

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

Submission to Board of Taxation

15 September 2008

MinterEllison

LAWYERS

AURORA PLACE, 88 PHILLIP STREET, SYDNEY NSW 2000, DX 117 SYDNEY
TEL: +61 2 9921 8888 FAX: +61 2 9921 8123
www.minterellison.com

Submissions to Board of Taxation

Contents

Introduction	3
Registration of Non-Residents	4
GST Groups	7
GST-free Going Concerns	8
GST Private Rulings	9
The General Interest Charge	10

Introduction

We refer to the release of *Review of the Legal Framework for the Administration of the Goods and Services Tax, Issues Paper* ('**Issues Paper**') in July 2008, providing an overview of the legal framework for the administration of the GST and a range of questions for consideration by relevant stakeholders.

We appreciate the opportunity to make submissions on certain aspects of GST administration and compliance raised in the Issues Paper, including the reforms which we consider would, if implemented, decrease GST compliance costs, remove anomalies and improve the operation of the GST.

Please note this submission is not intended as a comprehensive review and analysis of the entire GST system. Rather, the objective of this submission is to highlight some of administrative issues we regularly encounter in practice.

Contents covered by this submission:

- Registration of Non-Residents
- GST Groups
- GST-free Going Concerns
- GST Private Rulings
- The General Interest Charge

Please feel free to contact Rhys Guild, National Head of Minter Ellison's Taxation Group, on +61 2 9921 4782 (rhys.guild@minterellison.com) if you have any queries or would like to discuss any aspect of this submission.

Registration of Non-Residents

Reverse Charge

- 1.1 Chapter 1.1 of the Issues Paper deals with the registration of non-residents for GST in Australia. Paragraph 1.1.19 notes that a foreign resident supplier and a recipient in Australia can agree to reverse charge the GST payable on a taxable supply that the foreign resident makes where certain conditions are met.
- 1.2 Typically, reverse charge agreements are entered into to eliminate the need for the non-resident to register for GST in Australia, on the basis supplies that are reverse charged are excluded from the non-resident's GST turnover.
- 1.3 Section 188-40 of the *A New Tax System (Goods and Services Tax) Act 1999* ('**GST Act**') provides that supplies of employee services by a non-resident to its 100% subsidiary in Australia are to be disregarded from the non-resident's GST turnover. This provision is designed to ensure that international entities are not brought within the Australian GST net as a result of providing the services of their employees to their subsidiaries. Further, this provision eliminates unnecessary compliance otherwise associated with the non-resident entering into a reverse charge agreement with its subsidiary to avoid GST registration.
- 1.4 The current drafting of Section 188-40 only applies to circumstances where the recipient is a '100% subsidiary' of the non-resident. 100% subsidiary is given the meaning of Section 975-505 of the *Income Tax Assessment Act 1997* ('**ITAA 1997**'). This definition does not extend to circumstances where a non-resident sister company of the recipient provides the employee services. For example, even where the parent entity holds 100% of the shares in the two subsidiaries, Section 188-40 will not disregard supplies of employment services made by the non-resident subsidiary to its sister company in Australia.
- 1.5 We submit that the current drafting of Section 188-40 frustrates the purpose of this provision and adds an undue compliance burden for organisations that find it more efficient (for example, due to their structure) to provide the employment services to the recipient through a non-resident sister company, rather than the non-resident parent company. Further, we submit that there is no policy reason for legislating such an outcome.
- 1.6 **Submission:** We submit that Section 188-40 be extended to cover employment services provided to a recipient that is a company of the same '90% owned group' (in accordance with the definition in Section 190-1 of the GST Act), which would bring Section 188-40 in line with the GST grouping and membership provisions in the GST Act. Alternatively, if this broadens the concession to an extent which is not perceived as necessary, we submit the section should be amended so that it applies to any non-resident member of the group that can demonstrate 100% ultimate common ownership.

Information, documentation and proof of identity required for GST registration

- 1.7 Q1.5 in Chapter 1.1 of the Issues Paper queries whether there are any factors that discourage foreign entities from registration and if so what changes should be considered.
- 1.8 In order to register for GST, the Australian Taxation Office ('**ATO**') requires details of an Australian bank account into which refunds of GST will be paid. We submit that this

requirement is unnecessary and onerous for non-resident entities who at the time of applying to register may not have set up an Australian bank account or for non-resident entities that do not require an Australian bank account for any other purpose. We submit that non-residents should have the choice of whether to include details of an Australian bank account in the GST registration application and that such registrations be processed without these details (with any refunds to these entities made by cheque).

- 1.9 We submit that the current proof of identity rules requiring certification of identity documents at the Australian Consulate for all directors of the non-resident entity are onerous and unnecessary, particularly for non-resident entities that have significant numbers of directors or for large entities (such as listed entities) whose proof of identity is not in doubt in any event.
- 1.10 These requirements often delay the GST registration process which can result in non-resident taxpayers incurring interest on GST amounts attributable prior to the date registration is approved (if they are required to be registered for GST) and delays in claiming input tax credits. Additionally, we note registration delays can also cause problems for importers requiring approval to defer GST on imports of their goods.
- 1.11 We submit that these difficulties may discourage foreign entities from trading in Australia, or alternatively, from registering for GST in Australia.
- 1.12 **Submission:** We submit that the ATO's discretion to request only those documents necessary to satisfy it of the non-resident's proof of identity be codified, or alternatively, that the ATO considers accepting more accessible company documents as proof of identity, for example auditor's certificates. There should also be a statutory exception to these requirements for any non-resident entity that is part of a group that is listed on a recognised international stock exchange.

Refunds

- 1.13 **Submission:** We submit that non-residents should not be required to register for GST in Australia to secure one-off refunds. Rather, in circumstances where the non-resident is not required to be registered, we submit that a refund scheme, similar to the European Council 13th VAT Directive would be more efficient and would lower the administrative burden associated with registering for GST. Additionally, we submit this would make Australia's goods and services more competitive in relation to those from jurisdictions without such a scheme.

Resident Agents

- 1.14 Q1.6 in Chapter 1.1 queries whether the current arrangements for resident agents acting for non-residents operate effectively to enable their use by non-resident entities.
- 1.15 In this respect, we note that Section 57 of the GST Act states that GST is payable or claimable by a resident agent in respect of a taxable supply/importation or creditable acquisition/importation made by a non-resident *through* the resident agent. In these circumstances, the resident agent effectively takes over the non-resident's GST obligations in relation to a supply or acquisition, including associated administrative duties such as issuing tax invoices and lodging GST returns. This administrative function is particularly useful for non-residents who may not be aware of their Australian GST obligations or have the resources to effectively meet these obligations.
- 1.16 The current drafting of Section 57 limits the application of this section to circumstances where the supply is made through the agent (for example, where the agent makes the supply by signing the contract – see the ATO's interpretation of this phrase at

paragraphs 45 to 47 of GST Ruling *GSTR 2000/37*). Accordingly, the agent can not assume the non-resident's obligations/entitlements in relation to a particular supply or acquisition if the particular thing was not contractually made or acquired through the agent. We submit that this outcome is unnecessarily onerous and that a rule should be codified that allows the agent to account for all taxable supplies or acquisitions made by the non-resident in Australia (including the issuing of tax invoices on the non-resident's behalf), irrespective of whether the agent actually contractually made the particular supply or acquisition on behalf of the non-resident.

- 1.17 **Submission:** We submit that a rule be codified that entitles a non-resident to appoint an Australian resident GST registered agent to attend to the filing of necessary returns and payment of any corresponding liability. The operation of such a provision should not require the agent to have the power to bind the non-resident principal, nor should the agent be required to have entered into the relevant contract on behalf of the non-resident principal. Furthermore, the operation of such a section would provide non-residents with an effective alternative where an Australian resident customer was unwilling to enter into a Division 83 agreement with the non-resident.
- 1.18 We submit that the codification of such a rule would simplify GST administration for non-residents and reduce the risk of the agent or non-resident failing to account for particular supplies and acquisitions. If necessary, although not desirable, the ATO could provide a mechanism for Australian based agents to be authorised by the ATO to be appointed under such an arrangement.

GST Groups

- 1.1 Chapter 2.2 of the Issues Paper discusses the GST grouping provisions in the GST Act. Specifically, Q2.5 queries whether the current provisions in relation to timing of entry into and exit from GST groups operate effectively.
- 1.2 In the context of mergers and acquisitions, where a company exits one GST group and seeks to join the GST group of the acquiring entity, Division 48 of the GST Act states the date of effect of approval/revocation for the new/old GST group must be the beginning of a tax period applying to the members of the GST group in question. On the basis an entity must satisfy the membership requirements of a GST group at all times, the application of the date of effect rules mean that the acquired entity will not be a member of either GST group for a duration of one tax period.
- 1.3 We submit that this outcome is unnecessary and places an undue compliance and administrative burden on the acquiring and acquired entity for that tax period. That is, supplies between the acquired entity and the new GST group have to be accounted for separately for GST purposes and the acquired entity is required to complete its own GST return for that period. This can lead to a significant administrative burden for both the vendor and purchaser GST groups.
- 1.4 We also note the New Zealand Commissioner of Inland Revenue has dealt with this issue by closing out the migrating entity's old GST group membership at midnight on the last night prior to the acquisition and allowing the migrating entity to join the new GST group immediately thereafter (starting at 12.01am on the day of acquisition). This means the migrating entity is a member of a GST group at all times and therefore does not have to account separately for supplies it makes nor lodge its own GST return during what would otherwise be the migration period.
- 1.5 On the other hand, we are aware of occasions where the Australian Commissioner has, as a matter of discretion/interpretation, allowed entities to contemporaneously leave one group and join another group, provided the transfer of that entity is scheduled to take effect at midnight on the last day of a particular month/tax period. It is neither desirable, nor particularly-satisfactory, for such a practice to exist without statutory guidance.
- 1.6 **Submission:** We submit that the GST Grouping rules should be amended to ensure that the acquired entity can migrate directly from the old to the new GST group without effectively having to 'skip' a tax period. We submit that this approach should be codified in the Division 48 GST grouping provisions in the GST Act, perhaps as an election to exit and join GST groups mid-period, to ensure consistency, certainty and fairness between all taxpayers. Alternatively, if this is not acceptable, we submit that at the very least a rule be codified that allows a transfer from one group to the other if the acquisition is documented to take effect at midnight on the last day of the month.

GST-free Going Concerns

- 1.1 Q3.5 in Chapter 3.1 of the Issues Paper queries whether the GST-free going concern provisions operate effectively and, if not, what changes should be made to improve their operation and minimise the compliance costs of affected parties.
- 1.2 The Issues Paper reiterates that one of the main objectives of the concession is to prevent a purchaser having to borrow additional funds to cover the GST included in the price of the going concern. As such, it is a concession that provides a benefit to the purchaser in that it alleviates the need to fund the GST component of the price as well as reduces any stamp duty payable. It also recognises the fact that, as a general principle, given there is generally not a net gain to the Revenue from the sale of a business, it is inappropriate for the parties (and the ATO) to have to address the funding and administration that would otherwise result from such transactions being included in the GST net.
- 1.3 However, the risk in treating a supply as a GST-free going concern generally rests with the supplier (on the basis it is the entity liable for GST, penalties and interest if the Section 38-325 going concern requirements in the GST Act are later held not to be met).
- 1.4 We submit that the going concern test in Section 38-325 of the GST Act can be difficult to apply, particularly with respect to determining whether the supplier will supply to the recipient all of the things necessary for the continued operation of the enterprise. For example, it can be difficult in practice for a supplier to determine whether its supply of partly developed land, or alternatively, a building without management contracts will meet the 'all things necessary' requirement.
- 1.5 The difficulties and administrative costs associated with administering the concession (from both a technical and risk management perspective) can discourage a supplier from supplying an enterprise as a GST-free going concern (notwithstanding any indemnities provided by a purchaser, which we submit is also an unnecessary risk and deterrent from the purchaser's perspective). As such, we submit that the test as it currently stands frustrates the intention of Section 38-325.
- 1.6 **Submission:** We propose that the current going concern test be simplified and relaxed in order to provide suppliers with greater certainty regarding their GST position. For example, we submit that the supplier should not be required to supply to the recipient all of the things necessary to carry on the enterprise if the recipient already has some of the things (for example, business premises). We submit that inefficiencies and unnecessary costs (such as additional stamp duty costs) result where the recipient has to transfer assets to the purchaser (which the purchaser neither wants nor requires) simply to satisfy the GST 'going concern' test. This could be achieved by a simple legislative amendment which provided for the 'all things necessary test' to incorporate assets held by the purchaser that will be utilised in the business following completion of the transaction.
- 1.7 The simplification of these rules should not result in a net revenue loss (on the basis fully creditable registered recipients would have claimed full GST credits on the acquisition if it were treated as taxable anyway) and that in any event, Division 135 of the GST Act would still prevent non-creditable businesses from utilising a more relaxed going concern concession to acquire assets without GST.

GST Private Rulings

- 1.1 Q4.5 of Chapter 4.2 of the Issues Paper queries whether taxpayers should have the right to object to a private ruling in respect of GST on a question of law (notwithstanding the ATO's discretion to perform an informal review of the private ruling upon request).
- 1.2 As acknowledged in the Issues Paper, taxpayers cannot formally object to the Commissioner's view in a GST private ruling (although we acknowledge the ATO's internal review arrangements). Rather, if the taxpayer does not agree with the ruling issued, the taxpayer must undertake the proposed transaction in accordance with the Commissioner's view, request the ATO to make an assessment of its net amount for the period and then following that assessment, object to the assessment under Part IVC of the TAA.
- 1.3 We submit that the current approach, with no formal independent objection process in relation to the private ruling, is ineffective for the following reasons:
 - (a) It is inefficient and costly, both from the perspective of the taxpayer and the ATO;
 - (b) The current internal review process potentially results in inequitable and inconsistent treatment between taxpayers and fails to provide certainty to taxpayers regarding their affairs and at the very least can act as a discouragement to a taxpayer seeking a ruling in the first place; and
 - (c) Where a private ruling application is made on a joint income tax and GST issue (for example, for clarification regarding whether an entity has a permanent establishment in Australia), two different regimes apply to the ruling which can lead to the absurd result of having certainty about one tax position but not the other.
- 1.4 We believe that the ability to formally object to a GST private ruling and therefore obtain judicial review and comment may improve the quality and transparency of GST private rulings issued.
- 1.5 **Submission:** We submit that taxpayers should be provided with a formal right to object to GST private rulings and that the most efficient way to do this would be to include a GST private ruling made by the Commissioner as a reviewable GST decision in Section 110-50(2) of the *Taxation and Administration Act 1953* ('TAA').

The General Interest Charge

- 1.1 As noted in Chapter 4.4 of the Issues Paper, the GIC was designed to ensure that taxpayers pay the right amount of tax by the due date and to compensate the government for not having the use of the funds during the shortfall period. The rate is determined by adding a 7 percentage point uplift factor to the 90 day bank bill rate. In addition to the GIC, penalties ranging from 25% to 100% may be imposed on GST shortfall amounts, depending on the perceived culpability of the taxpayer.
- 1.2 We submit that the imposition of the full GIC on GST shortfall amounts in certain circumstances (that is, the uplift factor), such as wash transactions, is punitive in nature and unwarranted given the fact that the ATO has the ability to impose penalties as a punitive (and behavioural reform) measure if necessary and also given the fact the Government never lost the use of those funds during the relevant period anyway.
- 1.3 Further, we submit that the imposition of the GIC (particularly the 'uplift' component) does not encourage taxpayers to pay the right amount of tax in circumstances where the GST shortfall amount resulted from an honest mistake of the taxpayer or the taxpayer's reasonable interpretation of the way in which the GST law applied to their circumstances.
- 1.4 In making these comments, we note that the Commissioner has issued policy statements indicating how and when he might exercise his discretion to partially or fully remit GIC in certain circumstances (for example, Practice Statement *PS 2008/9 'GST revenue neutral corrections'*). However, there is necessarily an element of uncertainty and inconsistency where such remission is ultimately a matter of the Commissioner's discretion. Notwithstanding the Commissioner's discretion, we submit that the GIC be reviewed to determine whether it meets the purpose for which it was designed.
- 1.5 **Submission:** We submit that the shortfall interest charge (SIC) be codified for use in circumstances where there is a loss of use of funds by the Revenue but the taxpayer had no intention to delay payment to secure the use of those funds during the shortfall period. Examples of this type of situation include where the shortfall resulted from an inadvertent accounting error or the taxpayer's reasonable but incorrect interpretation of the way in which the GST law applied to their circumstances.
- 1.6 We submit that the imposition of a full GIC be codified for use in circumstances where a taxpayer has a greater level of culpability in relation to the shortfall (obviously rules would have to be codified to determine the required extent of culpability). Examples may include accounting for GST in a way that is contrary to an applicable public or private binding ruling or where a taxpayer continually makes a particular type of error and fails to put in place procedures to remedy the error.
- 1.7 We submit that the imposition of a GIC or SIC be codified as not applicable in circumstances where there is no net impact to the Revenue. Examples of this type of situation include wash transactions or where GST is not accounted for by a fully creditable non-resident under a reverse charge agreement. In these circumstances, we submit that penalties (where necessary) are the most appropriate approach for addressing and reforming taxpayer behaviour if necessary.
- 1.8 In any event, in addition to our submissions above, we note the Commissioner may exercise discretion to remit GIC in part or in full where certain conditions are met. Notwithstanding our submissions above, we submit that the way in which this discretion

must be applied is codified in the GST Act or the TAA in order to provide certainty to taxpayers regarding their GST affairs.



Rhys Guild
Partner – Tax



Lauren McHugh
Tax Consultant