Level 2
95 Pitt Street Sydney, NSW 2000
Telephone 02 8223 0000
Facsimile 02 8223 0077
Email tia@taxinstitute.com.au
Website www.taxinstitute.com.au
ABN 45 008 392 372

TAXATION INSTITUTE *of* AUSTRALIA
IT'S ESSENTIAL

19 September 2008

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

Email: taxboard@treasury.gov.au

Dear Sir

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

The Taxation Institute of Australia ('Taxation Institute') is pleased to provide the attached submission prepared by our GST Subcommittee in response to the Issues Paper, *Review of the Legal Framework for the Administration of the Goods and Services Tax* ('Issues Paper') released by the Board of Taxation ('Board') for public comment on 18 July 2008.

The Taxation Institute supports the Board's review of the legal framework for the administration of the GST and commends the Board for conducting extensive preliminary consultation with stakeholders during August 2008, also attended by representatives from our GST Subcommittee. Our submission is based on the Terms of Reference in the Issues Paper and the discussions at these preliminary consultations.

It is our understanding that the Board's Issues Paper is intended to facilitate public consultation. The Taxation Institute is happy to meet with the Board to discuss our submission in the context of the Issues Paper. If you would like to meet with the representatives from the Taxation Institute or require any further information or assistance in respect of our submission, please contact the writer on 03 9286 6135 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours faithfully

Sue Williamson
President

Submission by the Taxation Institute of Australia in response to the Board of Taxation's Review of the Legal Framework for the Administration of the Goods and Services Tax

September 2008

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1. INTRODUCTION

1.1 Scope and structure of our submission

The Taxation Institute of Australia ('Taxation Institute') welcomes the review by the Board of Taxation ('Board') of the legal framework for the administration of the GST, announced on 18 July 2008 and accompanied by the release of the Board's Issues Paper, *Review of the Legal Framework for the Administration of the Goods and Services Tax* ('Issues Paper').

The Taxation Institute strongly supports this review of the GST administration, its focus being on the merits of possible changes to the legal framework for the administration of the GST resulting in a reduction in compliance costs, the streamlining and improvement of the operation of the GST and the removal of anomalies.[1]

Whilst the Issues Paper contains a series of questions intended to assist in the preparation of submissions, we also note that submissions need not be limited to these questions. It is our understanding that the Board will consider other issues that fall within the review's focus, including identifying areas that do not work as they well as they could and making suggestions for changes, but not relating to the rate of GST, the scope and extent of what goods and services are subject to the GST or questions of the Commissioner's effectiveness in administering the GST.[2]

In addressing the above scope and proposed outcomes of this review, the Taxation Institute's submission focuses on identifying areas that do not work as well as they could in the current GST regime. In this context, we have identified a number of key issues within the review's Terms of Reference in the following five areas:

- international;
- financial services;
- property;
- administration; and
- other issues (grouping provisions).

In each of these areas, our submission provides:

- the identification and description of the issues at hand;
- our assessment of importance of each issue and its priority for resolution;
- an identification of the taxpayers affected by each issue; and
- recommended solutions.

Unless otherwise indicated, all legislative references are to the *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act') and *A New Tax System (Goods and Services Tax) Regulations 1999* ('GST Regulations').

1.2 Preparation

The Taxation Institute's submission was prepared by our National Technical Committee's GST Subcommittee.

Members of our GST Subcommittee are respected GST experts and leaders in their field with extensive experience in advising on all facets of GST both in the public and private sectors. A number of our Subcommittee members also currently or have represented the Taxation Institute in

[1] Terms of Reference, *Review of the Legal Framework for the Administration of the Goods and Services Tax*, 93.
[2] Above, Review Process, viii.

consultations with the Australian Taxation Office and the Treasury on a broad range of GST issues both at the administrative and policy levels.

Our submission draws on this considerable experience.

The current membership of our GST Subcommittee can found in the Appendix to this submission.

2. SUMMARY OF RECOMMENDATIONS

INTERNATIONAL

Information Requirements for Non- Resident Entity GST Registrations (3.1): the suggested solution is for further streamlining referable to objective benchmarks and which are proportional to the revenue risks to the Australian Taxation Office. For example, consideration should be given to introducing lesser requirements to be applied for different categories of non-resident entities, such as: (i) entities which already have a resident agent appointed under Division 57; (ii) entities which apply to be a member of a GST group (the application for GST grouping should probably also be moved to the same application form for GST registration in this circumstance and appropriate measures taken in circumstances where the non-resident entity exits from the GST group); or (iii) entities with particular thresholds of turnover or capitalisation.

This will ensure that less onerous proof of identity requirements are imposed on entities which already have considerable information available in the public domain and/or which pose a lesser revenue risk to the Australian Taxation Office. See also the separate recommendations of Rebecca Millar, which include excluding non-residents from the Australian GST regime in certain circumstances.[3]

Priority: High.
Taxpayers affected: All non-resident entities that must register for GST or that choose to register for GST.

Registration Turnover Threshold – GST-free Supplies (3.2): section 188-15 should be amended to exclude GST-free supplies so that it does not lead to an anomaly and, consequential GST administration issues including failure to register GST etc.

Priority: Medium.
Taxpayers affected: This impacts non-resident entities that make only GST-free supplies.

Resident Agent (3.3): there should be no requirement for non-resident entities to register in these circumstances. Alternatively, if required to register, then the information requirements should be streamlined (as suggested above), since the revenue risks to the Australian Taxation Office are lower. This is because the resident agent is, in any event, liable for the GST obligations of the non-resident entity.

Priority: Medium.
Taxpayers affected: Non-resident entities making supplies through resident agents.

Exported Services (3.4): The current thinking is that subsection 38-190(3) should not be applied to B2B transactions, because this results in costly one-off GST registration and compliance issues for non-resident entities (see 3.1 above).

Rebecca Millar[4] has suggested some additional solutions to this and related GST international issues, as follows: (i) limit the operation of s 38-190(3) so that it effectively only applies to B2C transactions, where "C" means any entity that is not registered for GST. Only in that scenario should the "provision to another entity in Australia" proxy be used; (ii) merge the reverse charge mechanisms in Division 83 and 84 and apply the reverse charge mechanism for all B2B supplies by non-residents who are not registered or required to be registered for GST and who do not make

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[3] A paper presented by Rebecca Millar at the CLA Conference "Commercial Practice in a Global Economy" held in Sydney on 1 August 2008, page 51.
[4] Above, page 51.

their supplies through an enterprise carried on in Australia; and (iii) prevent the unnecessary inclusion of non-resident entities in the Australian GST by excluding B2B supplies by non-residents from the registration threshold if they are connected with Australia only because the services were performed in Australia.

Priority: High.
Taxpayers affected: All taxpayers with international services transactions.

Taxable Importations and Creditable Importations (3.5): amendments should be made to Division 15 to clarify (in the GST Act and not in GST public rulings) that the entity that imports goods into Australia for GST purposes is entitled to claim input tax credits. This will rectify the mischief which GSTR 2003/15 seeks to address. This will ensure that the application and implementation of Division 15 is in line with what is apparently the intended application of the GST Act. In the absence of these amendments, anomalies in GST planning in international transactions will continue.

Priority: Medium/High.
Taxpayers affected: All taxpayers that import goods and, in addition, freight companies.

Review of legislative provisions re international issues/volume of Public Rulings (3.6): the issues relating to section 38-190 need to be re-considered and the legislative provisions amended to reduce the issues and problems associated with them; it is also not appropriate for public rulings to substitute for clear GST legislative provisions.

Priority: Low/Medium.
Taxpayers affected: All taxpayers with international transactions.

FINANCIAL SERVICES

Financial Acquisitions Threshold Test (FAT test) (4.1): amend the financial acquisitions threshold test to ease the compliance burden by: (i) taking the words "either or" out of subsections 189-5(1), 189-5(2), 198-10(1) and 189-10(2); (ii) lifting the input tax credit threshold incorporated into the FAT test from $50,000 to a higher amount; and (iii) excluding regular, but minor, financial supply activity from the test.

Priority: Medium/High.
Taxpayers affected: All.

Division 129 – Changes in the extent of creditable purpose (4.2): reduce the scope of Division 129 change of creditable purpose adjustments to ease the compliance burden by lifting the thresholds for acquisitions and/or importations before Division 129 applies and limiting the Division 129 adjustments to specific types of acquisitions.

Priority: Medium.
Taxpayers affected: All taxpayers making acquisitions or importation relating to business finance.

Division 135 – Supplies of Going Concern (4.3): (i) amend the legislation to make it clear that it is only GST-free supplies of going concerns that are captured by the Division; and (ii) exclude from the adjustment calculations acquisitions that would not otherwise have been taxable supplies under the GST Act.

Priority: Medium.
Taxpayers affected: All taxpayers acquiring under a supply of going concern, broadly defined.

Reduced Input Tax Credits (4.4): we recommend a comprehensive review of the operation of the RITC provisions as was indicated by the 1999 consultation document. In particular, we request a specific review of item 9; in our view it should be rewritten to include all securities' related transactions such as facilitation costs for mergers (for the company being acquired) and arranging takeover bids (in the reverse takeover situation).

Priority: Medium/High.
Taxpayers affected: All taxpayers who provide financial supplies.

General Insurance settlements – insured input tax credit entitlements (4.5): (i) amend Division 78 to require the insurer to request the insured's input tax credit entitlement on the premium at any time at or before a claim is first made under the policy, and then allow the insurer to rely upon the insured's response (or lack of response) in calculating its decreasing adjustment entitlements; and (ii) amend the GST Act to allow insurers to elect to apply standard industry-agreed recovery rates for different classes of insurance, similar to the election to use an "average input tax credit fraction" for CTP insurance in Division 79.

Priority: Medium.
Taxpayers affected: All general insurers (large taxpayers).

General Insurance settlements – claiming input tax credits (4.6): amend the GST Act to provide that where any payment is made by an insurer for any taxable supply in settlement of a claim under an insurance policy then this is a creditable acquisition for the insurer and not for any other entity. Alternatively, amend the legislation to allow for an agreement between the recipient of the supply (the claimant) and the payer (the insurer) to treat a supply as having been made by the third party supplier to the insurer.

Priority: Medium.
Taxpayers affected: All general insurers (large taxpayers).

Hire purchase (4.7): amend the GST Act to give the parties to a financing arrangement an option to treat hire purchase arrangements in a similar manner as to a lease.

Priority: High.
Taxpayers affected: All entities involved with hire purchase transactions.

Financial supplies which are treated as GST-free supplies (4.8): (i) amend the definitions of "current annual turnover" and "projected annual turnover" in Division 188 to exclude supplies that are financial supplies; and (ii) amend Division 189 so that acquisitions that relate to GST-free financial supplies are not taken into account in determining whether the financial acquisitions threshold is meet.

Priority: Medium.
Taxpayers affected: Superannuation and investment funds that invest in international securities.

Interaction of Division 72 with the ITAA 97 (4.9): amend section 17 and 27 of the ITAA 97 to ensure that the appropriate tax treatment is given to GST paid or GST received as a result of the operation of Division 72 of the GST Act.

Priority: High.
Taxpayers affected: Potentially any entity making financial supplies.

PROPERTY

Residential property generally (5.1): this area of GST needs to be subject to a more detailed and comprehensive review aimed at determining the most effective and efficient way to treat residential property for GST purposes without giving rising to the complexities and the lengthy and costly disputes that the current regime has created. Specific consideration needs to be given to whether the "option to tax" regime from other VAT systems would be the appropriate solution to these problems.

Priority: High.
Taxpayers affected: The numerous and diverse range of taxpayers that deal with development and sales of "residential premises" including property developers (from large listed companies to SME's and sole traders), retirement village operators, affordable housing bodies & charities.

Exclude tax law partnerships as a deemed entity (5.2): The GST Act does not operate clearly or effectively in deeming tax law partnerships to be an entity for GST purposes. The GST Act should ignore tax law partnerships and each co-owner should deal with its own GST payments and compliance. To effect this it is necessary to change the definition of "partnerships" for GST purposes in section 195-1 to cover "general law partnerships" only, as follows:

> *"partnership means an association of persons (other than a company) carrying on business as partners".*

Priority: High.
Taxpayers affected: Co-owners of property.

Partitioning: transfers on partitioning should be ignored for GST purposes (5.3): supplies by way of partition should be ignored for GST purposes. This can be achieved by expressly stating that such supplies are excluded from a supply (eg as an exclusion to what is a "supply" as a new sub-paragraph in subsection 9-10(4)).

Priority: High.
Taxpayers affected: Co-owners of property.

Adjustment Provisions: Decreasing adjustment for non-margin scheme sales (5.4): 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. This provision would effectively be a mirror to the increasing adjustment provisions, section 75-22, inserted in 2005.

Priority: Medium.
Taxpayers affected: Co-owners of property.

Land value increase while held by unregistered entity not to be taxed (5.5): An anomaly arises under Item 2 of paragraph 75-10(3)(b) where an unregistered entity acquires land after 1 July 2000, later registers for GST and then sells under the margin scheme resulting in the taxation of the increase in value of land held by an unregistered entity.

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

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

Priority: Medium.
Taxpayers affected: Property owners and developers buying from those property owners.

ADMINISTRATION ISSUES

Scope and binding nature of private indirect tax rulings (6.1): The indirect tax ruling regime should be amended so that indirect tax rulings bind the Commissioner in a similar way to rulings dealt with in Division 357 of Schedule 1 of the TAA 53: that is, without any need to show positive acts of reliance or that the ruling has been altered.

Priority: High.
Taxpayers affected: All.

No right to object against private indirect tax rulings (6.2): Give entities a right to object under Part IVC of the TAA 53 against private indirect tax rulings where they are dissatisfied with the decision made by the Commissioner in the ruling issued to them.

Priority: Medium/Low
Taxpayers affected: All.

Third party reliance on private indirect tax rulings (6.3): Where a third party in the supply chain has an identical fact pattern to the entity that has obtained the private indirect tax ruling, the Commissioner should also be bound by his position in the ruling where the third party has acted consistently with the private indirect tax ruling.

Priority: Medium/Low.
Taxpayers affected: All.

The imposition of GIC in respect of wash transactions (6.4): Give full remission of GIC in relation to 'wash' transactions and, to the extent that the failure to account correctly for GST is the result of a taxpayer's culpable behaviour, use the existing penalty regime in Division 284 of Schedule 1 to the TAA 53 as a deterrent.

Priority: High.
Taxpayers affected: All.

Applicability of the SIC to GST (6.5): A lower rate of GIC, akin to the SIC, should apply in respect of the period prior to the Commissioner notifying the taxpayer of an unpaid net amount or amount of indirect tax, or of a reduced input tax credit entitlement in respect of a particular tax period, where prior to notification the taxpayer was not aware of any unpaid amount remaining outstanding.

Priority: Medium.
Taxpayers affected: All.

OTHER

Formation and cessation of GST groups - 90% common ownership requirement for companies (7.1): The definition of a 90% owned group in section 190-1 should be expanded to include situations where two or more sister companies are commonly owned by a partnership, trust or individuals.

Priority: Medium.
Taxpayers affected: Taxpayers predominantly in the SME market who have a group structure that is controlled by an individual, a partnership or a trust, and who wish to form a GST group.

Formation and cessation of GST groups - distributions through interposed entities (7.2): three separate amendments are necessary to deal with the issue of interposed entities: (i) paragraph 48-15(1)(e) should be expanded to include interposed entities such as companies and trusts, where the shareholders or beneficiaries of those interposed entities are members of, or family members of members of, the company that will be a member of the GST group; (ii) regulation 48-10.03(2)(d) should be expanded to include distributions made to: (a) a company, the shareholders of which are all family members of the same individual; and (b) a trust, the beneficiaries of which are all family members of the same individual; and (iii) the definition of 'permitted beneficiary' in regulation 48-10.03(3) should be expanded to include: (a) a company, the shareholders of which are permitted beneficiaries; (b) a trust, the beneficiaries of which are permitted beneficiaries; and (c) an entity that is the beneficiary of, or a shareholder of, a permitted beneficiary.

Priority: Medium.
Taxpayers affected: All taxpayers who wish to form a GST group that includes a trust, where the beneficiaries of the trust include another trust and/or a company.

Formation and cessation of GST groups - date of effect of revocation of an approval (7.3): Consideration should be given to whether the date of effect of revocation of approval can be the actual date that the change of ownership occurs, which may be a date during the tax period. This may require two separate Business Activity Statements to be lodged for that tax period; one by the former GST group, and one by the new GST group or separately by the entities that are no longer members of a GST group.

Priority: Medium/High
Taxpayers affected: All taxpayers who are members of a GST group.

3. INTERNATIONAL

3.1 Information Requirements for Non- Resident Entity GST Registrations

3.1.1 Issue

The information requirements for GST registration of non-resident entities are too onerous and difficult to comply with. They are plainly unacceptable by international standards, particularly having regard to the fact that the GST Act allows non-resident entities to register. For example, proof of identity is required not only for the non-resident entity, but the directors of the non-resident entity with passports having to be certified as true and correct by Australian consular offices. Moreover, the same proof of identity requirements applied, until some recent changes, across the board to all entities, whether they were multi-national companies or small enterprises. On 4 April 2008, the Australian Taxation Office revised the proof of identity requirements for listed entities so that the identification documents required are lesser, however, more needs to be done to further streamline the information requirements for non-resident entities.

Note, also, that not all non-resident entities that apply for GST registration need to have an ABN nor a public officer, however, there is still considerable confusion as to these issues, some of it due to the Australian Taxation Office forms and information requirements. Another practical problem in GST registration of non-resident entities, is the Australian Taxation Office's insistence on the entity maintaining an Australian bank account, which it is impossible to establish with some banks unless the non-resident entity has an Australian Registered Body Number (ARBN).

The same information requirements apply to non-resident entities which apply to be a member of a GST group where there is a representative member that is an Australian resident and, in addition, to non-resident entities which have appointed a resident agent under Division 57. As there are already Australian entities known and properly identified to the Australian Taxation Office in these circumstances, the requirement for non-residents to additionally prove their identity is burdensome and creates unnecessary compliance costs.

3.1.2 Priority

High.

3.1.3 Taxpayers affected

All non-resident entities that must register for GST or that choose to register for GST.

3.1.4 Recommendations

The suggested solution is for further streamlining referable to objective benchmarks and which are proportional to the revenue risks to the Australian Taxation Office. For example, consideration should be given to introducing lesser requirements to be applied for different categories of non-resident entities, such as:

(i) entities which already have a resident agent appointed under Division 57;

(ii) entities which apply to be a member of a GST group (the application for GST grouping should probably also be moved to the same application form for GST registration in this circumstance and appropriate measures taken in circumstances where the non-resident entity exits from the GST group); or

(iii) entities with particular thresholds of turnover or capitalisation.

This will ensure that less onerous proof of identity requirements are imposed on entities which already have considerable information available in the public domain and/or which pose a lesser revenue risk to the Australian Taxation Office.

See also the separate recommendations of Rebecca Millar, which include excluding non-residents from the Australian GST regime in certain circumstances.[5]

3.2 Registration Turnover Threshold – GST-free Supplies

3.2.1 Issue

Pursuant to section 188-15 of the GST Act, the current GST turnover is calculated as the sum of all values of all the supplies made, which includes GST-free supplies. This means that non-resident entities (as well as resident ones that make only GST-free supplies) must register for GST notwithstanding that they have no GST payable. This is an anomalous outcome and the response of most non-resident entities to such advice is to ignore it because no GST is required to be paid.

3.2.2 Priority

Medium.

3.2.3 Taxpayers affected

This impacts non-resident entities that make only GST-free supplies.

3.2.4 Recommendations

Section 188-15 should be amended to exclude GST-free supplies so that it does not lead to this anomaly and, consequential GST administration issues including failure to register GST etc.

3.3 Resident Agent

3.3.1 Issue

Pursuant to Division 57, non-resident entities who are making supplies through a resident agent are still required to be registered for GST purposes even though they may not be required to give a GST return for any particular tax period.

As highlighted above, such non-resident entities are still subject to the same information requirements as other non-resident entities which do not have a resident agent.

3.3.2 Priority

Medium.

3.3.3 Taxpayers affected

Non-resident entities making supplies through resident agents.

[5] A paper presented by Rebecca Millar at the CLA Conference "Commercial Practice in a Global Economy" held in Sydney on 1 August 2008, page 51.

3.3.4 Recommendations

There should be no requirement for non-resident entities to register in these circumstances. Alternatively, if required to register, then the information requirements should be streamlined (as suggested above), since the revenue risks to the Australian Taxation Office are lower. This is because the resident agent is, in any event, liable for the GST obligations of the non-resident entity.

3.4 Exported Services

3.4.1 Issue

Subsection 38-190(3) broadly provides that supplies to non-residents are GST-free, provided that the supply is not a supply under an agreement entered into directly or indirectly with a non-resident and the supply is provided or the agreement requires it to be provided to another entity in Australia. The complexity surrounding the application of this subsection is extraordinary and impacts all kinds of international transactions and industries, including professional services, investments banking, R&D and service arrangements.

The OECD recommends that GST should be imposed in the jurisdiction where consumption takes place, which is generally where the customer is located. It should be noted that section 38-190 establishes the grounds for GST-free exported services and has the title "Supplies of things, other than goods or real property, for consumption outside Australia". However, the application of subsection 38-190(3) is not entirely consistent with the heading, nor the OECD's recommendations.

An illustration is where there is a global services arrangement between A and B. B (the supplier) is located in Australia. Under the arrangement, B agrees to supply its services to A, but upon A's instructions, B delivers the services to C (located in Australia). Although the customer in this instance is A (located outside of Australia) and where in accordance with the OECD's recommendation, GST is supposed to be imposed in the country where A is located - the application of subsection 38-190(3) results in B having to pay GST in Australia because the supply of the services was made to another entity in Australia (i.e. provided to C).[6]

In practice, there are enormous difficulties in determining whether a supply is "provided" to an entity in Australia in these circumstances, particularly where the supplier may not necessarily be certain if the services are "provided" to another entity in Australia eg the fact that another Australian entity is copied on advice supplied to a non-resident entity is not determinative of the issue.

The inconsistency resulting from subsection 38-190(3) with the generally accepted "place of consumption" basis for VAT/GST purposes may also cause cross-border GST conflicts. Numerous problems arise from cross-border GST conflicts, as highlighted by the OECD, including double-taxation or triple-taxation.[7]

3.4.2 Priority

High.

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[6] Detailed analysis in relation to the inconsistencies and problems caused by s.38-190(3) of the GST Act in global agreements are set out in a paper presented by Rebecca Millar at the CLA Conference "Commercial Practice in a Global Economy" held in Sydney on 1 August 2008, page 46.
[7] Centre for Tax Policy and Administration, *The Application of Consumption Taxes to the Trade in International Services and Intangibles* (OECD, Paris, 30 June 2004), p. 12 at para 24.

3.4.3 Taxpayers affected

All taxpayers with international services transactions.

3.4.4 Recommendations

The current thinking is that subsection 38-190(3) should not be applied to B2B transactions, because this results in costly one-off GST registration and compliance issues for non-resident entities (see 3.1 above).

Rebecca Millar[8] has suggested some additional solutions to this and related GST international issues, as follows:

1. limit the operation of subsection 38-190(3) so that it effectively only applies to B2C transactions, where "C" means any entity that is not registered for GST. Only in that scenario should the "provision to another entity in Australia" proxy be used;

2. merge the reverse charge mechanisms in Division 83 and 84 and apply the reverse charge mechanism for all B2B supplies by non-residents who are not registered or required to be registered for GST and who do not make their supplies through an enterprise carried on in Australia; and

3. prevent the unnecessary inclusion of non-resident entities in the Australian GST by excluding B2B supplies by non-residents from the registration threshold if they are connected with Australia only because the services were performed in Australia.

3.5 Taxable Importations and Creditable Importations

3.5.1 Issue

Section 15-5 of the GST Act provides that an entity is entitled to claim input tax credits for any creditable importation. GSTR 2003/15 provides that the entity that imports goods within the meaning of Division 15 is the entity that "causes the goods to be brought to Australia for application to its own purposes after importation, whether by way of supply, use or otherwise…"

The intention of GSTR 2003/15 is to minimise the revenue leakage associated with private consumers and other entities not entitled to recover GST using logistic companies to import goods and claim input tax credits. However, there is a mismatch in terms of who is entitled to claim input tax credits for imported goods i.e. the importer of record may not be the actual person who is "importing" the goods. Although GSTR 2003/15 seeks to clarify this, there is nothing in the GST Act that requires the phrase "you import goods solely or partly for a creditable purposes" to be read to include " goods to be brought to Australia for application to its own purposes after importation, whether by way of supply, use, or otherwise".

The interpretation set out in GSTR 2003/15 is also inconsistent with the definition of "owner" contained in subsection 68(2) of the Customs Act 1901, which has a wider definition and is not restricted to the entity applying the goods to its own purposes.

The narrow approach to "you import goods" adopted in GSTR2003/15 is inconsistent with the legislation drafted in relation to importation of goods and is not a correct application of the law as it is drafted.

[8] A paper presented by Rebecca Millar at the CLA Conference "Commercial Practice in a Global Economy" held in Sydney on 1 August 2008, page 51.

3.5.2 Priority

Medium/High.

3.5.3 Taxpayers affected

All taxpayers that import goods and, in addition, freight companies.

3.5.4 Recommendations

Amendments should be made to Division 15 to clarify (in the GST Act and not in GST public rulings) that the entity that imports goods into Australia for GST purposes is entitled to claim input tax credits. This will rectify the mischief which GSTR 2003/15 seeks to address. This will ensure that the application and implementation of Division 15 is in line with what is apparently the intended application of the GST Act. In the absence of these amendments, anomalies in GST planning in international transactions will continue.

3.6 Review of legislative provisions re international issues/volume of Public Rulings

3.6.1 Issue

The number of public rulings relating to GST issues, issued by the Australian Taxation Office are extensive. As of 4 August 2008, 769 pages of the consolidated versions of the rulings focus on international issues with 543 pages dealing with section 38-190 of the GST Act. The GST Act has been overtaken by the numerous explanations proffered in relation to international issues.

3.6.2 Priority

Low/Medium.

3.6.3 Taxpayers affected

All taxpayers with international transactions.

3.4.4 Recommendations

The issues relating to section 38-190, need to be re-considered and the legislative provisions amended to reduce the issues and problems associated with them. It is also not appropriate for public rulings to substitute for clear GST legislative provisions.

4. FINANCIAL SERVICES

4.1 Financial Acquisitions Threshold Test (FAT test)

4.1.1 Issue

In general, the GST Act allows input tax credits related to financial supplies as long as an enterprise does not breach the financial acquisition threshold ("FAT"). The FAT test is to be determined each month by reference to past activity and/or future activity. Subsection 11-15(4) and Division 189 provide the basic building blocks relevant to the FAT test.

The FAT test represents one of the more problematic areas for business to comply with from a GST perspective. Our experience indicates it forms a staple of Australian Taxation Office audit activity as well as being the subject matter of many voluntary disclosures. The fundamental problem with the FAT test is that in many instances it is a compliance issue generated by ad hoc and irregular activity that does not typically form part of an enterprise's regular operational activity. In many instances exposure to it is only generated by capital raising or merger and acquisition activity. Yet once breached there may be on-going, nuisance compliance based around minor financial supply activity for a period of time.

Whilst the FAT test was introduced to remove compliance burdens from businesses who did not make acquisitions of a defined size in relation to financial supplies it may be observed that the thresholds are too low and the compliance requirements not as practical as they may be. Ironically the FAT exacerbates compliance for businesses that are not engaged in financial supplies.

4.1.2. Priority

Medium/High.

4.1.3 Taxpayers affected

All taxpayers may be affected by the FAT test.

4.1.4 Recommendation

A lot of enterprises fail the FAT test simply because of their size and the costs associated with being publicly listed.

In many cases, these enterprises mainly if not solely make taxable supplies and, therefore, end up with apportionment ratios of 99% or higher. Conceptually, there is an argument that the FAT test should operate in such a way so that they don't have to monitor continually their apportionment ratio/compliance in respect of the FAT test. One solution could be to take the words "either or" out of subsections 189-5(1), 189-5(2), 198-10(1) and 189-10(2).

There is a need to consider lifting the input tax credit threshold incorporated into the FAT test from $50,000 to a higher amount.

Capital raisings and share acquisition activities in many instances remain ad hoc activities for enterprises yet it is undertaking this activity in a single instance that many times results in failing the FAT test.

Another option may be to exclude regular, but minor, financial supply activity from the test.

For example you have an enterprise with a small treasury area that is involved in making financial supplies through its currency activities, but only has input tax credits of $20,000 per year associated with these activities. It undertakes a capital raising and breaches the FAT test as a result of the combination of the treasury area function and the capital raising. Modifying the FAT test to remove regular minor activity from the FAT test where these activities do not of themselves combine to breach the FAT test would reduce the compliance burden, particularly as it relates to on-going monitoring.

4.2 Division 129 – Changes in the extent of creditable purpose

4.2.1 Issue

Division 129 of the GST Act, by reference to the Explanatory Memorandum covers the following at its simplest:

> *"Division 129 provides for an adjustment if your actual use of a thing is different from your intended extent of creditable purpose. This is an adjustment for change in creditable purpose."*

It has been noted in a number of articles that there are a number of perceived deficiencies in relation to this Division. It is not our intent to refer to these in detail but rather to note that some minor change around a specific point may ease the compliance costs associated with the application of this Division in the business finance sector.

Subsection 129-10(1) provides that an adjustment cannot arise under Division 129 for an acquisition or importation that relates to business finance unless the acquisition or importation had a GST exclusive value of more that $10,000. Subsection 129-20(2) then provides the adjustment periods for an acquisition or importation that relates to business finance. Given the broad definition of acquisitions for the purpose of this Division and the complexities inherent in its application we would take the view that there are grounds for the base acquisition thresholds for Division 129 to be applied, to be increased and for the potential scope of the adjustment provision to be reduced.

4.2.2 Priority

Medium.

4.2.3 Taxpayers affected

All taxpayers making acquisitions or importations relating to business finance.

4.2.4 Recommendations

Lifting the thresholds for acquisitions and/or importations relating to business finance before Division 129 applies.

Independent of the perceived issues surrounding the application of Division 129, it is noted that a strong underlying element inherent in its application is to track acquisitions of a particular size over specified periods in order to ensure that actual use reflected intended use. If there is a variation then an adjustment needs to occur in relation to the input tax credits claimed. Simply lifting the thresholds will reduce the number of acquisitions and/or importations that need to be tracked for these purposes. We would have an expectation that this change could be undertaken in consultation with industry.

Limiting the Division 129 adjustments to specific types of acquisitions.

To prevent onerous examination of all acquisitions and whether they have an ongoing use, Division 129 could be expressly limited to acquisitions of capital goods and real property.

4.3 Division 135 – Supplies of Going Concern

4.3.1 Issue

Division 135 of the GST Act is directed at the recipient of a supply of going concern. It requires the recipient to make an increasing adjustment in specified circumstances. There are a number of issues in relation to the application of Division 135. At this time we will focus on two fundamental ones where legislative change would remove what is generally perceived as unintended ambiguity.

The first fundamental issue with Division 135 is one of scope. Subsection 135-5(1)(a) provides that you have an increasing adjustment if you are the recipient of a supply of going concern or a supply that is GST-free under section 38-480 amongst other criteria. The problem this raises is that a distinction may be made between a GST-free supply of a going concern which satisfies all of the criteria of subsection 38-325(1) where you would then expect Division 135 to apply, and a supply of going concern as defined in subsection 38-325(2) but which does not satisfy all of the subsection 38-325(1) criteria (eg there was no written agreement to treat the supply as GST-free), where you would not expect Division 135 to apply. A literal reading of Division 135 would suggest that both instances are covered by the Division. This clearly could give rise to an increasing adjustment in circumstances where it is not intended.

The second fundamental issue with Division 135 that we would highlight is the operation of subsection 135-5(2). The amount of any increasing adjustment under this subsection may result in an amount of GST being accounted for a supply that would not otherwise have been taxable on acquisition. For instance a financial institution acquires a suburban property, which has residential premises and a retail store, as a supply of going concern. The residential premises would otherwise have been an input taxed supply to the financial institution. At least a portion of its quantum may now form part of an increasing adjustment.

We would take the view that if it is considered that changes can be made to the Division to take account of the fundamental issues we have raised, further consultation is sought in order to address the other perceived issues in its wording.

4.3.2 Priority

Medium.

4.3.3 Taxpayers affected

Those taxpayers acquiring assets under a supply of going concern, broadly defined.

4.3.4 Options

The first option would be to alter the legislation to make it clear that it is only GST-free supplies of going concerns that would be captured by the Division, in addition to GST-free supplies under section 38-480.

Another option would be to exclude acquisitions that would not otherwise have been taxable supplies under the GST Act from the adjustment calculations.

4.4 Reduced Input Tax Credits

4.4.1 Issue

Division 70 of the GST Act and Regulation 70 of the GST Regulations are the provisions that give effect to reduced input tax credits (RITCs) (RITC provisions) and are a peculiarity as far as world wide VAT systems are concerned.

They were included in the Australian GST Act as an alternative way of dealing with certain design difficulties faced by all VAT systems. Eight years on, it would seem appropriate to consider if the RITC provisions are an efficient way of dealing with these difficulties and if they are operating as intended.

On 2 August 1999 the Treasury released a discussion paper titled *'The Application of Goods and Services Tax to Financial Services'*.[9] This paper noted that generally financial services are input taxed in overseas jurisdictions due to the difficulty in identifying a financial intermediary's margin. It also noted that it is international practice to input tax many fees or commissions associated with the provision of financial supplies to avoid biases that may otherwise arise. In particular, the paper noted that many overseas jurisdictions have extended the scope of input taxation 'upstream' to suppliers of financial supplies to address the self supply bias.

In Australia the RITC provisions were introduced to address the self supply bias. Financial supply providers are allowed a reduced input tax credit on many acquisitions from 'upstream' suppliers rather than making the upstream suppliers' supplies input taxed. This approach was intended to reduce the compliance costs associated with having a greater number of suppliers subject to input taxation.

The 1999 discussion paper also contemplated that the Government would conduct regular reviews of both the list of services qualifying for a RITC and the applicable RITC rate. At this time we do not believe any such review has been conducted or, if conducted, published.

The fact that a review of the operation of the RITC provisions has apparently not been conducted means that we have not had an opportunity to assess if these provisions are operating as intended. We believe that these provisions are not always operating as intended. For example, a fee, as agent, for arranging the purchase or sale of equity securities was intended to be a reduced credit acquisition[10]. A number of examples are included in both the 1999 consultation document and the RITC provisions. The drafting of the RITC provisions does not seem to have given effect to the consultation document's intentions. For example, the consultation document includes the following as an example: [11]

> *As agent, arranging the purchase or sale of equity securities.*

- *fees for order placement and trade execution*
- *fees for settlement of trades*
- *fees for management of the issue of equity securities, including rights issues and bonus issues*
- *fees for arranging flotations or privatisations*
- *fees for arranging mergers and acquisitions*

[9] A copy of the Treasury Consultation Document *The Application of Goods and Services Tax to Financial Services* can be found at http://www.treasury.gov.au/contentitem.asp?NavId=022&ContentID=693
[10] Table 1, page 7 of the Consultation Document
[11] Table 1, page 7 of the Consultation Document

- *fees for arranging takeover bids*

The actual RITC provisions have been drafted so that an RITC entitlement does not arise unless the taxpayer actually sells shares. For example, only one of the two parties to a merger may be able to claim an RITC in relation to facilitation costs as generally one entity will buy the shares of the other from its shareholders, not from the entity itself. Also, where an entity chooses to implement a reverse takeover, in that the target entity will purchase the shares of the acquiring company, the company implementing the takeover (acquiring company) will not be able to claim a RITC.

In addition, we do not believe the anticipated reduction in compliance costs as a result of having a lesser number of suppliers subject to input taxation is well evidenced or documented. The Taxation Institute believes that the additional compliance cost of administering RITC claims for anyone who exceeds the financial acquisitions threshold outweighs any potential savings contemplated by the 1999 consultation paper. In this regard it is interesting to note that no other jurisdiction has chosen to implement RITC provisions over the past 8 years.

Finally, differing structures and terminology are used for the different items in the table in regulation 70-5.02. Sometimes the item is merely a description of the types of transactions that qualify as RITC acquisitions. Sometimes the item sets out additional requirements, e.g. arrangement by a financial supply facilitator, and then includes examples of the types of transactions that should be covered. In some cases, this has resulted in the original intention of the provision being lost.

4.4.2 Priority

Medium/High.

4.4.3 Taxpayers affected

All taxpayers who provide financial supplies.

4.4.4 Recommendations

We recommend a comprehensive review of the operation of the RITC provisions as was indicated by the 1999 consultation document.

In particular, we request a specific review of item 9; in our view it should be rewritten to include all securities' related transactions such as facilitation costs for mergers (for the company being acquired) and arranging takeover bids (in the reverse takeover situation).

4.5 General Insurance settlements – insured input tax credit entitlements

4.5.1 Issue

The decreasing adjustment entitlements of general insurers under section 78-10 are dependent upon the input tax credit entitlement of the insured on the premium for the policy. If a GST registered insured does not inform the insurer of its input tax credit entitlement on the premium at or before the time a claim was first made under the policy, or in informing the insurer it understated the input tax credit entitlement, then the insured may have a GST liability under section 78-50. Notwithstanding section 78-50 the current legislation does not entitle the insurer to rely upon the insured's input tax credit entitlement as notified at or before the time a claim was first made under the policy.

For example, where the insured would not respond to a request by the insurer for its input tax credit entitlement on the premium, but the insurer is then informed after the first claim was made that the insured had a 100% input tax credit entitlement, section 78-10 would appear to deny the insurer a decreasing adjustment even though the insured would itself be prima facie liable for GST under section 78-50.

The effect of this anomaly is compounded by the Commissioner's approach in audits to require insurers to assume 100% input tax credit entitlements where there was no notification of input tax credit entitlement by the insured, so as to deny the insurer a decreasing adjustment.

Some insurers also price premiums based on the input tax credit entitlement of the insured informed during the writing of the policy, and may therefore be adversely financially affected if the communicated entitlement is subsequently shown to be incorrect.

4.5.2 Priority

Medium.

4.5.3 Taxpayers affected

All general insurers (large taxpayers).

4.5.4 Recommendations

Division 78 could be amended to require the insurer to request the insured's input tax credit entitlement on the premium at any time at or before a claim is first made under the policy, and then allow the insurer to rely upon the insured's response (or lack of response) in calculating its decreasing adjustment entitlements.

The legislation could be amended to allow insurers to elect to apply standard industry-agreed recovery rates for different classes of insurance, similar to the election to use an "average input tax credit fraction" for Compulsory Third Party insurance in Division 79.

4.6 General Insurance settlements – claiming input tax credits

4.6.1 Issue

In settling a claim under an insurance policy an insurer is commonly invoiced by and pays a third party supplier directly (eg a repairer or supplier of replacement goods) where the goods or services are provided to the claimant (the insured or another party).

To claim an input tax credit under section 11-5 an entity must have acquired the taxable supply and provided, or been liable to provide, the consideration for the supply.

In some instances neither the insurer nor the claimant can claim an input tax credit for the GST included in the price of those goods or services. In other instances the claimant can claim an input tax credit even though it was the insurer which paid for the taxable supply. Both of these are anomalous results.

This is because the taxable supply may not be considered to be made to the insurer. The circumstances in which a supply has been made to an insurer in such circumstances has not been judicially considered in Australia. However, overseas VAT case law in respect of such tripartite situations and the Commissioner's ruling GSTR 2006/10 may not support the insurer's entitlement to an input tax credit in all circumstances, eg where the claimant instructs the supplier but the insurer subsequently agrees to pay the supplier directly.

If it was the clear understanding of the parties that the claimant was not liable to provide the consideration to the supplier, then the claimant also cannot claim an input tax credit. If the claimant could be considered to have been liable to pay for the supply, even if it was actually paid for by the insurer, the claimant could be entitled to claim an input tax credit despite having itself provided no consideration and, therefore, receive a windfall gain at the expense of the insurer. This is primarily an issue where the insured is a GST-registered business, which claimed an input tax credit on the premium. If the insured was not GST-registered, the insurer should be entitled to claim a decreasing adjustment in respect of the payment to the supplier under section 78-10.

4.6.2 Priority

Medium.

4.6.3 Taxpayers affected

All general insurers (large taxpayers).

4.6.4 Recommendations

A legislative provision could be inserted to give an insurer an input tax credit entitlement in these circumstances, eg to provide that where any payment is made by an insurer for any taxable supply in settlement of a claim under an insurance policy then this is a creditable acquisition for the insurer and not for any other entity.

The legislation could allow for an agreement between the recipient of the supply (the claimant) and the payer (the insurer) to treat the supply as having been made by the third party supplier to the insurer.

4.7 Hire purchase

4.7.1 Issue

One of the major issues in the financial services industry is the complexity surrounding the claiming of input tax credits in respect of hire purchase arrangements. There is significant disagreement between the industry and the Australian Taxation Office as to how input tax credits in respect to particular costs (eg overhead and commission costs) should be treated.

In addition, the GST treatment of the different types of asset financing results in the GST treatment determining what type of transaction entities enter into. This is not an optimal scenario. For example, it is unattractive for an entity which is registered on a cash basis to acquire an asset under a hire purchase arrangement as it effectively only obtains an input tax credit for the asset during the period of the arrangement even though the hirer's output tax was attributed up front. For these cash based entities the GST treatment of leases and chattel mortgages are more favourable.

In addition, the hirer is denied an input tax credit even where the hire purchase arrangement is to an entity entitled to full input tax credits, which is not the case with leases.

In many instances a financier's documentation for a hire purchase arrangement is remarkably similar to their documentation for a lease, ie the terms and conditions are nearly identical.

4.7.2 Priority

High.

4.7.3 Taxpayers affected

All entities involved with hire purchase transactions.

4.7.4 Recommendations

A way to diminish the aforementioned issues is to give the parties to the financing arrangement an option to treat hire purchase arrangements in a similar manner as to a lease. Registered entities are then less likely to enter into transactions based on the GST treatment. It would also eliminate the issue of the denial of input tax credits where the election is exercised.

4.8 Financial supplies which are treated as GST- free supplies

4.8.1 Issue

Adverse GST implications can arise where a financial supply is treated as GST-free.

For example, where a superannuation fund buys securities from or sells securities to non-residents, the purchase and sale of the shares may come within the definition of current GST turnover. This is because the definition only excludes supplies that are input taxed from turnover. It does not exclude financial supplies which are GST-free.

The consequence is that the purchase and sale of such shares results in the turnover increasing, which can have an impact on whether an entity is required to be registered (see also issue 3.2), whether it needs to account on an accruals basis and whether it needs to lodge BASs on a monthly basis.

In addition, issues also arise under the financial acquisition threshold in respect to such financial supplies as the threshold takes into account acquisitions that relate to financial supplies irrespective of whether the supplies are input taxed to not. If, for example, a unit trust invests solely in international shares, acquisitions relating to buying and selling of shares from non residents are treated for the purpose of determining whether the financial acquisition threshold is satisfied or not.

The consequence is that the unit trust whose main activities relate to GST-free supplies, does not have the benefit of the financial acquisition threshold. It may hence have to deny all credits in relation to the issuing of units to residents.

4.8.2 Priority

Medium.

4.8.3 Taxpayers affected

Maintaining superannuation funds and investment lists that invest in international securities.

4.8.4 Recommendations

The first problem would be removed if the definitions of "current annual turnover" and "projected annual turnover" in Division 188 were amended to exclude supplies that are financial supplies.

The second problem would be removed if Division 189 was amended so that acquisitions that relate to the GST-free financial supplies are not taken into account in determining whether the threshold is meet or not.

4.9 Interaction of Division 72 with the ITAA 97

4.9.1 Issue

The ITAA 97 does not contemplate GST being payable or claimable as a result of the deeming provisions on Division 72 of the GST Act. In particular Division 17 of the ITAA 97 provides that assessable income should be reduced by the amount of GST payable in respect to the assessable income. In a scenario where there is nil consideration paid on a supply but Division 72 deems there to be consideration, Division 17 does not give any relief for the payment of GST as there is no assessable income that can be reduced.

It is debatable as to whether a deduction will be allowable under section 8-1 of the ITAA 97.

Conversely, Division 27 of the ITAA 1997 does not deal with the assessability of credits arising as a result of deemed consideration under Division 72 and it is debatable as to whether the amounts are assessable under section 6-5 of the ITAA 97.

4.9.2 Priority

High.

4.9.3 Taxpayers affected

Potentially any entity making financial supplies.

4.9.4 Recommendations

The solution is to amend sections 17 and 27 of the ITAA 97 to ensure that the appropriate tax treatment is given to GST paid or GST received as a result of the operation of Division 72 of the GST Act.

5. PROPERTY

5.1 Residential property generally

5.1.1 Issue

The Taxation Institute believes the whole treatment of supplies of residential property needs to be reconsidered to remove the anomalies, administrative difficulties and to avoid the multitude of costly and lengthy disputes that have arisen on the current legislative treatment of residential property for GST purposes.

We acknowledge that such a comprehensive re-write of the provisions is outside the scope of the Board of Taxation's current Review, but we believe it is worth making the point at the outset that a lot of the issues that will be raised in this Review surrounding property may be better resolved by a more comprehensive review and legislative change.

The problems in this area of the GST legislation are illustrated by the statistics:

- approximately 30% of all GST cases currently in litigation are property related and most of these deal with margin scheme issues;[12]
- 5 Taxpayer Alerts regarding residential premises (mainly margin scheme issues) have been issued out of only 9 GST Taxpayer Alerts;
- 12 public rulings (with two more in draft) have been issued on residential property and margin scheme issues;
- GST audits on margin scheme valuation issues got a special mention in the Inspector General's review of GST audits as being "unfair" and involving "prolonged periods of angst and financial cost to the taxpayers involved";[13] and
- the margin scheme provisions, in Division 75, doubled in size after being substantially amended in 2005 and are still the subject of further major amendments.[14]

These problems and disputes in the property area are not reflective of the experience in other GST/VAT jurisdictions – possibly because of the different GST treatment.

That is, in most VAT systems, the sale of residential premises is not subject to GST but rather it is input taxed (or exempt) under an "option to tax" system that allows commercial property to be taxed and residential property to remain input taxed.

There are still disputes surrounding the borderline in the option to tax systems,[15] but nowhere near the quantum of disputes, uncertainty and administrative cost associated with the current Australian regime.

5.1.2 Priority

High.

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[12] Statistics cited by the Australian Taxation Office at the Taxation Institute's 2008 National GST Conference, 4-5 September 2008; see also the minutes to the NTLG GST subcommittee meetings.
[13] Refer page 60 of the Inspector General of Taxation's Report: Review of the Australian Taxation Office's administration of GST audits for large taxpayers, 22 January 2008
[14] As announced by the Federal Government in the budget, and the TIA understand the changes will be introduced in the Spring sittings of Parliament
[15] Refer Armand, Schellmann and Vermuelen, "Immovable Property and VAT – Lessons from past experience", International VAT Monitor, Sept/October 2005

5.1.3 Taxpayers affected

The numerous and diverse range of taxpayers that deal with development and sales of "residential premises" including property developers (from large listed companies to SME's and sole traders), retirement village operators, affordable housing bodies & charities.

5.1.4 Recommendation

We recommend that this area of GST be subject to a more detailed and comprehensive review aimed at determining the most effective and efficient way to treat residential property for GST purposes without giving rising to the complexities and the lengthy and costly disputes that the current regime has created.

Specific consideration needs to be given to whether the "option to tax" regime from other VAT systems would be the appropriate solution to these problems.

5.2 Exclude tax law partnerships as a deemed entity

5.2.1 Issue

The GST Act does not operate clearly or effectively in deeming "tax law partnerships" (TLPs) to be an entity for GST purposes - it should ignore TLPs and each co-owner should deal with it's own GST payments and compliance.

TLP is used to describe "an association of persons … in receipt of ordinary income or statutory income jointly" (eg GSTR 2004/6). Such an "association" is defined as a "partnership" for income tax purposes but is not recognised as a "partnership" at law, nor is it any other sort of legal entity. It is, in this regard, deemed to be an entity specifically for income tax purposes. However, despite being deemed to be an entity for income tax purposes, the entity is effectively ignored for income tax due to the Commissioner's administrative practice of not requiring a tax law partnership to submit partnership returns.

Currently the GST Act includes TLPs as an entity because Division 184-1 includes a "partnership" as an entity for GST purposes, and "partnership" for GST purposes is defined in section 195-1 to have the meaning given in by section 995-1 of the ITAA 97.

Difficulties, both practical and technical, have arisen in treating the income tax fiction as an entity for GST purposes, especially as it is not an entity legally and is effectively ignored for income tax and accounting.

Technical difficulties include:

- whether a TLP has "capital";[16] and
- whether the supply of the assets can be the supply of "an interest in the capital of a partnership" (which is input taxed for GST purposes).[17]

Some technical issues are so difficult the Commissioner has resorted to issuing rulings expressly stating the analysis does not apply to TLPs and leaving a void as to how TLPs are treated on the issue.[18]

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[16] The Commissioner's view in GSTR 2004/6 is that a TLP can have assets but does not have capital (refer paragraphs 99-108)
[17] Refer Reg 40-5.09(3), Item 10.
[18] Refer GSTR 2008/D2 General law partnerships & the margin scheme and GSTR 2008/D3 Partitioning rulings

The practical difficulties include determining when something is supplied by the co-owner and when it is supplied by the TLP. How far does the "deeming" apply? To take a very simple and very common example, if co-owner A sells its 50% share in land co-owned with B to a third party C, how is the transaction treated for GST purposes? Legally, as reflected in the contract, and for accounting purposes, it is a sale from A to C of a 50% interest in the land, but for GST does A sell a 50% interest in the property to C or does the A/B TLP sell a 50% interest in the property to C (or to the B/C TLP)?

The answer determines who (if anyone) is liable for the GST, who can claim the credits and impacts on the analysis for special rules such as supplies of a going concern or margin scheme sales.

This issue is difficult enough without the added complexity of the 'hybrid' TLP system that administratively operates for GST. The Commissioner has issued a public ruling that allows for certain TLPs not to register for GST purposes and for the co-owners to submit the relevant GST and claim the relevant input tax credits.[19]

This ruling has allowed a practical compliance approach for large property co-owners which reflects the legal and accounting treatment of transactions. However, the ruling has created a hybrid system where it can be very difficult for the taxpayers, their advisers and the Australian Taxation Office to determine whether certain co-owners are, or are not, "enterprise TLPs".

The Commissioner has had difficulties with straightforward input tax credit claims with general law partnerships,[20] so the hybrid system for TLPs and the potential for differing views on its application only compounds the difficulty if a dispute arises as to who is liable for GST or entitled to input tax credits for a TLP.

Given these difficulties – that arise on common and regular transactions – we submit that there will be more certainty and efficiency (and less disputes) where the GST liabilities, entitlements and compliance obligations are dealt with by the co-owners.

5.2.2 Priority

High.

5.2.3 Taxpayers affected

Co-owners of property.

5.2.4 Recommendation

To effect this solution, it is only necessary to change the definition of "partnerships" for GST purposes in section 195-1 to cover "general law partnerships" only, as follows:

> *"partnership means an association of persons (other than a company) carrying on business as partners".*

[19] Refer GSTR 2004/6 which makes the "distinction" between "enterprise TLPs" and "non-enterprise TLPs".
[20] Refer the facts in Deputy Commissioner of Taxation v De Angelis [2008] SADC 103.

5.3 Partitioning: transfers on partitioning should be ignored for GST purposes

5.3.1 Issue

The issue for GST purposes is whether a partition by agreement, where each co-owner's interest remains equal, should result in a taxable 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.[21]

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.

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.

5.3.2 Priority

High.

5.3.3 Taxpayers affected

Co-owners of property.

5.3.4 Recommendation

Supplies by way of partition should be ignored for GST purposes. This can be achieved by expressly stating that supplies are excluded from a supply (eg as an exclusion to what is a "supply" as a new sub-paragraph in subsection 9-10(4)).

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

5.4 Adjustment Provisions: Decreasing adjustment for non-margin scheme sales

5.4.1 Issue

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.

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.[22]

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 fully 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.

5.4.2 Priority

Medium.

5.4.3 Taxpayers affected

Co-owners of property.

5.4.4 Recommendation

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

[22] 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.

5.5 Land value increase while held by unregistered entity not to be taxed

5.5.1 Issue

It is the clear policy of the margin scheme provisions to tax the value added to land by registered entities after 1 July 2000.[23]

Currently, the margin scheme provisions of the GST Act appear not to 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, this provision, Item 2 of paragraph 75-10(3)(b), only applies 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.

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 paragraph 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 paragraph 75-10(3)(b) would not apply to such an entity, as it did not hold the land 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.

5.5.2 Priority

Medium.

5.5.3 Taxpayers affected

Property owners and developers buying from those property owners.

5.5.4 Recommendation

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

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

[23] Refer Sterling Guardian, Brady King.

6. ADMINISTRATION

6.1 Scope and binding nature of private indirect tax rulings

6.1.1 Issue

Indirect tax rulings only apply to protect entities in the circumstances outlined in subsection 105-60(1) of Schedule 1 to the Taxation Administration Act 1953 ('TAA 53'). Broadly, that subsection requires that:

- there must be a ruling that applied to the entity;
- that ruling must have been altered; and
- the entity must have underpaid a net amount or an amount of indirect tax, or the Commissioner has overpaid an amount, as a consequence of relying on the previous ruling.

Although the concept of the ruling 'applying' is common to the income tax provisions (see paragraph 357-60(1)(a) of Schedule 1 to the TAA 53), the concepts of 'alteration' and 'reliance' are the source of considerable uncertainty.

Notwithstanding that subsection 105-60(3) of Schedule 1 to the TAA 53 sets out rules for determining whether indirect tax rulings have been altered, these rules are of limited assistance. For instance:

- does the Commissioner 'alter' a ruling when he takes a position in issuing an assessment that is not consistent with the ruling; and
- does the Commissioner 'alter' a ruling where he publishes an inconsistent view in a document that is not said to be a public indirect tax ruling, such as an Australian Taxation Office Interpretative Decision (refer to PS LA 2008/3 at 60)?

One example in which the Australian Taxation Office purported to have altered a formally published 'GSTR' series public indirect tax ruling involved changing a 'Q&A' on a website without any formal notification to the public, nor any statement that the previous ruling had been altered to that extent (contra GSTR 1999/1 at 30; the example relates to the purported alteration of GSTR 2000/22 by the response to question 14.1 of the Financial Services – Questions and Answers document).

Other forms of rulings dealt with in Division 357 of Schedule 1 to the TAA 53 do not need to be altered; rather, the ruling simply ceases to apply after the Australian Taxation Office has changed its position and section 357-75 sets out 'tiebreaker' rules where rulings are inconsistent.

The second limitation of the current regime involves establishing reliance. Whereas a taxpayer may rely on a ruling dealt with in Division 357 of Schedule 1 to the TAA 53 by acting, or omitting to act, in accordance with the ruling, irrespective of whether or not the taxpayer is aware of the ruling or not (section 357-60 of Schedule 1 to the TAA 53), in a GST context it is necessary to show that some overt act occurred that was directly referable to the ruling (*Lyndon v Coventry Motors Retailers Pty Ltd* (1975) 11 SASR 308, 313).

Not only does this mean that taxpayers who happen to act consistently with a ruling, the existence of which they were not aware, would not have 'relied' on the ruling, but it also raises the question of precisely what evidence a taxpayer would require that they had relied on the ruling in taxation appeal proceedings in which taxpayers bear the onus of proof (paragraphs 14ZZK(b) and 14ZZO(b) of the TAA 53).

6.1.2 Priority

High.

6.1.3 Taxpayers affected

All.

6.1.4 Recommendation

Given these difficulties, the indirect tax ruling regime should be amended so that indirect tax rulings bind the Commissioner in a similar way to rulings dealt with in Division 357 of Schedule 1 of the TAA 53: that is, without any need to show positive acts of reliance or that the ruling has been altered.

6.2 No right to object against private indirect tax rulings

6.2.1 Issue

Taxpayers may object against a 'private ruling' if they are dissatisfied with the ruling (subsection 359-60(1) of Schedule 1 to the TAA 53). Similarly, where the Commissioner delays making the ruling for more than 60 days from the date of application, taxpayers are entitled to issue a notice compelling the Commissioner to make the ruling thereby triggering review rights (section 359-50 of Schedule 1 to the TAA 53). The term 'private ruling' is defined in such a way that it is clear that these provisions have no application to private indirect tax rulings (section 359-5 of Schedule 1 to the TAA 53 and section 357-55 of Schedule 1 to the TAA 53).

Accordingly, as the Issues Paper acknowledges at 4.2.17, entities who are dissatisfied with private rulings given in respect of GST have no formal objection and review rights in respect of rulings. This means that entities must choose to ignore the unfavourable ruling and then object against any subsequent assessment issued under Part IVC of the TAA 53.

Giving entities the ability to object against unfavourable private indirect tax rulings issued to them would ensure that the Australian Taxation Office is accountable for the quality of the private rulings it issues in respect of GST.

Furthermore, it would be a useful tool in commercial agreements where applying for a ruling is made a condition precedent to performance (as is sometimes the case in respect of GST-free supplies of going concerns where there are benefits for the recipient in treating the supply in a given way for GST purposes, but the supplier does not wish to take the commercial risk).

Currently, the parties have no choice but to accept the Australian Taxation Office's unfavourable ruling. However, if the party who applied for the ruling was able to object, that would ensure that the decision made by the Commissioner in the ruling could be properly tested before the parties were forced to accept the unfavourable ruling and its consequences for the commercial deal.

Although informal review is said to be available within the Australian Taxation Office (Issues Paper at 4.2.19), as the result of the review is not itself reviewable (in contradistinction to a decision on objection), it is questionable whether the informal review process provides sufficient rigor.

Finally, as is the case in the income tax context, a right to compel the Commissioner to make a ruling where the Commissioner has delayed issuing the ruling would be a useful tool in ensuring that GST rulings are delivered in a timely manner.

6.2.2 Priority

Medium/Low.

6.2.3 Taxpayers affected

All.

6.1.4 Recommendation

Give entities a right to object under Part IVC of the TAA 53 (TAA 53) against private indirect tax rulings where they are dissatisfied with the decision made by the Commissioner in the ruling issued to them.

6.3 Third party reliance on private indirect tax rulings

6.3.1 Issue

Paragraph 105-60(3)(a) of Sch 1 to the TAA 53 expressly provides that a private indirect tax ruling applies only to the entity to whom it was given. This is reinforced by the definition in section 995-1 of the ITAA 97. The only other form of ruling contemplated by the tax law is therefore the public indirect tax ruling, which is an indirect tax ruling other than a private indirect tax ruling (section 995-1, ITAA 1997).

As GST is a transactional tax, there will often be more than one entity sharing common facts that would have an interest in applying a GST treatment that is the corollary of, or consistent with, that of its transactional counterparty or counterparties. Although clearly it would not be appropriate to purport to rule in respect of an entity that did not apply for a ruling, arguably there should be some mechanism by which third parties to the transaction the subject-matter of the ruling, and with a common interest in the technical interpretation set out in the ruling, could notify the Commissioner that it has 'opted in' to be protected by the private indirect tax ruling that applies to the relevant transaction. Of course, due to privacy issues, this would only be possible where the applicant entity shared the private indirect tax ruling with its transactional counterparty or counterparties.

Further, in respect of public indirect tax rulings, there seems to be no reason why class rulings and product rulings could not be issued in respect of GST matters: the Commissioner would merely have to define the class of persons to whom the ruling applies in the same manner as is currently done in income tax (TR 2006/10 at 6).

6.3.2 Priority

Medium/Low.

6.3.3 Taxpayers affected

All.

6.3.4 Recommendation

Where a third party in the supply chain has an identical fact pattern to the entity that has obtained the private indirect tax ruling, the Commissioner should also be bound by his position in the ruling where the third party has acted consistently with the private indirect tax ruling.

6.4 The imposition of GIC in respect of wash transactions

6.4.1 Issue

The imposition of GIC in respect of wash transactions has been considered in some detail by the Australian Taxation Office National Tax Liaison Group's GST Subcommittee, including discussions about the Australian Taxation Office policy on remission of GIC imposed for the shortfall period on corrections of transactions where the correction involves equal and offsetting primary GST amounts (PSLA 2008/9). In addition, representatives from the Taxation Institute's GST Subcommittee have also met separately with the Australian Taxation Office to discuss the Australian Taxation Office's position on this issue.

Consistent with the Taxation Institute's position on the imposition of GIC on wash transactions, we agree with the Inspector-General of Taxation's conclusion in his Report on the Australian Taxation Office's administration of GST audits dated 11 June 2008. That is, the default position should be that it is inappropriate to apply any GIC to business-to-business transactions that are revenue neutral as the revenue has not suffered any time value of money loss.

Further, it is not appropriate to use GIC as a deterrent. Rather, the uniform penalty regime in Division 284 of Schedule 1 to the TAA 53 should be used by the Australian Taxation Office to deal with culpable behaviour, if any, by taxpayers in relation to revenue neutral transactions.

6.4.2 Priority

High.

6.4.3 Taxpayers affected

All.

6.4.4 Recommendation

Give full remission of GIC in relation to 'wash' transactions and, to the extent that the failure to account correctly for GST is the result of a taxpayer's culpable behaviour, use the existing penalty regime in Division 284 of Schedule 1 to the TAA 53 as a deterrent.

6.5 Applicability of the SIC to GST

6.5.1 Issue

The seven percentage point uplift embedded in the GIC rate under section 8AAD of the TAA 53 is intended to operate to 'support the policy objective that taxpayers should pay their tax liability on time' (refer to paragraph 4.6 of the supplementary explanatory memorandum to the Taxation Laws Amendment Bill (No 3) 2001.

However, in an income tax context the legislature has acknowledged that it is inappropriate to charge the full incentive premium to encourage prompt payment of tax liabilities during the period before the taxpayer is notified of their additional liability to pay tax. This is because taxpayers 'would not generally be in a position to respond to the incentive premium that is built into the general interest charge'.[24]

There is no reason why these policy principles do not apply equally to GST. Accordingly, a 'SIC-like' interest charge, with a reduced uplift, should apply to unpaid amounts notified in the GST context for the period:

- beginning at the start of the day on which the unpaid net amount or amount of indirect tax, as appropriate, would otherwise have been payable (or if not actually payable, then from the date that the net amount for the tax period in which the input tax credit or amount of indirect tax was taken into account would have been payable if it had been positive) under Division 33 of the GST Act; and
- ending at the end of the day before the day on which the Commissioner gave the entity notice of the unpaid amount, whether by issuing an assessment or via some other formal notification of the liability or debt, provided that the amount was quantified in the notice (ie, a notice issued by the Commissioner for the purposes of section 105-50 of Schedule 1 to the TAA 53 that did not give a precise numerical figure would not be sufficient).

The starting date for determining the relevant period could be modified for GST instalment payers (see, for instance, the rules in former subsection 170AA(4) of the *Income Tax Assessment Act 1936* (Cth), which was a precursor to SIC in that it imposed interest at a reduced rate to late payment interest before the introduction of GIC).

As with income tax, any 'SIC-like' charge should be notified to the taxpayer, the Commissioner should have a power to remit the 'SIC-like' charge and the taxpayer should be able to object against the remission decision in the circumstances described in section 280-170 of Schedule 1 to the TAA 53.

6.5.2 Priority

Medium.

6.5.3 Taxpayers affected

All.

6.5.4 Recommendation

A lower rate of GIC, akin to the SIC, should apply in respect of the period prior to the Commissioner notifying the taxpayer of an unpaid net amount or amount of indirect tax, or of a reduced input tax credit entitlement in respect of a particular tax period, where prior to notification the taxpayer was not aware of any unpaid amount remaining outstanding.

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[24] see Chapter 5 of the Department of Treasury's Report on Aspects of Income Tax Self Assessment (August 2004) and paragraphs 2.7-2.8 of the explanatory memorandum to the Tax Laws Amendment (Improvements to Self Assessment) Bill (No 1) 2005 (Cth)).

7. OTHER

7.1 Formation and cessation of GST groups - 90% common ownership requirement for companies

7.1.1 Issue

The practical opportunities for grouping two or more companies are often limited where a group of companies is controlled by a partnership, trust or individuals.

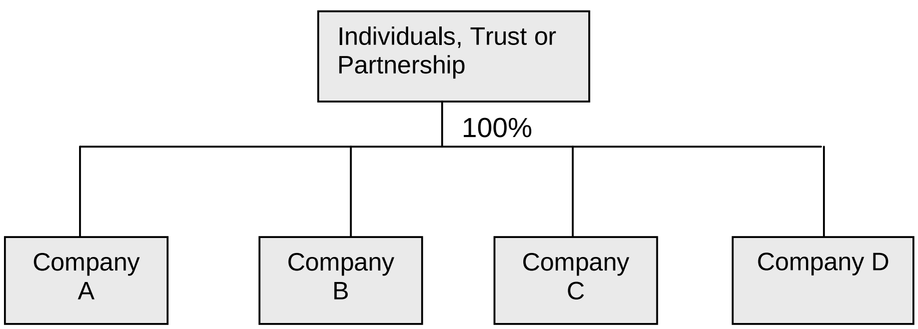
Paragraph 48-10(1)(b) does not allow two companies to be in the same GST group unless they are part of the same 90% owned group as all the other members of the GST group or proposed GST group that are also companies. Under section 190-1 two companies are members of the same 90% owned group if:

(a) one of the companies has at least a 90% stake in the other company; or

(b) a third company has at least a 90% stake in each of the two companies.

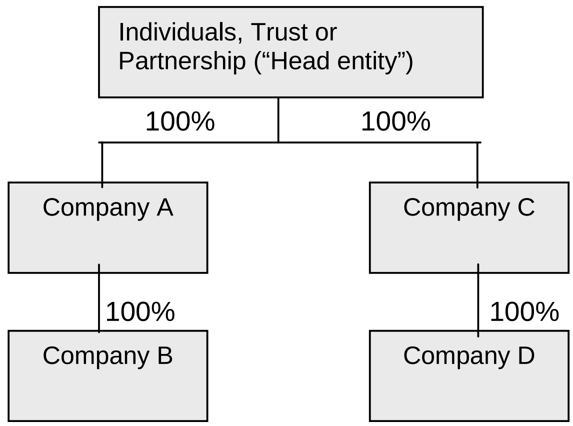
This definition is a problem for many businesses that do not have holding company structures. The examples below demonstrate some of the difficulties encountered.

Example 1



In this example the companies are unable to group despite the fact that they share common ownership. A common business structure is for Mr and Mrs A to own (in identical shareholdings) a number of sister companies, which each carry on a separate business. This sort of structure is used for limitation of liability purposes and helps confine the risk inherent in each business to the assets of that business. The present rules do not allow any of the sister companies to group with each other because they do not satisfy the 90% common ownership requirement.

Example 2



If all of the entities conduct enterprises then the following GST group options are available.

(i) Head entity, Company A and Company B;
(ii) Head entity, Company C and Company D;
(iii) Head entity and Company A;
(iv) Head entity and Company C;
(v) Company A and Company B; and
(vi) Company C and Company D.

However, the 4 companies cannot form a GST group, nor can the Head entity form a GST group with the 4 companies, due to the current 90% ownership requirement. There is no apparent policy reason why the entire group should not be able to benefit from GST grouping.

7.1.2 Priority

Medium.

7.1.3 Taxpayers affected

Taxpayers predominantly in the SME market who have a group structure that is controlled by an individual, a partnership or a trust, and who wish to form a GST group.

7.1.4 Recommendation

The definition of a 90% owned group in section 190-1 should be expanded to include situations where two or more sister companies are commonly owned by a partnership, trust or individuals.

7.2 Formation and cessation of GST groups - distributions through interposed entities

7.2.1 Issue

The existence of an interposed entity as a beneficiary of a trust may prevent that trust from being eligible to group with another trust or a company.

The ability of a trust to form a GST group with another trust or a company is restricted where one of the beneficiaries of the trust is either a company or a trust **("interposed entity")** that will not be a member of the GST group, and distributions have been made, or will be made to that interposed entity.

Example 3

Trusts A & B operate separate businesses. Trust A distributes income and capital only to the family of a single individual. Trust B distributes to Trust C which distributes only to the family of the same individual. Trust C is not registered for GST, as it does not conduct an enterprise.

The tracing rule in Regulation 48-10.01A has the effect that both Trust A and Trust B are taken (indirectly in the case of Trust B) to distribute to family members of the same individual. However, Regulation 48-10.01A merely provides that where a trustee makes a distribution to an entity indirectly through another trust or a company, the trustee is taken **also** to make the distribution to the other entity. This does not alter the fact that the interposed entity is the direct (or initial) recipient of the distribution. In Example 3 above, Trust B is therefore also making distributions to Trust C.

Applying the requirements of Regulation 48-10.03(2) (only one of which needs to be satisfied) the facts of Example 3:

(a) this is not applicable as there is no company that is a member of the GST group;

(b) the trustee of Trust B does not make distributions only to permitted beneficiaries because distributions are made to Trust C, which is not a permitted beneficiary;

(c) the trustees of Trust A and Trust B are not the sole beneficiary of any distribution by the trustee of another trust that is a member of the GST group; and

(d) the trustees of Trust A and B do not make distributions only to persons who are all family members of the same individual because Trust B makes distributions to Trust C.

Accordingly, despite the common 'ownership' of the 2 trusts, Trust A and Trust B do not satisfy the eligibility requirements to form a GST group.

Example 4

A family business selling goods in retail stores is organised in the following way:

- *Company A operates the business and is GST registered;*
- *Trust A owns the freehold titles of the properties from which the business operates, leases the properties to Company A and is GST registered; and*
- *Company B is a holding company that owns 100% of the shares in Company A. Company B is not GST registered because it does not carry on an enterprise.*

The shares in Company B are held equally by Mr and Mrs X. The beneficiaries of Trust A are Mr and Mrs X, Company A and Company B. Company A and Trust A wish to form a GST group.

Company A and Trust A cannot satisfy the requirements of paragraph 48-15(1)(e) in this case because Trust A makes distributions to Company B. Company B is not a member of the proposed GST group and cannot in fact be a member because it is not carrying on an enterprise and cannot therefore register for GST.

Even if the requirements of paragraph 48-15(1)(e) could be satisfied, it would also be necessary to satisfy the requirements of Regulation 48-10.03.

Applying the requirements of Regulation 48-10.03(2) (only one of which needs to be satisfied) to the facts of Example 4:

(a) the trustee of Trust A does not have at least a 90% stake in Company A;

(b) the trustee of Trust A does not make distributions only to permitted beneficiaries because distributions are made to Company B, which is not a permitted beneficiary;

(c) this is not applicable as Trust A is the only trust that is a member of the GST group;

(d) the trustee of Trust A does not make distributions only to persons who are all family members of the same individual because Trust B makes distributions to Company A and Company B.

Accordingly, despite the common 'ownership' of Company A and Trust A, they do not satisfy the eligibility requirements to form a GST group.

The tracing rule in Regulation 48-10.01A can also result in unintended consequences by deeming the ultimate recipient of distributions of income or capital of a trust to be a beneficiary of the trust. Unless that beneficiary is a charity, it then needs to be a member of the GST group in order to be a 'permitted beneficiary'.

The ownership structures referred to above are relatively common in the SME market, where flexibility and limitation of liability are often the key.

7.2.2 Priority

Medium.

7.2.3 Taxpayers affected

All taxpayers who wish to form a GST group that includes a trust, where the beneficiaries of the trust include another trust and/or a company.

7.2.4 Recommendations

We recommend three separate amendments to deal with the issue of interposed entities:

1. Paragraph 48-15(1)(e) should be expanded to include interposed entities such as companies and trusts, where the shareholders or beneficiaries of those interposed entities are members of, or family members of members of, the company that will be a member of the GST group.

2. Regulation 48-10.03(2)(d) should be expanded to include distributions made to:

   (a) a company, the shareholders of which are all family members of the same individual; and
   (b) a trust, the beneficiaries of which are all family members of the same individual.

3. The definition of 'permitted beneficiary' in Regulation 48-10.03(3) should be expanded to include:

(a) A company, the shareholders of which are permitted beneficiaries;
(b) A trust, the beneficiaries of which are permitted beneficiaries; and
(c) An entity that is the beneficiary of, or a shareholder of, a permitted beneficiary.

7.3 Formation and cessation of GST groups - date of effect of revocation of an approval

7.3.1 Issue

The current requirement that the date of effect of revocation of an approval in relation to a member of a GST group must be the beginning of a tax period causes difficulties where are an entity is sold.

Under section 48-85 the Commissioner must decide the date of effect of any approval, or any revocation of any approval, of a GST group. However, the date of effect must normally be the beginning of a tax period applying to the members of the GST group.

If the removal of a GST group member, or the complete cessation of a GST group, would otherwise occur during a tax period (for example upon a sale of shares), the Australian Taxation Office's practice is to backdate the change to the beginning of the tax period pursuant to the requirement in section 48-85. This backdating can impact on transactions that occurred before the member was required to leave the GST group. Supplies between group members that were previously ignored for GST purposes may then become taxable supplies, which gives rise to unexpected liabilities for the supplier.

7.3.2 Priority

Medium/High.

7.3.3 Taxpayers affected

All taxpayers who are members of a GST group.

7.3.4 Recommendation

Consideration should be given to whether the date of effect of revocation of approval can be the actual date that the change of ownership occurs, which may be a date during the tax period. This may require two separate Business Activity Statements to be lodged for that tax period; one by the former GST group, and one by the new GST group or separately by the entities that are no longer members of a GST group.

8. APPENDIX

8.1 The Taxation Institute's GST Subcommittee

Set out below are the current members of the Taxation Institute's GST Subcommittee, all of whom have contributed to the preparation of this submission:

Gina Lazanas, Chair
Baker & McKenzie, Sydney, NSW

Andrew Howe
Greenwoods & Freehills, Sydney, NSW

Lachlan Wolfers
KPMG, Sydney, NSW

Matthew Nicholls
Ernst Young, Adelaide, SA

Ian Jeffrey
PricewaterhouseCoopers, Melbourne, Vic

Andrew Nutman
Deloitte Touche Tohmatsu, Melbourne, Vic

Craig Whatman
Pitcher Partners, Melbourne, Vic

John Oesterheld
Deloitte Touche Tohmatsu, Perth, WA

Melanie Baker
Allens Arthur Robinson, Melbourne, Vic

Michael Patane
Deloitte Touche Tohmatsu, Brisbane, Qld

Damian Welshe
Damian Welshe & Associates, Brisbane, Qld

Suzanne Kneen
Blake Dawson, Melbourne, Vic