

Treasury Discussion Paper

Implementation of the recommendations of the Board of Taxation's review of the legal framework for the administration of the GST

NOTE TO PARTICIPANTS

The purpose of this discussion paper is to provide interested parties with an opportunity to comment on the proposed approaches to implementing the measures contained in this paper.

The contents of this paper are the preliminary views of the Treasury and do not represent the final views of the Government or the Treasury.

Contents

- CHAPTER 1: INTRODUCTION AND OVERVIEW3**
- CHAPTER 2: IMPLEMENTATION INFORMATION7**
 - Chapter 2.1: Adjustments 7
 - Chapter 2.2: Tax invoices and attribution 14
 - Chapter 2.3: Business to business supplies and option to tax 17
 - Chapter 2.4: Rulings..... 22
 - Chapter 2.5: Time to claim input tax credits 27
 - Chapter 2.6: Testing the financial acquisitions threshold..... 29
 - Chapter 2.7: Grouping and joint ventures 33
 - Chapter 2.8: Reverse charge mechanism, GST free farm land supplied for farming..... 53
 - Attachment A — Examples of entities eligibility to form a GST group under proposed principle-based membership rules..... 62

CHAPTER 1: INTRODUCTION AND OVERVIEW

Introduction

1.1.1 On 12 May 2009, the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon Chris Bowen MP, announced the Government's response to the Board of Taxation's review of the legal framework for the administration of the GST. In its response the Government agreed to implement most of the Board of Taxation's recommendations. The media release is available on the Assistant Treasurer's website (<http://assistant.treasurer.gov.au/>). The Board of Taxation's report is available from its website (<http://www.taxboard.gov.au>).

1.1.2 The unanimous agreement of the States and Territories will be required for those proposals that constitute a change to the GST base.

Purpose of this paper

1.1.3 The purpose of this paper is to provide additional information on how the announced Government measures might operate and to seek feedback on their design and implementation. This is in line with the Government's in-principle agreement in 2008 to implement the recommendations of the Tax Design Review Panel, including conducting consultations with stakeholders on this basis of the level of detail similar to drafting instructions that Treasury provides to the Office of Parliamentary Counsel.

1.1.4 The paper provides varying degrees of detail on the announced Government measures, with some chapters providing detailed information similar to drafting instructions with the principle purpose to be included in the law set out. For other measures a higher level description of the measure has been provided, generally with some implementation information and areas in which further feedback is sought on approaches to implementation.

Consultation processes

1.1.5 The paper provides detailed information on the proposed approach to implementing a number of the announced Government decisions in response to the Board of Taxation's recommendations. The measures and the Board of Taxation recommendations to which they relate are set out in the table below.

Cross reference to the Board of Taxation's recommendations

Chapter	Board of Taxation
Chapter 2.1: Adjustments	4,6
Chapter 2.2: Tax invoices and attribution	9,10
Chapter 2.3: Business to business transactions and option to tax	12
Chapter 2.4: Rulings	17,18
Chapter 2.5: Time to claim input tax credits	20
Chapter 2.6: Testing the financial acquisitions threshold	25
Chapter 2.7: Grouping and joint ventures	32
Chapter 2.8: Reverse charge mechanism, GST free farm land supplied for farming	33,34

1.1.6 A further paper, or papers, are planned to be issued following the closing date for comments on this paper providing information on the implementation of the remaining announced Government decisions in response to the remaining recommendations as set out in the table below.

Later discussion papers

Topic	Board of Taxation Recommendation no.
Adjustments for cession of registration and for pre-registration acquisitions	5,8
Technical amendment – adjustments	7
Adjustment notes	11
Self assessment	21
Refund collection system	31
General law partnerships	35
Tax law partnerships	36
Bare trusts	37
Incapacitated entities	38
Running balance account	39
Domestic agency provisions	40
Gambling supplies made to non-resident entities	41
Luxury car tax and wine equalisation tax – net amount	42
Non-profit sub-entities	43
Power to recover overpaid refunds	44
Payment of refunds of overpaid GST	45
Associates	46

1.1.7 As part of its response to the GST Administration review, three further reviews will be undertaken. The Government has asked the Board of Taxation to undertake a review of the application of the GST to cross-border transactions to ensure that they are treated in an efficient and effective manner. A particular focus will be those design features underpinning the involvement of non-residents in the Australian GST system with a view to simplifying the design. The terms of reference are contained in the press release issued on 12 May 2009 by the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs (<http://assistant.treasurer.gov.au/>).

1.1.8 Treasury is also undertaking reviews of the GST margin scheme and the application of GST to financial supplies. These reviews are designed to simplify the operation of the legislation and reduce both compliance and administrative costs whilst retaining the existing policy intent. Treasury has prepared discussion papers and these are available from the Treasury website (<http://www.treasury.gov.au/>).

Principle-based law design

1.1.9 The changes to the GST law will be drafted using the principled-based approach as much as possible.

1.1.10 Under principle-based law design, the operative legislative provisions that implement the policy are expressed as principles. They will prescribe the legislative outcome rather than the mechanism that produces it, and typically avoid the detail that appears in more traditional legislative design approaches.

1.1.11 At times, a principle may be wider in its application than the policy intent, for example it may encompass more situations than desired. Rather than modifying the principle in a way that results in a loss of coherence, carve-outs from the operation of the principle are used.

1.1.12 Alternatively, a principle may not cover a situation that needs to be treated in a similar way. An add-on to the principle is therefore identified, unless there is a coherent way of reforming the principle at a higher level.

Objectives of reforms

1.1.13 The key objective of the Government's reforms to GST administration is to ensure that compliance costs imposed under the GST law are minimised to the extent possible having regard to the multi-staged transaction based nature of the GST. The Government's reforms also streamline GST administration and remove existing anomalies in the GST law.

1.1.14 As the Board of Taxation noted in its report, administering and complying with the tax law imposes a cost on the community. Excessive compliance costs and complexity in the law that is imposed on taxpayers can also detract from their ability to comply with the law, particularly for those taxpayers who have more limited access to professional advice or assistance.

1.1.15 Consistent with its terms of reference, the Board of Taxation sought to ensure that the impact of its recommendations on other indirect taxes that share common administrative provisions were considered. Accordingly, where appropriate, the Government will be making changes to the wine equalisation tax, luxury car tax and fuel tax credits regimes to ensure consistent treatment between these different regimes.

Timetable for reforms

1.1.16 Most of the reforms to GST administration will apply from 1 July 2010. Other changes to the law will generally apply from the start of the first quarterly tax period after Royal Assent. The recommendation to correct an anomaly in the time period available to claim input tax credits (Chapter 2.5) applies from 7.30 pm (AEST) 12 May 2009.

Submissions

1.1.17 We invite interested parties to lodge written submissions on the design of the implementation of the measures in this paper. Submissions may address all of the measures set out in this paper or one or more of these. We also encourage the identification of any other issues, including interaction issues with other parts of the tax law, which may be relevant to the design of the measures. Specific focus questions have also been included in

Chapter 2 for each recommendation for which feedback is sought. While submissions may be lodged electronically, by post or by facsimile, electronic lodgement is preferred.

1.1.18 The closing date for submissions is Wednesday 10 June 2009.

1.1.19 All information (**including name and address details**) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information **marked** as such in a separate attachment. A request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Written submissions should be addressed to:

The General Manager
Indirect Tax Division
The Treasury
Langton Crescent PARKES ACT 2600

Fax: (02) 6263 4320
Email: GSTadministration@treasury.gov.au

Other enquiries may be directed to:

Chapter 2.1
Laurene Edsor
Indirect Tax Division
The Treasury
Langton Crescent PARKES ACT 2600

Phone: (02) 6263 4351

Chapters 2.2 – 2.6
Phil Bignell
Indirect Tax Division
The Treasury
Langton Crescent PARKES ACT 2600

Phone: (02) 6263 4372

Chapters 2.7, 2.8
Michael Harms
Indirect Tax Division
The Treasury
Langton Crescent PARKES ACT 2600

Phone: (02) 6263 3308

CHAPTER 2: IMPLEMENTATION INFORMATION

CHAPTER 2.1: ADJUSTMENTS

Government decision

Change in use adjustments

The GST law will be amended to provide that higher thresholds, together with fewer and shorter adjustment periods, will apply for adjustments (for example, two years for acquisitions less than \$100,000, five years for those over \$100,000, and ten years for real property). Where possible, the existing provisions will be consolidated within the GST law and aligned with other relevant rules elsewhere in the tax system.

The GST law will be amended to ensure that adjustments for private use are explicitly aligned with the percentage of private use for income tax purposes. Adjustments for input taxed use will only occur where the change in use is significant (for example, greater than 10 per cent change in use).

Adjustments for payments made by third parties

The GST law will be amended so as to require GST adjustments in all situations in which consideration is paid by an entity in the supply chain to a payee which effectively alters the consideration paid.

Background

2.1.1 The amount of GST paid or input tax credits claimed in a previous tax period may need to be adjusted to reflect changed circumstances and ensure that the correct GST outcome is obtained.

2.1.2 Adjustments may arise due to, amongst other things:

- the cancellation of a supply or acquisition;
- changes in consideration, such as a change in price due to a discount;
- changes in GST status, such as when goods intended for export are not exported within the time limit and may change status from GST free to taxable;
- changes in intended use;
- debts becoming bad or overdue for 12 months or more; or
- a change in enterprise or registration status.

2.1.3 An adjustment will either be an increasing or decreasing adjustment.

2.1.4 An increasing adjustment is added to the net amount for a tax period, which will either increase the amount payable by the entity to the Tax Office, or reduce the amount of any refund payable by the Tax Office to the entity.

2.1.5 A decreasing adjustment is subtracted from the net amount for a tax period, which will either decrease the amount payable by the entity to the Tax Office, or increase the amount of any refund payable by the Tax Office to the entity.

Change in use adjustments

2.1.6 The current thresholds and adjustment periods for change in use adjustment are shown in Figure 1 (section 129-10 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)). Under GSTR 2000/24, assets with the same adjustment periods may be pooled for tracking purposes.

Figure 1: Current thresholds for change in creditable purpose adjustments

Business Finance	Adjustment periods
\$10,001 — \$50,000*	1
\$50,001 — \$499,999	5
\$500,000 +	10
Other	
\$1,000 — \$5,000*	2
\$5,001 — \$499,999	5
\$500,000 +	10
*Thresholds are expressed as GST exclusive amounts	

Proposal

2.1.7 It is proposed that there be one set of thresholds and adjustment periods for adjustments relating to changes in the extent of private use, and one for other change in use adjustments which relate to the provision of input taxed supplies such as financial supplies and some real property. The thresholds will be based on the (GST exclusive) monetary value of the acquisition.

2.1.8 It is also proposed that change in use adjustments will be aligned with the due date for the lodgment of income tax returns and the first adjustment period will be at the first due date for lodgment of income tax returns after the acquisition is made. This means that the first adjustment period could be quite short. Consequently two adjustment periods may in fact be only a little over one year.

2.1.9 Some variations in the regimes for real property and financial supplies are proposed to accommodate the particular features and needs of each industry. There are a number of issues where the proposals require further development in the light of feedback from industry participants as to how best to minimise their compliance task within the existing policy intent.

Acquisitions partly for private use

2.1.10 It is proposed that where there are changes in the extent of private use, there will be three adjustment thresholds – for acquisitions below \$1,000 no adjustment will be required, over \$1,000 and up to \$10,000 there will be two adjustment periods and for acquisitions \$10,000 and over, five adjustment periods. For real property valued at over \$1 million there will be ten adjustment periods (See Figure 2). It will be made clear that the extent of private use can be calculated on the same basis as for income tax.

Figure 2: Proposed adjustment thresholds for change in extent of private use

Threshold	No. of periods
\$1,000 — \$9,999	2
\$10,000+	5
*\$1,000,000+	10

* applies to real property only

2.1.11 It is also proposed that adjustments for private use will be consolidated within one division of the GST Act. The current Division 130 provision covering adjustments for goods which are applied solely to private or domestic use will be retained, with some clarification of what constitutes application solely to domestic or private use.

Acquisitions relating to input taxed supplies

2.1.12 It is proposed that the different adjustment thresholds for business finance no longer apply and that a single set of thresholds for all input taxed supplies be introduced.

2.1.13 The proposed threshold and number of adjustment periods are shown in Figure 3.

Figure 3: Proposed adjustment thresholds for input taxed supplies

Threshold	No of periods
\$10,000- \$99,999	2
\$100,000 — \$999,999	5
\$1,000,000 +	10

2.1.14 Ten adjustment periods would apply for all acquisitions with a GST exclusive value of \$1,000,000 or over. It is likely that the majority of acquisitions with a GST exclusive value of \$1,000,000 or over will be real property, but there may be other acquisitions relating to input taxed supplies.

Aggregation of inputs into a single asset

2.1.15 To remove anomalies and reduce compliance costs it is proposed that, where inputs into what becomes a single item of real property are acquired over time, these acquisitions are aggregated into a single acquisition at a point in time for adjustment purposes. The value of the acquisition will be the sum of the (GST exclusive) prices of the individual acquisitions. The total value will determine the length of the adjustment period applicable.

2.1.16 This would apply to the acquisition of land, materials (that is bricks, concrete, appliances) and services (that is electricians, painters) attributable to a particular project, but apportionment of overall business overheads such as general office costs to particular projects will not be required. This aggregation would also apply to progress payments made

by a developer to a builder during construction. Where a project involves a number of individual units the cost will be apportioned over the individual units according to their expected sales price as a proportion of the total.

Focus questions:

Q.1A Do the proposed thresholds strike an appropriate balance between minimizing compliance costs and meeting the policy objective of ensuring that an appropriate level of input tax credits are claimed?

Q.1B Are monetary thresholds the appropriate way of determining the number of adjustment periods or would another method, such as using the effective life of types of assets, be preferable?

Q.1C Would there be significant compliance cost savings from introducing a (cumulative) ten percentage point threshold for change in the extent of application to private use or input taxed supplies before adjustments (both increasing and decreasing adjustments) will be permitted/required?

Q.1D Should the proposed aggregation of real property creditable inputs into a single acquisition be compulsory or optional? What is the appropriate point in the production cycle to require/permit aggregation into a single unit – the issue of a certificate of occupancy or some other point? Will this point vary with the type of development?

Q.1E Would there be compliance benefits in aligning the features of the proposed aggregation arrangement with the requirements of Division 43 of the *Income Tax Assessment Act 1997* (ITAA 1997)?

Q.1F Would there be any benefit in having a separate adjustment regime for real estate? What particular issues would it need to cover?

Q.1G Would there be compliance cost savings from aligning the thresholds for adjustments for changes in private use and input taxed supplies even if this resulted in lower thresholds for input taxed supplies?

Q.1H What types of assets other than real estate are likely to be captured by the \$1 million and over threshold? Is ten years an appropriate adjustment period for these assets?

Application date

2.1.17 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.1.18 Subject to that agreement, the measure will apply from 1 July 2010.

Adjustments for payments made by third parties

Current law

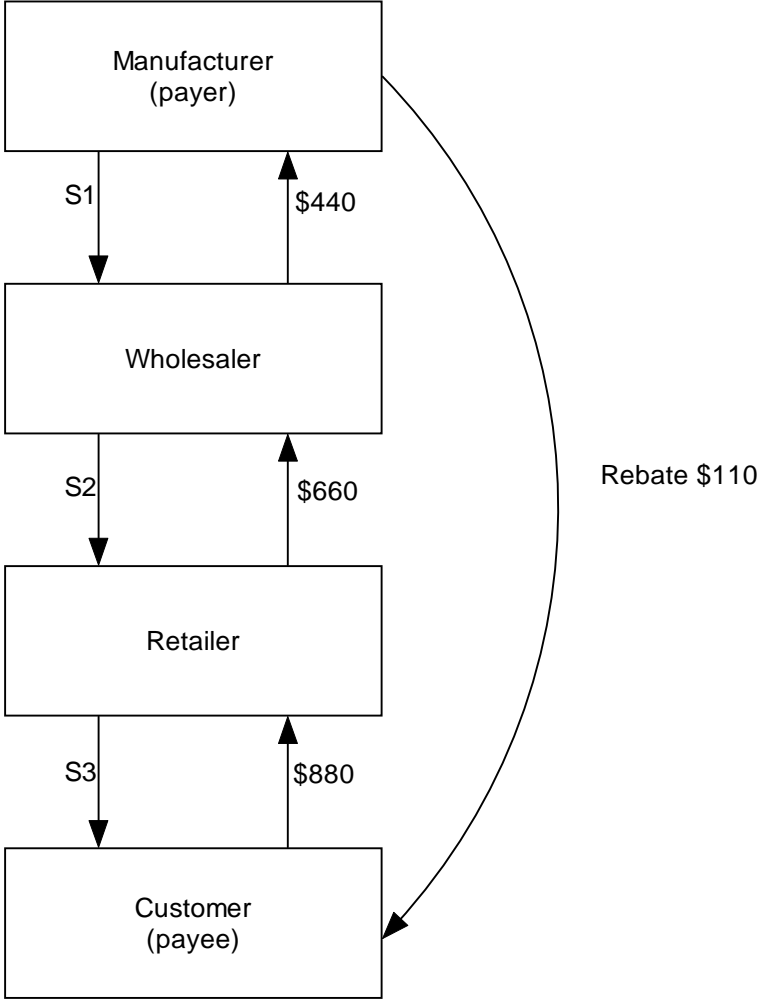
2.1.19 Adjustments for changes in consideration arise where the consideration for a supply or acquisition is changed in a subsequent tax period. This is limited to changes in consideration occurring between the original parties to the transaction.

2.1.20 Where a registered entity supplies a good to another entity, and that second entity on sells that good to another party, the original supplier of the good sometimes makes a payment to that other party. In this situation the first party (the payer) must remit GST based on the price to which it sells the goods to the second entity with no adjustment available for the payment made to the other party (the payee). In some circumstances, this type of payment may in fact be payment for a separate supply, in which case GST is payable on that separate supply.

2.1.21 An example of a payment made to a payee which does not presently give rise to an adjustment is as follows:

- A manufacturer supplies a computer printer to a wholesaler for \$440. The manufacturer accounts for \$40 GST, giving net revenue collected to this point in the supply chain of \$40.
- The wholesaler then supplies the printer to a retailer for \$660. The wholesaler accounts for \$40 input tax credit and accounts for GST of \$60, giving net GST of \$20.
- The retailer then supplies the printer to a customer for \$880. The retailer accounts for \$60 input tax credit and accounts for GST of \$80, giving net GST of \$20.
- The customer pays \$880 inclusive of \$80 GST being 1/11th of the total GST inclusive price the customer has paid. This is the correct amount of revenue $\$40 + \$20 + \$20 = \80 (which is equal to 10 per cent of the \$800 value added through the supply chain).
- The customer then receives a \$110 rebate from the manufacturer (and makes no separate supply to the manufacturer). The customer has now effectively paid \$770 for the printer. The value added through the supply chain is \$700. GST on the value added of \$700 at 10 per cent is \$70. However, total GST revenue collected is \$80. This scenario is shown diagrammatically in Figure 4.

Figure 4 — Example of third-party payments



Proposal

2.1.22 The proposal is to amend the GST law to provide for an adjustment event to cater for the circumstances in which a payer supplying goods for re-sale makes a cash payment¹ to a payee in consequence of its acquisition of those goods (whether the payee acquires the goods itself or they have been incorporated into other goods). This adjustment event occurs even though the payer does not supply the goods directly to the payee.

- This proposed adjustment would not apply to Government rebates such as those paid to consumers as utility rebates.

2.1.23 Where the payment to the payee effectively reduces the sum the payer has received for the good, an adjustment event would occur so that the payer is entitled to a decreasing adjustment reflecting the difference between the GST remitted on the original payment and the GST which would have been payable on the actual amount of payment effectively received for the goods. This adjustment event would arise even if there are several interposed entities in the supply chain.

1 It is not proposed to provide an adjustment for non-monetary payments as an input tax credit would generally have been obtained by the payer upon the acquisition of the goods.

2.1.24 This adjustment event would only arise if the payment between the payer and the payee is not a payment for a separate supply from the payee to the payer.

2.1.25 The payment would be treated as an adjustment event even where the payment occurs in the same GST period as the original supply. (The existing types of adjustment events only arise in later GST periods).

2.1.26 The proposed measure is limited to payments relating to taxable supplies of goods, including goods which are incorporated into other goods supplied to the payee, and does not extend to supplies of services or rights. The measure is limited to payments between parties in a supply chain.

2.1.27 Where such an adjustment event occurs and the payee is also registered for GST there will be a corresponding increasing adjustment so that the amount of input tax credits the payee receives reflects the amount they have effectively paid for the goods.

- This adjustment event will also only arise if the payment between the payer and payee is not a payment for a separate supply from the payee to the payer.
- This event will also be treated as an adjustment event even where the payment occurs in the same GST period as the original supply.

2.1.28 A form of adjustment note will be required. The payer will create the adjustment note for the payment and a copy of the note will be provided to the payee.

Focus questions:

Q.1I Are there any types of payment occurring within a supply chain which change the effective consideration for a supply which are not dealt with by this proposal?

Q.1J Should an adjustment event be available in circumstances where a rebate is paid in respect of goods which are incorporated into a service provided to the payee? For example, a manufacturer (the payer) provides paint to a painting services contractor who uses it to provide painting services to a customer (the payee). The payer then provides a rebate to the payee in respect of the paint. Would it be possible in practice to link the supply of goods to the rebate in this type of circumstance?

Application date

2.1.29 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.1.30 Subject to that agreement, the measure will apply from 1 July 2010.

CHAPTER 2.2: TAX INVOICES AND ATTRIBUTION

Government decision

The GST law will be amended to allow taxpayers to disregard minor errors in tax invoices and enable taxpayers to treat other documents as a tax invoice in certain situations.

The GST law will also be amended to remove any doubt about the ability to attribute input tax credits in later tax periods.

Background

Operation of existing law

2.2.1 Input tax credits are generally attributable to the tax period in which any consideration is provided by the recipient, or the tax period in which an invoice is received if this occurs before any consideration is provided (special rules apply if the taxpayer accounts on a cash basis).

2.2.2 A taxpayer must hold a tax invoice in order to claim input tax credits for acquisitions of more than \$75 (exclusive of GST) (see subsection 29-10(3) of the GST Act and regulation 29-80.01 of *A New Tax System (Goods and Services Tax) Regulations 1999*). The Commissioner has a discretion to treat as a tax invoice a document that is not a tax invoice (subsection 29-70(1) of the GST Act). The Commissioner may also determine in writing that the requirement to hold a tax invoice to claim an input tax credit does not apply in certain circumstances.

2.2.3 If the taxpayer provides a GST return for a tax period that does not take into account an input tax credit, the input tax credit will be attributable to the first period in which a return is provided taking the credit into account.

Proposal — changes to GST tax invoice requirements

Principle 1 — minor errors

2.2.4 An invoice that is not a valid tax invoice may be treated by a taxpayer as a valid tax invoice if:

- it fails to qualify as a tax invoice solely because of a minor error or errors; and
- the taxpayer can verify any incorrect or missing information from other documents.

Commentary

2.2.5 This principle is intended to minimise costs for taxpayers associated with correcting minor errors on tax invoices. To clarify whether an error is minor or significant, it is intended that guidance will be provided in explanatory material and that assistance will also be provided by the Commissioner. An example of a minor error in a tax invoice is where a typographical error occurs. An example of a significant error that could not be disregarded is a failure to detail the quantity and nature of the supplies.

2.2.6 The principle links attribution to the ability to verify that a creditable acquisition has been made rather than requiring evidence of actual verification or the creation of alternate documents such as a recipient-created tax invoice. However, as this only affects the attribution of claims, claims for an input tax credit for the wrong amount or by the wrong entity remain invalid.

2.2.7 The discretion of the Commissioner to treat a document as a tax invoice that is not a tax invoice will be retained as this discretion will still be relevant where this provision does not apply (such as where the error is significant).

2.2.8 The term invoice rather than document is used to avoid the result that could arise if taxpayers were able to claim input tax credits in circumstances where an invoice had not been issued (and therefore the liability of the supplier was not yet attributable under section 29-5 of the GST Act).

Principle 2 — using other documents

2.2.9 A document that is not a valid tax invoice may be treated by a taxpayer as a valid tax invoice if:

- the taxpayer cannot, after undertaking all reasonable steps, obtain a valid tax invoice;
- the document or documents comply with requirements determined by the Commissioner; and
- the taxpayer provides written notice to the Commissioner in a form accompanying the relevant Business Activity Statement (BAS).

Commentary

2.2.10 This principle is intended to allow taxpayers to claim input tax credits where the credit is available but a tax invoice cannot be obtained without the need to have the Commissioner exercise the relevant discretion. It is only intended to affect the need for the tax invoice not the underlying requirement that an entitlement to an input tax credit exist.

2.2.11 The notification requirement ensures that information flows to the Commissioner are preserved and protects the integrity of the GST system.

Principle 3 — attributing input tax credits

2.2.12 Taxpayers will be permitted to attribute input tax credits in their current tax period that otherwise would be attributable to a prior tax period.

Carve-out

2.2.13 The input tax credit (or part of an input tax credit, such as may be attributable for cash-basis taxpayers under subsection 29-10(2)) will not be attributable to the current tax period, if:

- the taxpayer does not hold the relevant tax invoice; or
- if the tax period commences more than four years after the end of the period to which it was otherwise attributable under subsections 29-10(1) and (2).

Commentary

2.2.14 The current law is intended to express this principle and the carve-out. However, concerns were raised in the course of the Board of Taxation review that the present wording, with its explicit mention of paragraph 29-10(3)(b), might be uncertain in its application to other circumstances.

Focus questions:

Q.2A Will the proposed rules be effective in reducing compliance costs?

Q.2B Are there any further issues that might arise from this clarification of the current law around attribution?

Application date

2.2.15 The measure will apply from 1 July 2010.

CHAPTER 2.3: BUSINESS TO BUSINESS SUPPLIES AND OPTION TO TAX

Government decision

The GST law will be amended to ensure that where it is not possible to know at the time of entering into a supply the extent to which it is taxable, registered parties will, by mutual agreement, be allowed the option to treat the transaction as fully taxable. This will not apply to a supply where a part or all of it is an input taxed supply.

Background

Operation of existing law

2.3.1 If a supply is partly taxable and partly GST free or out of scope, the supplier is generally required to apportion the consideration for the supply to account for GST on the taxable part of the supply. However, there will be cases where an entity makes a supply but the proportion of the supply that is non-taxable (for example GST free) is not known by the enterprise before attributing the supply. This may occur when the tax status of the transaction depends on factors that are not ascertainable by the supplier or within its control. When the actual portion is not known at the time the invoice is issued or payment is received, the supplier needs to make an advance estimate.

2.3.2 Once the appropriate proportions are known, the relevant BAS needs to be reviewed and the tax invoice may need to be amended. The adjustment provisions do not apply to a miscalculation in these circumstances and both the supplier and the recipient may need to make corrections. This will increase the compliance costs of both parties as revisions may need to be made to GST payable and input tax credits claimed on the supply. Where an entity's BAS is later revised because the GST liability was understated or its input credit entitlement was overstated, the shortfall potentially attracts a general interest charge from the due date of the original BAS.

Proposal — option to treat business to business supplies as fully taxable

Principle 1 — option to tax

2.3.3 An entity is able to treat a supply to another entity that is partly a taxable supply and partly a non-taxable supply as fully taxable, where:

- the supplier and the recipient are registered;
- the taxable component of the supply represents an acquisition for which the *recipient* is entitled to claim a full input tax credit;
- the non-taxable component of the supply relates to acquisitions of the *supplier* that are for a creditable purpose of the supplier;
- the supplier must not know at the 'trigger time' the extent to which the supply is taxable and the extent to which it is non-taxable; and
- the supplier and recipient must agree in writing that the supply is to be treated as fully taxable and this agreement must be made at or before the 'trigger time'.

Commentary

2.3.4 Removing the need for apportionment of partly taxable supplies in the circumstances identified in Principle 1 would reduce compliance costs of affected parties. This reflects that neither the supplier nor the recipient will need to make corrections to their BAS and compliance costs will be reduced.

Focus questions:

Q.3A Should the measure require that the whole supply must be acquired by the recipient for a creditable purpose to ensure that the recipient can claim an input tax credit on all components of the supply treated as taxable?

Q.3B Would this unduly restrict the application of the measure?

Q.3C Would it reduce potentially adverse interactions of the measure with other provisions of the GST Act (for example the associate provisions (Division 72))?

No retrospective application or application to unregistered suppliers

2.3.5 It is not proposed to allow unregistered suppliers who are required to be registered to utilise this measure. Nor is it proposed to allow suppliers who are unregistered at the time of the making of a supply but apply to the Commissioner successfully for registration to be backdated to before the making of the supply to utilise the measure. Extending eligibility to these circumstances will not provide the same compliance cost reduction benefits.

Trigger time

2.3.6 The supplier must not know at the 'trigger time' the extent to which the supply is taxable. This time should be the time when the supplier issues the tax invoice. The trigger time could be the time when the supplier must turn its mind to determining the GST liability for the supply. Two possible trigger times are:

- the earlier of the due date for lodging the BAS for the tax period to which the supply is attributable or the time of issuing the tax invoice. For an entity accounting for GST on a cash basis, the GST will be attributed to the tax period in which the supply is paid for and included in that period's BAS. For an entity accounting for GST on an accruals basis, the GST liability will be attributed to the tax period in which the invoice for the supply is issued; or
- the earlier of the time when the GST arises on a supply (the time when the supply is paid for where the supplier uses the cash basis of accounting or the time of issuing the invoice where the supplier uses the accruals basis of accounting) or the issue of the tax invoice.

Focus question:

Q.3D What trigger time should apply?

Agreement

2.3.7 The supplier and recipient will be required to agree to treat the supply as fully taxable. The agreement will need to be in writing. This will avoid disputes between the entity and the Tax Office over whether such agreement has been obtained.

2.3.8 However, to reduce compliance costs, an agreement could be made for a single supply, or an ongoing agreement made between the supplier and recipient that a particular class of supplies be treated as fully taxable. The agreement could be provided in the initial contract of supply which may indicate that further supplies of a particular kind would be able to be treated as fully taxable. The agreement may also be obtained by stating in the tax invoice that acceptance of the supplies covered by the invoice indicates acceptance that supplies of that kind will be treated as fully taxable.

Other issues — adjustments

2.3.9 If the recipient agrees to treat a supply to it as fully taxable, it will pay more GST but benefit from a larger input tax credit. If there is a change in use (for example part private use), it will have a larger increasing adjustment than if it had not agreed to apply the measure.

2.3.10 Where the adjustment arises because of, for example, Division 138 (cessation of registration), the recipient would not have been in a position to anticipate the larger increasing adjustment that arises when initially entering into the agreement to treat the acquisition as being fully taxable.

Focus question:

Q.3E Are the proposed ways in which 'option to tax' agreements can be entered into appropriate?

Application of proposal to voluntary reverse charge

Operation of existing law

2.3.11 Under Division 83, a supplier and recipient may agree that the recipient will assume the supplier's GST liability on a taxable supply under certain conditions. These include that the supplier must be a non-resident and must not make the supply through a permanent establishment in Australia and the recipient must be registered or required to be registered.

Principle 2 — voluntary reverse charge

2.3.12 A supplier and a recipient can agree to apply a reverse charge to the whole of a supply under similar conditions to Principle 1. These conditions are:

- the supply is partly taxable and partly non-taxable;
- the supplier and the recipient could agree to apply a reverse charge to the supply under Division 83 if it were wholly taxable, where the recipient is registered (the non-resident supplier does not have to be registered or required to be registered);
- the supply relates to an acquisition that is for a creditable purpose of the recipient;
- the non-taxable component of the supply is not input-taxed; and
- at the trigger time, the recipient did not know the extent to which the supply is taxable and the extent to which it is non-taxable.

Commentary

2.3.13 This principle applies the measure to the case of a ‘reverse charge’ under Division 83.

2.3.14 Where a supply by a non-resident is partly taxable and partly non-taxable (including GST free), the Division 83 reverse charge generally only applies to the taxable component of the supply. Consistent with Principle 1, the recipient and the supplier should be able to apply a reverse charge to the whole supply. This results in the recipient being entitled to claim a full input tax credit for the supply and offset it against the whole GST liability that the recipient assumes from the non-resident.

2.3.15 The other conditions for the Division 83 ‘reverse charge’ would still have to be met. These are that the supplier must be a non-resident and must not make the supply through a permanent establishment carried on in Australia and the recipient must be registered. Consistent with Principle 1, it will not be enough for the recipient to be unregistered but required to be registered.

2.3.16 However, the following modifications to or clarification of the conditions set out in Principle 1 may be appropriate.

Registration

2.3.17 It will not be necessary for the supplier to be registered for the option to tax to be available in the case of voluntary reverse charges. This reflects that it is not necessary for the supplier to be registered for the voluntary reverse charge to apply to a wholly taxable supply.

Trigger time

2.3.18 Principle 1 requires that the *supplier* not know at the trigger time the extent to which the supply is taxable. In the case of partly taxable reverse charges it is the *recipient* who must not know at the trigger time the extent to which the supply is taxable. This is more appropriate because it is the recipient who is assuming the GST liability.

2.3.19 While the Board of Taxation’s report suggested that the GST treatment should be assessed at the time the supplier issues the tax invoice, we propose that the time of issue of a tax invoice should not be relevant for determining knowledge of taxability in the case of ‘reverse charged’ supplies. The recipient does not need to issue a tax invoice in the case of a Division 83 reverse charge (nor does the supplier).

2.3.20 The trigger time will be when the recipient turns its mind to determining the GST liability on the taxable supply. However, it does not appear reasonable to assess knowledge of actual GST treatment before the recipient accepts the reverse charge (as this is a condition for the measure to apply to the reverse charge). A reverse charge agreement cannot be retrospective.²

2.3.21 Two possible dates for the trigger time in the case of voluntary reverse charges are:

- the due date for lodging the BAS for the tax period to which the supply is attributable;
- in the case of a recipient accounting for GST on a cash basis, the GST on the reverse charged supply will be attributed to the period in which the recipient pays for the supply;

² ATO Interpretative Decision 2004/117.

for a recipient accounting for GST on an accruals basis, the reverse charged supply will be attributed to the period in which the recipient receives an invoice for the supply; or

- when the recipient pays for the supply (if the recipient accounts for GST on a cash basis) or when the recipient receives an invoice for the acquisition (if the recipient accounts on an accruals basis).

Focus question:

Q.3F When should the trigger time be in the case of a voluntary reverse charge?

Agreement

2.3.22 If the recipient has accepted liability for the GST under a voluntary reverse charge, then the agreement of the supplier to treat the supply as fully taxable no longer appears relevant. It is proposed that it is enough that the supplier and the recipient have agreed to 'reverse charge'. Consistent with the current Division 83 reverse charge, it is not proposed to require the 'reverse charge' agreement to be in writing for the measure to apply.

2.3.23 Principle 2 is intended to be the sole mechanism by which fully taxable treatment can be applied to a taxable supply under a reverse charge. If Principle 2 does not apply to a partly taxable supply under a reverse charge, it is not intended that Principle 1 can apply to such a supply.

Application date

2.3.24 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.3.25 Subject to that agreement, the measure will apply from 1 July 2010.

CHAPTER 2.4: RULINGS

Government decision

Adopting the broader rulings regime

The law will be amended to include GST, luxury car tax (LCT) and wine equalisation tax (WET) in the rulings regime which applies to income tax (and other taxes including the Medicare levy, fringe benefits tax, withholding tax and net fuel amounts).

Relying on private rulings issued to the other party to a supply

The law will be amended to enable recipients and suppliers to rely on each other's rulings in relation to the tax status of the supply between them, where they agree to provide their rulings to each other for this purpose. However, this will not extend to supplies in other parts of the supply chain.

Where recipients and suppliers agree to rely on the other's ruling, they should be bound to apply the ruling in the preparation of their BAS, but they may object to the other's ruling.

Background

2.4.1 In 2005, a new advice and rulings regime for income tax and other taxes was created in response to the recommendations from the Treasury *Report on Aspects of Income Tax Self Assessment* (RoSA). The key features of that regime are:

- there is an express legislative framework;
- if a ruling applies to a taxpayer and they rely on the ruling by acting in accordance with the ruling, the ruling is binding on the Commissioner;
- taxpayers may use objection and review procedures to dispute private rulings; and
- the Commissioner is able to issue class, product and oral rulings.

2.4.2 The income tax rulings regime, however, does not apply to indirect taxes such as the GST.

Operation of existing law

Rulings regime

2.4.3 Indirect tax rulings are issued under the Commissioner's power of general administration of indirect tax laws, in section 356-5 of Schedule 1 to the *Taxation Administration Act 1953* (TAA).

2.4.4 Where the Commissioner alters an indirect tax ruling, section 105-60 in Schedule 1 to the TAA provides protection to taxpayers who, in relying on that ruling, have underpaid a net amount or an amount of indirect tax or have been overpaid a refund by the Commissioner. However, it does not provide any broader framework or rights for taxpayers, such as the right to object to a private ruling.

Private rulings

2.4.5 Under the existing law a private ruling gives protection to the taxpayer(s) it is specifically issued to, and recipients and suppliers are not able to rely on rulings issued to the other party. In addition, there is no express provision as to whether the Commissioner is able to issue class and product rulings for GST. However, taxpayers are able to lodge joint applications for rulings.

Binding nature of rulings

2.4.6 Under the existing law, while rulings bind the Commissioner, the recipients of rulings are not bound by them.

Proposal — rulings regime

Principle — adopting income tax rulings system

2.4.7 The income tax rulings regime should be expanded to include GST, LCT and WET.

Carve-out — oral rulings and trustees

2.4.8 Oral rulings should not be provided on GST, LCT or WET matters.

2.4.9 The rules about the application of rulings given to trustees should not extend to GST, WET or LCT.

Add-on — default end date

2.4.10 Unless otherwise stated in a ruling for GST, WET and LCT, private rulings should not apply to working out an entity's net amount for tax periods that end more than one year after the ruling started to apply. In instances where an amount of indirect tax does not form part of an entity's net amount (as is the case with GST payable on taxable importations for example), the default end-date would instead be one year after the ruling started to apply.

Commentary

Adopting the income tax rulings system

2.4.11 Section 357-55 of Schedule 1 to the TAA lists the taxes covered by the rulings regime. The intention of this principle is to broaden the scope of the rulings regime to include GST, LCT and WET.

2.4.12 Taxpayers will also have access to the objection, reviews and appeals processes for private rulings.

2.4.13 This will allow the Commissioner to issue class and product rulings for GST, minimising the need for individual taxpayers to seek private rulings in situations like food classification.

Oral rulings

2.4.14 Under the income tax ruling regime, taxpayers can apply to the Commissioner for advice in the form of an oral ruling. However, oral rulings can not be given in relation to business matters. For taxpayers to be registered for GST, they are required to be carrying on an enterprise, so this part of the rulings regime does not translate well in the indirect tax context. WET and LCT should also be excluded from the oral rulings regime as entities must be registered for GST to collect LCT, and WET is collected and remitted by wine producers, wine wholesalers, and wine importers.

Trustees

2.4.15 Section 359-30 of Schedule 1 to the TAA provides that a private ruling given to or for the trustee of a trust and relating to the affairs of the trust also applies to another trustee appointed to replace the trustee, or to the beneficiaries of the trust. This rule is important in the income tax context because under section 97 of the *Income Tax Assessment Act 1936* (ITAA 1936), beneficiaries may be subject to tax on the income of the trust. However, in the GST context, it is not necessary to extend the effect of a ruling to beneficiaries, as trusts and beneficiaries are separate entities for GST purposes (subsection 184-1(2) of the GST Act).

End-dates of private rulings

2.4.16 Unlike income tax, the tax periods for GST may be as short as one month, therefore the default period for GST, WET and LCT should be extended to one year after the ruling started to apply.

Consequential amendments

2.4.17 The rules about reliance on the Commissioner's interpretation of an indirect tax law in section 105-60 of Schedule 1 to the TAA should be removed, subject to the transitional rules set out below.

2.4.18 The definitions of indirect tax ruling, private indirect tax ruling and public indirect tax ruling in section 995-1 of the ITAA 1997 should be removed.

Dates and transitional rules

Application date

2.4.19 The amendments will apply to:

- applications for private rulings made after 30 June 2010;
- pending private ruling applications made before 30 June 2010, but not decided at that time;
- private rulings issued after 30 June 2010, including rulings that concern supplies that:
 - have occurred before 1 July 2010; or
 - occur both before, on and after 1 July 2010; and
- public rulings issued after 30 June 2010.

Transitional rules

2.4.20 Indirect tax rulings issued before 1 July 2010 (and which have been gazetted) should be treated as if they were made under the new regime. This is consistent with the approach adopted when the income tax rulings regime was introduced. The *Tax Law Amendment (Improvements to Self Assessment) Act (No. 2) 2005* included transitional rules about the status of existing rulings and pending applications.

2.4.21 The term indirect tax ruling is currently defined broadly and includes all advice given or published by the Commissioner in relation to a GST, WET or LCT law. As a result, for GST, WET and LCT purposes, fact sheets, guides and other products published by the Commissioner constitute public rulings. The rulings regime contained in Part 5-5 of Schedule 1 to the TAA provides the flexibility to issue advice (such as fact sheets) that is

non-ruling advice. After 30 June 2010, only public indirect tax rulings which have been gazetted should be public rulings under the new regime. Other information which has previously been treated as a public ruling (such as the fact sheets) will be non-ruling advice under the new regime, unless it is gazetted.

Focus questions:

Are any other modifications to the broader rulings regime required for GST, WET and LCT?

Are there any other transitional issues which need to be addressed in the move to the broader rulings regime?

Fuel tax is already part of the income tax rulings system. The tax periods that apply to an entity for GST purposes also apply to it for fuel tax purposes. Currently a ruling about a fuel tax provision (that does not specify an end-date) can last for one month. What arrangements should apply for fuel tax?

Proposal — private rulings issued to the other party to a supply

2.4.22 It is proposed that where a private ruling is issued to a supplier to determine the GST tax status of a supply, the recipient that acquired the supply should be able to rely on the private ruling to assist in determining their *input tax credit entitlements* on the acquisition, but only where the supplier has agreed to provide the ruling to them.

2.4.23 The recipient of the supply should only be able to rely on a private ruling in relation to the tax status of the supply and not in relation to the other requirements for input tax credits: these are whether the acquisition is used for a creditable purpose; the recipient is liable to provide consideration; or whether the recipient is registered or required to be registered. Whether the other requirements for input tax credits (excluding consideration) are met is something that only the recipient will have all the necessary information to determine.

2.4.24 It is also proposed that where a private ruling is issued to a recipient (that acquires a supply) to determine the GST tax status of an acquisition made, the supplier should be able to rely on the private ruling to assist in determining their *GST liability* on the supply, but only where the recipient has agreed to provide the ruling to them.

2.4.25 The supplier should only be able to rely on a private ruling in relation to the tax status of the supply and not in relation to the other requirements for a taxable supply: that there is consideration; the supply is made in the carrying on of an enterprise; the supply is connected with Australia and the supplier is registered or required to be registered. Whether the other requirements for a taxable supply (excluding consideration) are met is something that only the supplier will have all the necessary information to determine.

2.4.26 The recipient or supplier would need to agree in writing to provide the ruling to the other party.

2.4.27 It is proposed that the entity should only be able to rely on the other entity's private ruling in respect of the tax status of the supply between them. Reliance would not extend to the inputs of the supplier, nor to supplies further down the supply chain.

Focus questions:

Q.4A To what extent does the adoption of the income tax rulings system (which includes the ability for the Commissioner to issue class and product rulings) address concerns about the ability of both parties to a transaction being able to rely on a ruling?

Q.4B Are there any changes required concerning the objection and appeals process?

Q.4C Could one party change their mind and cease to rely on a ruling, or would both parties have to agree to stop relying on the ruling?

Q.4D What are the implications for penalties?

Q.4E Are there any issues where a ruling is provided to more than one recipient?

2.4.28 It is proposed that where recipients and suppliers agree to rely on the other's ruling, they should be bound to apply the ruling in the preparation of their BAS, but they may object to the other's ruling.

2.4.29 Where a taxpayer is successful in their objection to a private ruling, the initial private ruling will no longer apply. Accordingly, the other party will no longer be able to continue to rely on the initial private ruling.

Focus questions:

Q.4F What are the implications of making a ruling binding on taxpayers?

Q.4G If there are a number of other parties, should they all have to agree to be bound by it?

Q.4H How would the objection and appeals process work where the other party to the transaction objects to the private ruling? In particular:

- Should the other party be able to object to the private ruling before being bound to apply the private ruling in the preparation of their BAS?
- Should the taxpayer that received the ruling be able to participate in the objection process initiated by the other party?

Q.4I Are there any privacy issues?

Application date

2.4.30 This proposal will apply from 1 July 2010.

CHAPTER 2.5: TIME TO CLAIM INPUT TAX CREDITS

Government decision

The GST law will be amended to limit to four years the period in which input tax credits may be claimed. This measure applies from the time of public announcement (7:30 pm AEST on 12 May 2009).

Background

Operation of existing law

2.5.1 Presently, input tax credits are generally attributable to the tax period in which any consideration is provided by the recipient, or the tax period in which an invoice is received if this occurs before any consideration is provided (special rules apply if the taxpayer accounts on a cash basis). However, where a taxpayer does not hold a tax invoice, relevant input tax credits are instead attributable to the first tax period in which the taxpayer holds a tax invoice. Further, if the taxpayer provides a GST return for a tax period that does not take into account an input tax credit, the input tax credit will be attributable to the first period in which a return is provided taking the credit into account.

2.5.2 A four year limitation period exists for indirect tax liabilities and entitlements, including input tax credits, in the current law, running broadly from the end of the tax period to which the relevant amount is attributable for credits or refunds and from the time liabilities become due and payable. The four year limitation period may be extended by the issue of a notice by the Commissioner, or, in the case of credits and refunds, from a notice by the taxpayer, within the time limit and does not apply to cases involving fraud and evasion. The flexible attribution of input tax credits has the consequence that there is no effective limitation period for input tax credits.

Proposal — creating a consistent four year period for claiming input tax credits

Principle 1

2.5.3 Input tax credits can not be attributed to a tax period after the expiry of the time limit. The time limit is the limitation period under section 105-55 of Schedule 1 to the TAA for the tax period to which that input tax credit would be attributable under subsections 29-10(1) and (2) of the GST Act.

Add-on

2.5.4 If the time limit for making claims set by section 105-55 of Schedule 1 to the TAA is extended, taxpayers are entitled to claim or increase a past claim for related input tax credits until the end of the extended period for those claims.

Commentary

2.5.5 The effect of this principle is to link the period of time in which input tax credits can be attributed with the limitation period for the tax period to which the input tax credit would normally be attributable. This preserves the intended outcome of these provisions, allowing

taxpayers to claim overlooked input tax credits without amending prior GST returns, while removing the anomaly under which input tax credits can be claimed indefinitely.

2.5.6 This principle could be implemented by the inclusion of a new subsection or by modifications to subsections 29-10(3) and (4) of the GST Act.

2.5.7 The add-on ensures that where the time limit is extended for particular matters (see subsections 105-50(3) and 105-55(1) of Schedule 1 to the TAA), taxpayers will be able to attribute any related input tax credits or increased input tax credit entitlements during the extended period. This may arise, for example, where fraud or evasion has resulted in supplies being treated as input taxed or where a taxpayer is unable to obtain a tax invoice within the limitation period and lodges a notice to provide extra time.

Focus questions:

Q.5A Fuel tax credits operate with similar attribution rules to those applying to GST input tax credits. Should similar amendments also be made to the attribution of fuel tax credits?

Q.5B Should the reference to GST in paragraph 105-55(2)(b) of Schedule 1 to the TAA be retained following these amendments?

Application date

2.5.8 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.5.9 Subject to that agreement, the measure will apply from 7.30 pm AEST 12 May 2009.

CHAPTER 2.6: TESTING THE FINANCIAL ACQUISITIONS THRESHOLD

Government decision

The GST law will be amended to simplify the financial acquisitions threshold (FAT) by reducing the frequency of testing to an annual basis.

Background

Operation of the existing law

2.6.1 An entity will not exceed the FAT if the entity passes two tests – a retrospective test and a prospective test.

2.6.2 An entity exceeds the FAT if it makes, or is likely to make, financial acquisitions where the input tax credits related to making those acquisitions would exceed the lesser of either:

- \$50,000; or
- 10 per cent of the total amount of input tax credits including for financial acquisitions to which it would be entitled.

2.6.3 If either or both of these levels are exceeded, it will have exceeded the FAT. Whether or not the FAT is exceeded in a given month is based on acquisitions in:

- that month and the previous 11 months (retrospective test); and
- that month and the next 11 months (prospective test).

Principle 1 — frequency of testing FAT — single entities

2.6.4 An entity will have to test the FAT only once every 12 months under the prospective and retrospective tests in order to be able to claim input tax credits relating to its financial acquisitions for the next 12 months (the 12 months from the test day (including the test day)). The retrospective test will cover the 12 months preceding the test day. The prospective test will cover the 12 months from the test day (including the test day).

Commentary

2.6.5 Testing would be similar to the current approach but an entity will carry out the test only once a year. For example, an entity calculates on 1 July 2010 its input tax credits for financial acquisitions (if financial acquisitions were creditable) for the period 1 July 2009 to 30 June 2010 under the retrospective test. The entity will ‘pass’ the retrospective test if this amount does not exceed \$50,000 or 10 per cent of all input tax credits (including those for financial acquisitions) to which the entity would be entitled. The entity also estimates on 1 July 2010 its input tax credits for its likely financial acquisitions (if financial acquisitions were creditable) for the period 1 July 2010 to 30 June 2011. If this amount does not exceed \$50,000 or 10 per cent of its likely total input tax credits for the period, the entity will ‘pass’ the prospective test.

2.6.6 If the entity passes both the prospective and retrospective tests, the entity will be able to claim input tax credits for financial acquisitions from 1 July 2010 to 30 June 2011. The next test day would be 1 July 2011.

2.6.7 The proposal may create a non-neutrality between firms which anticipate on the test day that they may undertake an isolated transaction leading to substantial financial acquisitions during the year³ and firms which undertake such a transaction during the year but do not anticipate this on the test day. These differences are magnified if entities can choose the test day they want in the year.

2.6.8 The retrospective test that is undertaken in the following year may not always deal with the non-neutrality. The test would only apply to input tax credits in the following year, when the entity's financial acquisitions might be minimal. The test would not change the FAT status in the year in which the isolated transaction took place and the entitlement to input tax credits would remain.

2.6.9 The following are possible ways of modifying Principle 1 to minimise the risk of non-neutral outcomes arising:

- require all entities to use 1 July as their test day;
- when the FAT is tested the following year, require adjustments if the retrospective FAT test is failed (effectively input tax credits would be denied retrospectively for the preceding 12 months); and
- provide that an entity is taken to immediately exceed the FAT if it makes an acquisition (or series of acquisitions) that exceeds a specified value and these acquisitions have not been included in the prospective test.

Focus questions:

Q.6A Do the potential non-neutralities warrant the possible modification(s), with their possible increases in compliance costs?

Q.6B If so, is one of the approaches preferred to the others?

Q.6C Are there any alternatives to deal with the perceived problem that could be acceptable (for example, could the FAT be tested every 6 months rather than 12 months)?

New entities

2.6.10 If an entity could not perform the retrospective test because it was newly registered for GST, it would only perform the prospective test. New entities would test the FAT from the first trading day or first day of a new entity's operations following registration (including that day if operations were conducted on that day). However, the actual day on which the FAT test could be performed could be any time during their first tax period as long as the test is from the first trading day/first day of operations.

2.6.11 To ensure that new entities transition to a single test day applying to all entities, the FAT outcome for new entrants would only be applied to financial acquisitions until the next

3 For example, a large takeover.

1 July. Then the FAT would have to be tested again for the next 12 months (although the retrospective test would cover only the period from the first trading day to 1 July).

Focus question:

Q.6D Is this approach for new entities workable? What other approaches could apply?

Test day

2.6.12 All entities could be required to use 1 July 2010 as their first test day, although the actual testing could be performed on any day in the entity's first tax period after 1 July 2010 (inclusive). The alternative would be to allow any day in the first month or quarter after 1 July to be used as the test day. The latter option, however, may raise an entity's compliance costs; for example it may place entities in the position where they might only be able to claim input tax credits for part of a tax period.

Focus question:

Q.6E Are there commercial reasons why entities may want to use a day other than 1 July as their test day?

Principle 2 — Frequency of testing FAT — group entities

2.6.13 A member of a GST group will not exceed its FAT for the next twelve months from the test day (inclusive) if the group does not exceed the threshold under the prospective or retrospective tests on the test day.

Commentary

2.6.14 At present each member of a GST group tests the FAT monthly but takes the financial acquisitions of the other members of the group into account in doing so. An option is to require all members of the GST group to use the same test day to test the FAT. In this way if the GST group as a whole exceeds the financial acquisitions threshold under the prospective or retrospective tests, each member of the GST group will exceed the financial acquisitions threshold. The group would have to perform the prospective and retrospective tests only once in a twelve month period. The test day would be 1 July.

2.6.15 Changes in membership of a GST group may change the balance of creditable and financial acquisitions that the group as a whole makes. It may be distortionary to apply the outcome of a FAT test for 12 months from a test day when the composition of the GST group may be significantly different later in the year than at the test day. It is noted the Government has announced that entities will be able to enter or leave a GST group at any time during a tax period.

2.6.16 The proposed principle will require groups to re-test their relationship with the FAT every time the membership of the group changes. The group (or each entity of the group) could be required to test the FAT again from a new test day in the next month following a change in group membership or perhaps from the next quarter. However, this would increase FAT compliance costs relative to Principle 2.

2.6.17 If an entity passed the FAT test as a member of a GST group, it may be unlikely that it would fail the FAT test as a stand-alone entity. Such an entity need not be required to test its FAT again until the next test day. This would be the next 1 July.

2.6.18 If an entity failed the FAT test as a member of a GST group, it may still pass the FAT test as a stand-alone entity. If the entity wanted to claim input tax credits for its financial acquisitions after leaving the GST group, then it would have to test its FAT again at a new test day in the next month or tax period. The outcome would apply until 1 July.

Focus questions:

Q.6F How should the proposed FAT test deal with membership changes in GST groups?

Q.6G Should a GST group have to re-test its FAT every time its membership changed? Should all GST groups have to test their FATs using a 1 July test date?

Q.6H Are there any alternatives to deal with these issues?

Q.6I How should entities that leave GST groups and operate as stand-alone entities be treated?

Q.6J Should the next test date for entities leaving GST groups be the next 1 July, the next test date for the GST group (assuming there were no further membership changes) or some other date?

Application date

2.6.19 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.6.20 Subject to that agreement, the measure will apply from 1 July 2010.

CHAPTER 2.7: GROUPING AND JOINT VENTURES

Government decision

The GST law and the TAA will be amended as follows:

- GST grouping membership rules will be simplified and broadened by replacing the detailed rules with principle-based rules;
- holding companies will be entitled to register and group for GST purposes, despite not carrying on an enterprise. However, they will not be entitled to continue to be registered once they leave the group, unless at that time they are carrying on an enterprise;
- entities will be able to self-assess their eligibility to form, alter and revoke a GST group or GST joint venture, and to form, alter and revoke a GST group or GST joint venture at any time during a tax period; and
- clean exit rules will be introduced to allow entities to leave GST groups or GST joint ventures clear of any GST consequences.

Background

2.7.1 The Government's decision includes the following measures:

- Measure A: replace the detailed GST grouping membership rules with principle-based rules.
- Measure B: allow holding companies to register and group for GST purposes despite not carrying on an enterprise.
- Measure C: allow entities to self-assess their eligibility to form, alter and revoke a GST group or GST joint venture, and to form, alter and revoke a GST group or GST joint venture at any time during a tax period.
- Measure D: introduce clean exit rules to allow entities to leave a GST group or GST joint venture clear of any GST consequences.

2.7.2 Measures A, B and C will involve amendments to the GST Act and the Measure D will involve amendments to the TAA.

2.7.3 These measures are aimed at:

- simplifying and broadening the GST grouping membership rules; and
- reducing compliance costs and uncertainty for entities forming, altering and revoking a GST group or a GST joint venture.

Operation of existing law

2.7.4 The GST Act allows entities who choose to form a GST group or a GST joint venture to apply special rules for reporting their GST liabilities and entitlements, and to ignore most intra-group transactions. In general terms, the special rules result in effectively treating GST groups and, to a lesser extent, GST joint ventures, as if they were a single entity for GST purposes.

GST groups

2.7.5 Under Division 48 (GST groups) of the GST Act, companies within a 90 per cent owned group (as defined in Division 190), and in some cases other entities including partnerships, trusts and individuals, can be approved as a GST group (subdivision 48-A). A GST group is treated as a single entity for certain purposes, with one member of the group (the representative member) dealing with all the GST liabilities and entitlements of all members of the group (subdivision 48-B). This allows the grouped entities to effectively ignore most intra-group transactions for GST purposes. The representative member must be an Australian resident for taxation purposes.

2.7.6 To group for GST purposes, entities must satisfy membership requirements (sections 48-10 and 48-15) and obtain the Commissioner's approval (section 48-5). The membership requirements vary with the type of entity and in the case of partnerships, trusts and individuals these requirements are specified in the *A New Tax System (Goods and Services Tax) Regulations 1999* (subdivision 48-A) (the Regulations). Broadly, the basis for allowing entities to group is: a degree of common ownership and control between entities; a degree of commonality of beneficiaries, shareholders and partners of entities seeking to group (or their family members), and if the entities are non-profit bodies that they are members of the same non-profit association.

2.7.7 To form a GST group, members must satisfy the following criteria in addition to the membership requirements:

- be registered for GST purposes;
- have the same GST tax period as all other group members;
- account for GST on the same basis as all other group members;
- not be a member of any other GST group; and
- not have any branch registered for GST.

GST joint ventures

2.7.8 Under Division 51 of the GST Act, entities engaged in certain joint ventures can have them approved as GST joint ventures (subdivision 51-A). The joint venture operator (that is, an entity nominated for this role by the participants) deals with the GST liabilities and entitlements arising from the joint venture dealing on behalf of the participants in the joint venture (subdivision 51-B). To form a GST joint venture, the entities must satisfy the participation requirements of a GST joint venture (section 51-10) and obtain the Commissioner's approval (section 51-5). The participation requirements are that each joint venture participant:

- participates, or intends to participate, in a joint venture for exploration or exploitation of mineral deposits or for a purpose specified in regulation 51-5.01;

- is a party to a joint venture agreement with all the other participants or intended participants;
- is registered for GST; and
- accounts for GST on the same basis as all other participants.

Altering and revoking a GST group and GST joint venture

2.7.9 As with forming a GST group, altering the membership of a GST group, replacing a representative member with another, or revoking the approval of a GST group also needs to be approved by the Commissioner. The Commissioner must remove a member from a GST group if that member does not satisfy the membership requirements for the group and revoke a GST group if none or only one of its members satisfies the membership requirements of the GST group (sections 48-70 and 48-75).

2.7.10 Similarly, altering and revoking a GST joint venture has to be done with the approval of the Commissioner. The Commissioner must also revoke the approval of a participant of a GST joint venture if it does not satisfy the participation requirements or the whole GST joint venture if none or only one of its participants satisfies the participation requirements of the GST joint venture (sections 51-70 and 51-75).

Timing of formation, alteration or revocation of a GST group or a GST joint venture

2.7.11 Entities can only form, alter or revoke a GST group or a GST joint venture from the beginning of a tax period (subsection 48-85(3) and 51-85(2)). For a GST group there is an exception to this rule – namely the rule does not apply to entities that pay GST by instalments or report and pay GST annually (subsection 48-85(3)).

Joint and several liability of members of a GST group and participants of a GST joint venture

2.7.12 Each member of a GST group (or participant in a GST joint venture) is jointly and severally liable to pay any amount that is payable under an indirect tax law by the representative member (or the joint venture operator) (section 444-90 and 444-80 in Schedule 1 to the TAA). An indirect tax law is defined in section 995-1 of the ITAA 97) as any of the following – the GST law, the wine equalisation tax law, the luxury car tax law and the fuel tax law.

Links to other legislation

2.7.13 GST groups and GST joint venture are also recognised as one entity for the purposes of:

- the wine equalisation tax (Division 21 of the *A New Tax System (Wine Equalisation Tax) Act 1999*);
- the luxury car tax (Division 16 of the *A New Tax System (Luxury Car Tax) Act 1999*); and
- fuel tax credit (sections 70-05 and 70-15 of the *Fuel Tax Act 2006*).

Measure (A) — Replace the detailed GST grouping membership rules with principle-based rules

2.7.14 The existing detailed GST grouping membership rules contained in sections 48-10 and 48-15 of the GST Act and in the Regulations will be replaced with four principled-based rules set out below. The principled-based rules provide for a 90 per cent

owned group model, a single family model, a multiple families model and a non-profit model. Diagrams providing illustrative examples on how entities can form a GST group under these proposed principle-based rules are provided at Attachment A.

Principle 1 — the 90 per cent owned group model

2.7.15 Companies, partnerships or trusts can group where they are part of a 90 per cent owned group.

Carve-out

2.7.16 A non-fixed trust cannot be a member of a 90 per cent owned group if any of the recipients of distributions are not members of the GST group, and a partnership cannot be a member of a group unless all of its partners are members of the group.

Add-on

2.7.17 Trusts can be a member of a 90 per cent owned group even if the trustee also makes distributions to a charitable institution, a trustee of a charitable fund, or a gift-deductible entity.

Commentary

2.7.18 Under this principle it is proposed that companies, partnerships and trusts will be able to form a GST group if the entities are part of the same 90 per cent owned group. This principle is modelled on the existing membership rules which allow companies or fixed trusts to group for GST purposes where a company or the trustee of a fixed trust (see Diagram 1.1 in Attachment A) has at least a 90 per cent ownership interest in another company or fixed trust; or a third company or trustee of a third fixed trust has at least a 90 per cent ownership interest in the other companies or fixed trusts.

2.7.19 The proposed principle expands the existing rules by allowing combinations of 90 per cent owned companies, fixed trusts, non-fixed trusts and partnerships to group as follows:

- combinations of 90 per cent owned companies and fixed trusts will be able to form a group;
- partnerships and non-fixed trusts that have at least a 90 per cent ownership interest in another entity⁴ can group with that entity and other entities where there is 90 per cent common ownership between the entities; and
- partnerships and non-fixed trusts that make distributions only to other members of a group can be a member of a 90 per cent owned group.

2.7.20 If entities are eligible to be a member of a 90 per cent owned group, it is not necessary for all of the eligible members, including the holding entity, to group for GST purposes (see Diagram 1.2 in Attachment A). A non-resident entity can be a member of a GST group but, as required by section 48-5 of the GST Act, the representative member of the GST group must be an Australian resident.

2.7.21 For a company or fixed trust to form a GST group with a partnership or non-fixed trust as the 'holding entity', the partners in the partnership or the trustee of the non-fixed

⁴ This will occur if the partners have, or the trustee of the trust has, at least a 90 per cent stake in the other entity.

trust must have at least a 90 per cent membership interest in the company or fixed trust and thus hold at least 90 per cent of their shares or units (see Diagram 1.3 in Attachment A).

2.7.22 Redeemable preference shares will be excluded from the ownership test for GST grouping. That is, a differentiation will be drawn between debt and equity interests.

2.7.23 To be a member of a 90 per cent owned group, a non-fixed trust or partnership must only make distributions to members of the GST group. A partnership or non-fixed trust will not be eligible to be a member of a GST group if it makes distributions other than to members of the group (see Diagram 1.4 in Attachment A). That is, a partnership or trust cannot make distributions to an entity that is part of the 90 per cent owned group but is not a member of the group for GST purposes.

Principle 2 — the single family model

2.7.24 An individual and one or more of his/her family members, and companies, partnerships or trusts can group where the only individuals that hold interests in those entities are the individual or a family member of the individual. However, if the entity is a non-fixed trust, the beneficiaries must be the individual or a family member of the individual, or an entity controlled by family members.

Add-on

2.7.25 Trusts can be a member of a family group even if the trustee of a trust also makes distributions to a charitable institution, a trustee of a charitable fund or a gift-deductible entity.

2.7.26 Companies, fixed trusts and partnerships can be a member of a family group even if they make income or capital distributions to non-family members, provided these distributions are not more than 10 per cent of the total distributions with a tax period.

Commentary

2.7.27 Under the single family model it is proposed that members of a single family carrying on enterprises as sole traders will be able to group (see Diagram 2.1 in Attachment A), as well as businesses that are operated by their family members through a company, partnership or trust.

2.7.28 For companies, fixed trusts, and partnerships to be able to group under the single family model, it will be necessary that all the interests in those entities be held (directly or indirectly through interposed entities) by members of the same family (see Diagram 2.2 in Attachment A). In determining which individuals hold interests, it will be necessary to look at the individuals who are entitled to receive distributions (directly or indirectly) of income or capital from those entities within a tax period. Companies, fixed trusts and partnerships, however, will remain eligible to group even if they make an income or capital distribution to non-family members, if such distributions are not greater than 10 per cent of the total income or capital distributions by these entities within a tax period. In addition, fixed trusts will remain eligible to group if the distributions are made to a charitable institution, a trustee of a charitable fund or a gift-deductible entity.

2.7.29 For non-fixed trusts to be able to group under the single family model, it will be necessary that all their beneficiaries are members of the same family or the beneficiary is an entity that is controlled by family members. Non-fixed trusts will also be able to group if their beneficiaries include a charitable institution, a trustee of a charitable fund or a gift-deductible entity.

2.7.30 Family members will be determined by their relationship to the primary individual (the test individual) prescribed by the definition of family group in the ITAA 1936. In addition, family members for GST groups will include aunts and uncles of the test individual.

2.7.31 The single family model can apply to horizontal structures (that is entities directly owned by a family) and a combination of horizontal and vertical structures (that is a family holds two or more entities, some of which own other entities). For example, a company owned by another company where the only shareholders of the first company are members of the same family can group with a partnership where the only partners are also members of the same family (see Diagram 2.3 in Attachment A).

Principle 3 — the multiple families model

2.7.32 Companies, partnerships or trusts can group where they are wholly owned by the same individuals or family members of those individuals. However, if the entity is a non-fixed trust, the beneficiaries must be the same individuals or family members of those individuals, or an entity controlled by the same individuals or family members.

Add-on

2.7.33 A trust can be a member of a GST group under the multiple families model even if the trustee also makes distributions to a charitable institution, a trustee of a charitable fund, or a gift-deductible entity.

2.7.34 Companies, fixed trusts and partnerships can be a member of a GST group under the multiple families model even if they make income or capital distributions to non-family members, provided these distributions are not more than 10 per cent of the total distribution within a tax period.

Commentary

2.7.35 Under the multiple families model, it is proposed that businesses wholly owned by and/or wholly benefiting individuals of two or more families will be able form a GST group.

2.7.36 Under this model it is proposed that companies which are wholly owned by individuals of two or more families, and partnerships and fixed trusts where the only recipients of distributions are members of those two or more families, will be able to form a GST group. It will be necessary that all the interests in those entities be held ultimately by the same individuals or their family members with each individual or a family member represented in each entity in the group. For example, Company A with shareholders B, C and D can group with Company E with shareholders F, G and H if shareholders F, G and H are spouses of B, C and D (see Diagram 3.1 in Attachment A).

2.7.37 In determining which individuals hold interests, it will be necessary to look at the individuals who are entitled to receive distributions (directly or indirectly) of income or capital from those entities within a tax period. Companies, fixed trusts and partnerships, however, will remain eligible to group even if they make an income or capital distribution to non-family members, if that distribution is not greater than 10 per cent of the total income or capital distributions by these entities within a tax period. In addition, fixed trusts will remain eligible to group if distributions are made to a charitable institution, a trustee of a charitable fund or a gift-deductible entity.

2.7.38 For non-fixed trusts to be able to group under the multiple families model, it will be necessary that all their beneficiaries are individuals of two or more families or the beneficiary

is an entity that is controlled by those individuals or their family members. Non-fixed trusts will also be able to group if their beneficiaries include a charitable institution, a trustee of a charitable fund or a gift-deductible entity.

2.7.39 Under the proposed multiple families model, there will not be a limit to the number of families that can be represented in the entities that can group under this principle. Diagrams 3.2 and 3.3 in Attachment A provide further examples of how companies, partnerships and trusts can group under this principle. Further, this model could apply to horizontal structures and a combination of horizontal and vertical structures. For example, it is intended to cover the following arrangement – Company X owns Company Y. Trust Z has two beneficiaries, Company X and Company Y. The shares in Company X are held by two or more individuals or their family members (see Diagram 3.4 in Attachment A).

2.7.40 It should be noted that for horizontal structures it will not always be necessary to trace through interposed entities to determine which individuals (or family entities) hold the interests in the entities seeking to group. For example, if two companies (G and H) both owned by the same trusts (X and Y) wish to group it will not be necessary to trace through the trusts to determine which individuals are ultimately benefiting from the distributions made by the trusts. This is because these individuals, the beneficiaries of trusts X and Y, will be the same for both companies (see Diagram 3.5a in Attachment A).

2.7.41 However, if trusts X and Y also wish to group with the companies it will be necessary to look at which individuals are receiving or likely to receive distributions from the trusts. This is because we need to compare the relationships of Trust X's beneficiaries with those of Trust Y. If the beneficiaries of the trusts are the same individuals (or their family members) these trusts will be able to group with the companies (see Diagram 3.5b in Attachment A). On the other hand, if the beneficiaries of each trust are not the same individuals, or family members of those individuals, these trusts will not be able to group with the companies.

2.7.42 The proposed multiple families model will allow certain commonly used structures to group. For example, arrangements used by professional firms that involve service companies, partnerships or trusts with the same shareholders/partners/beneficiaries (or their family members) will be able to group. In addition, this model will allow businesses operated by two or more families to group where all the interests in the entities are owned by those families (see Diagram 3.6 in Attachment A).

Principle 4 — the non-profit model

2.7.43 Non-profit bodies can group where they are members of the same non-profit association.

Commentary

2.7.44 Non-profit bodies that can currently group under subsection 48-10(2) of the GST Act will continue to be able to group under that principle. However, it should be noted that non-profit bodies can also qualify to group under the other principles.

Other membership requirements

2.7.45 In addition to meeting one of the above principles, for an entity to satisfy the membership requirements it will also need to:

- be registered for GST;

- have the same tax periods applying to it as the tax periods applying to all the other members of the GST group or proposed GST group;
- account on the same basis as all the other members of the GST group or proposed GST group; and
- not have any branch that is registered as a GST branch under Division 54 of the GST Act.

Definitions and concepts

2.7.46 The above principles use the following definitions and concepts.

2.7.47 *Company* has the meaning given by section 195-1 of the GST Act.

2.7.48 A *distribution* made by a trust has the meaning provided by section 272-45 of Schedule F to the ITAA 1936.

2.7.49 The term '**family**' is intended to cover individuals who would fall within the definition of 'family group' in section 272-90 of Schedule 2F to the ITAA 1936 as well as aunts or uncles of the test individual or the test individual's spouse. This will ensure that the wider concept of family that applies to partnerships under the existing law will be available to other entities that wish to become a member of a GST group.

2.7.50 *Financial year* has the meaning given by section 195-1 of the GST Act (that is, the term refers to a 12 month period spanning 1 July to 30 June).

2.7.51 *Fixed trust* is defined in subsection 995-1(1) of the ITAA 1997.

2.7.52 An interest (including a membership interest) is held *indirectly* if held through interposed companies, partnerships or trusts.

2.7.53 An *interest* in a company, trust or partnership is the right to receive a distribution of income or capital of the entity. In determining an interest, debt interests do not constitute an interest.

2.7.54 A *membership interest* in a company or fixed trust is defined in section 960-130 of the ITAA 1997.

Focus questions:

Q.7A Will the proposed principle-based GST grouping membership rules prevent entities that are currently eligible to form a GST group from forming a GST group in the future?

Q.7B Do the proposed grouping membership rules provide sufficient clarity? If not, what matters require clarification and how could further clarity be achieved? In regard to the family models, do the proposed rules provide sufficient clarity in relation to:

- interposed entities; and
- when an entity is controlled by an individual or family member?

Q.7C Is the proposed yearly test to determine that distributions to non-family members are not greater than 10 per cent of the total distributions in an income year the most appropriate test?

Q.7D Can the proposed grouping membership rules be further simplified whilst still achieving broadly the same outcomes and reducing compliance costs?

Application date

2.7.55 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.7.56 Subject to that agreement, the measure will apply from 1 July 2010.

Measure (B) — Allow holding companies to register and group for GST purposes despite not carrying on an enterprise

2.7.57 Holding companies will be allowed to register for the purposes of joining or forming a GST group despite not carrying on an enterprise as set out below.

Principle 1

2.7.58 A company may elect to be treated as carrying on an enterprise for the purpose of forming or joining a GST group if it is the holding company of that 90 per cent owned GST group.

Carve-out

2.7.59 A holding company will only be regarded as carrying on an enterprise to the extent that its activities relate to the activities of the GST group.

Commentary

2.7.60 Under this principle it is proposed that a company (the holding company) which holds at least 90 per cent ownership interests in subsidiary companies and other entities but does not meet the enterprise test in section 9-20 of the GST Act will be able to register for GST purposes and to form or join a GST group. The period that the company will be able to be treated as carrying on an enterprise will be limited to the period in which it is the holding company and a member of the GST group. Further, the holding company will only be regarded as carrying on an enterprise (and thus being able to register for GST) in respect to the activities of the GST group. The holding company will not be able to become a

representative member of the GST group. The holding company will need to satisfy other GST group membership requirements such as, for example, accounting on the same basis as all the other members of the GST group.

2.7.61 This principle will allow transactions between the holding company and other members of the GST group to be treated as intra-group transactions and thus not subject to GST. Similarly, in respect of creditable acquisitions or importations by the holding company, a representative member of the GST group will be able to claim an input tax credit. However, an entitlement to input tax credits will be limited to the holding company's creditable acquisitions and importations that relate to the activities of the GST group. Conversely, if the holding company makes supplies in the furtherance of the enterprise of the GST group, then this supply will be a taxable supply.

2.7.62 A company will be regarded as a holding company if has at least a 90 per cent stake in another company (the subsidiary company) as specified in section 190-5 of the GST Act.

Measure (C) — Allow entities to self-assess their eligibility to form, alter and revoke a GST group or GST joint venture and to do so at any time during a tax period

2.7.63 Entities will be allowed to self-assess their eligibility to form, alter and revoke a GST group or GST joint venture. Entities will also be able to form, alter and revoke a GST group or a GST joint venture at any time during a tax period as set out below.

Principle 1

2.7.64 Entities who satisfy the membership requirements of a GST group may elect to form a GST group.

Carve-out

2.7.65 If entities have already lodged a BAS and a GST group is to be formed, altered or revoked with effect from a date before the lodgement of a BAS by these entities, then the entities need to seek the Commissioner's approval for this.

2.7.66 Entities need to form a GST group for at least 30 days or a whole tax period.

Add-on

2.7.67 The representative member of a GST group must notify the Commissioner of:

- the details of the GST group membership and the date of effect of the GST group being formed; and
- any changes to group membership and the date of effect of the changes.

2.7.68 A GST group ceases to exist from the date of effect nominated by the representative member of a GST group and notified to the Commissioner as the date the group ceases to elect to report as a GST group.

2.7.69 Entities can form, alter and revoke a GST group and change a representative member at any time during a tax period provided that the formation, alteration and revocation is done for at least 30 days or a whole tax period.

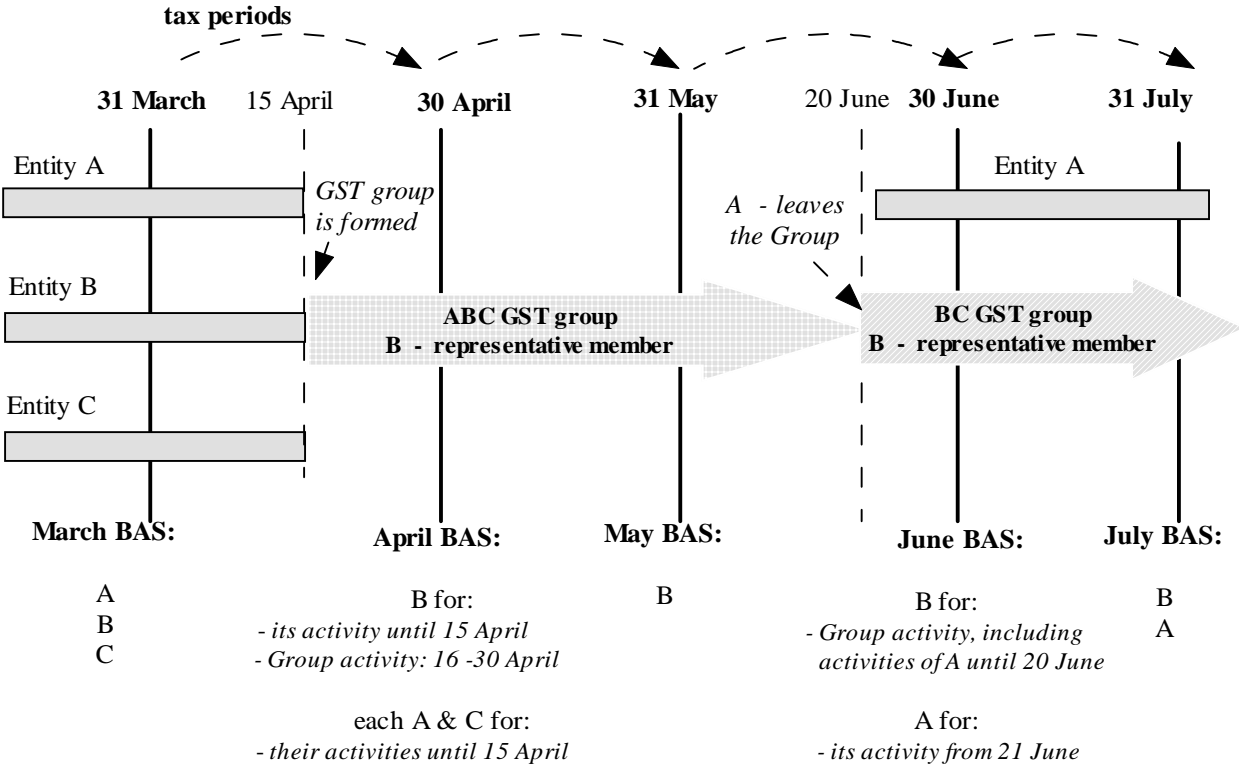
Commentary

2.7.70 Under this principle entities will be able to self-assess their eligibility to form, alter and revoke a GST group. Entities will need to satisfy the membership requirements of a GST group, elect to form a GST group and nominate a representative member. Members will need to notify the Commissioner within a period of 21 days, or within such further period as the Commissioner allows, of the details of the GST group, including who is the representative member, and the date of forming, altering or revoking the group or changing a representative member. The notification will have to be made in an approved form.

2.7.71 Formation, alteration and revocation of a GST group or changes in a representative member after the due date for the last lodgement of a BAS by the members or a representative member of the group with a date of effect prior to that due date will need to be approved by the Commissioner. In deciding whether to grant a retrospective approval, the Commissioner will take appropriate account of the potential administrative and compliance costs and risks to the revenue. The Commissioner will not be able to provide retrospective approvals for the formation, alteration or revocation of a GST group with a date of effect longer than four years from the due date for the last BAS of entities affected by such an approval.

2.7.72 While entities will be able to form, alter or revoke a GST group at any time during a tax period, they will need to account for GST as if there were two tax periods, otherwise the attribution rules may lead to a double reporting of a member's transactions. To this end, where an entity moves from one GST group to another GST group, the representative members of these two groups would both be liable to attribute relevant amounts for all of the member entities transactions. However, entities forming, altering and revoking a GST group, will not be required to lodge additional BASs. Diagram 1 below illustrates responsibilities for accounting and reporting for GST by both entities forming and leaving a GST group, and the representative member of the GST group under this proposal.

DIAGRAM 1: INTRA-TAX PERIOD FORMATION AND ALTERATION OF THE GST GROUP AND ACCOUNTING FOR GST IN BUSINESS ACTIVITY STATEMENTS



2.7.73 In this example, entities A, B and C form a GST group on 15 April with entity B becoming the representative member of the group. Under the proposed principle, each entity will be required to lodge a BAS for the tax period ending on 30 April, with:

- the representative member (entity B) accounting for its activity from 1 April to 15 April and the GST group activity for the period from 16 April to 30 April; and
- entity A and entity C accounting for their own activities from 1 April to 15 April.

2.7.74 Further, the membership of the ABC GST group is altered on 20 June when entity A leaves the group. Under the proposed principle, this will require:

- the representative member (entity B) to account for the activities of the GST group for the whole of the tax period, including entity A’s activities until 20 June, in its BAS for the tax period ending on 30 June; and
- entity A accounting for its activities from 21 June to 30 June.

2.7.75 Entity A (together with entities B and C) will have joint and several liability for the GST group’s liabilities in respect of the group’s activities for the period from 16 April (when it joins the GST group) until 20 June (when it leaves the GST group). These joint and several liabilities will only arise in the case that entity B, as a representative member of the GST group, defaults on the payment of the group’s GST liabilities for that period.

Principle 2

2.7.76 Entities who satisfy the participation requirements of a GST joint venture may elect to form a GST joint venture.

Carve-out

2.7.77 If entities have already lodged a BAS and a GST joint venture is to be formed with the effect from a date before the lodgement of a BAS by these entities, then the entities need to seek the Commissioner's approval for forming a GST joint venture.

2.7.78 Entities need to form a GST joint venture for at least 30 days or a whole tax period.

Add-on

2.7.79 The joint venture operator of a GST joint venture must notify the Commissioner of:

- the details of the GST joint venture and the date of effect of the GST joint venture being formed; and
- any changes to GST joint venture membership and the date of effect of the change.

2.7.80 A GST joint venture ceases to exist from the date of effect nominated by the joint venture operator of a GST joint venture and notified to the Commissioner, as the date the joint venture ceases to elect to report as a GST joint venture.

2.7.81 Entities can form, alter and revoke a GST joint venture and change a joint venture operator at any time during a tax period provided that the formation, alteration and revocation is done for at least 30 days or a whole tax period.

Commentary

2.7.82 Under this principle entities will be able to self-assess their eligibility to form, alter and revoke a GST joint venture. Entities will need to satisfy the participation requirements of a GST joint venture, elect to form a GST joint venture and nominate a joint venture operator. Participants will need to notify the Commissioner within a period of 21 days, or within such further period as the Commissioner allows, of the details of the GST joint venture, including who is the joint venture operator, and the date of forming, altering or revoking a GST joint venture or changing a joint venture operator. The notification will need to be made in an approved form.

2.7.83 Formation, alteration and revocation of a GST joint venture or changes in a joint venture operator after the due date for the last lodgement of a BAS by the participants or a joint venture operator with a date of effect prior to that due date will need to be approved by the Commissioner. In deciding whether to grant retrospective approval, the Commissioner will take appropriate account of the potential administrative and compliance costs and risks to the revenue. The Commissioner will not be able to provide retrospective approvals for the formation, alteration or revocation of a GST joint venture with a date of effect longer than four years from the due date for the last BAS of entities affected by such an approval.

2.7.84 While entities will be able to form, alter or revoke a GST joint venture at any time during a tax period, they will need to account for GST as if there were two tax periods, otherwise the attribution rules may lead to a double reporting of a member's transactions. To this end, where an entity moves from one GST joint venture to another GST joint venture, the joint venture operators of these two GST joint ventures would both be liable to attribute

relevant amounts for all of the participant entities transactions. Entities forming, altering and revoking the GST joint venture, however, will not be required to lodge additional BASs.

2.7.85 The mechanics of intra-tax period formation, alteration or revocation of GST joint venture will be similar to that for GST groups illustrated in Diagram 1.

Focus questions:

Q.7E Will the proposed self-assessment and intra-tax period changes to membership for both a GST group and a GST joint venture operate effectively to reduce compliance costs?

Q.7F Should the proposed rules regarding intra-tax period formation and alteration of a GST group be extended to a GST group that makes a choice to have annual tax periods and makes payment of GST by instalments under Divisions 151 and 162 of the GST law respectively?

Application Date

2.7.86 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.7.87 Subject to that agreement, the measure will apply from 1 July 2010.

Measure (D) — Introduce clean exit rules to allow entities to leave a GST group or GST joint venture clear of any GST consequences

2.7.88 Entities will be able to leave a GST group or GST joint venture clear of any GST consequences.

Principle 1

2.7.89 A member of a GST group can enter into a clean exit agreement (CEA) with a representative member of the same GST group to avoid the consequences of joint and several liability to pay any amount that becomes due and payable under the GST law after it exits the GST group.

Carve-out

2.7.90 The CEA does not apply to the extent that:

- any GST liability that is due and payable by the representative member in respect of tax periods before the member left the GST group remains unpaid;
- the CEA is entered into as part of an arrangement, a purpose of which was to prejudice the Commissioner's recovery of some or all of the GST group liability to pay an amount that is payable under the GST law; or
- the Commissioner serves a notice on the representative member requesting a copy of the CEA in the approved form and it is not provided within 14 days.

2.7.91 A member leaving a GST group under a CEA must make a payment to the representative member in lieu of its share of a GST liability for the period the CEA applied but that does not become due and payable until after it leaves the GST group.

Commentary

2.7.92 Under this principle, a member and a representative member of a GST group will be able to enter into an agreement allowing the member to leave a GST group clear of any GST liability that may become due and payable after it leaves the GST group but in respect of a tax period in which the member was a part of the GST group. However, for the member to be clear of any such GST liabilities, it will need to pay the representative member prior to leaving the GST group an amount equal to its share of the GST liabilities for the tax period in which it leaves the group. Such a payment will need to be made prior to the due date for the representative member to lodge a BAS for the final tax period in which that member was still part of the GST group.

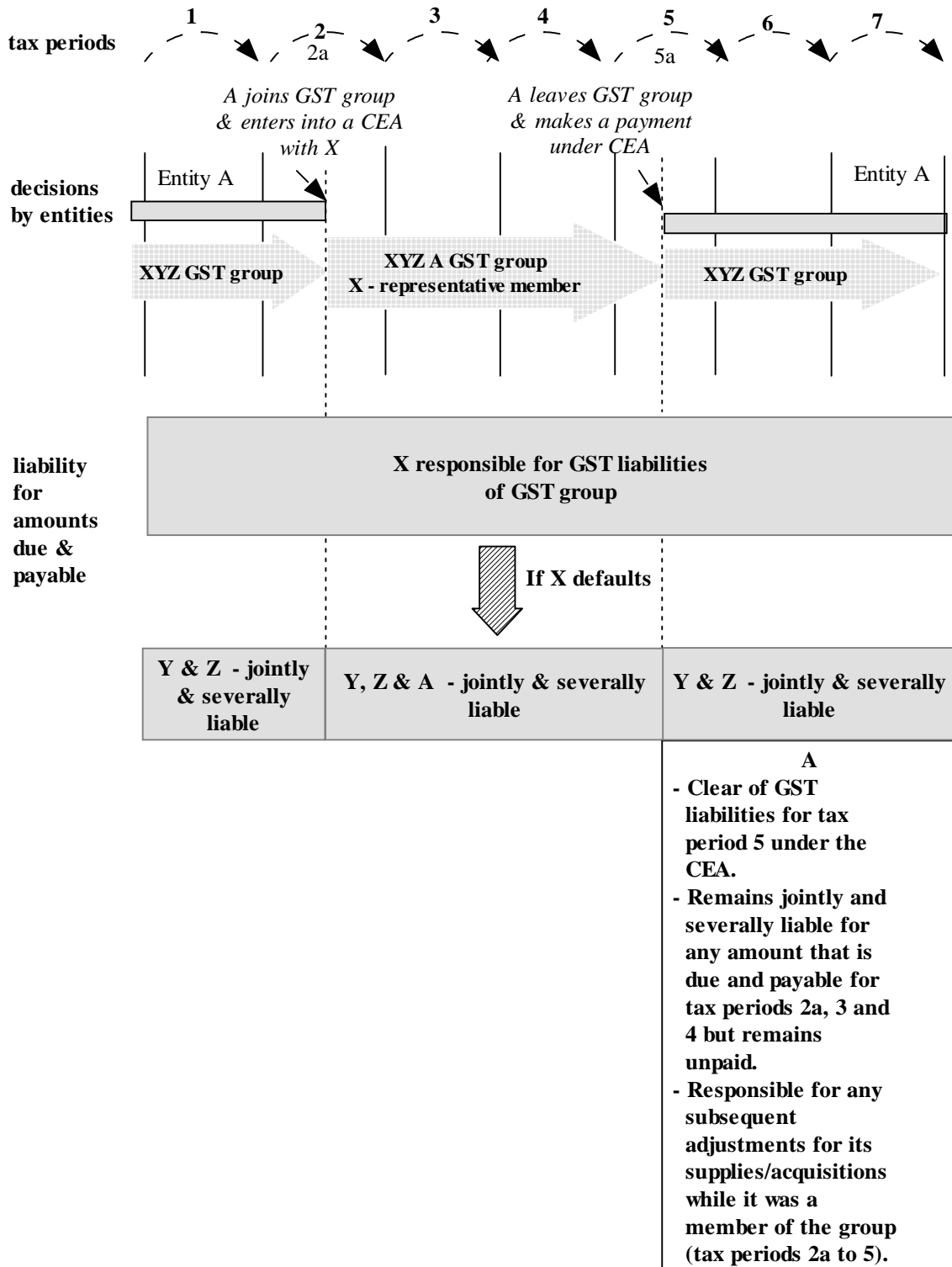
This principle does not remove or limit:

- The responsibility of a representative member for the GST liability for the whole GST group. The CEA only ensures that a member leaving a GST group is not liable for any GST liability related to the activity of the GST group that has not yet become due and payable, in the event that the representative member of the GST group defaults on the payment of GST liabilities of the GST group. Under the existing law, in this situation the member would be jointly and severally liable to meet such liabilities even after leaving a GST group.
- The joint and several liability of a member with a CEA while it is in a GST group. That is, in the case the representative member defaults on the payment of a group's GST liabilities, a member with a CEA remains jointly and severally liable for the GST liability of the GST group during the period it is a member of that GST group.
- The joint and several liability of a member with a CEA for a GST liability that arose in a tax period while it was a member of the group and which remains unpaid by the representative entity after the date on which it was due and payable. In the event that the representative entity defaults on the payment of such GST liabilities, the member will remain joint and severally liable for the debt.
- The responsibility of a member for increasing and decreasing adjustments that may arise after the member leaves the GST group in respect of supplies and acquisitions that it made while being a part of the GST group.

2.7.93 The CEA can only apply prospectively, that is from the time the agreement is entered into.

2.7.94 Diagram 2 illustrates the operation of clean exit rules for GST groups, in particular the impact on the GST liability of a member with a valid CEA that leaves a GST group and the liabilities of the remaining members of the GST group.

DIAGRAM 2: LEAVING A GST GROUP WITH A VALID CLEAN EXIT AGREEMENT — IMPACT ON GST LIABILITIES OF GST GROUP MEMBERS



2.7.95 In this example, a GST group operates that consists of entity X (a representative member of the group), and entities Y and Z. Entity A joins this group in the middle of tax period 2 which is to be allowed under Measure C. This point of time is referred to as 2a. Entity A enters into a CEA with the representative member of the GST group (entity X) at the same time. Entity A leaves the group in the middle of tax period 5 after making a payment to X under the CEA for its GST liabilities that have not yet become due and payable. This point of time is referred to as 5a. In this scenario:

- The representative member (X) is responsible for GST liabilities of the GST group for the duration it was the representative member of the group;
- If X defaults on the payment of the GST liabilities of the GST group:
 - before entity A leaves the group, entities Y, Z and A (despite having the CEA) are jointly and severally liable for the GST liability of the GST group;
 - after entity A leaves the group:
 - : entities Y, Z and A are jointly and severally liable for the GST liability of the GST group that arose in a tax period prior to A leaving the group; and
 - : entity A does not have any GST liabilities for tax periods after it exited the GST group under a valid CEA.
- Entity A remains responsible for any increasing and decreasing adjustments that might arise after it leaves the group (for example, in tax period 7) but in respect of supplies and acquisitions that A made while it was a member of the GST group (from 2a to 5).

Principle 2

2.7.96 A participant of a GST joint venture can enter into a CEA with a joint venture operator of the same GST joint venture to avoid the consequences of joint and several liability to pay any amount that is payable under the GST tax law after it exits the GST joint venture.

Carve-out

2.7.97 The CEA does not apply to the extent that:

- any GST liability that is due and payable by the joint venture operator in respect of tax periods before the participant left the GST joint venture remains unpaid;
- the CEA is entered into as part of an arrangement, a purpose of which was to prejudice the Commissioner's recovery of some or all of the GST joint venture liability to pay amount that is payable under the GST law; or
- the Commissioner serves a notice on the joint venture operator requesting a copy of the CEA in the approved form and it is not provided within 14 days.

2.7.98 A participant leaving a GST joint venture under a CEA must make a payment to the joint venture operator in lieu of its share of a GST liability for the period the CEA applied but that does not become due and payable until after it leaves the GST joint venture.

Commentary

2.7.99 Under this principle, a participant and a joint venture operator of a GST joint venture will be able to enter into an agreement allowing the participant to leave a GST joint venture clear of any GST liability that may become due and payable after it leaves the GST joint venture but in respect to a tax period in which the participant was a part of the GST joint venture. However, for the participant to be clear of any such GST liabilities, it will need to pay the joint venture operator prior to leaving the GST joint venture an amount equal to its share of the GST liabilities for the tax period in which it leaves the joint venture. Such a payment will need to be made prior to the due date for the joint venture operator to lodge a BAS for the final tax period in which that participant was still part of the GST joint venture.

2.7.100 This principle does not remove or limit:

- The responsibility of a joint venture operator for the GST liability for the whole GST joint venture. The CEA only ensures that a participant leaving a GST joint venture is not liable for any GST liability related to the activity of the GST joint venture, in the event that the joint venture operator of the GST joint venture defaults on the payment of GST liabilities of the GST joint venture. Under the existing law, in this situation the participant would be jointly and severally liable to meet such liabilities even after leaving a GST joint venture.
- The joint and several liability of a GST joint venture participant while it is in GST joint venture. That is, in the case the joint venture operator defaults on the payment of a joint venture's GST liabilities, the participant with the CEA remains jointly and severally liable for the GST liability of the GST joint venture during the period it is a participant of that GST joint venture.
- The joint and several liability of a participant with a CEA for a GST liability that arose in a tax period while it was a participant in the GST joint venture and which remains unpaid by the joint venture operator after the date on which it was due and payable. In the event that the joint venture operator defaults on the payment of such GST liabilities, the participant will remain joint and severally liable for the debt.
- The responsibility of a participant for increasing and decreasing adjustments that may arise after the participant leaves the GST joint venture in respect of supplies and acquisitions that it made while being a part of the GST joint venture.

2.7.101 The CEA can only apply prospectively, that is from the time the agreement is entered into.

Alternative to Principle 1 and 2

2.7.102 The proposed clean exit rules contain additional integrity rules to safeguard the revenue in the event that the representative member or the joint venture operator defaults on payment on a GST liability. These rules add complexity and limit the extent of the operation of the clean exit rules. The clean exit rules may be able to be simplified if entities participating in a GST group or a GST joint venture were only liable for their own GST liabilities in a similar way as entities participating in a GST religious group, rather than being jointly and severally liable for the liabilities of the group/joint venture.

2.7.103 To this end, another option for allowing entities leaving a GST group or a GST joint venture clear of liabilities would be to adopt a similar approach to that taken for GST religious groups.

2.7.104 That is, for GST groups (and GST joint ventures):

- intra-group (intra-joint venture) transactions for GST purposes would be ignored;
- each member (participant) has the liability for GST and entitlement for input tax credits on the supplies and acquisitions it makes outside the GST group (GST joint venture), and has any related adjustments; and
- either;
 - each member (participant) lodges its own BAS, in which case members (participants) would not need to have the same tax periods; or
 - one BAS is lodged for the GST group (the GST joint venture) by the representative member (joint venture operator), in which case members (participants), would need to have the same tax periods.

2.7.105 As each member (participant) retains the GST liabilities and entitlements for its own activities rather than them being moved to the representative member (GST joint venture), as is currently the case, there would be no need for joint and several liability for the GST group's (GST joint venture's) transactions. As there would be no joint and several liability and as each member (participant) would be liable for its own transactions, members (participants) would be able to identify their potential liability on exit from a GST group (GST joint venture).

2.7.106 As each member (participant) would bear its own liabilities, if each member (participant) were to lodge its own BAS there may be no need for the special tax period rules as part of Measure C.

Focus questions:

Q.7G Would the proposed CEA adequately address industry concerns about uncertainty, compliance costs, negative impact on companies' credit ratings and the disincentive for entities to joint or form a GST group arising from the current rules?

Q.7H Would there be greater compliance cost savings from adopting the alternative approach based on religious groups, or from retaining the current approach and allowing for CEAs?

Q.7I Would there be greater compliance cost savings from requiring a single BAS for the group to be lodged by the representative member, with the associated aggregation of data from all the other members, or from requiring each entity to lodge its own BAS with the associated costs of lodging BAS?

Q.7J Would there be benefits in extending the proposed GST clean exit rules to all indirect tax laws?⁵

Application date

2.7.107 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.7.108 Subject to that agreement, the measure will apply from 1 July 2010.

⁵ The indirect tax law comprises the GST law, the wine tax law, the luxury car tax law and the fuel tax law (as defined in section 995-1 of the ITAA 1997).

CHAPTER 2.8: REVERSE CHARGE MECHANISM, GST FREE FARM LAND SUPPLIED FOR FARMING

Government decision

Reverse charge mechanism

The GST law will be amended to remove the GST free concessions for the supply of going concerns and farm land supplied for farming, and replace the concessions with a reverse charge mechanism. The reverse charge mechanism will also be available for a wider range of supplies of going concerns.

Background

2.8.1 The mechanism by which the current law effectively allows a GST exclusive price is to provide that certain supplies of going concerns and supplies of farm land are treated as GST free. The current definition of a supply of a going concern is, in general terms, the sale of a continuing enterprise.

2.8.2 This measure replaces this approach with a reverse charge mechanism to reflect the Board of Taxation's finding that the GST free going concern provision can be too narrow and uncertain in its application.

Operation of existing law

2.8.3 Unlike other GST free supplies in the Act, the GST free status of a supply of a going concern is not given to provide an exemption from taxing final private consumption. Instead, it is intended to allow a GST exclusive price to be charged in a business to business transaction.

2.8.4 A supply of a going concern is GST free if the supply is for consideration, the recipient is registered and the parties have agreed in writing that the supply is of a going concern. To be treated as a going concern the supplier must provide to the recipient all of the things that are necessary for the continued operation of the enterprise and the supplier must carry on the enterprise until the day of the supply (subdivision 38-J, section 38-325).

2.8.5 A supply of farm land is GST free if the land is land on which a farming business has been carried on for at least five years preceding the supply and the recipient of the supply intends that a farming business be carried on, on the land (subdivision 38-O, section 38-480). The term 'farming business' is defined in sub-section 388-475(2). There is no requirement for the recipient of a GST free supply of farm land to be registered.

2.8.6 GST free supplies of going concerns and farm land are subject to the adjustment provisions contained in Division 135. The adjustment provisions are intended to ensure that the recipient of the supply is liable for an adjustment (payment of GST) if they do not acquire the supply solely for a creditable purpose, or do not use the supply solely for a creditable purpose. The intended effect of Division 135 is to produce the same net GST outcome as would arise had the supply been taxable and the recipient had been entitled to claim an input tax credit to the extent that the acquisition was for a creditable purpose.

Proposal

Principle 1

2.8.7 The GST on a supply of a going concern or farm land may, at the agreement of the parties, be treated as reverse charged.

Carve out

2.8.8 The reverse charge only applies to the extent that a supply (or parts of a supply) is a taxable supply.

Add-on:

2.8.9 The amount of GST that is reverse charged on a supply of a going concern is equal to 10 per cent of that part of the price of the supply that relates to the taxable component of the supply.

2.8.10 The parties to the supply must agree in writing on or before the date of supply that the supply will be subject to a reverse charge mechanism.

2.8.11 In order for a supply of a going concern or farm land to be eligible to use a reverse charge mechanism, the recipient of the supply must be registered or required to be registered for GST.

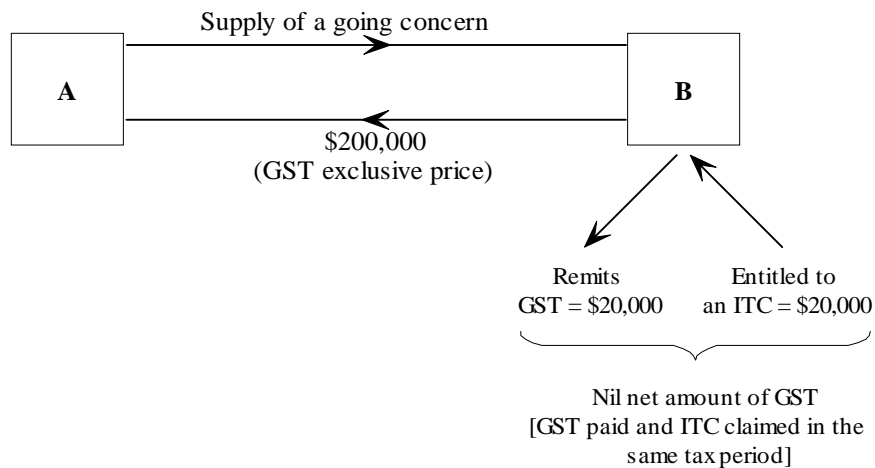
2.8.12 Where the supplier and the recipient are associates and the supply is without consideration, or for inadequate consideration, the amount of GST on the supply is 10 per cent of the GST exclusive market value.

Commentary

2.8.13 Under a reverse charge mechanism, the recipient of a supply is responsible for remitting GST that would otherwise be remitted by the supplier. The recipient is also entitled to claim input tax credits where it has made a creditable acquisition. Thus at the time of acquisition the recipient will be liable to remit the GST and will be entitled to claim input tax credits to the extent it has made a creditable acquisition. The two amounts, generally, would offset one another, whilst maintaining the normal GST revenue result. The reverse charge for the supply of a going concern and farm land would operate similarly to section 83-5 of the GST Act.

2.8.14 The amount of GST charged is 10 per cent of that part of the price of the supply that relates to the taxable component of the supply because using the basic GST rules (broadly 1/11th of the price) would not result in the correct amount of GST.

OPERATION OF THE REVERSE CHARGE MECHANISM



2.8.15 The diagram above represents the supply of a going concern from A to B under the reverse charge mechanism. The supply consists of taxable supplies for a GST exclusive price of \$200,000. In the circumstances represented above, the GST relating to the taxable supply of a going concern will be reversed charged and B will be liable for the GST and will claim the relevant input tax credit.

2.8.16 Limiting the reverse charge to taxable supplies will ensure that the general provisions dealing with creditable acquisitions found in Division 11 and the general adjustment provisions for changes in extent of creditable purpose found in Division 129 apply under the reverse charge and operate as intended (see Principle 2 below).

2.8.17 The use of the reverse charge for a supply of a going concern or farm land is voluntary and therefore can only be used where both parties agree. The requirement that agreement must be in writing and made on or before the date of supply is intended to avoid a source of dispute between a supplier and recipient as to the GST treatment on a supply and to remove confusion between the parties as to which party is liable to remit the GST. This is consistent with the current requirement for the supply of a going concern under paragraph 38-325(1)(c). Where there is no agreement in writing that the supply is subject to a reverse charge the normal GST rules will apply.

2.8.18 The recipient must be a registered entity, or required to be registered, to ensure that a reverse charge mechanism can operate and produce an outcome consistent with the basic GST rules. This is because only a registered recipient of a supply is entitled to claim input tax credits. An unregistered recipient would have no input tax entitlement and is expected to bear the economic incidence of the GST.

2.8.19 It was noted by the Board of Taxation that unregistered recipients of supplies of farm land could bear less GST in the same circumstances than a GST registered recipient under the current provisions. The replacement of the GST free farm land provision with a reverse charge mechanism will mean that a supply of farm land from a registered entity to an unregistered recipient will attract GST. Requiring registration for recipient entities who wish to use the reverse charge concession would address this. In order to meet the requirements for the current GST free treatment of farm land supplied for farming, a recipient must intend to carry on a farming business. As a result, it would generally be expected that recipients of supplies of farm land would be registered.

2.8.20 Where a going concern is supplied between associates for no or inadequate consideration the rules contained in Division 72 will apply to ensure that sufficient consideration is captured in the GST base. Section 15D of the *A New Tax System (Goods and Services Tax Transition) Act 1999* (GST Transition Act) provides some legislative guidance as to how the reverse charge amendments might be drafted in respect of supplies between associates.

Meaning of supply of a going concern

2.8.21 The supply of a going concern must consist of all or *substantially all* things that are necessary to allow the recipient to continue to carry on an enterprise of the same or similar business. This definition will encompass a broader range of supplies than are currently available under the going concern provisions.

2.8.22 The enterprise to which the supply of the going concern relates must be operating, or must previously have been operated by the supplier and be capable of operating as an enterprise at the date of supply (whether or not as part of a larger enterprise carried on by the supplier).

Commentary

2.8.23 The effect of a supply of a going concern is to put the recipient in possession of an enterprise which can be operated as such. The sale of capital assets will not in itself be a supply of a going concern. The vital consideration is whether the effect of the supply is to put the recipient in possession of an operational enterprise, the activities of which could be carried on without interruption. The recipient's current operational capacity could be taken into account when assessing whether the supply was of 'everything' necessary for the continuation of an enterprise. For example, a supplier does not have to supply to a recipient, as part of a supply of a going concern, anything that the recipient already has that is necessary for the continuation of the enterprise.

2.8.24 A business may be sold to more than one recipient. As long as each sale is the supply of a going concern and capable of being carried on as an enterprise these should constitute the supply of a going concern.

2.8.25 The intention is to broaden the scope of the current requirement under paragraph 38-325(2)(b). The requirement that a going concern needs to be operating right up until the day of supply is considered to be too onerous. The law will allow for the supply of a going concern that may have ceased but is still capable of being operated as a going concern.

Meaning of farm land supplied for farming

2.8.26 The supply of farm land must be land on which, prior to supply, a farm business had been carried on for a period of at least five years. The recipient of a supply of farm land must intend that a farming business be carried on, on the land.

Commentary

2.8.27 The intention of this requirement is to maintain the current requirement to qualify for a GST free supply of farm land under paragraphs 38-480(a) and (b).

Focus questions:

Q.8A Will the proposed reverse charge mechanism for supplies of going concerns and farm land operate effectively?

Q.8B Is the definition of a supply of a going concern sufficiently broad to address the concerns raised with the Board of Taxation? If not, how else could the definition operate, noting the requirement that the reverse charge mechanism is not intended to apply to the sale of assets, only to enterprises?

Q.8C Are there any concerns with the proposal to replace the GST free treatment of a supply of farm land with a reverse charge mechanism?

Principle 2

2.8.28 The general GST adjustment principles and provisions apply to supplies that have been made under a reverse charge mechanism.

Commentary

2.8.29 The intention of this principle is to ensure that a recipient of a supply is liable for an adjustment if they later change the extent to which a supply is used for a creditable purpose.

2.8.30 This will ensure that entities that acquire a going concern or farm land under a reverse charge mechanism will effectively bear the same amount of net GST as they would under the normal GST rules.

2.8.31 The current Division 135 will no longer apply and will be repealed. However, a transitional provision will be necessary to ensure that where an entity has previously made a supply of a going concern which is GST free under subdivision 38-J, and is making later adjustments because of a change in the extent of creditable purpose under section 135-10 (which interacts with Division 129), the later adjustments should continue over the relevant adjustment period.

Focus question:

Q.8D Will the proposed adjustment provisions operate effectively for supplies of going concerns and farm land?

Principle 3

2.8.32 A supplier of a going concern or farm land, under the reverse charge mechanism, will not have to supply:

- a tax invoice for the recipient to be entitled to an input tax credit; or
- an adjustment note where there is an adjustment event resulting in a decreasing adjustment.

Commentary

2.8.33 The recipient of a supply of a going concern or farm land is entitled to claim an input tax credit for the acquisition despite not having a tax invoice from the supplier. This is similar to section 83-35 in relation to non-residents making supplies connected with Australia.

2.8.34 An adjustment event may arise in relation to a supply of going concern or farm land, for example, where the consideration changes for the supply. Under section 29-20 if an adjustment event results in a decreasing adjustment (that is, a reduction of GST or an increase in input tax credits) the recipient will need to hold an adjustment note at the time they lodge their return for the tax period in which the adjustment is claimed. However, the recipient does not need to have an adjustment note to claim an adjustment if the Commissioner has given a written determination that it is not required (section 29-20). For example, legislative determination WAN 2004/7 waives the requirement for an adjustment note with respect to section 83-5 (non-residents making supplies connected with Australia).

2.8.35 It is intended that the legislation provide that an adjustment note is not required in relation to decreasing adjustments in respect of the supply of a going concern or farm land where the GST is reverse charged. This would negate the need for the Commissioner to produce a legislative instrument.

2.8.36 This principle should operate similarly to section 15H of the GST Transition Act.

Focus question:

Q.8E Are there any circumstances where taxpayers may require an invoice?

Principle 4

2.8.37 If a supply of a going concern involves real property, the GST liability on that part of the supply which is a taxable supply of real property may be determined under the margin scheme and remitted by the supplier.

Commentary

2.8.38 The margin scheme is an alternative mechanism for determining GST liability on taxable supplies of real property (see Division 75). The intention is that GST is only payable on each supplier's 'margin' or increase in value. This ensures that the value added to real property before 1 July 2000 when the GST was introduced is not subject to GST.

2.8.39 Part of a going concern may be real property. This principle is intended to allow the use of the margin scheme in respect of the part of a supply of a going concern that is a supply of real property, where the supply would otherwise be eligible for the margin scheme.

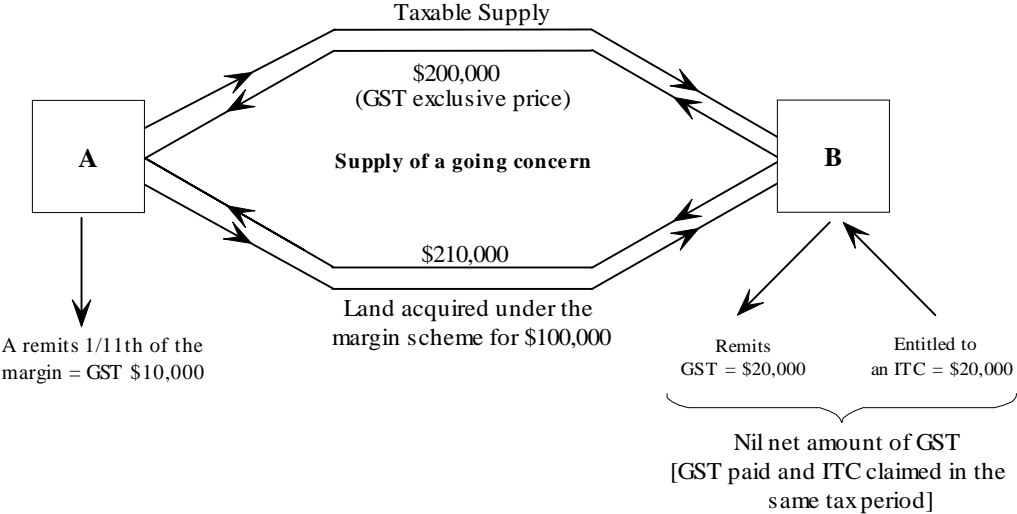
2.8.40 The supplier and recipient would need to agree in writing that the supply is a supply of a going concern (and meet the criteria). The supplier and recipient would need to further agree in writing that the GST liability in respect of part of the going concern that is eligible for the margin scheme will be determined under the margin scheme (see section 75-5). The recipient would not be entitled to an input tax credit (see section 75-20) for that part of the supply. The supplier would remain liable for the GST on that part of the supply of the going concern made under the margin scheme. The GST liability on the remainder of

the supply of the 'going concern' could be determined under the normal rules and be reverse charged to the recipient.

2.8.41 If the margin scheme is used to determine the liability on the real property component, a subsequent supply of the real property would be eligible to use the margin scheme. If the margin scheme is not used, a subsequent supply of the real property will not be able to use the margin scheme (see subsection 75-5(3)).

2.8.42 Notwithstanding that the margin scheme is used to determine the GST liability on real property that forms part of a going concern, the real property is taken into account in determining whether the supply is a supply of a going concern.

OPERATION OF THE REVERSE CHARGE MECHANISM AND THE MARGIN SCHEME



2.8.43 The diagram above represents the supply of a going concern from A to B under the reverse charge mechanism. The supply consists of taxable supplies for a GST exclusive price of \$200,000 and a supply of land under the margin scheme for \$210,000. The land was previously bought by A under the margin scheme in 2001 for \$100,000 and is eligible for the margin scheme.

2.8.44 Under the reverse charge mechanism, all the assets supplied will be considered in assessing the eligibility of the supply as a reverse charged going concern. However, at the discretion of the parties, land eligible to be taxed under the margin scheme can be taxed under the margin scheme whilst all the other supplies will be reverse charged. In the circumstances represented above, the GST relating to the taxable supply of a going concern will be reverse charged; B will be liable for the GST and will claim the relevant input tax credit. A will be liable for the GST on the supply of the land, under the margin scheme, and will remit 1/11th of the margin and is not entitled to an input tax credit.

Focus question:

Q.8F Will the proposed reverse charge mechanism interact effectively with the margin scheme provisions?

Consequential amendments

2.8.45 Division 135 would be repealed and instead the normal adjustment rules under Division 129 (as amended in line with Government's announced measure) will apply. A transitional provision may be necessary to allow entities already using Division 135 as the basis of adjusting for a change in extent of creditable purpose to continue to do so.

2.8.46 The supply of a going concern under subdivision 38-J and farm land supplied for farming under section 38-480 would be removed from Division 38 as they will no longer be GST free supplies.

2.8.47 Section 188-23 specifies that supplies reverse charged under Division 83 are not included in the recipient's GST turnover. For the avoidance of doubt a similar reference is proposed to be included.

Adjustments for bad debts

2.8.48 If debts are written off or are overdue after 12 months on the consideration payable for a taxable supply or a creditable acquisition, Divisions 21 and 136 of the GST Act generally provide rules for adjustments to the GST payable or input tax credits allowed. These bad debt rules do not apply to taxpayers accounting on a cash basis. But if a taxpayer's accounting basis changes, sections 159-15 and 159-25 provide rules on how to treat the bad debt adjustments.

2.8.49 The rules in Divisions 21 and 136, as well as sections 159-15 and 159-25, would not work appropriately for the proposed reverse charge mechanism because:

- it would not be appropriate for the supplier to have a decreasing adjustment if the GST is payable by the recipient, not the supplier;
- the reverse charge is based on 10 per cent (not 1/11th) of the price of the supply. (Subdivision 136-B, which deals with adjustments for transactions that are taxable or creditable at less than 1/11th of the price, does not apply to a transaction taxable at 10 per cent of the price); and
- the operation of sections 159-15 and 159-25 is linked to the application of Division 21.

2.8.50 Accordingly, the proposed amendments will need to ensure that a bad debt adjustment under the reverse charge mechanism only applies to the recipient and not the supplier and is worked out as 10 per cent of the amount written off or overdue by 12 months or more (as the case requires). Section 15G of the GST Transition Act provides some legislative guidance as to how the reverse charge amendments might be drafted in respect of bad debt adjustments.

2.8.51 Section 15G of the GST Transition Act is an example of special 'bad debt' rules applying to the 'reverse charge' under the long-term non-reviewable contracts provisions. However, section 15 does not address all of the potential problems identified above. For example, if an increasing adjustment for a creditable acquisition arises for the recipient, section 15G does not provide for the adjustment to be worked out as 10 per cent of the bad debt amount. Such an increasing adjustment would be worked out under section 21-15 of the GST Act, which would be 1/11th of the bad debt amount. This would be at odds with how the decreasing adjustment is worked out for the recipient (that is 10 per cent of the bad debt amount).

2.8.52 Further, section 15G does not provide for an apportionment of the decreasing adjustment for a partly taxable supply. Nor does it interact appropriately with Subdivision 136-A which provides for apportionment of bad debt adjustments for a partly taxable supply or creditable acquisition. This is because the Subdivision 136-A apportionment method applies to an adjustment based on 1/11th of the bad debt amount rather than 10 per cent.

2.8.53 The interactions with sections 19-40, 19-45, 19-70, 19-75, 129-80 and 131-55 are also not addressed by section 15G.

Focus question:

Q.8G Are there any further consequential amendments required to ensure that the reverse charge mechanism operates appropriately?

Application date

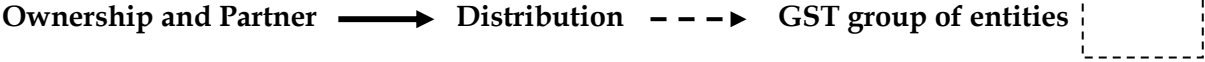
2.8.54 The unanimous agreement of the State and Territories will be required for this measure as it comprises a change to the GST base.

2.8.55 Subject to that agreement, the measure will apply from 1 July 2010.

ATTACHMENT A — EXAMPLES OF ENTITIES ELIGIBILITY TO FORM A GST GROUP UNDER PROPOSED PRINCIPLE-BASED MEMBERSHIP RULES

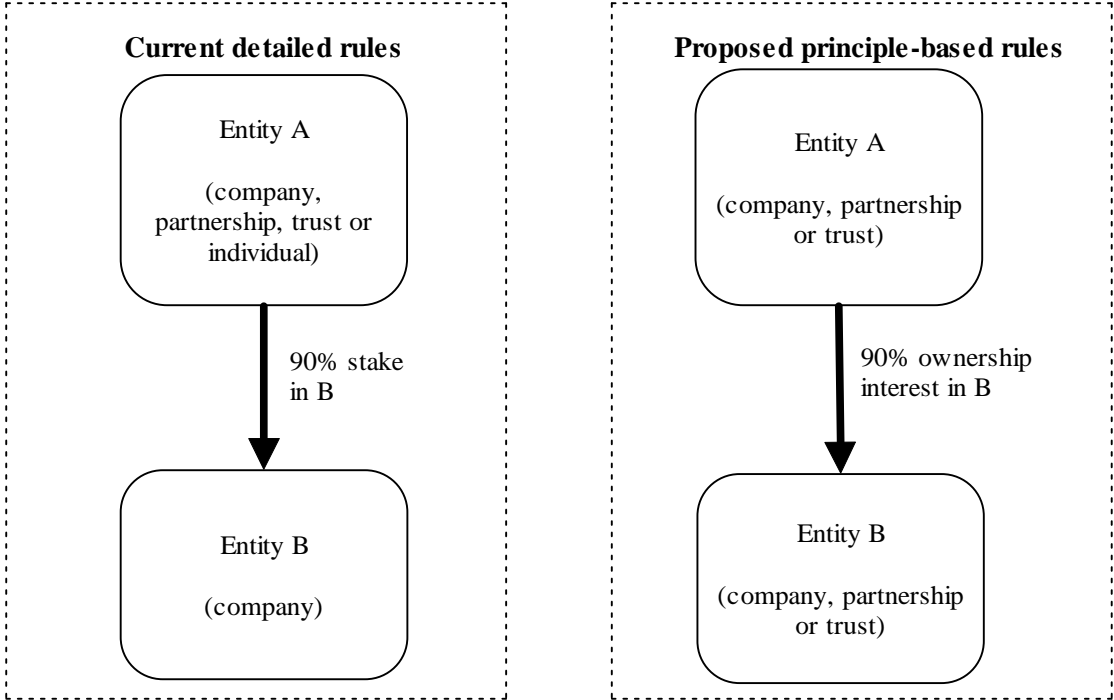
Note: The examples provided below are not intended to be exhaustive examples of scenarios under which entities will be entitled to form a GST group under the proposed membership rules.

Legend:



PRINCIPLE 1 — 90 PER CENT OWNED GROUP MODEL

DIAGRAM A1.1

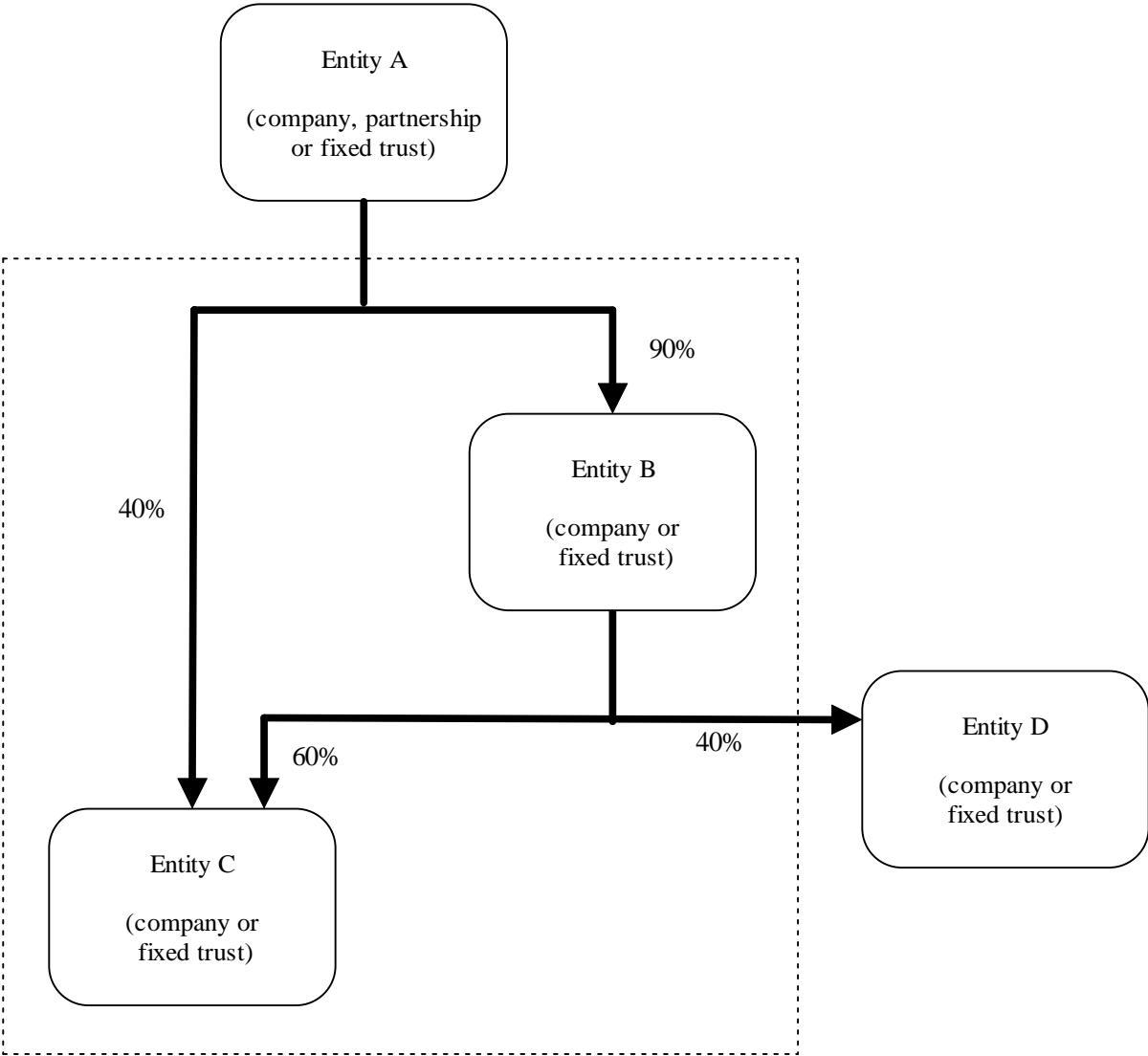


Commentary

Under the proposed Principle 1, an Entity A can choose to group with a subsidiary Entity B if it holds a 90 per cent ownership interest in Entity B. Entity A – a ‘holding entity’ – can be a company, partnership or trust but it cannot be an individual as under the current detailed rules⁶. Entity B can be a company, and in addition under the proposed principle, also a partnership or trust.

⁶ Individuals can group under conditions prescribed in Principle 2 (Single Family Model), providing that they are registered for GST purposes and satisfy other grouping membership criteria such as, for example, having the same tax periods as all other group members.

DIAGRAM A1.2

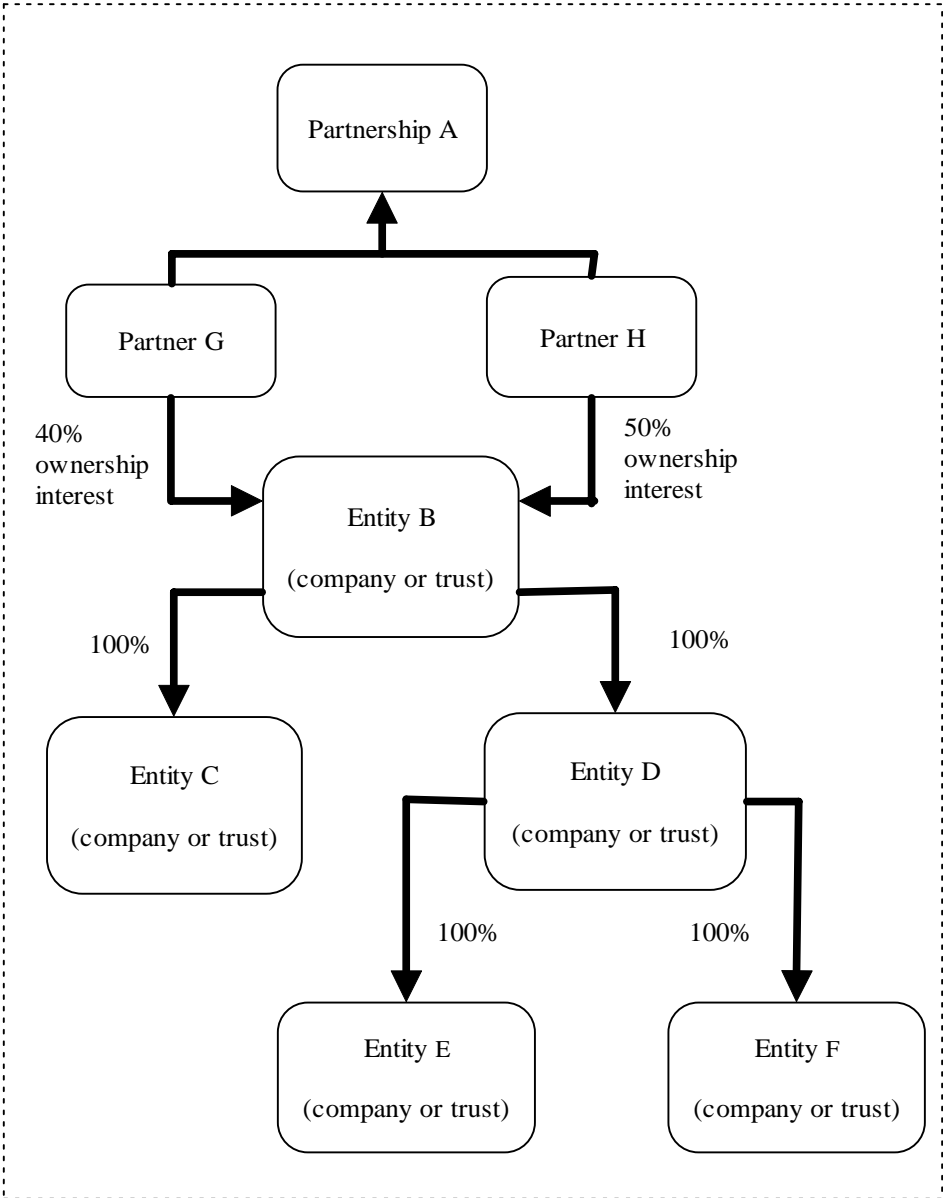


Commentary

Entities B, C and D are subsidiary members of a group headed by Entity A. Entities A, B and C can choose to group as Entities B and C are at least 90 per cent-owned by Entity A. Entity D cannot group as it is not 90 per cent-owned (directly or indirectly) by Entity A.

Note that although entities may be eligible to be members of a group, it is not necessary for all of the eligible members (including the 'holding entity' that is Entity A) to group for GST purposes.

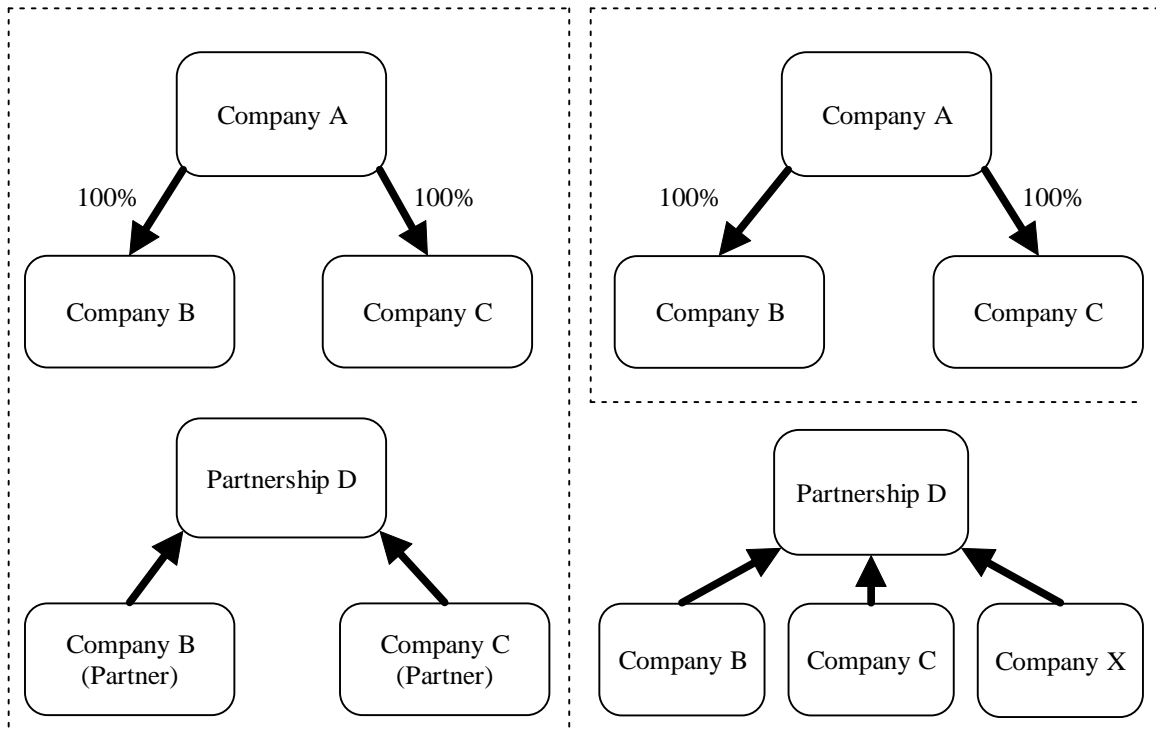
DIAGRAM A1.3



Commentary

A partnership or non-fixed trust can be a holding entity of a 90 per cent owned group if the partners in the partnership or the trustee of the non-fixed trust holds at least 90 per cent of the membership interests in the other entities of the group.

DIAGRAM A1.4



Commentary

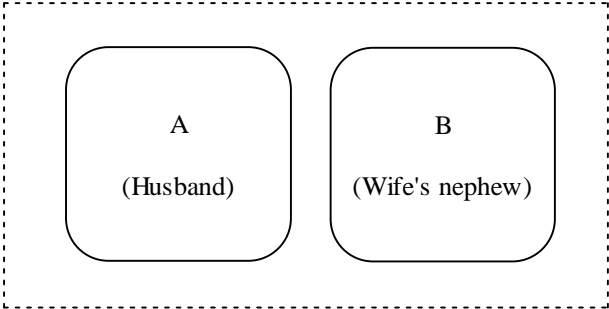
Partnership D can be a member of a group with company A, B and C, if its partners (Company B and Company C) are also members of the group.

Partnership D cannot be a member of a group with company A, B and C, if one of its partners (in this case Company X in the second diagram) is not a member of the group. In this case, the GST group can only be formed between company A, B and C.

Further, if the entities choose to exclude either Company B or Company C from the group, Company A and Partnership D cannot group.

PRINCIPLE 2 — SINGLE FAMILY MODEL

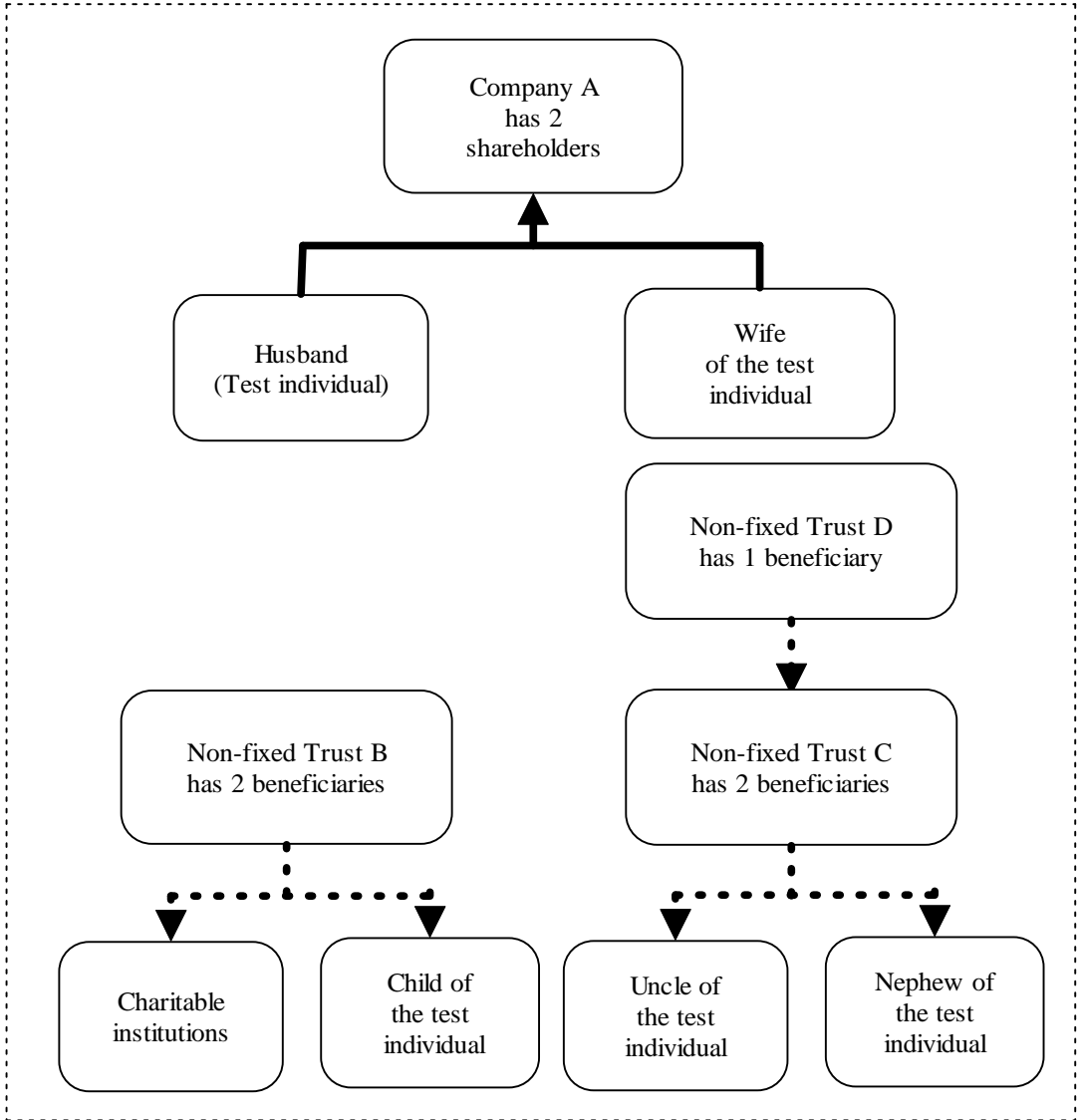
DIAGRAM A2.1



Commentary

Individuals A and B who are sole traders cannot group under the current detailed membership rules. However, under the proposed principles, they may group as members of the same family.

DIAGRAM A2.2

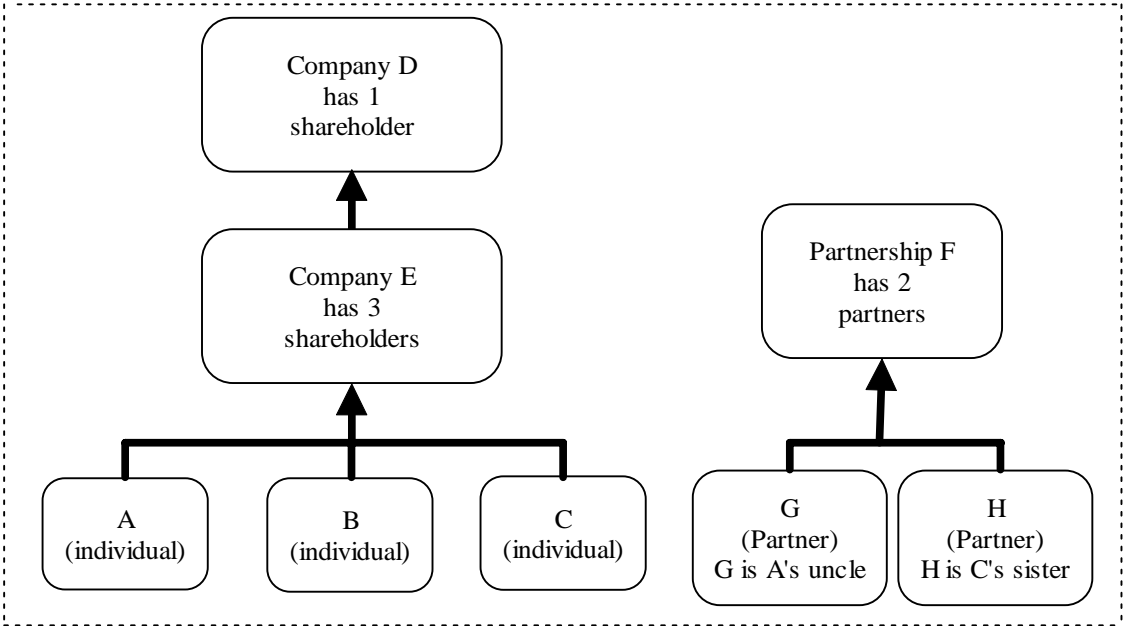


Commentary

Under the proposed Principle 2 Entities A, B, C and D may group because the only individuals who can directly or indirectly receive distributions are all family members of the same test individual (assume this is the husband) or the test individual’s spouse. The individuals (if registered) may also be members of the group.

The proposed principles will also apply if there are interposed entities between the entities (the trust, partnership or company) and the individuals who are members of the family.

DIAGRAM A2.3



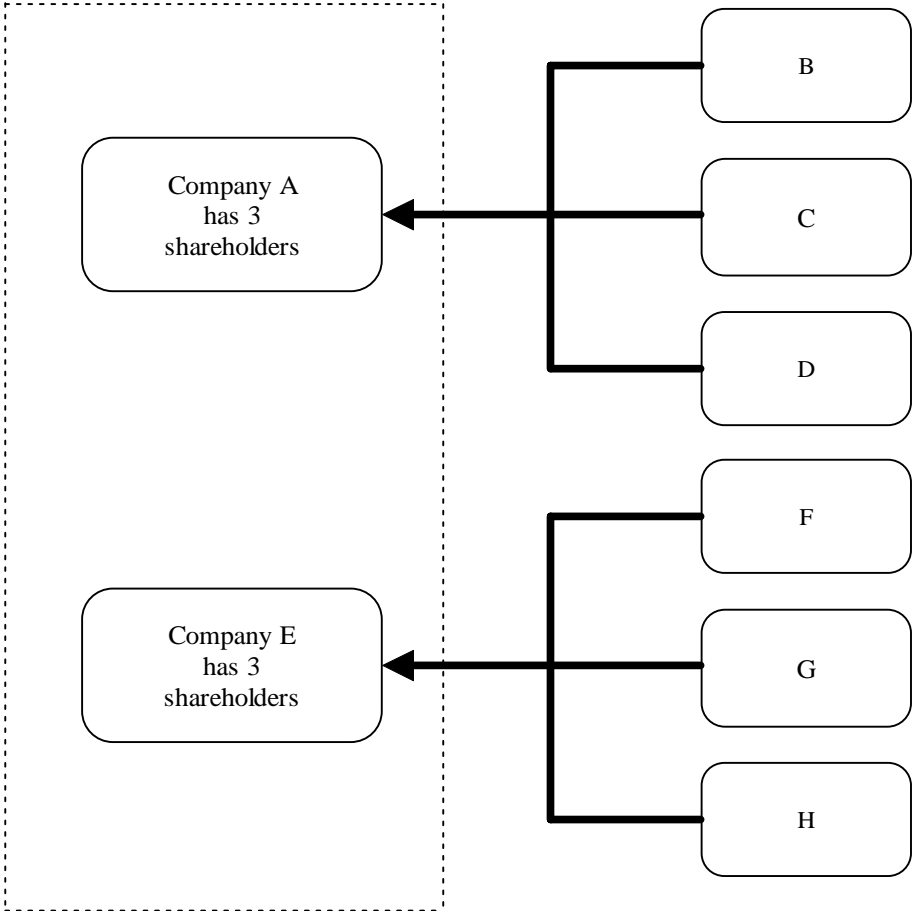
Commentary

Company E owns Company D. A, B and C who are members of the same family are the only shareholders of Company E.

Companies D and E may group as D is wholly owned by E. Companies D and E may also group with Partnership F because the only partners (that is G and H) are members of the same family as the owners of Company E.

PRINCIPLE 3 — MULTIPLE FAMILIES MODEL

DIAGRAM A3.1

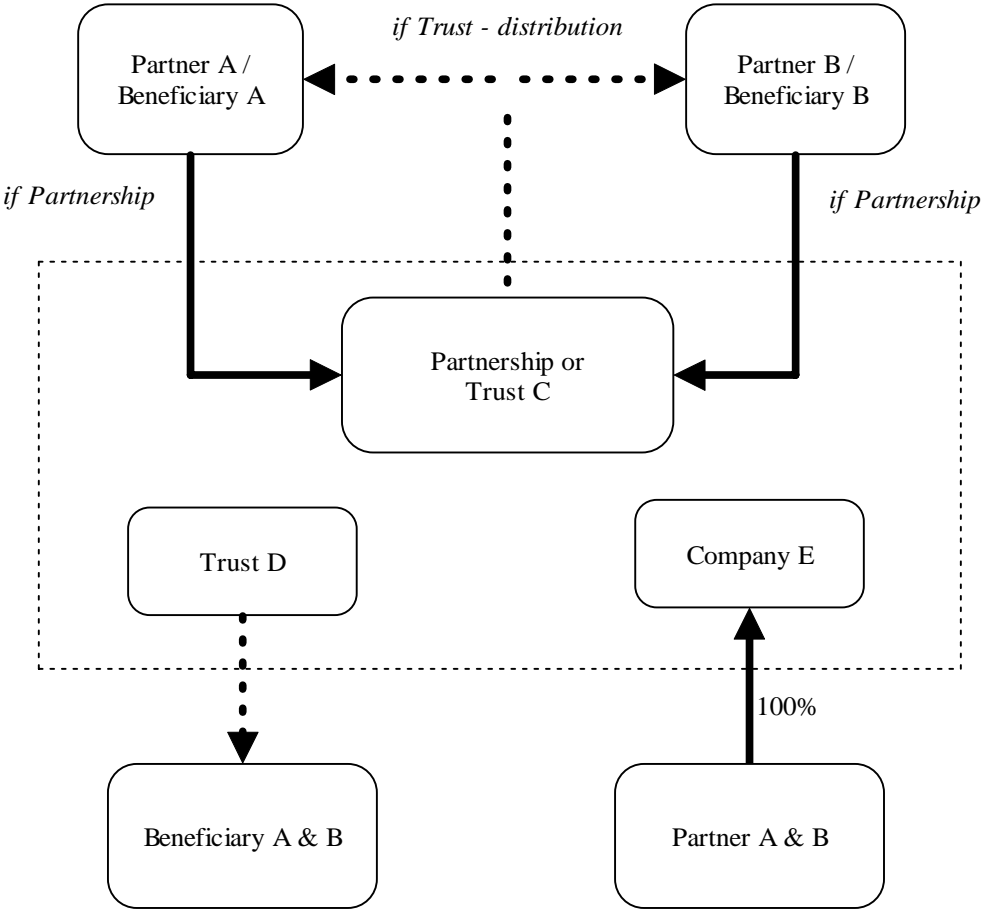


Commentary

Under the multiple families model, companies, partnerships and trusts which are wholly owned by individuals of two or more families or their family members, can form a GST group.

For example, Company A may group with Company E if shareholders F, G and H are spouses of B, C and D. However, if H is not related to D, Company A and Company E cannot group because D has no family member represented in Company E. Further, even if H is related to either B or C, Company A and Company E still cannot group.

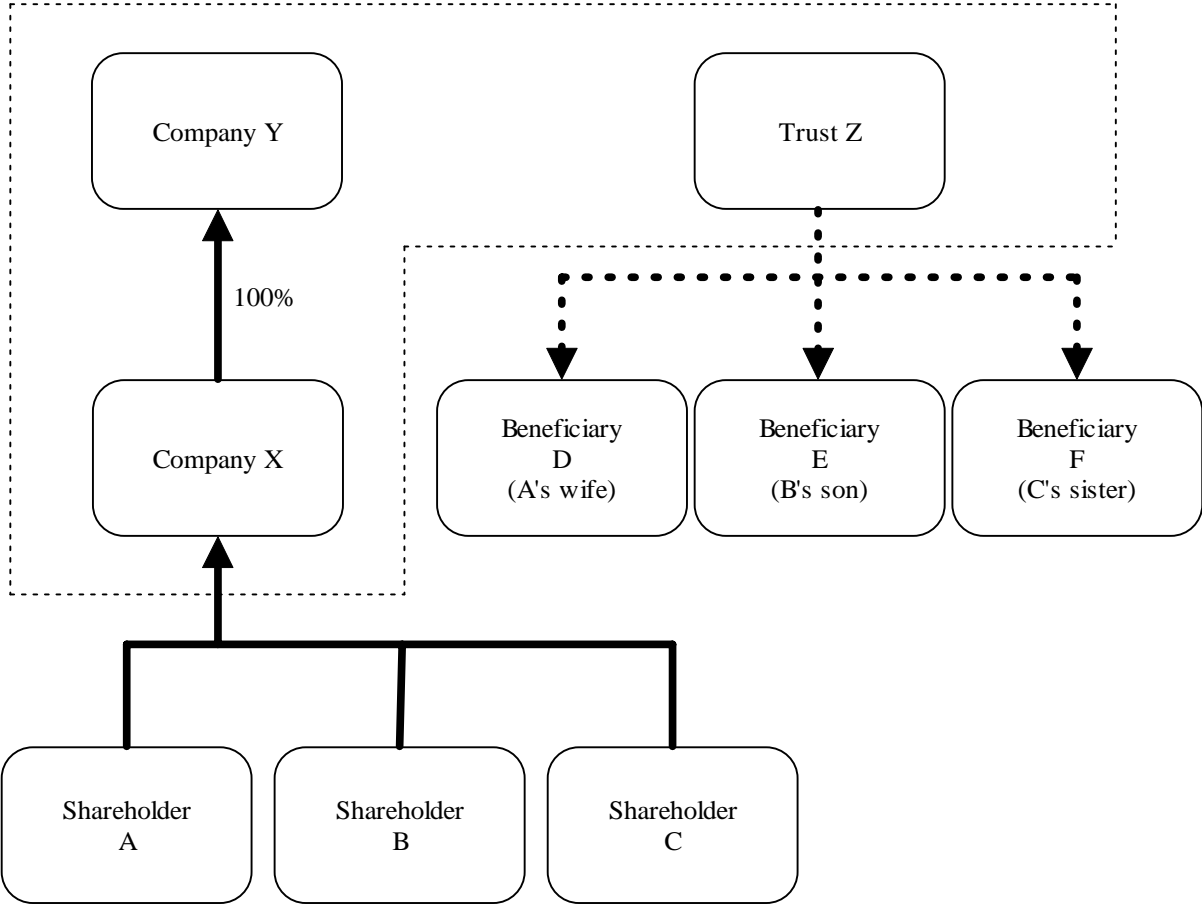
DIAGRAM A3.2



Commentary

Entities C, D and E may group because the entities are ultimately controlled by the same individuals, who may either be from the same family or different families (as each family is represented in each entity). If A and B are related the single family model applies. If A and B are not related, the multiple families model applies.

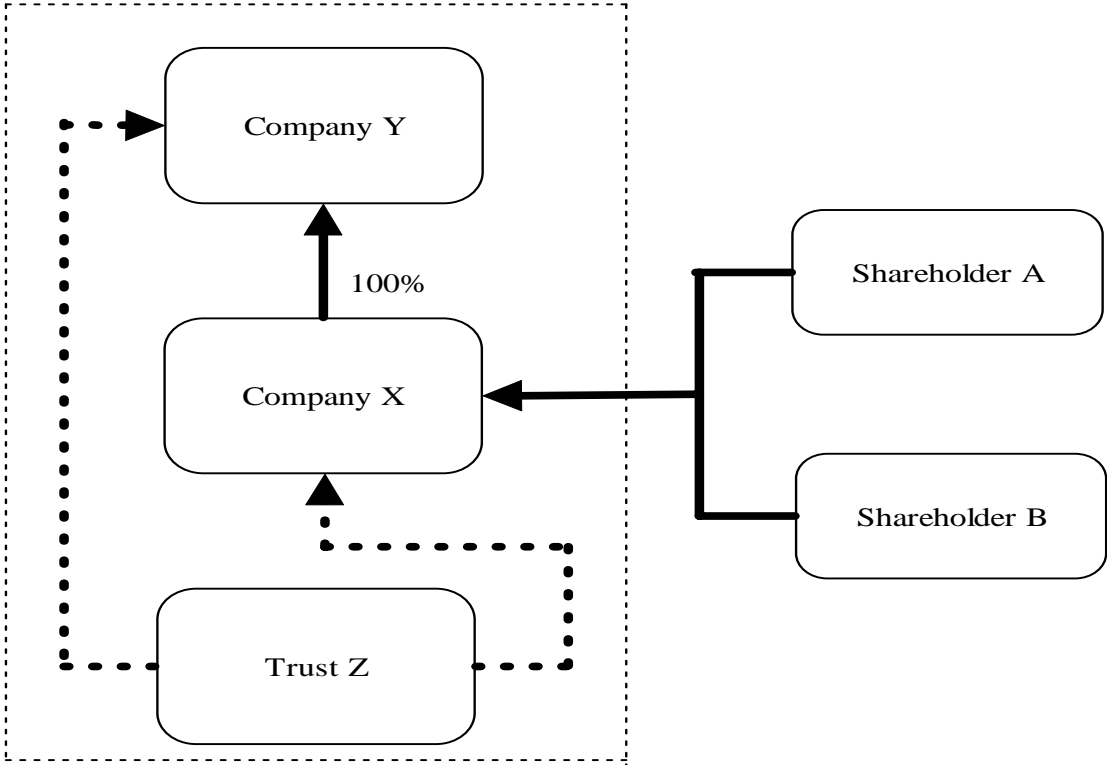
DIAGRAM A3.3



Commentary

Trust Z is eligible to be part of the same group as Company X and Y as it is owned by the same family members who own Company X and Company Y. That is, family members of A, B and C are represented as beneficiaries of Trust Z.

DIAGRAM A3.4



Commentary

Under the proposed Principle 3, Company Y and Trust Z can group with or without Company X being in the group if ultimately they are owned and controlled by the same individuals or their family members.

DIAGRAM A3.5A

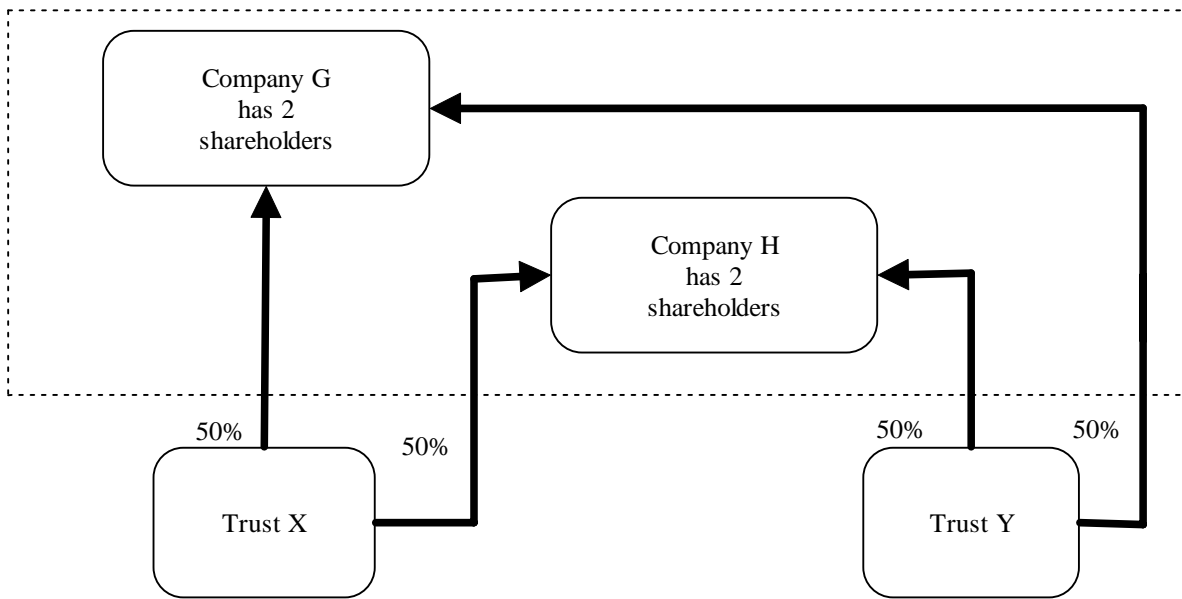
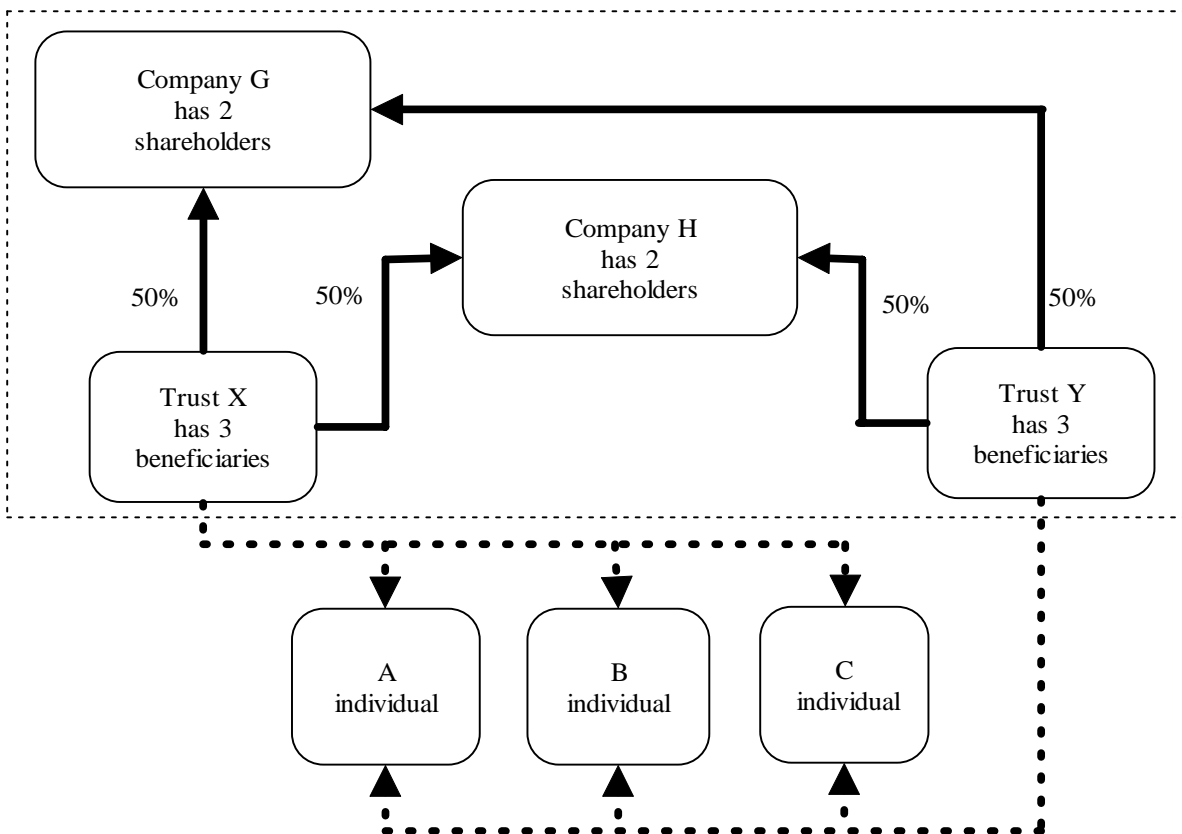


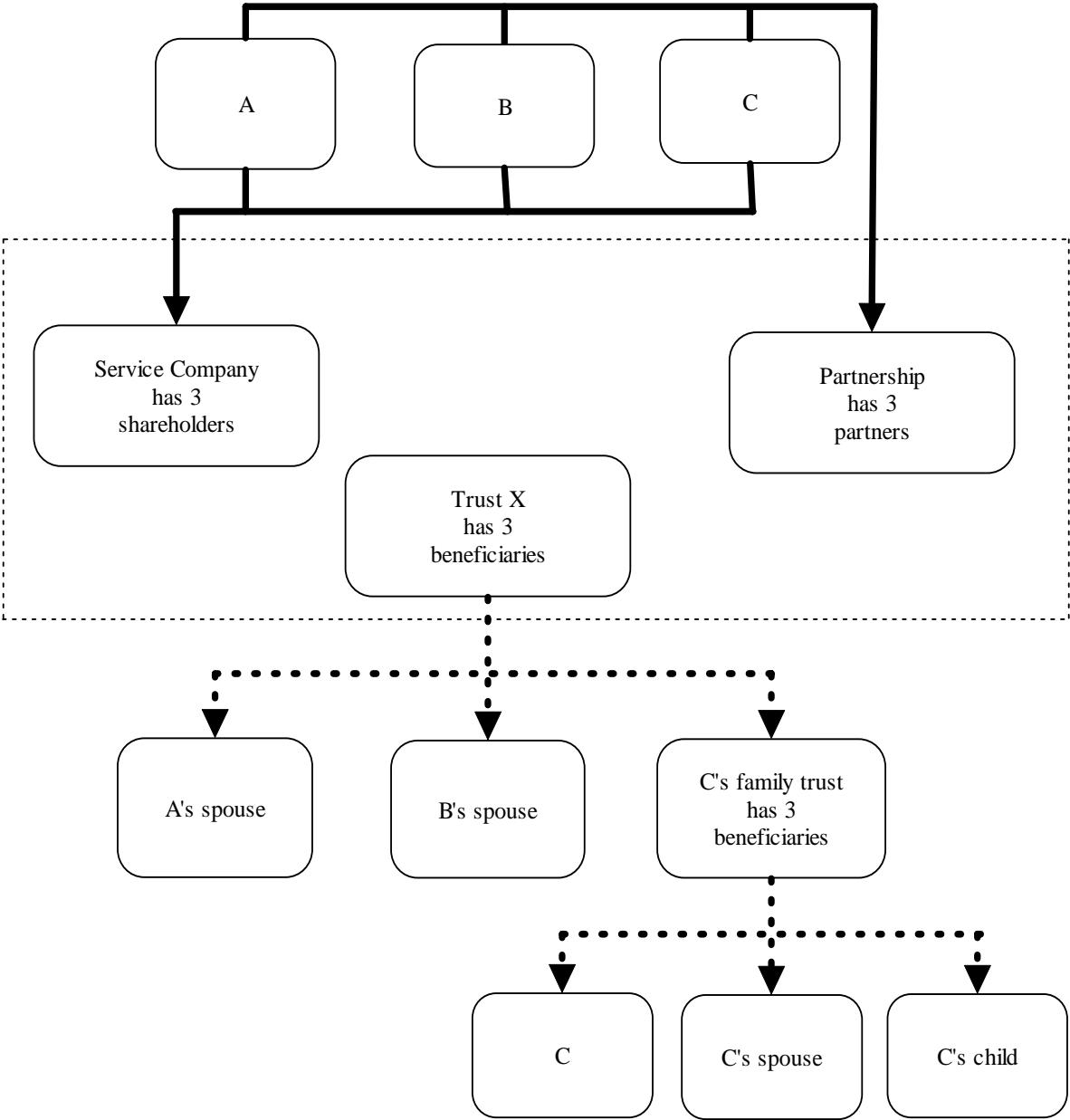
DIAGRAM 3.5B



Commentary

Company G and Company H can group under the proposed principles because they are both owned by the same trusts. If the trusts also wish to be members of the same group as the companies it will be necessary to trace through to the beneficiaries of the trust. As the beneficiaries of the trusts are the same individuals, the trusts can group with each other and with the companies. That is, the companies are ultimately owned by the same individuals.

DIAGRAM A3.6



Commentary

The existing grouping rules apply as follows: As the shareholders of the service company are the same as the partners in the partnership, the partnership may be able to form a GST group with the service company. Trust X can join the GST group, as at least two of its beneficiaries are family members of different shareholders of the company. However, C's family trust will not be able to join the GST group as its beneficiaries represent only one partner and the family of that partner.

The same outcome will be achieved under the proposed principles. The company, trust and partnership can group because they are controlled and owned by the same individuals. Similarly, C's family trust cannot group because it is owned and controlled only by C and family members.