

GSTAlert

Grant Thornton periodical reporting
on Goods and Services Tax issues
for clients in business.

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This edition of GST Alert focuses on **‘enterprise’** – what does it mean and how does this definition impact your group or business structure?

Whilst the Draft Miscellaneous Taxation Ruling MT 2005/D1 (the meaning of entity carrying on an enterprise) offers some flexibility and clarifies occasions where an entity can be regarded as being an enterprise, it also reveals a number of flaws and issues that still need to be addressed. As an ABN is essential to enable a business to claim credits and ensure that payments to it are not subject to 48.5% withholdings, obtaining an ABN is vital but cannot be obtained without an enterprise being carried on.

There are many matters that need to be considered in respect of an enterprise. The following points are just a few:

The definition of enterprise is wide and subjective

This area of law is untested in the Courts and what one person does may be regarded as an enterprise, whilst a similar transaction may not. For instance, a person subdividing land held in the family, and putting in the necessary roads and services may, or may not, be regarded as an enterprise. Minor subdivisions are not regarded as an enterprise, but even a small subdivision will be treated as an enterprise where land is bought with an intention to resell at a profit.

Some definitions for tax law have been extended

For instance, the definition of a partnership is extended and includes the situation where two or more persons derive income from real estate that they own as joint tenants or as tenants in common. This is an important distinction from a joint venture and there are different GST liabilities for passing property between the parties.

Correct structure

All activities of the enterprise will be subject to GST (if the turnover level is reached). Thus, where an individual has two business activities it is not possible to register for one activity and not the other.

Commencement costs

The ATO has stated that once registered for GST an enterprise can reclaim GST on activities that are of the character ordinarily undertaken to commence an enterprise. Unfortunately, the ATO then goes on to state that these types of activities may not be considered to be commencement activities when the eventual enterprise is conducted differently from the one originally intended. This is arguably an incorrect interpretation of the law by the ATO.

One-off activities

A single activity can be sufficient for the activity to be regarded as an enterprise. Thus, a one-off transaction, if conducted in the form of a business or in the nature of trade, will require the entity to obtain an ABN and also (usually) register for GST. The ATO has stated in Taxation Ruling TR 97/11 and repeated in MT 2005/D1 that the indicators of a business include:

- significant commercial activity
- an intention to engage in commercial activity, and profit from it
- the recurrent or regular nature of the activity
- the activity is carried on in a similar manner to that of other businesses in the same or similar trade
- activity is systematic, organised and carried on in a business like manner and records are kept
- the activities are of a reasonable scale and size.

These are, as described, indicators only and an activity will be determined to be an enterprise or not by weighing all the relevant indicators.

Determining if an entity is an enterprise or not is of vital importance to ensure that GST credits can be claimed, that commencement expenditure is creditable and that the correct structure is used. In addition, insufficient regard of the enterprise rules may mean that GST on outputs is accounted for unnecessarily or may not be accounted for at all, which can lead to penalties and interest charges.

The extent to which input tax credits can be claimed – apportionment

Where a good or service is acquired by an enterprise an entitlement to input tax credits only arises to the extent that the acquisition is made for a creditable purpose. A creditable purpose generally exists if the acquisition was made for the purpose of making taxable supplies rather than input taxed supplies. For example a landlord who purchases a fridge for use in a leased residential unit cannot claim an input tax credit for the fridge as the leasing out of residential premises is an input taxed supply.

However, apportionment issues arise where the acquisition is made for both an input taxed as well as a taxable purpose. The ATO has released GSTR 2006/4 which contains examples of acceptable methods to apportion the input tax credit. The following apportionment methods may be acceptable provided they are reasonable in the circumstances:

- distance (eg the kilometres travelled by a motor vehicle)
- time spent on input taxed versus taxable activities
- volume (eg numbers of input taxed versus taxable transactions)
- space (eg floor area where the space is used for different activities)
- staff numbers (eg measuring the actual use of acquisitions by identified staff)

It is important to note that one method may be more advantageous over another. Hence, when faced with an apportionment issue, you should seek assistance from a GST specialist in order to apply the method that gives the best outcome provided it can be justified as being reasonable in the circumstances as well as substantiated.

Residential premises – legislative amendments

The Government has now introduced legislation into Parliament dealing with the Marana Holdings GST decision. Broadly, the legislation will clarify the GST law in respect of the meaning of the term "residential premises". In particular:

- premises may qualify as residential premises regardless of the duration of the occupation (Marana Holdings held that short term stays in accommodation did not constitute "residential premises"). Hence such supplies will be input taxed
- the sale of a strata titled unit in commercial residential premises, such as a hotel or motel, will be input taxed as the sale of a "residential premises"

A number of taxpayers will be affected by these changes, which are retrospective to 1 July 2000. For example, the following scenarios will be affected:

- claiming of input tax credits upon purchase of a strata titled unit complex which is then let out in a letting pool for short term stays
- short term employee accommodation provided by employers.

Clients should review their entitlement to input tax credits for acquisitions made in relation to the above scenarios. It may be that input tax credits already claimed will need to be repaid.

Guarantees and indemnities

Broadly, the provision, acquisition or disposal of an interest in or under a "guarantee, including an indemnity (except a warranty for goods or a contract or insurance or reinsurance)" can be a financial supply. In this regard the ATO has issued GSTR 2006/1 in which it states how GST applies to payments made under guarantees and indemnities and classifies them into those arrangements that may be taxable supplies and those that may be input taxed financial supplies.

Generally, the ruling takes the view that the payment of monies by the guarantor is not consideration for any supply made by the creditor to the guarantor. Rather, the payment is in satisfaction of the creditor's right. However the payment may constitute consideration (which moves from the guarantor) for a supply made by the creditor to the debtor.

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