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15th September 2008

Anne Millward
Board of Taxation Secretariat
Board of Taxation
c/- Treasury Department
Langton Crescent
PARKES ACT 2600

Dear Ms Millward,

Request for Submissions for Board of Taxation review on the legal framework for the GST.

This submission has been prepared by the Local Government Association of Queensland (LGAQ) on behalf of Queensland councils in relation to the Terms of Reference set out by the Board of Taxation to undertake a review of the legal framework for the administration of the GST.

On behalf of all Queensland councils, the association looks forward to the Board providing a robust final report, which will contain solid and workable clarification of the issues raised.

If you have any questions related to this submission please contact
Mark Johnson Finance & Governance Policy Officer & LG Asset Coordinator,
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Yours sincerely

Greg Hoffman PSM
Director - Policy and Representation

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Submission to the Board of Taxation On The Legal Framework for the Administration Of GST

BACKGROUND

On 11 June 2008, the Assistant Treasurer announced that he had asked the Board of Taxation to undertake a review of the legal framework for the administration of the GST.

The terms of reference for the review ensure that the focus will be on:

- Streamlining and improving the operation of the GST;
- Reducing compliance costs; and
- Removing anomalies.

The Board's terms of reference will not extend to proposals to change the rate of GST or the scope and extent of the goods and services subject to the GST.

INTRODUCTION

On 1 July 2000, the Commonwealth Government implemented its vision for Australian taxation reform, the agenda for which is manifested in the New Tax System. Both the direct and indirect tax regimes were substantially modified.

Changes to the indirect tax regime were sweeping in nature. The centrepiece of these reforms was the introduction of a broadly based value added tax referred to as a Goods and Services Tax (GST) to replace the Wholesale Sales Tax (WST), which applied only selectively to goods and exempted services.

These changes were designed to achieve the key taxation reform objectives/criteria stated by the Commonwealth Government in its *Tax Reform White Paper* in 1998, which included:

- **equity/fairness**
- **economic efficiency**
- **simplicity/administrative efficiency**

In addressing the terms of reference of the review, Local Government will submit that the present GST treatment of funding received from both the Commonwealth and State fails the objectives/criteria outlined by the Commonwealth in its *Tax Reform White Paper* in 1998.

The changes recommended by Local Government will seek to address these anomalies in much the same way as the Commonwealth has already with the BAS Easy option.

Queensland Local Government Submission

BACKGROUND

Australia

Support for the existing GST treatment of funding provided to Local Governments by the Commonwealth and State can be found in *The Taxation Review Committee Report* of 31 January 1975 (the Asprey Committee Report) where it stated at paragraph 27-38:

"In some countries certain government services are exempt, but where there is competition between these ones and private ones subject to VAT, equity can only be maintained only if all are liable."

In 1991, the GST Planning and Co-ordination Office was established to make recommendations on the administrative features of a GST as proposed by the then Federal Opposition. The office was staffed by tax professionals provided by the Institute of Chartered Accountants in Australia. The report that was completed by the office is known as the Cole Committee Report.

Chapter 37 of the report considered the impact of the proposed GST on government. In considering the supply of funds to public sector bodies, by way of payments from the Crown in grants as a part of the transfer to a department from consolidated revenue, the report recommended that the funding not be regarded as consideration for the supply of goods and services.

In August 1998, the Federal Government announced a plan for a new tax system – *"Tax Reform, not a new tax, a new tax system."* A key component of the plan was the introduction of a broad based indirect tax to replace the wholesale sales tax and a number of state taxes.

At page 5 of the document, the Government made the following statement:

"The Government's tax reform plan builds on four pillars to achieve a fairer tax system: incentive, security, consistency, and simplicity."

In discussing the impact of the GST on Government, the following statement was made at page 98:

"For example, appropriations for general government activities will not be taxable, nor will grants from one level of government to another, as neither constitutes consideration for a supply."

Overseas

In New Zealand, which is claimed to have one of the simplest forms of GST, funding from the Crown is subject to GST under the normal supply rules. It had always been the government's intention that a payment made by the Crown in the form of a grant or subsidy would be subject to GST when received in respect of a registered person's taxable activity.

However, the legislation had to be amended in 1990 following the decision of the Taxation Review Authority (TRA) in decision M129 (1990) 12 NZTC. The TRA decided that the funding received in respect of a job opportunity scheme was not consideration for a supply of goods and services and therefore not subject to GST.

Overseas litigation has shown a trend towards disputes in relation to the basic concepts – supply and consideration. This trend occurs in every country regardless of individual attempts to reduce its incidence.

LEGISLATIVE PROVISION

The original 1998 bill, which became A New Tax System (Goods and Services Tax) Act (GST Act), did not contain a specific exclusion from GST for appropriations. Amendments were moved by the then Federal Government which inserted a provision into the legislation that made special provision for government appropriations.

A further amendment to this provision was made in 1999 to include local government in the definition of Australian Government agency.

Section 9-15 of the GST Act contains the definition of consideration. Section 9-15(3)(c) of the GST Act states that:

"a payment made by an Australian Government agency to another Australian Government agency is not the provision of consideration if the payment is specifically covered by an appropriation under an Australian law."

It should be noted that this provision follows the recommendation that the Cole Committee made in 1992.

ATO RULINGS

The ATO has issued three public rulings, two withdrawn, dealing with the impact of GST on appropriations. Good and Services Tax Ruling (GSTR) 2000/4 was withdrawn on 30 June 2004 whilst GSTR 2004/5 was withdrawn on 22 November 2006. The current ruling is GSTR 2006/11.

In addition, the ATO has issued numerous private GST rulings to taxpayers many of which are no longer applicable due to the change in interpretation expressed in the three public rulings. The ATO interpretation of appropriations expressed in GSTR 2006/11, compared to the previously withdrawn prior rulings, contains a much

broader class of document that can be used to determine whether funding is an appropriation and not subject to GST than was previously the case.

It might seem unusual that the ATO has had to issue three public rulings in eight years to explain, what is drafted as, a very simple provision.

The ATO in the latest ruling seems to be returning to the interpretation of basic GST concepts – supply and consideration. If funds are provided to Local Government for general purpose use, the nexus between supply and consideration necessary for a taxable supply is noticeably absent.

At paragraph 31 of the ruling, the ATO states:

"Aside from the operation of paragraph 9-15(3)(c), the allocation of funds is a payment for GST purposes."

It is also understood that GSTR 2006/11 is to be reviewed.

Regardless of the issue of a new public ruling, the fact remains that ATO rulings to date have failed to provide specificity.

PRACTICAL APPLICATION

Whilst the legislative provision is expressed in relatively simple terms, its practical application has had somewhat different results as can be evidenced from three public rulings and numerous private rulings from the ATO.

A basic precept to the operation of the GST is that the supplier in any transaction is able to determine the GST classification of the transaction. Unfortunately, in the case of appropriations, the entity that has all of the necessary information to determine the GST classification is the funding body not the Local Government.

The ATO has attempted to address this knowledge loss with the mechanism of recipient created tax invoices (RCTI). Unfortunately, unlike sugar and livestock industries, RCTIs have not been as successful in the local government area. In part this is a result of the funding bodies being reluctant to take responsibility for the determination of the GST in the event that the GST classification is incorrect.

PRACTICAL EXAMPLES

The normal funding of public libraries for local governments e.g. Quarterly Library Grants were originally treated as an appropriation when GST was introduced on 1st July 2000. However, within a couple of years the State Government's position changed to calling the grant a taxable supply and grossing up the grant to include GST i.e. no longer an appropriation.

On the other hand, State Government Rates Subsidies were treated as a taxable supply when GST was introduced 1/07/2000 and included GST. However, within a couple of years the position changed from a taxable supply to an appropriation.

A recent example of the inability of local government to rely on their State counterparts may also be informative. The 2008 Local Government elections were run by the State. The State invoiced local governments for this service without including GST. If a State body with a far greater access to tax expertise can treat such a basis transaction incorrectly for GST, it begs the question, "How can local government rely on these same entities to provide assistance on a matter as complex as appropriations?"

EQUITY/FAIRNESS

With the introduction of GST, the Government sought to eliminate some of the inequitable and unfair features of the existing indirect tax system.

In the Federal Government's plan for a new tax system – *"Tax Reform, not a new tax, a new tax system"* at page 71 stated:

"Australians are subject to several inefficient indirect taxes. A key example is the wholesale sales tax. It was introduced in 1930 when the economy had a fundamentally different structure. It is now simply out of date."

It would be prophetic if the method presently in use to classify appropriations for GST purposes, exhibits exactly the same features that the Government sought to eliminate.

ECONOMIC EFFICIENCY

From an economic efficiency perspective, the LGAQ considers that the present method of treating appropriations for GST purposes fails the economic efficiency criteria.

New Zealand, which it is claimed, has the purest form of GST tax funding from the Central Government to local governments relies on basic GST concepts of supply and consideration to determine the GST classification.

Economic efficiency, from a tax perspective, is maximized when there are few, if any, special provisions incorporated in legislative provisions. This was one of the obvious problems with the previous sales tax legislation.

SIMPLICITY/ADMINISTRATIVE EFFICIENCY

It is submitted that the present method of treating appropriations for GST purposes is far from simple and, in fact, leads to economic inefficiencies. Local governments spend an inordinate amount of time ensuring that the correct GST treatment is applied to grants and appropriations. This is complicated by the fact the background documentation to the funding is not held by local governments, the supplier for GST purposes.

This is neither simple nor administratively efficient.

The present method clearly fails this policy objective.

CONCLUSIONS

It is clear that Local Governments in Queensland, and probably throughout Australia, have been badly disadvantaged by the interpretation and application of the legislative provisions as they relate to appropriations. The provision, it seems, was originally drafted to make for ease of administration, but unfortunately in practice, the opposite has occurred.

The ATO, in its attempts to make administration easier for Local Government, has re-written and re-interpreted a reasonably simple provision. It would seem that if the administering authority, the ATO, has trouble with the specific provision, then Local Governments with limited resources compared to the ATO, would face enormous challenges.

Experience has shown that the more attempts are made to insert specific provisions to shelter certain transactions, the more likely that the legislation will become unworkable and unwieldy. The previous indirect tax regime in Australia is a classic example and it was one of the over-riding reasons that this regime was replaced by a simple GST.

Legislative Amendment

The simplest solution for this matter would be the amendment of the legislation to exclude section 9-15(3) (c) of the GST Act. If this matter was outside the scope of this review, then alternatively, the ATO rulings program could be amended or expanded.

ATO Rulings

Perhaps an alternative approach to resolution for this issue might be the issue of the ATO of public rulings with specificity; something along the lines of a class ruling.

Under present arrangements private rulings can only be relied upon by the party that applies for the ruling. Only that party can rely on the Commissioner's opinion. In relation to appropriations, in the majority of cases, the party that applies for the private ruling is the funding body which is not the taxpayer and which is not liable for any GST payable. The recipient of the funding cannot rely on the ruling received by the grantor in determining the GST classification and, to ensure certainty, needs to apply for its own private ruling.

This is, in our opinion, a waste of valuable Local Government and ATO resources. We are aware that this matter has been bought to the attention of the ATO in the past.

Perhaps a more effective method would be the issue of a class or product ruling so that all parties could receive the benefit of the Commissioner's protection. Initially, this initiative could target relatively simple and widespread funding programs such as Financial Assistance Grants (FAG). This is a funding source received by all local governments and, as such, any ruling would provide certainty for a large number of taxpayers.

The ATO in GSTR 1999/1 states that the GST rulings system has its legislative basis in section 63 of the Tax Administration Act 1953 (TAA) whereas class ruling CR 2001/1 states that the legislative basis for class rulings can be found under division 358 of Schedule 1 to the TAA.

Some legislative amendment might be required to enable the ATO to issue class rulings on GST.

Based on the success of this initiative, other popular funding programs could be targeted for a ruling in the future.

The LGAQ has already tried to achieve this result with a ruling request on a number of funding programs but, unfortunately, even with local support from the ATO, the request was denied by the ATO in Canberra.

RECOMMENDATIONS

In view of the analysis and conclusions above, consistent with the Government's nominated criteria for tax design of equity, economic efficiency, and administrative efficiency and the terms of reference of the review, it is recommended that:

- Consideration be given to a legislative amendment to section 9-15(3) (c) of the GST Act such that the GST classification of appropriations is subject to the basic GST concepts rather than the present specific treatment. We appreciate that the terms of reference for the review might not allow this recommendation to be acted upon at this time;

- Additionally or as an alternative, the ATO be required to issue class rulings in relation to the GST classification of appropriations. This might also require some legislative amendment to enable the ATO to issue class rulings in respect of GST.