 105, a mortgagee could be exposed to GST liability equal to 1/11th of the total consideration for a supply of real property, notwithstanding that:

1. the supply would not in fact have been taxable had it been made by a debtor; OR

2. the debtor would have applied the margin scheme in reducing the GST payable on the sale had it been made by the debtor (i.e. using information not available to a mortgagee).

The requirement of any mortgagee that is in a net "loss" position to remit GST pursuant to Division 105 would result in a further loss. This may arise as a result of additional GST liability that has been *created* by Division 105 (i.e. would not have arisen but for the application of Division 105).

It is submitted that the recommendations would:

- provide mortgagees with a reasonable opportunity to apply the margin scheme on a taxable supply in circumstances where no reasonable information is available to the mortgagee for this purpose and the debtor is likely to have applied the margin scheme had the debtor made the supply;

- reduce uncertainty and compliance risk to mortgagees-in-possession and provide a real and practical opportunity to comply with Division 105, without artificially increasing GST revenue; and

- preserve and protect GST revenue so as to better achieve the policy intent of Division 105.

AGENCY

RECOMMENDATION:

Allow:

1) subdivision 153A and 153B to be used by agents that do not have the ability to bind the principal in contacts (eg invoicing agents); and

2) foreign principals to be unregistered for GST where they have a registered Australian agent.

Subdivision 153A covers invoicing and attribution for acquisitions or supplies "through" agents. Subdivision 153B provides that where a supply or acquisition is made "through" an agent, the principal and the agent may agree to treat the agent as a principal in the supply or acquisition. Both of these provisions are very useful and, for the taxpayers who utilize them, eliminate administrative complexity in meeting GST obligations from such arrangements. It allows the agent for a acquisition or supply to deal with invoices as if it was principal and account for the tax.

The difficulty is that the supply must be made "through" the agent. This has been interpreted to mean that the agent must have authority to bind the principal legally into contracts before the provision can be used. There are many circumstances where agents do not have the authority to bind and the provisions do not have application. Examples include invoicing agents such as real estate agents in relation to rented commercial property.

It would eliminate administrative complexity and uncertainty if such agents and their principals could rely upon subdivisions 153A or 153B as administrative or commercial convenience requires.

The application of agency principles to GST generally could be streamlined to eliminate complexity and uncertainty. For example, if agents are acting for their principals in invoicing for them it would be far simpler if the agent could issue invoices as agent but in its own name and with its own ABN without the need for special stationery reflecting the ABN and identity of the principal. The use of such arrangements would not affect the liability of the principal in respect of the transaction because agency principles would apply in the same way as they do now.

Another area concerns agents for foreign principals. Such agents may agree with the principal to meet the GST obligations of the principal in Australia. The current GST law requires the foreign principal to have an ABN and be registered for GST. This is a requirement that causes the foreign taxpayers concern because they fear that they will, by registering, have a tax presence here. While such fears are usually misguided it often represents an impediment to trade. There does not seem to be a logical reason to register these taxpayers, particularly as they are largely beyond the reach of the ATO. It would be preferable if this requirement was dispensed with where, pursuant to division 57, they have an Australian representative. Registration per se does not achieve anything because it does not bring the foreign principal any more within the reach of Australian taxation law than if they were not registered.

Tax Law Partnership Returns

RECOMMENDATION:

Allow Tax Law Partnerships to account for their share of income and expenses through each partner's own returns without lodging partnership returns.

Joint property owners (joint tenants or tenants in common) in receipt of income from the property are treated as tax law partnerships. If they have income over the GST de minimus thresholds they are required to effect registration and account for GST through the tax law partnership which is treated as a separate entity.

For income tax purposes such persons are not required to lodge partnership returns by the ATO but may simply account for their share of income and expenses through their own returns. This eliminates a compliance burden for the taxpayers concerned.

If a parallel approach were adopted for GST it would mean that joint owners of investment property could elect to be treated as a partnership for GST purposes or elect not to and account for the GST in their own right. For those that it suited it would mean that electing out would reduce the compliance burden of GST for their investment. There would not be any significant impact on revenue except perhaps where collectively the owners are above de minimus thresholds but individually they are not. The ATO, in GSTR 2004/6, already accepts that certain tax law partnerships do not carry on an enterprise and that the joint owners carry on the enterprise in their own right. An election available in the GST law for tax law partnerships to be treated in this way would provide more certainty. Expanded GST agency provisions (refer above) would eliminate any difficulties with invoicing if the owners want to issue a single invoice covering their separate supplies.

GST Joint Ventures

RECOMMENDATION:

GST Joint Venture provisions to be expanded to allow any joint venture that is a joint venture for accounting purposes under IFRS to elect to be treated as a joint venture for GST purposes.

Grouping of all staples to be allowed

RECOMMENDATION:

Allow any two or more entities/groups that are stapled to elect to be grouped for GST purposes.

The GST grouping rules applying to partnerships and trusts (and interaction with other entities such as individuals and companies) is particularly complex and should be clarified.

One particular area involves stapled entities (e.g. stapled trusts) that have multiple owners but must have the same constitution of owners (i.e. an investor in the stapled group must have 1 unit in trust A and 1 unit in trust B).

Under the current GST grouping rules, the 2 stapled entities would not be eligible for GST grouping as distributions would not made only to another entity in the same GST group (section 48-15(1)(e) of the GST Act and Regulation 48-10.03(2) of the GST Regulations). However, at a commercial level, the stapled entities are treated as a single entity or group. In the interests of reducing compliance costs, stapled entities should be able to be grouped for GST purposes.

It should be clarified that any revision of GST grouping rules would not have any adverse impact in any other tax context (e.g. classifications as trading trusts etc).

Grouping/degrouped mid tax period to be allowed.

RECOMMENDATION:

Expand ability to enter or leave a GST group so that any eligible entity can join or leave a GST group at any time.

Entities may only be added to a GST group from the first day of a tax period (section 48-85(3)(a) of the GST Act). This is a rather frustrating requirement as it means that new entities established other than at the start of a tax period must lodge at least 1 separate GST return for the remainder of the tax period, and that activities during that period between the entity and other members of the GST group could give rise to taxable supplies and creditable acquisitions.

The inability to add members to a GST group during a tax period has resulted in additional compliance for taxpayers and also create an unnecessary and inappropriate risk that supplies between the new entity and other members of the GST group could be taxable.

For similar reasons, the GST grouping rules should also be amended to enable entities to leave a GST group from any day during a tax period.

Adjustment Notes

RECOMMENDATION:

Consider abolition/simplification of adjustment note provisions in recognition of the fact that adjustment notes are rarely issued in practice.

Whilst taxpayers have established and reviewed systems and processes for the purpose of issuing tax invoices, it has added a further layer of complexity in ensuring that systems can also generate adjustment notes (or adjustment notes may be prepared manually).

It is submitted that the requirement for adjustment notes has created unnecessary further compliance obligations and costs (e.g. determining whether

an item should appear in a tax invoice or an adjustment note, creating separate sections in documents in order for a document to satisfy both requirements etc). Such a concept is not considered to be beneficial to GST revenue or audit trail, nor is it considered cost-effective for taxpayers to implement or even for the Commissioner to enforce.

For these reasons, any requirement for a separate document such as an adjustment note should be abolished. Rather, any adjustments arising from adjustment events should be able to be accounted for by way of an adjusted total or additional line item in an tax invoice for a subsequent tax period.

Recipient Created Tax Invoices ("RCTIs")

RECOMMENDATION:

RCTIs provisions should be amended to allow the RCTI agreement to be embodied into the relevant tax invoice.

Before parties can use RCTIs, it is necessary for the supplier and recipient to first enter into a written RCTI agreement. This can be a costly and burdensome requirement. To reduce such costs, we submit that the RCTIs provisions should be amended to allow the RCTI agreement to be embodied into the relevant tax invoice.

General GST on-line administration

RECOMMENDATION:

Expand on-line access to eliminate written communication.

Expand and further develop on-line access to the ATO to enable broader tax paying community to interact seamlessly with the ATO with aim of eliminating written communication from either the ATO or the taxpayer. For example:

- on-line GST registration and confirmation;
- seamless set up of electronic certificates;
- on-line GST grouping and degrouping;
- on-line access to composition of GST group;
- on-line access to account details;
- ability to drill down (e.g. on GIC calculations); and
- ability to query and receive response on-line.

Barter transactions

RECOMMENDATION:
Remove the requirement to identify and report on barter transactions where no net revenue would be collected from the transaction.

The key issue for taxpayers here is that most business-to-business supplies and acquisitions of barter transactions (or in-kind consideration arrangements) yield no net additional revenue for the Government, yet, the administrative compliance costs can be significant.

By enforcing a requirement on businesses to identify and report business-to-business revenue-neutral barter transactions, significant resources must be diverted away from other more productive uses within a taxpayer's organisation. Often it may also be the case that the organisation finds it fundamentally difficult to comprehensivley identify a list of all barter transactions in which their organisation is involved, as in some instances, such arrangements do not follow the same financial system processes as regular supplies and acquisitions.

Our recommendation is that the Board should consider easing the burden on businesses to identify and report barter transactions where zero net revenue would be collected from the transaction. The Property Council believes that making compliance in this specific area voluntary will ease the administrative compliance burden in this area.

Where a business-to-business barter arrangement does result in a net revenue collection for the Government (because the recipient is not entitled to full input tax credits on a taxable supply), then the existing rules should obviously remain in place.

Threshold limits

RECOMMENDATION:

Government should:

1) **Increase the current limits on all existing thresholds contained in the GST Law; and**

2) **Provide regulations to allow Parliament to alter the threshold limits on a periodic basis in-line with changes in the relative economic scale of business activities.**

Predominantly all of the existing thresholds contained in the GST Law were set by the Parliament when the legislation was passed back in 1999 (with the exception of the GST registration and tax invoice thresholds that were increased as part of the 2008/09 Federal Budget measures). Some examples of the limits set in 1999 that are still in place are the financial acquisitions threshold contained in Division and Regulation 40 of the GST Law, and the monthly tax periods threshold contained in Division 188.

Since the time that they were set in 1999, the scale and complexity of business transactions has increased significantly. On that basis, we believe the Board should recommend to the Government that all existing thresholds contained in the GST Law be reviewed, with a view towards increasing the current limits. Furthermore, provision should be made for Parliament to be able to alter the threshold limits on a periodic basis in-line with changes in the relative economic scale of business activities that take place over time (as a guide, perhaps every three years). Also, the thresholds currently adopted by the ATO for correcting GST mistakes should be increased and provided for in the GST Law.

Review of income tax self assessment (ROSA) changes

RECOMMENDATION:

ROSA style initiatives should be investigated and applied to the GST regime.

We believe that the ROSA initiatives taken by the Government back in 2005 in relation to providing more certainty for taxpayers can be applied in a GST context.

The changes that could be made (that would mirror those made in an income tax context) relate to matters such as: the expanded scope of private and public binding rulings; periods of review, and the penalties regime. Further work may need to be done with taxpayers in order to identify the specific range of ROSA initiatives that could be applied in a GST context. However, for the purposes of this submission, the Property Council feels that it is important to confirm that the broad-based nature of the ROSA initiatives would generally be welcomed by taxpayers in the property sector.

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