

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

**Second consultation paper**

**September 2009**

© Commonwealth of Australia 2009  
ISBN 978-0-642-74533-0

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration  
Attorney-General's Department  
3-5 National Circuit  
BARTON ACT 2600

Or online at:  
<http://www.ag.gov.au/cca>

# CONSULTATION PROCESS

## Request for feedback and comments

The Government is seeking your feedback and comments on the design of the measures in this paper. Submissions may address all of the measures set out in this paper or one or more of these. Submissions should also identify 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 measure for which feedback is sought. While submissions may be lodged electronically, by post or by facsimile, electronic lodgment is preferred.

All information (**including name and address details**) contained in submissions will be made available to the public on the Treasury website unless respondents indicate that they would like all or part of their 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* to make available a submission marked 'confidential' will be determined in accordance with that Act.

Closing date for submissions: Friday 9 October 2009.

### 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, 2.7

Sue Piper  
Indirect Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600  
Phone: 02 6263 4310

Chapters 2.2, 2.5, 2.8

Phil Bignell  
Indirect Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600  
Phone: 02 6263 4372

Chapters 2.3, 2.4, 2.6

Michael Harms  
Indirect Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600  
Phone: 02 6263 3308

# CONTENTS

- CHAPTER 1: INTRODUCTION AND OVERVIEW ..... 1**
- CHAPTER 2: IMPLEMENTATION INFORMATION ..... 3**
- 2.1 Adjustments ..... 3
- 2.2 Self assessment..... 21
- 2.3 General law partnerships ..... 31
- 2.4 Tax law partnerships..... 39
- 2.5 Bare trusts..... 45
- 2.6 Running balance account..... 48
- 2.7 Non-profit sub-entities ..... 50
- 2.8 Payment of refunds of overpaid GST ..... 52



## FOREWORD

I am very pleased to release this second discussion paper containing further proposed changes to GST administration, following the release of an earlier discussion paper on 12 May 2009.

This second discussion paper contains additional implementation information on a number of GST administration measures announced by the Rudd Government in the 2009-10 Budget.

The Rudd Government is committed to reducing GST compliance costs and streamlining and removing anomalies in the administrative framework of the GST.

These proposed tax changes will significantly assist and we look forward to receiving the community's view.

SIGNED

Assistant Treasurer  
Senator Nick Sherry

# CHAPTER 1: INTRODUCTION AND OVERVIEW

## Introduction

1.1.1 On 12 May 2009, the Government announced its 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 former Assistant Treasurer's website (<http://ministers.treasury.gov.au>). The Board of Taxation's report is available from its website (<http://www.taxboard.gov.au>).

1.1.2 The States and Territories have agreed to 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 a number of the announced Government measures might operate and to seek feedback on their design and implementation. This follows the release of an earlier discussion paper setting out information on how 12 of the announced Government measures might operate.

1.1.4 Conducting consultation on announced Government measures 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 the basis of the level of detail similar to drafting instructions that Treasury provides to the Office of Parliamentary Counsel.

## Consultation processes

1.1.5 The paper provides detailed information similar to drafting instructions, with the principles to be included in the law set out and areas in which further feedback is sought on approaches to implementation. 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 recommendation no.
Chapter 2.1: Adjustments	4, 5, 7, 8
Chapter 2.2: Self assessment, period of review, net amount of luxury car tax and wine equalisation tax	19, 21,42
Chapter 2.3: General law partnerships	35
Chapter 2.4: Tax law partnerships	36
Chapter 2.5: Bare trusts	37
Chapter 2.6: Running balance account	39
Chapter 2.7: Non-profit sub-entities	43
Chapter 2.8: Payment of refunds of overpaid GST	45

## Principles-based law design

1.1.6 The changes to the GST law will be drafted using the principles-based approach where possible.

1.1.7 Under principles-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.

1.1.8 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.

1.1.9 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

1.1.10 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-stage transaction-based nature of the GST. The Government's reforms also streamline GST administration and remove existing anomalies in the GST law.

1.1.11 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 limited access to professional advice or assistance.

1.1.12 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 was 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

1.1.13 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.

## CHAPTER 2: IMPLEMENTATION INFORMATION

### 2.1 ADJUSTMENTS

2.1.1 As the GST is a multi-stage transaction-based tax, adjustments are sometimes necessary to ensure the correct amount of tax is paid, and the correct amount of input tax credits claimed when there are changing circumstances around a transaction. It is important that the correct amount of tax is paid to avoid embedded taxation, to ensure competitive neutrality and to protect the revenue. At the same time, it is important to ensure that making adjustments does not impose an excessive compliance burden on taxpayers. The recommendations in this area attempt to balance these competing considerations.

#### A. Amendments to the interpretation of the terms 'apply' and 'application' in the adjustments provisions

##### Government decision

The GST law should be amended to ensure consistency and certainty in the use of the terms 'apply' and 'application' in the adjustment provisions.

##### Operation of existing law

2.1.2 The terms 'apply' and 'application' are used in Divisions 129, 130 and 138 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) to describe instances in which the use of an acquisition over time, or because of certain events, may change the extent of creditable purpose and require an adjustment. These Divisions collectively address a range of circumstances in which this may arise, and the terms 'apply' and 'application' are intended to describe the circumstances which change the extent of creditable purpose relevant for each Division. However, the law currently provides for only one meaning of the term 'apply' across each of these Divisions, and providing a consistent meaning to give each Division its intended effect is problematic.

##### Division 130

2.1.3 Division 130 applies to goods that were acquired solely for a creditable purpose (and hence for which a full input tax credit is likely to have been claimed) such that if the goods are subsequently applied solely for a private or domestic use, there is a 100 per cent increasing adjustment. Division 130 applies to all goods and an adjustment is required in the tax period in which the private or domestic application occurs. However, Division 130 does not apply if a previous adjustment has been made under Division 129.

2.1.4 The intent of Division 130 is that goods acquired for a creditable purpose, including goods acquired as trading stock and other goods, should be subject to a 100 per cent increasing adjustment if the goods are subsequently consumed privately by that same entity. Currently under Division 130 an increasing adjustment arises where goods are applied solely to private or domestic use, and the terms 'apply' and 'application' have the same meaning in Division 130 as they do in Division 129.

2.1.5 On the basis of the view that holding something for the purpose of sale is an application of that thing for the purposes of Division 129, it is necessary to interpret Division 130 such that past application of the relevant goods in an entity's enterprise, prior to them being

'applied solely to private or domestic purposes', does not preclude a Division 130 increasing adjustment arising with respect to those goods. However this raises some difficulties. It is arguable that for those goods other than trading stock that are used for some time in a business then used for private purposes, a 100 per cent adjustment is not appropriate as some of the economic value of the goods will have been used in the enterprise.

## Proposal

2.1.6 The proposal is to limit Division 130 to trading stock (other than real property) and raw materials, to cater for instances in which input tax credits have been claimed but the goods are subsequently used wholly for private or domestic purposes. In these circumstances 100 per cent adjustments will continue to apply. Raw materials will include goods acquired for the purpose of incorporation into trading stock and goods intended to be supplied as part of the provision of services (for example paint used by a house painter in providing painting services).

2.1.7 The language of Division 130 will also be amended to reflect this intention and to avoid any confusion with the concept of 'apply' and 'application' as these terms are used in Divisions 129 and 138.

2.1.8 For goods other than trading stock or raw materials that are removed from use in an enterprise and subsequently used wholly for private or domestic purposes, increasing adjustments will be made under the proposed private use adjustments provisions of Division 129 and will be subject to the thresholds and adjustment periods proposed for changes in the extent of private use.

2.1.9 Currently Division 130 adjustments are limited to sole traders. Where items are removed from an enterprise for private use by entities other than sole traders, these supplies are made in the course of furtherance of the enterprise and Division 72 may apply in relevant circumstances where the item is supplied to an associate so that GST will be payable on the market value of the supply. Given the operation of Division 72 there does not appear to be a case for broadening the scope of Division 130 to cover other forms of enterprise.

2.1.10 To assist in reducing compliance costs, it is further proposed that Division 130 adjustments would only be required annually and aligned with the due date for the lodgment of income tax returns. The entity's tax period in which their income tax return is due to be lodged would be the adjustment period to which the Division 130 increasing adjustment would be attributable for any Division 130 adjustments that arose during the relevant income tax year. For example, if an entity with quarterly tax periods was due to lodge its tax return for the financial year 2008-09 on 31 October 2009, the adjustments for any trading stock or raw materials consumed privately in the financial year 2008-09 would be made in the tax period ending 31 December 2009.

## B. Change in use adjustments

### Government decision

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).

2.1.11 A broad outline of proposed changes to the change in use adjustment provision was included in the first discussion paper released on 12 May 2009. As a result of feedback received from stakeholders, these proposals have been further developed.

2.1.12 It is proposed that there be three separate adjustment regimes, one for real property used for making supplies of residential rent and sales of residential property, one for change in the extent of private use of supplies, and one for inputs into other input taxed supplies – predominantly financial services.

#### Change in use adjustments and supplies of residential property.

2.1.13 The sale of new residential premises is a taxable supply whereas the renting out of residential premises is an input taxed supply, as is the sale of residential premises which are not 'new'. Consequently input tax credits are available where residential premises are constructed for the purpose of sale but not where they are constructed for the purpose of renting. Changes in the extent of creditable purpose may lead to adjustments under Division 129.

2.1.14 It is recognised that developers constructing residential premises may have a dual planned use for the premises - that is, they may intend to lease the property for some time before sale. In addition, their plans may change over time due to factors such as market conditions. It is possible for developers to have 'dual concurrent' applications of premises where a property is being held for the purpose of sale but is nevertheless leased. That is, the premises can be applied to creditable and non-creditable purposes at the same time. This gives rise to complex issues of how to determine the intention of the developer when circumstances change, how to apportion input tax credits between dual applications and what adjustments should be made when the actual use varies from the intended use.

2.1.15 GSTR 2009/4 sets out accepted methodologies for such apportionment under the current law. The Commissioner has indicated that he will accept an apportionment method where the increasing adjustment for a property which is leased after full input tax credits have been claimed can be based on the ratio of rental earnings to the sum of rental earnings and the expected sale price of the property.

#### Example of application of GSTR 2009/4

John is registered for GST and has quarterly tax periods. He constructed new residential premises for the purpose of sale and was entitled to full input tax credits on his acquisitions. One particular

acquisition of construction services was made on 1 October 2006 for \$55,000 (GST inclusive). The premises were completed on 1 February 2007. John continued to hold the premises for the purpose of sale but also commenced leasing the premises for residential accommodation on 1 April 2007. John received rental income of \$2,500 per month and expected to sell the premises for \$500,000. John has continued to retain the dual concurrent application since 1 April 2007.

The first adjustment period in relation to the acquisition of construction services is the period ending 30 June 2008. There are 21 months in the relevant period between the acquisition on 1 October 2006 and the end of the first adjustment period on 30 June 2008.

For the six months from 1 October 2006 to 31 March 2007, John applied the premises solely for a creditable purpose, that is, an extent of creditable purpose of 100 per cent. For the 15 months from 1 April 2007 to 30 June 2008, John applied the premises for both a creditable purpose and a non-creditable purpose. John works out the extent of creditable purpose for the relevant period by using an output based indirect method (using estimated sales consideration) as follows:

$$\begin{aligned} & \frac{\$500,000}{\$500,000 + \$37,500} \\ & = 93.02 \text{ per cent} \end{aligned}$$

This percentage is the actual application of the thing for the purposes of step 1 of the method statement in subsection 129-40(1).

Suppose that, rather than continuing to hold the premises for sale as part of the enterprise, John decided on 1 April 2007 to hold the premises solely for the purpose of leasing.

As in the example above, for the six months from 1 October 2006 to 31 March 2007 John applied the premises solely for a creditable purpose, that is, an extent of creditable purpose of 100 per cent.

For the 15 months from 1 April 2007 to 30 June 2008 John applied the premises solely in relation to making input taxed supplies, that is, an extent of creditable purpose of zero per cent.

John applies a time-based apportionment to the application for a creditable purpose to ascertain the extent of creditable purpose for the relevant period (this is because for the rest of the period the extent of creditable purpose is zero per cent):

$$\begin{aligned} & (6 \text{ mths} / 21 \text{ mths} \times 100 \text{ per cent}) \\ & = 28.57 \text{ per cent} \end{aligned}$$

This percentage is the actual application of the thing for the purposes of step 1 of the method statement in subsection 129-40(1).

*Premises applied for a creditable purpose, to some extent, for part of the relevant period, and then subsequently applied for a zero per cent creditable purpose for the remainder of the period*

Supposing instead John continued to apply the premises for the dual concurrent application of the creditable purpose of sale and the non-creditable purpose of leasing from 1 April 2007 to 31 December 2007. However, on 1 January 2008 John decided to hold the premises solely for the purpose of leasing.

For the 15 months from 1 October 2006 to 31 December 2007 John applied the premises for a creditable purpose to some extent. For the remainder of the relevant period John applied the

premises solely in relation to making input taxed supplies, that is, an extent of creditable purpose of zero per cent.

John works out the extent of creditable purpose for the relevant period in two steps. First, John uses an output-based indirect method (using estimated sales consideration) as follows:

$$\frac{\$500,000}{\$500,000 + \$37,500} = 93.02 \text{ per cent}$$

John now needs to undertake a further apportionment to reflect the fact that the premises were not held for the purpose of sale for the entire relevant period. This is calculated by adjusting the percentage determined above by the proportion of the relevant period for which the premises were being held for the purpose of sale:

$$93.02 \text{ per cent} \times 15 \text{ months} / 21 \text{ months} = 66.44 \text{ per cent}$$

## Interaction with the GST treatment of new residential premises

2.1.16 Section 40-75 deals with the definition of new residential premises. It provides, inter alia, that if new residential premises have only been used for making input taxed supplies of residential premises by way of lease for a continuous period of five years or more they cease to be new residential premises, with the result that any subsequent sale of the building is input taxed.

2.1.17 The view taken with respect of the term 'apply' in Division 129 also affects the operation of the five-year rule in section 40-75. A consistent interpretation has been taken in relation to the meaning of 'apply' in Division 129 and the meaning of 'used' in section 40-75. This means that if an entity has applied new residential premises for a creditable purpose in accordance with Division 129, the premises will not have been used solely for making input taxed supplies of residential rent and the five-year rule will not have been satisfied. That is, in a period where there is a dual concurrent application of new residential premises for the creditable purpose of sale and the non-creditable purpose of residential rental, during that period the premises will not have been used only to make input taxed supplies of residential rent.

2.1.18 Despite this view, the application of Division 129 with respect to residential property can be complex and is largely determined by an objective assessment of facts and circumstances, including the intention of the property owner. Subsequently, the interaction between Division 129 and section 40-75 also requires this assessment under changing circumstances, which can pose compliance difficulties.

## Proposal

### Separate adjustment regime

2.1.19 In order to overcome these compliance difficulties and those noted in paragraph 2.1.14, it is proposed that there be a separate adjustment regime for real property where there are changes of use involving the sale of new residential premises or the provision of residential rent. Changes in use of real property involving the provision of financial services will not be included in this regime.

**Change to definition of new residential premises**

2.1.20 Section 40-75 will be amended to provide that all premises will cease to be taxable as new residential premises if not sold within five years (or five adjustment periods) of completion of construction, regardless of whether or not the premises were continuously leased for residential purposes during that five-year period or whether or not they have also been applied for the creditable purpose of sale during that time.

**Aggregation of acquisitions and five adjustment periods**

2.1.21 As is currently the case, where properties are intended for sale, input tax credits are claimed as inputs are acquired during the construction process. Under this proposal, the adjustment period for all input tax credits relating to premises which had been intended for sale but are subsequently rented before their first sale will start when those premises are completed. That is, all input tax credits, other than those for items with a GST exclusive value of less than \$1,000, claimed up to that point will be aggregated and adjusted as a whole, rather than tracking individual items according to when they were acquired and input tax credits claimed.

2.1.22 Five annual adjustments will apply commencing from the next adjustment date. The length of the adjustment period will not change with increases in the value of the construction project.

**Flat rate annual adjustment prior to sale**

2.1.23 Where input tax credits have been claimed during the construction of premises on the basis that the premises are to be sold and those premises are subsequently made available for residential rental, in each of the adjustment periods an increasing adjustment equal to a fixed percentage of aggregated input tax credits will be required until either the property is sold or four of the five adjustment periods have elapsed. The actual percentage to be applied will reflect the average rental return on residential properties and will be determined in consultation with industry. A 7 per cent rate has been assumed in the example below. A final adjustment will be made to ensure an appropriate amount of input tax credits have been claimed in relation to the final mix of taxable and input taxed supplies.

**Adjustments for private use**

2.1.24 Use of premises for private residential purposes will be treated in the same way as use for residential rent.

**Final adjustments**

2.1.25 Should the premises be sold within the five adjustment periods, the seller would be required to remit GST on the sale of the premises. There would be a final adjustment (either increasing or decreasing) based on the amount of input taxed income to taxable income earned – that is, the rental income and the sale price

$$\text{Adjustment on sale} = \text{ITCs} - \text{IAs} - \text{ITCs} \times \frac{(\text{sale price})}{(\text{sale price} + \text{lease income})}$$

Where: ITCs are the input tax credits claimed throughout the construction of the premises;  
IAs are the increasing adjustments made following the premises first being made available for rental.

2.1.26 If the premises remain unsold at the completion of five adjustment periods from the completion of the premises, the final (increasing) adjustment will be calculated to ensure that all input tax credits claimed during construction have been repaid. Thereafter any subsequent use of the premises either for sale or rental will be treated as an input taxed supply.

2.1.27 Adjustment where property is unsold = ITCs - IAs

Where: ITCs are the input tax credits claimed throughout the construction of the premises;

IAs are the increasing adjustments made following the premises first being made available for rental.

### Premises constructed for the purpose of supplying residential rent

2.1.28 Where premises are constructed with the intention of using them only to earn rental income, no input tax credits are claimed and no GST is remitted on the rental income. Under this proposal, where such premises are sold within five years of being completed, the premises remain new residential premises and may be a taxable supply if the requirements of section 9-5 are met. If the sale of the premises is a taxable supply then a decreasing adjustment can be made to claim some of the input tax paid in the construction of the premises. The decreasing adjustment will be calculated as follows:

$$DA = \text{notional ITCs} \times \frac{(\text{sale price})}{(\text{sale price} + \text{lease income})}$$

Where: The notional input tax credits are all of the input tax credits which could have been claimed during the construction phase had the premises been intended for sale.

#### Example

Tina completes the construction of a house in May 2009. As she intended to sell the premises she claimed input tax credits of \$25,000 during the construction period. However, as she has been unable to sell the property, she leases the premises from 1 October 2009 at a monthly rental of \$2,500.

The house is still unsold at 1 July 2010 so she makes an increasing adjustment of \$1,313 ( $\$25,000 \times 0.07 \times 9/12$ ).

At 1 July 2011 the property is still unsold and continues to be rented for \$2,500 per month. A further increasing adjustment of \$1,750 is made.

On 1 December 2011 the house is sold for \$500,000. GST of \$45,455 is payable. The final adjustment is based on total receipts of \$567,000, being leasing income of \$67,500 (27 months at \$2,500 per month) and the \$500,000 sale proceeds.

Hence the input tax credit claimable with regard to the premises would be 88.1 per cent of the total input tax credits originally claimed ( $\$500,000/\$567,000$ ).

This leads to a decreasing adjustment of \$89 ( $\$25,000 - \$3,063 - \$22,026$ ).

Suppose Tina has not been able to sell the premises by 1 July 2014. By that time she will have made four increasing adjustments totalling \$6,563. On 1 July 2014 she makes a final increasing adjustment of \$18,437. Thereafter any use of the premise either for rental or for sale will be

treated as an input taxed supply and no GST will be payable.

If Tina had originally intended to hold the premises for earning rental income, she would not have claimed the \$25,000 of input tax credits during the construction phase. Had she rented the premises at \$2,500 per month from 1 June 2009 to 30 November 2010 and then sold the premises for \$500,000 she would have been required to remit \$45,455 on the sale and could have claimed a decreasing adjustment of \$22,936 calculated as follows:

$$\frac{\$25,000}{(\$2500 \times 18 + \$500,000)} \times \$500,000$$

2.1.29 The benefits of this proposal are:

- It is much simpler to calculate adjustments to be made during the period in which the premises are used for rental purposes. This is particularly so because it is not necessary to track individual inputs which may have different attribution periods, but also because using the formula of a set percentage of input tax credits in each period (7 per cent in this paper for illustration purposes) avoids the need to compare rental receipts with expected sale proceeds in each period.
- It does not require detailed examination of changes in intent by the developer and removes uncertainty about whether or not there is a dual concurrent application. This in turn removes uncertainty as to whether there has been sole use for making input taxed supplies for a continuous period of five years.
- It avoids the possibility of mismatch between the length of adjustment periods under Division 129 and the 'five-year period' under section 40 -75. Where a property is sold as an input taxed supply, all input tax credits will have been recovered. Where a property is used for both taxable and input taxed purposes it allows for a reasonable apportionment of input tax credits between those uses, once the property has been sold and the final proportions are known.

## Construction of new residential premises by charities

2.1.30 There will be no change to the treatment of charitable organisations constructing residential premises to be supplied as GST free accommodation under section 38-250 of the GST Act or GST free retirement village accommodation under section 38-260 of the GST Act. That is, supplies under these provisions will be GST free and input tax credits can be claimed to offset the GST payable in respect of the construction.

2.1.31 Should the charity decide to sell the premises, GST will be payable on the sale as the premises will meet the definition of new residential premises. This maintains competitive neutrality between supplies of new residential property by commercial operators and supplies by charities.

2.1.32 However, should a charity decide to rent at commercial rates residential premises originally constructed to make GST free supplies of accommodation, the adjustment provisions outlined in paragraph 2.1.23 would come into operation. If the premises were sold within five years of first being rented at commercial rates, the supply would be subject to GST and an adjustment would be required to reflect the ratio of input taxed supplies and taxable supplies according to the formula:

$$\text{Adjustment on sale} = \text{ITCs} - \text{IAs} - \text{ITCs} \times \frac{\text{sale price}}{(\text{sale price} + \text{lease income})}$$

Where: ITCs are the input tax credits claimed throughout the construction of the premises;  
IAs are the increasing adjustments made following the premises being rented at commercial rates.

2.1.33 If the premises continue to be rented at commercial rates for five adjustment periods from the first commercial rental of the premises, a final (increasing) adjustment will be calculated to ensure that all input tax credits claimed during construction have been repaid. Thereafter any subsequent use of the premises either for sale or rental will be treated as an input taxed supply.

Adjustment after five years continuous commercial rental = ITCs - IAs

Where: ITCs are the input tax credits claimed throughout the construction of the premises;  
IAs are the increasing adjustments made following the premises being rented at commercial rates.

## Changes in the extent of private use and other input taxed supplies

2.1.34 It is proposed that for adjustments for changes in the extent of private use and other input taxed supplies a 10 per cent tolerance will apply, so that no adjustment will be required or allowed unless the change in use varies by 10 percentage points or more from the original intent for attribution purposes or from the last adjustment. This 10 percentage point change will be cumulative.

2.1.35 It is also proposed that, for changes in the extent of private use and other input taxed supplies, it will be assumed that the change in the extent of creditable purpose will be permanent. Tax payers will be required to make a one-off adjustment which reflects that extent of creditable purpose for the remainder of the adjustment period. Consequently, unless the extent of creditable purpose changes by more than 10 percentage points from the extent on which the most recent attribution/adjustment was made, no further adjustments will be required or allowed.

## Changes in the extent of private use

2.1.36 It is proposed that for changes in the extent of private use, there will be three adjustment thresholds – for acquisitions below \$2,000 no adjustment will be required, for acquisitions from \$2,000 up to \$14,999 there will be two adjustment periods and for acquisitions \$15,000 and over, five adjustment periods. For real property valued at over \$1 million there will be ten adjustment periods.

2.1.37 It is also proposed that change in use adjustments for changes in private use will be aligned with the due date for the lodgment of income tax returns and the first adjustment period will be the tax period in which falls 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.

2.1.38 The extent of private use can be calculated on the same basis as for income tax and over the same tax period. No adjustment (either increasing or decreasing) is made unless the change in use varies by 10 percentage points or more from the original percentage on which the original attribution of input tax credits was based, or any subsequent adjustment.

2.1.39 Proposed adjustment thresholds for change in extent of private use are shown below.

Threshold	No. of periods
\$2,000 - \$14,999	2
\$15,000+	5
*\$1,000,000+	10
* applies to real property only	

### Example

Jenny is a training consultant and is registered for GST with a quarterly tax period. In September 2009 she purchases a new car for \$27,500 (GST inclusive). She estimates that the car will be used 65 per cent for business purposes and 35 per cent for private use and therefore claims an input tax credit of \$1,650. As the GST exclusive value of the car is more than \$15,000 it is subject to five adjustment periods.

Jenny accounts for her motor vehicle use for income tax purposes using the log book method. Her income tax year is 1 July to 30 June with her income tax return due on 1 October 2010, so her first adjustment period ends on 31 December 2010. For the financial year ended 30 June 2010 she calculates her business-related use of the vehicle to be 70 per cent of the kilometres travelled. As this is within 10 percentage points of the intended use of the car, no adjustment is required.

For the financial year ended 30 June 2011 she calculates her business-related use of the car to be 78 per cent. As this is more than 10 percentage points above her intended use of 65 per cent she is able to make a decreasing adjustment. In the year ended 30 June 2012 her business-related use is calculated to be 80 per cent. As this is a less than 10 percentage point increase over the latest adjustment percentage, no adjustment is required.

In the following year the business-related usage falls to 70 per cent. As this is still within 10 percentage points of the percentage at the last adjustment, no adjustment is required. In the last adjustment period, business usage falls to 60 per cent and an increasing adjustment is made.

## Adjustments for change in use regarding other input taxed supplies.

2.1.40 There will be a separate adjustment regime of changes in use other than for non-commercial residential real estate and changes in the extent of private use. The main types of activities this will cover are financial supplies.

2.1.41 The proposed thresholds and number of adjustment periods are shown below.

Threshold	No. of periods
\$20,000 — \$499,999	2
\$500,000 +	5
*\$5,000,000+	10
* applies to real property only	

## Optional aggregation of items into a single asset

2.1.42 To reduce compliance costs it is proposed that, where inputs into what becomes a single asset are acquired over time, these acquisitions may be aggregated into a single acquisition for adjustment purposes. The total value of the acquisition, which will determine the length of the adjustment period applicable, will be the sum of the (GST exclusive) value of the individual acquisitions. The adjustment period will commence when the asset commences to be used in the enterprise. Acquisitions below \$20,000 need not be included. Taxpayers will need to elect whether an acquisition is to be included in an aggregated asset prior to the first adjustment date for the first acquisition in the aggregation.

### Example

Customers First Credit Union is acquiring a new computing system. It makes a series of progress payments to the system developer as follows:

1 January 2008	\$300,000 (+ GST)
1 July 2008	\$300,000 (+ GST)
1 January 2009	\$300,000 (+ GST)
1 July 2009	\$300,000 (+ GST)

Rollout of the system commences on 1 September 2009. Following the successful rollout of the system, Customers First makes a final payment of \$800,000 (+ GST) to the system developer.

At the outset of the project Customers First expects that the system will be used 80 per cent for making input taxed supplies and claims a 20 per cent input tax credit on each instalment payment. It elects to aggregate these payments for adjustment purposes on 30 June 2009. As the value of all the acquisitions is \$2 million (GST exclusive), it has five adjustment periods commencing the first adjustment period after 1 September 2009.

### Focus questions:

Q.1A Are there any scenarios where it is not clear which set of adjustment provisions (i.e. real property, extent of private use, or other creditable purpose) should apply? Are there any overlaps?

Q.1B For changes in the extent of private use and other changes in creditable purpose, should there be a final balancing adjustment at the end of the adjustment period even where the extent of change in creditable purpose is less than 10 per cent? Should such a balancing adjustment only arise for acquisition above a certain threshold?

Q.1C Should there be a limited range of acquisitions to which the optional aggregation proposal for other creditable purposes can apply?

## C. Adjustments for preregistration acquisitions

### Government decision

The GST law will be amended to allow an entitlement for an adjustment to the extent of the remaining economic value for things acquired before an entity was registered for GST. The amendment should not apply to adjustments that are already available.

2.1.43 Division 137 of the GST Act provides for a decreasing adjustment for trading stock or raw materials acquired before an entity is registered for GST but which are on hand at the time of registration. A decreasing adjustment is not available in respect of other things which may have been acquired prior to registration. However, if they were acquired following registration, input tax credits would be available.

2.1.44 Division 60 of the GST Act provides for input tax credits to arise in some circumstances where acquisitions and importations are made before a company is in existence.

### Proposal

2.1.45 It is proposed that the GST law will be amended to allow decreasing adjustments for plant and equipment, prepaid periodic services, and real property which are held by an entity at the time of registration and subsequently used wholly or partly for creditable purposes. A valid tax invoice must be held for the acquisition of the thing.

2.1.46 The value of the thing at the time of registration will be based on its GST exclusive market value in the case of goods and real property as this is a concept already established with regard to cessation of registration. In the case of prepaid services, the value of the thing will be pro-rated on an appropriate basis, such as the length of the contract and the amount of the contract which has elapsed at the time of registration.

2.1.47 Any applicable adjustment period for the thing commences from the time of original acquisition of the thing and the number of periods would be based on the original GST exclusive value of the thing. If the number of applicable adjustment periods has already passed since the thing was acquired, no adjustment will be available.

2.1.48 The amount of input tax credit available as an adjustment will be up to ten per cent of the GST exclusive market value at registration. (A full 10 per cent input tax credit would not be available if the thing was not being used solely for a creditable purpose.) The value of the input tax credit cannot exceed the value of the GST actually paid on the original acquisition. If no GST was paid on the acquisition (for example) because the vendor was not registered or because it was purchased prior to the introduction of the GST, no adjustments would be available.

2.1.49 Adjustments will only be available for things which have an original GST exclusive value of more than \$1,000. The proposal is not intended to affect the operation of the provisions relating to trading stock and raw materials (Division 137) or pre-establishment costs (Division 60).

2.1.50 Consequential amendments may be required to ensure that the proposed rules interact appropriately with existing rules.

2.1.51 The measure will apply to acquisitions made on or after 1 July 2010.

## D. Adjustments on cessation of registration

### Government decision

The GST law will be amended so that taxpayers are not required to make adjustments in relation to goods in the event that they deregister, provided the goods are effectively exported and used in the non-Australian enterprise.

Technical amendments will be made to the provisions relating to attribution and entitlement on cessation of registration to ensure consistent and appropriate treatment of taxpayers.

### Operation of existing law

2.1.52 Division 138 of the GST Act is concerned with cessation of registration. It provides an attribution rule for amounts not previously attributed when an entity ceases to be registered. Division 138 also provides for an increasing adjustment if an entity's registration is cancelled and, immediately before the cancellation takes effect, the entity's assets include anything in respect of which it was, or is, entitled to an input tax credit. Essentially, the increasing adjustment repays a portion of the input tax credits claimed for assets that will now be consumed privately, or used in the unregistered sector.

2.1.53 As for other adjustments, the Division 138 adjustment rule and the Division 138 attribution rule are both intended to ensure the correct amount of GST is collected on value added. If these rules do not operate as intended, this design feature of GST will be undermined.

2.1.54 It is proposed that a number of anomalies regarding attribution and adjustments for cessation of registration will be addressed. The intention is to ensure that the cessation of registration provisions interact with other areas of the GST law, including other adjustment provisions, to ensure that, when an entity ceases to be registered, the appropriate amount of tax has been paid and the appropriate amounts of input tax credits claimed. This includes ensuring:

- tax liabilities and input tax credits relating to the period in which the entity was registered for GST are all accounted for prior to or in the entity's final activity statement;
- where assets have economic value at the time the entity ceases to be registered, input tax credits which have been claimed in relation to those assets are repaid to the extent of the remaining value;
- where assets have been acquired GST free under the going concern, farmland<sup>1</sup> or associate provisions, on cessation of registration of the acquiring entity, adjustments are made to the same extent that adjustments would be made had those assets been acquired as taxable acquisitions; and
- where assets are effectively exported (even where there is no change in ownership), input tax credits are not recouped as they are in effect used for a creditable purpose.

### Proposal

2.1.55 Recast Division 138 in terms of the principle outlined above at paragraph 2.1.14.

---

1 Farmland acquired GST free under section 38-475 would not be impacted by this proposal.

### Focus question:

Q.1D Would such a principle address all situations where an increasing adjustment is necessary upon cessation of registration?

## Alternative Approach

2.1.56 The alternative approach is to deal with each of the issues as detailed below.

2.1.57 The amendments relating to cessation of registration discussed below will apply to enterprises which cancel their registration on or after the start of the first quarterly tax period after Royal Assent.

## Adjustments for goods leaving Australia on cessation of registration

### Operation of existing law

2.1.58 Currently, increasing adjustments are required to recoup input tax credits on goods held by an entity when that entity ceases operating in Australia and deregisters. This adjustment is still required where there is no change in ownership but the goods are effectively exported because they leave Australia to be used in the entity's operations outside Australia. However, if the goods were sold for export, no adjustment would be required. Currently, there is no mechanism to cease registration without an adjustment so that enterprises which have ceased operating in Australia may choose not to cancel their registration, resulting in unnecessary compliance and administration costs.

### Proposal

2.1.59 It is proposed that Division 138 be amended so that enterprises which are no longer required to be registered may cancel their registration without being required to make an adjustment in respect of goods they have transferred to their operations that are carried on outside Australia. It will be a requirement of this provision that the goods in question have left Australia prior to the cancellation of registration.

## Attribution rules for entities accounting on a non-cash basis

### Operation of existing law

2.1.60 Currently, Division 138 seeks to provide a special attribution rule for entities accounting on a cash basis that cease to be registered, in order to allow them to attribute GST and input tax credits for which they are liable or entitled but for which attribution under the normal rules would occur after they cease to be registered.

2.1.61 However, the Division 138 attribution rule only applies to entities that account on a cash basis. There are also circumstances where an entity that accounts on a non-cash basis will have liabilities or entitlements arising before they cease to be registered, which would not be attributed under the normal attribution rules until after they cease being registered. The fact that Division 138 does not apply in these circumstances leads to anomalous results, as taxpayers are not able to account for input tax credits to which they should be entitled or can avoid remitting tax on supplies for which they should be liable.

2.1.62 For example, an entity that accounts on a non-cash basis could make a creditable acquisition before it cancels its registration. It does not receive a tax invoice until after its registration is cancelled. While it is entitled to an input tax credit, it cannot attribute that input tax credit before it ceases to be registered because it does not hold a tax invoice. (Note that even if the entity had accounted on a cash basis, Division 138 may still not apply for the reasons discussed in paragraphs 2.1.27 and 2.1.28 below.)

2.1.63 In contrast, a non-cash accounting entity may escape paying GST on a taxable supply it makes before it ceases to be registered by delaying issue of an invoice and receipt of money until after its registration is cancelled.

## **Proposal**

2.1.64 The GST law will be amended to provide for an attribution rule similar to the Division 138 attribution rule for entities accounting on a non-cash basis. This would ensure that GST liabilities and entitlements that have arisen for these entities, but have not been accounted for prior to the time their GST registration is cancelled, can be brought to account in their last activity statement.

2.1.65 The GST law will also be amended to allow an input tax credit to be claimed where a tax invoice is not held at the time an entity ceases to be registered. This will be achieved by allowing enterprises to amend their final business activity statement (BAS) as invoices are received. (The four-year limit on claiming input tax credits from 12 May 2009 would apply.)

## **All GST liabilities and entitlements may not be brought to account**

### **Operation of existing law**

2.1.66 Under section 138-15, a GST liability or entitlement that an entity has, but has not yet accounted for (prior to the time its GST registration is cancelled), is only brought forward to the entity's concluding tax period if the amount would have been attributable to a previous tax period had the entity not accounted for GST on a cash basis.

2.1.67 If a GST liability or entitlement would not have been attributable to a previous tax period (under the non-cash basis of accounting), this Division may not apply to bring the liability or entitlement to account in an entity's concluding tax period. This may be the case where, for instance, an entity is liable to pay GST on a supply made shortly before the cancellation of its GST registration, for which it did not receive any payment or issue an invoice prior to the time its registration was cancelled.

## **Proposal**

2.1.68 It is proposed that Division 138 be amended to ensure that it operates to bring to account all GST liabilities and entitlements that have not been previously accounted for to an entity's concluding tax period – not just those attributable to a previous tax period.

## **Liabilities and entitlements which have been partly accounted for**

### **Operation of existing law**

2.1.69 Division 138 can be interpreted as applying only to liabilities and entitlements which have not been previously accounted for to any extent. This would give rise to anomalous outcomes where an entity accounting for GST on a cash basis makes an acquisition prior to the

cessation of registration but makes multiple payments for the acquisition over time (for example, a hire purchase agreement), including payments made after the cancellation of registration. If interpreted in this way, the Division 138 attribution rule would not apply to input tax credits relating to payments made after the cancellation of registration. However, the entity would face an increasing adjustment relating to the asset on cancellation of registration, based on the lower of the market value of the asset and the total amount of payments made by the entity both before and after cancellation of registration. In this way the increasing adjustment could exceed the value of the input tax credits claimed for the acquisition.

## **Proposal**

2.1.70 To avoid uncertainty, it is proposed that Division 138 be amended to make it clear that liabilities and entitlements which have been partly attributed prior to the cancellation of registration are brought to account in the concluding tax period to the extent they have not been previously attributed.

## **GST free supplies of going concerns and farm land and acquisitions from associates without consideration**

### **Operation of existing law**

2.1.71 Under Division 138, increasing adjustments only apply to assets where, prior to the cancellation of registration, the entity was entitled to input tax credits relating to the asset – that is, Division 138 adjustments are limited to assets which were acquired under a taxable supply.

2.1.72 Under the GST legislation, there are some acquisitions of assets which are normally treated as taxable supplies that are treated as tax free in certain circumstances. This treatment is currently applied to assets acquired as GST free under supplies made as going concerns (under section 38-325) or farm land (section 38-480). In this situation, treating the acquisition as GST free generally has the same practical consequences as treating it as taxable, with the supplier remitting GST and the acquirer paying the GST inclusive price and claiming input tax credits.

2.1.73 This treatment is not granted with a view to removing value added by the supplier from the tax base. Rather, it is to relieve the recipient of the burden of obtaining additional funds to cover the GST included in the price of these supplies when ordinarily the recipient would be able to claim input tax credits. The provisions are not intended to exempt private consumption (which includes use by unregistered entities).

2.1.74 Division 135 is intended to provide for increasing adjustments for assets acquired under the going concern and farm land provisions if they are not used solely for creditable purposes over the relevant adjustment periods. Hence, this provision applies if assets are partly applied to non-creditable purposes. Division 135 provides for adjustments relating to the extent the acquisition is used for making input taxed supplies, but not for any adjustments on cancellation of registration. Further, as the assets were acquired GST free, an adjustment may not arise under Division 138 as this Division only applies to actual input tax credits. Consequently, in effect there may be 'over claiming of input tax credits' where an entity acquires assets under the going concern and farm land provisions and subsequently has its registration cancelled.

2.1.75 A similar issue arises regarding assets acquired from associates without consideration in cases where the supply from the associate is not a taxable supply only because the recipient is both registered and acquires that asset solely for a creditable purpose. Broadly speaking, under section 72-5 such acquisitions are not taxable if the acquirer would have been

entitled to a full input tax credit. However, if an asset is acquired without tax under this provision, an adjustment may not arise if the acquirer's registration is subsequently cancelled. This is despite the fact that, if the acquirer had not been registered at the time of supply, net tax would have been collected on the supply of the asset to it, consistent with the intention to tax final private consumption.

## Proposal

2.1.76 It is proposed that Division 138 be amended to provide for adjustments to arise in relation to assets acquired GST free under the current going concern and farm land provisions and the provisions relating to acquisitions from associates without consideration, where such adjustments are necessary to achieve appropriate outcomes with regard to the claiming of input tax credits.

2.1.77 This amendment is still desirable notwithstanding the proposed amendments to going concern and farm land provisions as there will be assets acquired under the current provisions for which adjustments will be appropriate for up to 10 years from the repeal of these provisions.

2.1.78 It is proposed that the adjustments will be based on the GST exclusive market value of the assets at the time of cessation of registration.

## Interaction of cessation of registration adjustments with supplies made in satisfaction of a debt

### Operation of existing law

2.1.79 Division 105 provides that where a creditor supplies the property of a debtor to a third party in satisfaction of a debt, the creditor is liable to pay GST on the supply if the supply would have been taxable if made by the debtor, regardless of whether or not the creditor is registered for GST. The interaction between this Division and the cessation of registration provisions in Division 138 may lead to anomalous outcomes. For example, where an entity ceases to carry on a leasing enterprise because the asset leased is sold by a creditor, that entity may have its registration cancelled and may be required to make an increasing adjustment of up to 100 per cent of the input tax credits previously claimed in relation to the asset. However, the creditor may be required to remit GST on the sale of the asset, with the result that there may be over taxation in relation to the asset.

## Proposal

2.1.80 It is proposed that the interaction between Divisions 105 and 138 be considered to ensure that an appropriate amount of tax is collected in cases where a mortgagee takes possession of an asset that an entity used in a leasing enterprise, thus triggering the cancellation of that entity's GST registration.

### Focus questions:

Q.1E Does the proposed use of market value for adjustments for preregistration acquisitions create any compliance difficulties?

Q.1F Are there any practical difficulties with the proposal that entities whose GST registration is cancelled no longer be required to make adjustments on assets which have left Australia, in particular, the requirement that the assets have left Australia prior to the cancellation of registration? Will entities have any difficulty in demonstrating that the goods have left Australia?

Q.1G Do the proposed amendments to Division 138 resolve the anomalies identified without creating further anomalies?

Q.1H Are there other anomalies relating to cessation of registration, including the interaction of Division 138 with other adjustment provisions, which should be addressed?

Q.1I Are there any sections of the law relating to adjustments on cessation of registration where the meaning is unclear?

Q.1J Would it be feasible to redraft the cessation of registration provisions in Division 138 as a principle (or series of principles)?

### Application date

2.1.81 The measure will apply from 1 July 2010 with any adjustments attributable to tax periods commencing on or after 1 July 2010.

## 2.2 SELF ASSESSMENT

### Government decision

The indirect tax law will be amended to harmonise, where appropriate, the current self-actuating system that applies to GST, luxury car tax, wine equalisation tax and fuel tax credits with the self assessment based system that applies to companies and certain other entities for income tax.

In the context of this change, the law will also be amended to ensure that the period of review is refreshed when an amendment is made to a taxpayer's assessment.

### Background

#### Operation of existing law

2.2.1 Currently, the GST, luxury car tax (LCT), wine equalisation tax (WET) and fuel tax credits systems operate on what has been termed a self-actuating basis. Under this system, a taxpayer is automatically liable for tax or entitled to a refund based on the liabilities and entitlements attributable to a tax period. Even if the taxpayer incorrectly states their net amount in their return, they remain liable to pay the correct amount (or entitled to a refund if the amount is negative). This will be the case even if this error is not detected. However, a limitation period (typically four years) applies after which the Commissioner may no longer require payment of any liabilities and the taxpayer may no longer require the payment of any entitlements.

2.2.2 A separate system applies to GST, WET and LCT liabilities that arise upon importation of goods and in certain other circumstances. Such liabilities are not connected to tax periods and do not become part of the net amount. Input tax credits arising from importations and other similar liabilities, however, are included in the net amount.

2.2.3 The full self assessment system which applies to companies and certain other taxpayers for income tax purposes differs from the self-actuating system described above. In the full self assessment system, taxpayers must, at the end of the financial year, assess their total liability and lodge a return with the Commissioner, specifying their taxable income and the tax payable to the Commissioner. The Commissioner is taken to have made an assessment of these specified amounts on the date of lodgment. The return lodged by the taxpayer is treated as the notice of this assessment, served on the taxpayer on the day the assessment is made or is taken to have been made. Taxpayers are required to pay the assessed amount by a specified date, even if the assessment was based on an error of law or fact.

2.2.4 Once a liability has been established in an assessment under the self assessment system, there is no limit on the period in which the Commissioner may seek to recover that liability. There is a period of review in which an assessment may be amended or challenged to address errors. After this period expires, the assessment cannot generally be amended. However, where an assessment is amended, the period of review will be extended in relation to the particular giving rise to the amendment.

## Proposal – Self assessment

### Principle – Liabilities and entitlements are defined by assessment

2.2.5 Taxpayers will only be liable to pay or entitled to receive the GST, WET, LCT and fuel tax credit liabilities and entitlements stated in their assessment. The amount stated in the assessment will be conclusive evidence of the taxpayer's liability or entitlement (other than in proceedings commenced under Part IVC of the *Tax Administration Act 1953* (TAA), such as an objection against the assessment), even where the facts or legal interpretation on which the assessment is based may not be correct.

### Add-on – Period to object to an assessment

2.2.6 Decisions relating to an assessment are reviewable indirect tax decisions. The period to object to these decisions will be the later of:

- four years after notice of the initial assessment has been provided, or is taken to have been provided<sup>2</sup>; or
- 60 days after notice of the relevant decision has been provided to the taxpayer.

### Commentary

2.2.7 The measure to harmonise with the income tax self assessment regime will achieve greater standardisation between the indirect tax system and the income tax regime, resulting in lower compliance costs for taxpayers with common rules applying across taxes.

2.2.8 The intention of this principle is to link taxpayers' GST, WET, LCT and fuel tax credit liabilities and entitlements to their assessment.

2.2.9 As a consequence of this, the assessment will be a conclusive statement of a taxpayer's net liabilities or entitlements (although it may be amended within the period of review or challenged by lodging an objection).<sup>3</sup> As is the case with other assessments of tax, including under income tax self assessment<sup>4</sup>, challenges to the facts or legal views underlying an assessment will not affect the validity of the assessment and the obligations it imposes for taxpayers and the Commissioner. However, successful objections may involve changes to assessed liabilities and entitlements.

2.2.10 Most assessments will relate to a taxpayer's net amount (which includes LCT and WET as well as GST) or net fuel amount in a tax period as set out in their monthly or quarterly BAS or their annual GST return, if they have opted to report and pay GST on an annual basis. However, liabilities and entitlements that arise outside of the net amount or net fuel amount, such as liabilities arising on importations or in relation to certain insurance settlements<sup>5</sup>, will also be included in the assessment regime. The determination by the Commissioner that a taxpayer's liability or entitlement for a tax period or fuel tax return period is zero is an assessment.

---

<sup>2</sup> Any further references in this paper to notice having been provided also includes situations where notice is taken to have been provided under the principles set out in this paper.

<sup>3</sup> See Part IVC of the TAA.

<sup>4</sup> See sections 175 and 177 of the *Income Tax Assessment Act 1936* (ITAA 1936) and section 105-100 of Schedule 1 to the TAA.

<sup>5</sup> Under section 78-50 of the GST Act.

2.2.11 This will require amendments to the provisions imposing liabilities and creating entitlements in the indirect tax law in order to ensure that all obligations relate to the assessed amounts.<sup>6</sup> It will also require significant changes to the current assessment mechanisms.<sup>7</sup>

2.2.12 This principle will also require consequential amendments to the current provisions contained in Schedule 1 to the TAA imposing limitation periods on claims relating to indirect tax liabilities and entitlements.

2.2.13 The add-on aligns the period for taxpayers to object so that, consistent with income tax, it runs from the date of assessment rather than the end of the relevant tax period or fuel tax return period.

### Principle – Self assessment

2.2.14 When a taxpayer's GST return or return for the purposes of the fuel tax law (fuel tax return) for a tax period or a fuel tax return period (including a nil return) is lodged with the Commissioner, the Commissioner will be taken to have made an assessment of the taxpayer's relevant indirect tax liability or entitlement as the amount set out in the return.

### Carve-out 1 – Earlier assessments

2.2.15 An assessment will not be taken to be made if an assessment has already been made of the relevant liability or entitlement for that tax period or fuel tax return period before the taxpayer lodges their return.

### Carve-out 2 – Net fuel tax returns on forms other than the BAS

2.2.16 The Commissioner will not be taken to have made an assessment of the taxpayer's liability or entitlement for a fuel tax return period upon receipt of a fuel tax return for the period where this return is provided using a form other than a business activity statement or such other form or forms as the Commissioner may determine in writing.

### Add-on – Notice of assessment

2.2.17 The taxpayer's GST return or fuel tax return will be treated as the notice of the assessment under the above principle. This assessment will be considered to be made and the notice served treated as being served on the day the return is lodged with the Commissioner.

### Commentary

2.2.18 Under this principle, the lodgment of a taxpayer's GST return or fuel tax return will be taken to give rise to an assessment by the Commissioner of the taxpayer's relevant liability or entitlement for the tax period or fuel tax return period as the amount stated in the return. The Commissioner will still be entitled to make an assessment of taxpayers' liabilities or entitlements outside the self assessment process (for example, where a taxpayer has not lodged a return). GST returns also include WET and LCT liabilities and entitlements and therefore this principle will also extend self assessment to these taxes.

2.2.19 The lodgment of GST instalment returns will not be taken to give rise to an assessment. Instalment returns are an estimate of liabilities which are subject to later revisions

---

<sup>6</sup> Most significantly Divisions 33 and 35 of the GST Act and Division 61 of the *Fuel Tax Act 2006*.

<sup>7</sup> See subdivision 105-A of Schedule 1 to the TAA, particularly section 105-15 (which provides that assessments are not required).

when the final liability for the period has been determined in the taxpayer's annual GST or fuel tax return. As such, it is appropriate that only the annual return will give rise to an assessment.

2.2.20 Self assessment of certain liabilities or entitlements (such as the liabilities that arise for importations and certain WET credits) will not be possible as these liabilities or entitlements are not included on any return. Self assessment will also not be possible for amounts that are not attributable to any tax period (such as those arising under the insurance provisions in section 78-50 of the GST Act). Such liabilities and entitlements will need to be assessed by the Commissioner or those acting on his behalf. This will minimise any need for changes to existing practice by the Commissioner and taxpayers.

2.2.21 The purpose of the first carve-out is to ensure that where an assessment has already been made of the relevant liability or entitlement (either by the Commissioner or as a result of an earlier return being lodged), the lodgment of a later GST return for the same period will not be taken to result in another original assessment. The return may be treated by the Commissioner as a request for an amendment to the assessment if appropriate.

2.2.22 The purpose of the second carve-out is to minimise any change to existing arrangements. The present forms used to provide fuel tax returns by taxpayers not reporting on the BAS are better suited to providing the basis for an assessment made by the Commissioner rather than giving rise to a deemed assessment.

2.2.23 The purpose of the add-on concerning the notice of assessment is, consistent with income tax, to remove the need for taxpayers to be notified of their assessment when the assessment is based solely on the return provided by the taxpayer. This eliminates unnecessary compliance and administration costs.

## Principle – Period for assessment and review

### Assessments

2.2.24 The Commissioner may make, or be taken to make, an initial assessment of GST, WET, LCT or fuel tax credit liabilities and entitlements at any time.

### Amending assessments

2.2.25 The Commissioner may amend an assessment within four years from the date the Commissioner provided notice of the assessment to a taxpayer or the date when the taxpayer was required to lodge a return, whichever is later.

2.2.26 For amounts which are not required to be included in a return, the Commissioner may amend an assessment within four years of the date on which notice of the assessment of the amount was provided.

2.2.27 After the conclusion of this four-year period, no amendment can be made to the assessment. An unlimited number of amendments may be made to an assessment within the four-year period. An amended assessment remains an assessment.

2.2.28 During the four-year period of review, taxpayers may apply to the Commissioner for an amendment to their assessment. In considering such an application the Commissioner may accept taxpayers' claims as correct without further verification. Making such an amendment at the request of a taxpayer does not preclude the Commissioner from making subsequent amendments.

### Carve-out 1 – Fraud and evasion

2.2.29 The Commissioner will have an unlimited period in which to amend assessments (as well as make an initial assessment) for matters related to fraud and evasion.

### Carve-out 2 – Refreshed period of review for amendments

2.2.30 Where an assessment has been amended in relation to a particular, the Commissioner may subsequently amend the amended assessment in respect of the particular for four years from the day notice was provided of the amended assessment. This could occur on multiple occasions where repeated amendments are made in relation to a particular.

### Carve-out 3 – Extension by agreement or court order

2.2.31 Prior to the conclusion of the period of review (including any extension previously granted), the Commissioner and taxpayer may agree, in writing, to an extension of the period of review for an agreed period.

2.2.32 The Commissioner may, prior to the conclusion of the period of review (including any extension previously granted), apply to the Federal Court of Australia for an order to extend the limitation period. The Court may grant this order for a specified period if it is satisfied that it is either not reasonably practical or not appropriate for the Commissioner to complete the examination of a taxpayer's liability or entitlement in the remainder of the period of review due to actions or a failure to take reasonable actions on the part of the taxpayer.

2.2.33 The period of review may be extended an unlimited number of times under these provisions.

### Carve-out 4 – Amendments after the period has expired

2.2.34 The Commissioner may amend an assessment at any time to give effect to a decision on an objection, review or appeal or to settle a review or appeal. Such amendments must relate directly to the dispute.

2.2.35 If a taxpayer requests an amendment to an assessment or seeks a private ruling for a tax period or fuel tax return period in the approved form within the four-year period of review, then the Commissioner may amend the assessment to give effect to the decision on the request or the ruling request after the expiry of the four-year period.

### Carve-out 5 – Restrictions on amending amended assessments

2.2.36 After the four-year period of review for the initial assessment for a tax period or fuel tax period has expired, the Commissioner cannot later amend the assessment under carve-out 2 in relation to a particular to:

- increase the taxpayer's liability (or decrease the taxpayer's entitlement), if the Commissioner has previously amended the taxpayer's assessment in relation to that particular after the four-year period to increase the taxpayer's liability or decrease the taxpayer's entitlement; or
- decrease the taxpayer's liability (or increase the taxpayer's entitlement), if the Commissioner has previously amended the taxpayer's assessment in relation to that particular after the four-year period to decrease the taxpayer's liability or increase the taxpayer's entitlement.

2.2.37 This principle does not restrict the period in which to make amendments that arise under carve-out 4 or carve-out 1.

## Add-on – Notice of amended assessments

2.2.38 Where the Commissioner amends an assessment at the request of a taxpayer that has been made in the approved form, the document in which the taxpayer makes the request will be taken to be notice to the taxpayer of the amended assessment. This notice will be taken to have been received on the day the amendment is made by the Commissioner.

## Commentary

### Assessments and amended assessments

2.2.39 The principle sets out the period in which assessments can be made and amended. It establishes the basic rule that the liabilities and entitlements of taxpayers must be identified and specified within the four-year period of review.

2.2.40 Consistent with the present limitation period, the four-year period is intended to provide a reasonable balance between ensuring the correct amount of tax is collected and providing certainty and finality to taxpayers and the tax system.

2.2.41 The period of review will commence from the later of the date the Commissioner provides notice of an assessment or the date on which the taxpayer was required to lodge a return. For liabilities and entitlements that are not required to be included on any return, such as those relating to taxable importations for GST, the period of review always commences from the date of assessment.

2.2.42 This will broadly harmonise the indirect tax system with the current income tax rules and prevent indirect taxes from ceasing to be payable after four years from the required date of lodgment even where the taxpayer has never lodged or been assessed. This change will ensure that taxpayers who lodge late do not gain an advantage over taxpayers who lodge within time.<sup>8</sup>

2.2.43 Consistent with income tax self assessment, taxpayers may apply to have their assessment revised and the Commissioner may make such revisions without needing to investigate the basis for the requested change. This is intended to facilitate the correction of errors identified by taxpayers and to avoid the imposition of a higher standard of evidence for amendments than exists for the initial assessment. However, unlike the initial assessment, such amendments are not taken to be made upon lodgment.<sup>9</sup>

2.2.44 The ability of the Commissioner to amend an indirect tax assessment within the period of review is not restricted by any prior amendments that may have been made. For example, if the Commissioner amends an assessment following a request from a taxpayer on the basis of statements later found to be incorrect, the Commissioner can make a further amendment to correct the position. Similarly, if the Commissioner makes an amendment based on a particular view of the law and later revises this view, the assessment can be further amended to reflect this view.

2.2.45 Consistent with income tax, any assessment of a taxpayer's liability after the initial assessment for the relevant period will be an amended assessment.

### Carve-outs

2.2.46 The intention of the first carve-out is to ensure that fraudulent or evasive activity is not protected by the restrictions imposed by the period of review. Periods of review are limited in

---

<sup>8</sup> Similar to subsection 170(1) of the *Income Tax Assessment Act 1936*.

<sup>9</sup> Similar to section 169A of the *Income Tax Assessment Act 1936*.

order to provide taxpayers and the tax system with certainty and finality. It is not appropriate to provide taxpayers with such certainty and finality for fraudulent or evasive behaviour.

2.2.47 Similarly, the intention of the second carve-out is to ensure that the Commissioner and taxpayers have adequate time to investigate and respond to changes made to an assessment.<sup>10</sup>

2.2.48 In some circumstances, the constraints set by the period of review may be impractical. The purpose of the third carve-out is to allow this period to be extended in certain circumstances. Where the Commissioner and taxpayer both agree that the period should be extended, they will be permitted to give effect to this agreement. Similarly, it would not be appropriate to allow taxpayers to benefit from the expiry of the period of review where they have hindered the Commissioner. This principle is consistent with the provisions of the income tax law.<sup>11</sup>

2.2.49 The intention of the fourth carve-out is to ensure that where a taxpayer has sought a change to their assessment within the period of review, such as by objecting to the assessment, the Commissioner can still give effect to this even if the time taken to consider the taxpayer's position extends beyond the four-year period of review. This is consistent with the position taken in the income tax law.<sup>12</sup> Amendments made after four years will refresh the period of review in the same way as amendments made within time, extending it for an additional four years from the date of the amendment.

2.2.50 The purpose of the fifth carve-out is to increase certainty for taxpayers by preventing repeated revisions of assessments in relation to the same matter outside the period of review. This carve-out ensures that repeated amendments cannot be made leaving the period of review open in relation to a particular for excessive periods. However, taxpayers who are dissatisfied with the position reached by the Commissioner may object and have the Commissioner's decision reviewed.<sup>13</sup>

#### Add-ons

2.2.51 Finally, the intention of the add-on to the principle is to minimise costs for taxpayers and the Commissioner by allowing a taxpayer's request for an amendment to be treated as a notice of the amended assessment if the Commissioner accepts the requested amendment. This is consistent with the approach that no separate notice is required for the initial assessment resulting from the lodgment of a return.

2.2.52 An amendment is made on the date on which the Commissioner makes the adjustment to the taxpayer's running balance account. As the Commissioner may need time to consider the amendment request, this date may be some time after the request for an amendment is made to the Commissioner.

---

<sup>10</sup> Similar to subsection 170(3) of the *ITAA 1936*.

<sup>11</sup> See subsections 170(7) and 170(8) of the *ITAA 1936*.

<sup>12</sup> See item 6 of subsection 170(1) of the *ITAA 1936*.

<sup>13</sup> This provision is broadly equivalent to subsections 170(3) and 170(4) of the *ITAA 1936*.

## Focus Questions

Q.2A Are there any features of the income tax self assessment regime not covered under the current principles that should also be adopted for indirect tax self assessment?

Q.2B Alternately, are there features of self assessment adopted in this proposal that are not considered appropriate?

Q.2C Do the proposed rules adequately address GST payable on importation and other indirect tax liabilities or entitlements arising outside net amounts and/or returns?

Q.2D Are there any special features of LCT, WET or fuel tax credits that have not been addressed in these rules?

## Principle – Correcting mistakes

2.2.53 The Commissioner may, in writing, determine the circumstances in which a class of taxpayers may calculate their net amount or net fuel amount for a tax period or fuel tax return period to take account of errors arising from genuine and reasonable mistakes made in a prior assessment, provided the period of review relevant to the error has not expired.

### Commentary

2.2.54 Currently the GST Act provides a power for the Commissioner to issue a determination permitting taxpayers in specified circumstances to take into account errors in the immediately preceding tax period in working out the net amount for the current tax period.<sup>14</sup>

2.2.55 However, as this is restricted to errors in the immediately preceding tax period, it has limited application. Instead, taxpayers have relied upon the Commissioner's exercise of his general administrative power to allow certain errors to be included in current net amounts.

2.2.56 Concerns have been expressed by taxpayers about how this administrative concession may be affected by the introduction of self assessment. While it was considered that the status of the concession would be unaffected by self assessment, it was regarded as appropriate to address the limitations of the current GST law and remove the need for the exercise of the general administrative discretion.

2.2.57 The principle above provides a clear legislative basis for the current administrative concession, allowing the Commissioner to determine circumstances in which categories of taxpayers may correct mistakes.

2.2.58 To increase consistency across the range of indirect taxes, the principle extends the operation of the concession to WET, LCT and fuel tax credits. It also allows for the correction of errors that arise outside net amounts.

---

<sup>14</sup> See section 17-20 of the GST Act.

## Consequential amendments

### Operative

2.2.59 There are currently limitation periods on claims relating to GST, LCT, WET and fuel tax credit liabilities and entitlements.<sup>15</sup> In a self-actuating system, where a taxpayer is always liable to pay their true net amount, such a provision is needed for certainty. However, under an assessment-based system, the taxpayer's liability is the amount stated in the assessment, subject to revisions in the period of review. In this context, a limitation period serves no purpose. Accordingly, these provisions will be amended so that these limitation periods do not apply to claims made under self assessment.

2.2.60 Following the adoption of self assessment, it will be also necessary to make consequential amendments to the four-year period in which input tax credits can be claimed put in place from Budget night (see Chapter 2.5 of the Treasury discussion paper released 12 May 2009). The present rules operate by reference to the limitation period on claims, but following the adoption of self assessment, there will be no limitation period for most amounts.

2.2.61 Instead the consequential amendment will provide that the four-year period will be defined by reference to the period of review. Where the period of review is extended (see above), the period to attribute any related input tax credits will also be extended. This will preserve the effect of the previous measure within the self assessment system.

2.2.62 General consequential amendments will also be required to the GST Act and the TAA to deal with the changes resulting from self assessment.<sup>16</sup> Amendments will also be required to the WET, LCT and Fuel Tax Acts, particularly as they relate to the payment of WET credits and net fuel tax amounts. Some changes will also be required to the indirect tax anti-avoidance provisions.<sup>17</sup>

2.2.63 One of the areas of the law that will require amendment is the provisions in the GST Act relating to payments and refunds of net amounts.<sup>18</sup> To improve clarity and provide a single location for indirect tax obligations, one possible approach to these amendments might involve transferring these provisions from the GST Act and *Fuel Tax Act 2006* to the TAA.

### Focus Questions

Q.2E Do these consequential amendments apply appropriately?

Q.2F Are further consequential amendments required for other self assessment changes?

Q.2G Would there be advantages to moving the indirect tax payment and refund provisions from the GST Act and *Fuel Tax Act 2006* into Schedule 1 to the TAA together with the other indirect tax administrative provisions?

---

<sup>15</sup> See sections 105-50 and 105-55 of Schedule 1 to the TAA.

<sup>16</sup> Particularly Part 2-7 of the GST Act and Division 105 of Schedule 1 to the TAA.

<sup>17</sup> Found in Division 165 of the GST Act and Division 75 of the *Fuel Tax Act 2006*.

<sup>18</sup> Particularly Divisions 33 and 35 of the GST Act.

## Application date and transitional rules

### Application date

2.2.64 These measures will apply to payments and refunds for tax periods or fuel tax return periods commencing on or after 1 July 2010. These measures will apply to payments and refunds that do not relate to tax periods, where the relevant liability or entitlement arose on or after 1 July 2010.

### Transitional rules

2.2.65 The current rules will continue to apply to payments and refunds for tax periods and fuel tax return periods commencing prior to 1 July 2010. The current rules will also continue to apply to payments and refunds that do not relate to tax periods, if the relevant liability or entitlement occurs prior to 1 July 2010.

### Focus Questions

Q.2H Are other transitional arrangements required?

Q.2I Will the proposed application date cause any difficulties?

## 2.3 GENERAL LAW PARTNERSHIPS

### Government decision

The GST law should be amended to clarify the treatment of general law partnerships, including in relation to matters such as partner-to-partnership transactions or changes in membership of a partnership.

### Background

#### Operation of existing law

2.3.1 The term 'partnership' is defined for income tax purposes in section 995-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) to include both an association of persons 'carrying on a business as partners' (a general law partnership) and an association of persons 'in receipt of ordinary income or statutory income jointly' (a tax law partnership). The GST Act provides that the term 'partnership' has the same meaning as that given by the income tax law.<sup>19</sup>

2.3.2 The first limb of paragraph (a) of the partnership definition in section 995-1 refers to 'an association of persons carrying on a business as partners', which reflects the general law definition of a partnership: a 'relation which subsists between persons carrying on a business in common with a view of profit'.<sup>20</sup> This is a general law partnership.

2.3.3 A general law partnership is not a separate entity distinct from the partners at general law; the enterprise is carried on by the persons who are in partnership and not by the partnership as a separate conception. This is statutorily reversed for the purposes of GST; the definition of 'entity' in the GST law includes 'partnerships' which means that general law partnerships are an entity for GST purposes.<sup>21</sup> Therefore, a general law partnership is treated as an entity for all purposes of the GST Act and can make supplies and acquisitions which are taxable or creditable.

2.3.4 A general law partnership is formed when two or more entities commence carrying on an enterprise as partners. Whether and from what date a general law partnership exists is a question of fact. This is best determined by the partnership agreement with regard to the circumstances surrounding the partnership's formation and the intention of the partners.

2.3.5 Under the Commissioner's view, the formation of a general law partnership may involve two supplies. The partnership supplies the partner with an interest in the partnership. If the partnership is registered for GST, this supply will be a financial supply and therefore input taxed under section 40-5 of the GST Act which specifies that financial supplies, as defined by regulation, are input taxed. 'An interest in or under the capital of a partnership' is referred to in subregulation 40-5.09(3)(item 10) in the definition of securities for the purposes of financial supplies. Furthermore the expression 'capital of a partnership' has been interpreted broadly by the Commissioner to include all the interests that a partner acquires from the partnership as a consequence of being a partner of that partnership.

---

<sup>19</sup> See definition of 'partnership' in section 195-1 of the GST Act which refers to section 995-1 of the ITAA 1997.

<sup>20</sup> Refer to the general law definition in the Partnership Act of each State and Territory.

<sup>21</sup> See paragraph 184-1(1)(e) of the GST Act.

2.3.6 If a partner contributes property (other than money) as capital of the partnership, a second supply may occur. This second supply is that of an in-kind capital contribution, made by the partner to the partnership. Such a supply can be taxable, if the supplying partner is registered and the supply is made in the course of furtherance of its enterprise (provided the supply is not GST free or input taxed). Otherwise, such a supply is non-taxable. If the supply is taxable, the partnership may be entitled to claim an input tax credit.

2.3.7 Under the Commissioner's view, where a single entity (for example, a 'sole trader') takes a partner into its enterprise, the resulting entity is a partnership, in which each partner acquires an interest. The sole trader, in this instance, makes a supply of the previous enterprise to the partnership.<sup>22</sup> The consideration is an interest in the partnership and a payment of money (equivalent to the amount paid by other partners in acquiring their interest in the partnership).

2.3.8 A general law partnership may register for GST. However, a partnership is required to be registered if it meets the GST registration turnover threshold of \$75,000. A partnership may be registered from a date no earlier than when the partnership undertakes activities in the commencement of its enterprise.

2.3.9 Partners of a general law partnership may make supplies and acquisitions in their capacity as partners (subsection 184-5(1) of the GST Act). For GST purposes, such supplies are made by the general law partnership. Whether a supply or acquisition made by a partner is within their capacity as a partner is a question of fact.

2.3.10 Furthermore, under Division 444 in Schedule 1 to the TAA 1953, the obligations on a partnership are imposed on each partner. Partners are jointly and severally liable to meet the GST obligations of the partnership.

2.3.11 Division 111 of the GST Act allows a partnership to claim an input tax credit if it reimburses a partner for an acquisition the partner makes, in their own capacity, that is directly related to the partnership's activities.

2.3.12 Upon cessation of a general law partnership, the partnership may make an in-kind distribution of partnership property to partners. The Commissioner is of the view that such a distribution is a supply that is made for consideration in the course or furtherance of the partnership's enterprise.

2.3.13 The Commissioner is of the view that, for the purposes of the GST law, a change in the membership of a partnership does not necessarily give rise to the cessation of that partnership and the creation of a new one. This is providing that there is an express or implied continuity clause and that there is no break in the continuity of the partnership's enterprise.

## Proposal

2.3.14 This proposal aims to clarify and codify the treatment of general law partnerships to give greater certainty to taxpayers.

### Principle – A supply of an interest in a partnership is an input taxed financial supply

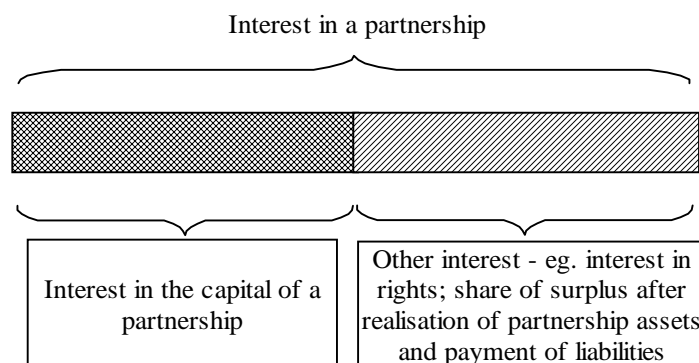
2.3.15 A supply of an interest in a partnership is an input taxed financial supply.

---

<sup>22</sup> It is assumed that the partnership is formed at or prior to the time of the sole trader's supply.

## Commentary

2.3.16 Under paragraph 40-5.09(3) item 10 (d) of the GST Regulations an interest, for the purposes of a financial supply, includes an interest in 'the capital of a partnership or trust'. The Commissioner currently administers the law as though the entire interest is being supplied, rather than just the capital portion of the interest, as a financial supply. This is expressed diagrammatically below.



2.3.17 The principle envisages an amendment to item 10(d) in subregulation 40-5.09(3) of the GST Regulations to replace the phrase 'the capital of a partnership' with 'interest in a partnership'.<sup>23</sup> This would clarify the law and align it with the Commissioner's practice.

2.3.18 If the term 'interest in the capital of a partnership' is interpreted under a plain reading of the current subregulation 40-5.09(3), only part of the interest supplied by a partnership to a partner on formation of the partnership may be input taxed, while the remainder may be subject to GST. The partner would not be able to claim an input tax credit to offset the GST<sup>24</sup> and, thus, would bear unrecoverable tax.

## Principle – In-kind capital contribution

2.3.19 An in-kind capital contribution made by a partner to a partnership upon formation or throughout the operation of a partnership is treated as a supply that is made by the partner to the partnership for consideration equal to the GST inclusive market value of the property contributed.

### Add-on

2.3.20 An in-kind capital contribution of property is a supply by way of a 'sale' that is made for consideration equal to the GST inclusive market value of the contributed property.

## Commentary

2.3.21 Under the proposed principle, an in-kind capital contribution will be taken to be made for consideration equal to the GST inclusive market value of the property contributed.

---

<sup>23</sup> A change will also be required to item 7 of Part 8 of Schedule 7 of the GST Regulations, which currently has "Interests in a partnership" as an example for item 10(d).

<sup>24</sup> As the partner may not be registered or, if it is, the acquisition of the interest in the partnership may not be made in the course of carrying on the partner's separate enterprise.

2.3.22 The in-kind capital contribution will be taken to be a 'sale' for the purposes of the GST law including, for example, for the purposes of section 40-65 of the GST Act (under which the sale of residential premises may be input taxed).

### **Principle – In-kind distribution of partnership property**

2.3.23 An in-kind distribution of property made by a partnership to a partner throughout the operation or upon dissolution of the partnership will be a supply that is made in the course or furtherance of the partnership's enterprise.

#### **Add-on**

2.3.24 An in-kind distribution of property is a supply by way of a 'sale' that is made for consideration equal to the GST inclusive market value of the distributed property.

### **Commentary**

2.3.25 An in-kind distribution of partnership property by a partnership to a partner is a supply for consideration. 'Consideration' is interpreted widely by reference to subsection 9-15(1) of the GST Act to include monetary and non-monetary consideration. An in-kind distribution of property by a partnership to a partner discharges a claim the partner has over the assets of the partnership, reducing the value of the partner's entitlement to their share of partnership assets. Therefore, in broad terms, the consideration for an in-kind distribution from a partnership is the GST inclusive market value of the reduction in the value of the partner's interest in the partnership. The precise characterisation of the consideration may vary depending on the circumstances surrounding the distribution.

2.3.26 The 'add-on' ensures that an in-kind distribution will be taken to be a sale for the purposes of the GST law. The in-kind distribution of partnership property to a partner is a supply by way of a 'sale' made in the course or furtherance of the partnership's enterprise, thus the normal GST rules or, if applicable, the margin scheme will apply.

### **Principle – Adjustments for private use**

2.3.27 A general law partnership may make acquisitions for a partly private or domestic purpose of the partners.

#### **Commentary**

2.3.28 A general law partnership may acquire an item that a partner or partners intend to use partly for private or domestic purposes. The partnership, however, is only entitled to an input tax credit to the extent that the acquisition is used for a creditable purpose.

2.3.29 Where a partnership acquires an item for a fully creditable purpose and later allows a partner private or domestic use of that item, or where the extent of private or domestic use changes from the intended use, the partnership is liable for an adjustment.

2.3.30 Where partnership property is used purely for a private or domestic purpose, by a partner, then the transaction is a supply by the partnership to the partner. The supply would be taxable under Division 72 of the GST Act, on the basis that the partner is an associate of the

partnership. The amount of GST payable would be 10 per cent of the GST exclusive market value of the supply.<sup>25</sup>

### **Principle – Single entity taking a partner into its enterprise**

2.3.31 If a partnership is formed as a result of an entity ('Entity A') taking a partner ('Entity B') into its enterprise, then, for the purposes of the GST law, the arrangement is taken to involve a supply of the enterprise assets from Entity A to the partnership. The supply of the enterprise assets by Entity A will be for consideration that is equal to the GST inclusive market value of the supply.

### **Carve-out**

2.3.32 The arrangement is not taken to involve a supply from Entity A to Entity B.

### **Commentary**

2.3.33 When Entity A takes a partner into its enterprise, the agreement to do so frequently provides for the new partner to purchase a share of the enterprise or a share of the assets of the enterprise. If the supply of the enterprise, by Entity A to the partnership, meets the requirements, the supply will be considered the supply of a going concern.<sup>26</sup>

2.3.34 This transaction results in the formation of a partnership and an acquisition of an interest in the partnership by each partner. The consideration provided by the 'purchaser' for the interest in the partnership is the amount payable to the 'vendor' in respect of the acquisition of the interest in the enterprise.

2.3.35 The entity selling the enterprise makes a supply of an enterprise to the partnership, with the consideration being a supply of an interest in the partnership, together with a payment of money.

### **Principle – Change in membership does not give rise to a general dissolution**

2.3.36 A partnership may choose to be reconstituted, for GST purposes, upon a change in membership.

### **Carve-out**

2.3.37 There must be an express or implied continuity clause in the partnership agreement.

2.3.38 The reconstituted partnership must continue to carry on the same enterprise as the original partnership.

### **Add-on**

2.3.39 A partnership is required to notify the Commissioner of any change in its membership within 28 days of the change.

---

<sup>25</sup> In accordance with subsection 72-10(1) of the GST Act.

<sup>26</sup> If the supply of the enterprise meets the requirements of section 38-325 of the GST Act, it is a supply of a going concern that is GST free. Please note, there are proposed amendments to remove the GST free going concerns and replace them with a reverse charge mechanism.

## Commentary

2.3.40 A technical dissolution will occur when continuing partners and any new partner/s persist with the enterprise of the partnership without any break in its continuity. Determining the continuity of the enterprise will require examination of the partnership agreement for an express or implied continuity clause. However, the presence of a continuity clause is not definitive evidence of the continuity of an enterprise. Other indicators of the continuity of an enterprise are that:

- substantially all of the partnership assets remain with the continuing partnership;
- the nature of the enterprise remains substantially unchanged;
- the client or customer base remains substantially unchanged; and
- the business name or name of the firm remains unchanged.

2.3.41 A reconstituted partnership may be regarded as carrying on the same enterprise for GST purposes without the burden and compliance costs of re-registering for GST. However, the Commissioner must be notified of any changes in membership of partnership, to ensure that any recovery action commences against the correct composition of partners.

2.3.42 Where an outgoing partner sells or assigns its interest in the partnership to an incoming partner or continuing partner there will be no GST consequences for the general law partnership, as it has not made a supply. If the outgoing partner is registered for GST then the supply may be an input taxed financial supply of an interest in the partnership.

## Principle – Changes in the legal interests of the partnership property

2.3.43 A change in the legal interest in partnership property (where the property remains a partnership asset) is not taken to give rise to a supply of an interest in the property from one partner to another.

## Commentary

2.3.44 The purpose of this principle is to clarify the law through a deeming provision.

2.3.45 As partnerships, at general law, are not recognised as separate legal entities, legal title of partnership property is held by the partners. Regardless of the legal title, each partner has an interest in each and every partnership asset. A partner holds legal title of partnership property on trust for the partnership.

2.3.46 A supply of an interest in a partnership by a partner may, for example, require an outgoing partner to effect a change in legal title or interest in a partnership asset. The acquiring partner acquires the legal interests under the supply of an interest in a partnership. For GST purposes, the transfer of the legal interest does not involve a separate supply by the outgoing partner. Any supply of partnership property would be by the partnership. Therefore, where property stays in the partnership, there is no supply as the supply and acquisition would be by the same entity – the partnership.

2.3.47 For instance, entities A, B and C are partners to a partnership. Entity A buys a commercial property, on behalf of the partnership, and holds the title on the property. Later, entity A leaves the partnership and transfers the title of the partnership's commercial property to

entity B. For GST purposes, the transfer of title in the partnership property from entity A to entity B is not the supply of an interest in the property, because the asset remains partnership property.

### **Principle – Joint and several liability where a change in membership occurs**

2.3.48 Where a change in membership occurs part way through a tax period the 'original' composition of partners will be liable for the partnership's net amount up to the date of the change in membership.

#### **Add-on**

2.3.49 Where a change in membership occurs part way through a tax period, the revised composition of partners is liable for the remainder of the partnership's net amount for the relevant tax period.

### **Commentary**

2.3.50 Under section 444-30 in Schedule 1 to the TAA, partners are joint and severally liable for the liabilities of the partnership.

2.3.51 Where a partner leaves a partnership, that partner is only liable for the GST responsibilities and obligations of the partnership prior to the disposal of their interest in the partnership. Therefore, the partner is liable only for those amounts that would be attributable while it was a partner (applying the attribution rules as though the part of the tax period that the entity was a partner was a tax period). Similarly, a new partner is only responsible for the GST liabilities and obligations of the partnership obtained after the new partner has acquired an interest in the partnership and not for any prior liabilities.

### **Principle – Treatment of a continuing enterprise upon a general dissolution**

2.3.52 If a change in the membership of a partnership gives rise to a general dissolution of the partnership (the 'original' partnership) and the creation of a new partnership (the 'new partnership') then, for the purposes of GST law, this is taken to involve a supply by the original partnership to the new partnership of the enterprise assets for consideration equal to the market value of the supply.

#### **Carve-out**

2.3.53 The arrangement is not taken to involve a supply of partnership property by the original partnership to the entities that were partners prior to the change in membership; nor is it taken to involve a supply of partnership property from the entities that are partners after the change in membership to the new partnership.

### **Commentary**

2.3.54 This principle is to minimise the compliance burden on partners when there is a change of membership, which is ineligible to be a technical dissolution. It is intended that this principle and the carve-out will only apply to the extent that the enterprise assets being supplied become assets of the 'new partnership' – i.e. the principle and the carve-out are not intended to apply to any distributions of assets made to outgoing partners.

2.3.55 Under the normal GST rules, the general dissolution of a partnership results in a distribution of partnership property to the partners. The distribution of partnership property would be determined by the partner's individual interest in the partnership.

2.3.56 However, if the continuing partnership creates a 'new' partnership, the supply of the 'original' partnership's enterprise will be taken to be a supply made by the 'original' partnership to the 'new' partnership. Subsequently, there will be no distribution of partnership property to the continuing partners upon the general dissolution of the 'old' partnership.

2.3.57 For example, Amy, Bob and Carl operate a shoe manufacturing enterprise in partnership (the original partnership). Carl decides to leave the partnership. This results in a general dissolution of the original partnership. Amy and Bob continue to operate the shoe manufacturing enterprise together in partnership (the new partnership). In accordance with the principle, this arrangement involves a supply of the assets of the enterprise from the original partnership to the new partnership. Additionally, there will be no distribution of partnership property to Amy or Bob upon the general dissolution of the original partnership.

2.3.58 If the supply of the enterprise meets the requirements, the supply will be considered the supply of a going concern.<sup>27</sup>

#### Focus questions:

Q.3A Do the proposed principles sufficiently clarify the law relating to partner-to-partnership supplies, partnership distributions and the treatment of transactions associated with changes in membership of a partnership?

Q.3B With regard to the principle at paragraph 3.2.30, would an alternative to the proposed principle, involving introducing a rollover-type provision or provisions (i.e. rules which would ensure that the new partnership picks up the history of the 'single entity' for various purposes – e.g. margin scheme, change of use adjustments) be more appropriate?

Q.3C Do the proposed principles give rise to any unintended consequences relating to the GST treatment of general law partnerships?

Q.3D Are there other issues relating to GST treatment of general law partnerships that require clarification?

#### Application date

2.3.59 The measure is to apply at the start of the first quarterly tax period after Royal Assent.

---

<sup>27</sup> If the supply of the enterprise meets the requirements of section 38-325 of the GST Act, it is a supply of a going concern that is GST free. Note, there are proposed amendments to remove the GST free going concern provision and replace it with a reverse charge mechanism.

## 2.4 TAX LAW PARTNERSHIPS

### Government decision

The GST law should be amended to clarify the treatment of tax law partnerships, including in relation to matters arising when a tax law partnership is formed or dissolved and when it makes a supply or an acquisition.

### Background

#### Operation of existing law

2.4.1 The GST Act provides that the term 'partnership' has the same meaning as that given by the income tax law. 'Partnership' is defined for income tax purposes in section 995-1 of the ITAA 1997 to include both an association of persons 'carrying on a business as partners' (a general law partnership) and an association of persons 'in receipt of ordinary income or statutory income jointly' (a tax law partnership). This concept of a 'partnership' extends beyond the general law concept of a partnership recognised by the state Partnership Acts (a general law partnership) to persons who are in receipt of assessable income jointly (a tax law partnership).

2.4.2 A tax law partnership is treated as an entity for the purposes of the GST Act due to the tax law definition of partnership. Therefore, a tax law partnership can carry on an enterprise and make taxable supplies and creditable acquisitions.

2.4.3 A tax law partnership exists when there is an association of persons 'in receipt of income jointly'. The Commissioner has taken the view that 'in receipt of income' should be interpreted broadly to include all steps leading to a joint right or entitlement to income – this is referred to as a 'time of association' approach. The 'time of association' approach allows a tax law partnership to claim input tax credits, in some circumstances, for creditable acquisitions made prior to a right to the receipt of joint income arising - however this depends on the facts and circumstances of each situation.

2.4.4 Under the Commissioner's view, the fact that a tax law partnership may exist does not necessarily mean that it is the entity that is carrying on the enterprise for GST purposes. Rather, consideration has to be given to a number of factors in determining whether any enterprise that is being carried on is carried on by the tax law partnership or the partners in their own right. A tax law partnership that is carrying on an enterprise (an 'enterprise tax law partnership') must register for GST if it meets the turnover threshold of \$75,000. A partnership may be registered from the date when it begins undertaking activities in the commencement of its enterprise.

2.4.5 Partners of an enterprise tax law partnership cannot register for GST, nor acquire an ABN in relation to the enterprise carried on by the partnership.

2.4.6 The Commissioner views entities in a tax law partnership as partners for the purposes of subsection 184-5(1) of the GST Act. Thus a partner of a tax law partnership may make supplies and acquisitions on behalf of the partnership for the purposes of the GST law, provided it is within their capacity as a partner. However, this approach is contrary to the general law position, as the partner of a tax law partnership holds no capacity to act on behalf of the 'fictional entity'.

2.4.7 Under section 444-30 in Schedule 1 to the TAA 1953 the obligations on a partnership are imposed on each partner. Partners are jointly and severally liable to meet the indirect tax obligations of the partnership.

2.4.8 A tax law partnership terminates when the association of persons is no longer in receipt of income jointly. The Commissioner is of the view that, unlike a general law partnership, a tax law partnership cannot be reconstituted.

2.4.9 The intention of the following proposals is to remove the uncertainty surrounding the GST treatment of tax law partnerships by clarifying when a tax law partnership commences, when a supply or acquisition is made by a tax law partnership or by a partner, and the GST implications for the dissolution of a tax law partnership.

## **Proposal 1 – Treat tax law partnerships as general law partnerships**

2.4.10 Under this approach, a tax law partnership would be treated for GST purposes in exactly the same way as a general law partnership.

### **Formation**

2.4.11 As is currently the case under the Commissioner's view, a tax law partnership will be formed at the time the partners jointly commence an activity from which income is or will be received jointly.

2.4.12 In cases where a tax law partnership is formed because co-owners of property convert that property to an income producing purpose, the partners would be taken to make a supply of the property to the partnership in exchange for an interest in the partnership. The supplies made by the partners will be taxable if the partners are registered for GST and the other requirements of section 9-5 of the GST Act are met. The supply of the interest in the partnership made by the tax law partnership will, if the tax law partnership is registered for GST, be an input taxed financial supply.

2.4.13 In instances where a tax law partnership is formed at or before the time the partnership property (from which income will be derived jointly) is acquired, the acquisition of the property would be taken to be made by the partnership. In such cases, the formation of a tax law partnership would not be taken to involve an in-kind contribution of property by the partners to the partnership.<sup>28</sup>

2.4.14 A tax law partnership would be required to be registered for GST if its turnover meets the registration threshold.

### **Operation**

2.4.15 Partners in a tax law partnership would be able to act in their capacity as partners. Supplies and acquisitions by the partners, in their capacity as partners, would be taken to be supplies and acquisitions on behalf of the tax law partnership.

2.4.16 The partnership may acquire an item that a partner or partners intend to use partly for private or domestic purposes. However, the partnership is only entitled to an input tax credit to the extent that the acquisition is used for a creditable purpose of the partnership.

---

<sup>28</sup> This is assuming the partnership did not acquire the property from one of the partners.

## Changes in 'membership'

2.4.17 A partner may sell their interest in the partnership to an 'incoming partner', and where there is agreement between the remaining partners and the incoming partner, the tax law partnership may be treated as a continuing entity – provided the partnership continues to operate the previous enterprise. This reconstituted partnership would be required to notify the Commissioner of the change in membership within 28 days. In cases where a change in the membership of a tax law partnership occurs part way through a tax period, the initial composition of partners will be jointly and severally liable for the partnership's debt up to the time of the change and the new composition of partners will be jointly and severally liable for the remainder of the debt. This is consistent with the normal joint and several liability rules (in section 444-30 in Schedule 1 to the TAA).

## Cessation

2.4.18 Where a change in membership gives rise to a cessation of the original partnership and the creation of a new tax law partnership, it would be taken to be a supply of partnership property from the original tax law partnership to the new partnership – not a supply from the outgoing partner selling their interest in property to an incoming partner.

2.4.19 In cases where the cessation of a tax law partnership arises because income ceases to be derived jointly, the partnership is taken to supply the partnership property to the partners. The supply made to each partner will be taken to be a supply that is made in the course or furtherance of the partnership's enterprise for consideration equal to the GST inclusive market value of the property.

2.4.20 Where a registered tax law partnership chooses to cancel its GST registration, the partnership may be liable for a Division 138 adjustment in respect of property on hand at the time of cancellation.

## Proposal 2 – Retain tax law partnerships for reporting and turnover threshold purposes only

2.4.21 Under this option, the GST consequences of all activities which give rise to receipt of income jointly would be determined on the basis that each co-owner is carrying on an enterprise in their own right. The tax law partnership would not be regarded as carrying on an enterprise although it would exist as the partners would be jointly in receipt of income. The combined turnover of all the 'partners' (in relation to the activities which give rise to the joint receipt of income) will be aggregated to determine whether or not the 'partners' of the tax law partnership are required to be registered for GST. If the combined turnover exceeds the registration threshold, the partners would be required to register for GST in their own right. The partners would, however, be provided with the option of reporting as a tax law partnership or reporting separately in their own right.

## Reporting as a tax law partnership (default position)

2.4.22 The default reporting position is that partners of a tax law partnership will report as a tax law partnership. All supplies and acquisitions made by the partners, in relation to the enterprise carried on by the tax law partnership, will be aggregated and reported by the lodgment of a single BAS on behalf of the tax law partnership. A tax law partnership may be notionally registered, for the purposes of making a consolidated partnership return, although the activities which give rise to the joint receipt of income will be carried on by the partners individually (and not the tax law partnership). The partners in the tax law partnership would not be required to

lodge a GST return in their own right, unless they are carrying on an enterprise separate from the enterprise giving rise to receipt of income jointly.

2.4.23 Where a registered partner is carrying on a separate enterprise, it will be required to lodge separate BASs – the tax law partnership BAS (consolidated with the other partner/s' tax law partnership activities) and a BAS relating to its other enterprise.

2.4.24 Where a partner is already registered for GST, with regard to its other separate enterprises, and is required to be registered because the tax law partnership exceeds the registration threshold, that partner will not have to apply for a separate GST registration, for itself, in relation to the tax law partnership.

### Reporting separately as partners

2.4.25 Partners in a tax law partnership would, however, be able to elect to report separately, rather than as a tax law partnership. As the partners are deemed to be carrying on an enterprise and must be registered for GST, the partners may report separately in regard to supplies and acquisitions made in relation to the partnership. There would be no registration of the tax law partnership. This would mean that individual partners would lodge separate BASs, paying the GST and claiming input tax credits attributed to their relevant supplies and acquisitions. In the case where a partner is already registered for GST (in relation to a separate enterprise it carries on), the supplies and acquisitions made in relation to the tax law partnership would be included in the individual's BAS.

### Aggregating turnover

2.4.26 Where the turnover of the tax law partnership does not exceed the registration threshold, the aggregate GST turnover of a partner, in relation to turnover of the tax law partnership and the turnover of the partner's other enterprises (if any), would determine whether the partner is required to be registered for GST. It may be the case that the overall turnover of a tax law partnership is below the registration threshold, but the combined GST activities of an individual partner require it to be registered. Hence, one partner of the tax law partnership would be required to be registered but the other partners may not need to register. This is subject to a focus question below.

### Consequences of treating supplies as having been made by the partners

2.4.27 All supplies and acquisitions would be taken to be made by the partners and not the tax law partnership.

2.4.28 Amongst other things, this means the GST payable on, for example, a sale of jointly owned real property made under the margin scheme will be determined with reference to the 'partner's cost base'. Each transaction undertaken by the tax law partnership will be taken to involve multiple supplies and acquisitions by the partners. For example, a supply of real property by a three-person tax law partnership will consist of three separate supplies, requiring three separate invoices. A special rule may be required to ensure that, if the partners choose to report as a tax law partnership, only one tax invoice needs to be issued in relation to multiple supplies made by the partners.

### Joint and several liability

2.4.29 Where partners choose to lodge a single BAS on behalf of the tax law partnership in relation to jointly received income, the partners will be jointly and severally liable for any amount payable. Where the partners have elected to report individually, the partners would not be jointly

and severally liable, but liable only in relation to the supplies and acquisitions they have actually made in relation to the activities that give rise to the joint receipt of income.

## Changes in membership and cessation

2.4.30 A change in the membership of a tax law partnership would give rise to the cessation of the original partnership and the formation of a new partnership. The cessation may trigger a concluding tax period for the partners, requiring the lodgment of a return on behalf of the tax law partnership – or separately, in the case that the partners have elected to report separately. The period beginning after the cessation of the tax law partnership may be a tax period that applies to the new composition of partners. The supply of the interest in the partnership property, that triggers the change in membership, will be a partner-to-partner supply and the GST consequences would be calculated accordingly.

2.4.31 In cases where the cessation of a tax law partnership arises because income ceases to be derived jointly, a partner's registration would need to be cancelled if the partner is no longer carrying on an enterprise. A Division 138 adjustment may be applicable with regard to the property used in carrying on the 'tax law partnership enterprise', which is on hand at the time of cancellation. In cases where partners are carrying on other separate enterprises, the partner would not have to cancel their registration, but adjustments may be applicable under Division 129 if they proceed to use property that was previously used in the partnership enterprise, for a different purpose.

### Example

2.4.32 Tom and Mary are partners in a tax law partnership that involves the leasing of commercial property. Tom and Mary derive \$30,000 each a year from the leasing activity. Tom, a plumber, carries on a separate enterprise that derives \$60,000 annually. Mary does not carry on a separate enterprise.

2.4.33 Under proposal 2, Tom would be required to register for GST as his aggregate GST turnover exceeds the registration turnover threshold of \$75,000. Mary, however, would not be required to register for GST as her turnover is less than the threshold.

2.4.34 If both Tom and Mary register for GST, they would have the choice of either reporting as a tax law partnership or lodging separate returns. If they choose to report as a tax law partnership (the default position), Tom and Mary would be required to lodge one consolidated GST return for each tax period (in which they would be required to report amounts relating to the 'tax law partnership's enterprise'). Tom and Mary would be jointly and severally liable for the partnership's net liability. Additionally, Tom would be required to lodge a further GST return each tax period in relation to his plumbing enterprise.

If, however, Tom and Mary elect to lodge separate returns, Tom would be required to lodge one return each tax period in which he would report his liabilities and entitlements relating to both the 'tax law partnership enterprise' and his plumbing enterprise. Mary would be required to lodge a GST return in which she would report her liabilities and entitlements in relation to the 'tax law partnership enterprise'. Tom and Mary would not be jointly and severally liable for any amount.

### Focus questions

Q.4A Would either option 1 or option 2 clarify the GST treatment of tax law partnerships?

Q.4B Does either option give rise to any unintended consequences?

Q.4C Is there a more effective alternative approach, which would clarify the GST treatment of tax law partnerships?

### Application date

2.4.35 The measure is to apply at the start of the first quarterly tax period after Royal Assent.

## 2.5 BARE TRUSTS

### Government decision

The GST law will be amended to clarify the GST liabilities and entitlements of bare trusts.

### Background

#### Operation of existing law

2.5.1 The GST law imposes an obligation to remit GST on entities that make taxable supplies or taxable importations and similarly provides an entity with an entitlement to claim input tax credits on creditable acquisitions and creditable importations.

2.5.2 There is uncertainty concerning the current operation of the GST law concerning bare trusts. The Commissioner, however, has taken the view<sup>29</sup> that dealings in relation to real property held by a trustee of a bare trust<sup>30</sup> are considered to be undertaken by the beneficiary or beneficiaries of the trust where the beneficiary or beneficiaries carry on an enterprise with the asset.

2.5.3 Any tax invoices issued or held by the trustee of such bare trusts are issued or held on behalf of the beneficiary or beneficiaries of the trust.

2.5.4 The measure seeks to clarify the operation of the GST law to bare trusts to provide greater certainty for affected taxpayers.

### Proposal – Transactions undertaken by trustees of bare trusts

#### Principle – Bare trust supplies treated as made by beneficiary

2.5.5 Supplies, acquisitions, taxable importations and creditable importations made by a bare trustee are not made in the course of an enterprise by the trustee and are considered to be made by the beneficiary or beneficiaries of the bare trust to the extent of their interest in the assets of the trust.

#### Add-on – trusts that operate similarly to bare trusts

2.5.6 The above principle also applies to trustees of trusts that operate in a similar way to bare trusts and may only perform minor active duties and are only entitled to act at the direction of a beneficiary or beneficiaries of the trust.

---

<sup>29</sup> Public ruling GSTR 2008/3.

<sup>30</sup> The term bare trust is used in GSTR 2008/3 to refer to both bare trusts under the established meaning of the term (being a trust under which the trustee holds property without any interest in it, except because of its office and the legal title as trustee, and without any duty to perform, apart from transferring the property when demanded to the beneficiaries or as directed by them, such as when the property is sold to a third party) and also similar trusts where the trustee has limited active duties and acts solely at the direction of the beneficiary or beneficiaries.

## Carve-out – partnership beneficiaries treated as a single entity

2.5.7 Where a trustee of a bare trust acts on behalf of beneficiaries carrying on an enterprise as a partnership in relation to trust property, then it is the partnership that is considered to have made the relevant supply, acquisition, taxable importation or creditable importation and not the beneficiaries.

## Carve-out – transactions undertaken as agent

2.5.8 The above principle does not apply to transactions undertaken by a trustee of a bare trust in the capacity as agent for a beneficiary of the bare trust.

## Commentary

2.5.9 The principle clarifies the GST law and ensures that certain activities of a trustee of a bare trust are not considered to be made in the course of an enterprise by the trustee and therefore are not subject to GST. This will be the case where the trustee has only minor active duties and acts and is only entitled to act under the direction of the beneficiaries of the bare trust.

2.5.10 Where the trustee acts for more than one beneficiary, then transactions are treated as having been made by the beneficiaries, having regard to the extent of their interest in the assets of the trust.

2.5.11 In circumstances in which a bare trust is established to account for trust property on behalf of the partners of a partnership, then the partnership is treated as carrying on the enterprise rather than each of the partners separately. This ensures that each partner does not need to account separately for GST purposes for the transactions of the partnership.

2.5.12 Finally, no changes are proposed to the treatment of transactions undertaken by the trustee of a bare trust in the capacity of agent for a beneficiary of the bare trust. This reflects that the existing application of the GST law to agency relationships will continue to apply in these situations.

## Alternative to the principle

2.5.13 An alternative approach of treating a bare trustee and similar trustees as an agent of the beneficiary for which they act could provide compliance benefits for some taxpayers. This would remove any doubt as to when an agency relationship exists and would, for example, result in resident trustees accounting for GST for transactions that non-residents undertake through their resident agents.<sup>31</sup>

---

<sup>31</sup> Division 57 of the GST Act applies to resident agents acting for non-residents.

### Focus questions:

Q.5A Will the proposed principle give rise to any unintended consequences?

Q.5B Does the proposed principle apply appropriately to:

- arrangements in place for financial instruments such as instalment warrants that may operate in a similar way to bare trusts; and
- trustee arrangements in the funds management industry such as investor-directed portfolio services?

Q.5C Would the alternative approach of treating bare trustees and similar trustees as agents of beneficiaries improve certainty for taxpayers and provide compliance benefits for taxpayers?

Q.5D Do the tax invoice requirements operate effectively for bare trusts?

### Application date

2.5.14 The measure will apply to:

- supplies, acquisitions and creditable importations made by bare trustees for which GST and input tax credits are attributable to tax periods commencing on or after the start of the first quarterly tax period after Royal Assent; and
- taxable importations made by bare trustees on or after the start of the first quarterly tax period after Royal Assent.

## 2.6 RUNNING BALANCE ACCOUNT

### Government decision

The GST law will be amended so that there is only a requirement to offset a credit against a business activity statement amount when that amount becomes due and payable and not before this time.

Additionally, the activities of each joint venture role that a joint venture operator undertakes, should be treated separately for running balance account purposes, and also separately from the activities of the joint venture operator in its own capacity as an entity.

### Background

#### Operation of existing law

2.6.1 An entity can have a variety of capacities in which it accounts for GST. These can include in its capacity as an entity in its own right and as a GST joint venture operator.

2.6.2 Entities are required to notify a number of their business tax liabilities (for example GST, WET, LCT and fuel tax credits) to the Commissioner by lodging a BAS so that those debts and any credit entitlements and payments made can all be recorded on one running balance account (RBA).

2.6.3 Currently, the offsetting of payments, credits or RBA surpluses against a BAS debt that is due but not yet payable is mandatory.<sup>32</sup>

2.6.4 These offsetting rules for debts and refunds, in their current form, produce inappropriate outcomes in some circumstances and can give rise to compliance costs for taxpayers. For example, the current offsetting rules can involve compliance costs for taxpayers in determining how the Commissioner has treated their refund, and where it has not been applied to a debt, having it transferred back to the correct role, entity or branch.

2.6.5 Currently a GST joint venture operator in accounting for the activities of the GST joint venture may have credits offset against any liabilities of the GST joint venture operator's own RBA. Although the activities of each GST joint venture that a GST joint venture operator undertakes are treated separately for RBA purposes, the offsetting of any credits or refunds to the GST joint venture operator's own RBA unnecessarily increases complexity.

### Proposal – Offsetting when due and payable

#### Principle—offsetting

2.6.6 There is a requirement to offset a RBA payment, credit or RBA surplus against a BAS amount when that amount becomes due and payable.

---

<sup>32</sup> This reflects the operation of subsections 8AAZL(1) and (2) of the TAA.

## Commentary

2.6.7 It is intended that subparagraph 8AAZL(3)(a)(i) of the TAA will be repealed so that the Commissioner will have the discretion not to offset a payment, credit or RBA surplus against a BAS debt before the due and payable date. It is intended that the principle will not remove the Commissioner's ability to offset amounts before the due and payable date.

### Focus question:

Q.6A Will the proposed amendment to the legislation address concerns about the treatment of payments, credits or RBA surpluses under the RBA?

## Application date

2.6.8 The measure will apply in offsetting amounts on the RBA on or after 1 July 2011.

## 2.7 NON-PROFIT SUB-ENTITIES

### Government decision

The GST law will be amended to ensure that non-profit sub-entities are able to access the same GST concessions as their parent entity.

### Background

#### Operation of existing law

2.7.1 A number of concessions are available to non-profit bodies under the GST Act.

2.7.2 Certain entities have the option of separately identifying some or all of their operations and treating each as a separate entity for GST purposes. These operations are known as 'non-profit sub-entities', and they only have to register if their GST turnover is above the registration threshold. If their turnover is less than \$150,000, these non-profit sub-entities can choose not to register and can conduct activities (such as lamington drives, fundraising dinners, fetes and so on) so that no GST is payable on sales (and no input tax credits can be claimed). However, the parent entity must remain registered for the non-profit sub-entity to exist (subsection 63-5(2)).

2.7.3 The following types of registered entities are able to access the non-profit sub-entity provisions:

- an endorsed charitable institution;
- an endorsed trustee of a charitable fund;
- a government school;
- a gift-deductible entity that is a non-profit body; or
- a non-profit body that is exempt from income tax under the following provisions of the ITAA 1997 – sections 50-5, 50-10, 50-15, 50-40 or item 9.1 or 9.2 of section 50-45.

2.7.4 The intention of the law is that non-profit sub-entities are able to access the same GST concessions as their parent entity and access the higher registration turnover threshold that applies to non-profit bodies. Consistent with this, the Commissioner currently allows non-profit sub-entities to access the same GST concessions as their parent entity and to use the higher registration turnover threshold that applies to non-profit bodies. However, there has been some uncertainty as to whether the legislation is clear. This amendment will ensure that the Government's policy intent is clearly stated in the GST law.

2.7.5 Under section 38-250, supplies by charities, gift-deductible entities or government schools which are made for nominal consideration are GST free. However, where they are registered for GST, their commercial activities (that is, those for more than nominal consideration) are treated the same as any other entity. This is designed to ensure no commercial advantage arises. Commercial activities include non-accommodation supplies made at 50 per cent or more of the market value and 75 per cent or more of the cost of supplying them.

2.7.6 The creation of non-profit sub-entities could allow some commercial advantage to arise in some instances if the parent entity claims input tax credits on acquisitions related to things that are provided to the non-profit sub-entity for on-supply or are used by the non-profit sub-entity in making supplies. To negate this commercial advantage, section 72-92 provides that the associate provisions in Division 72 apply to transactions between the parent entity and its non-profit sub-entities.

2.7.7 Despite the intention that the associate provisions in Division 72 should interact appropriately with the non-profit sub-entity provisions to negate the commercial advantage described above, there has been some uncertainty as to whether the law clearly achieves this result. An amendment will ensure that the Government's policy intent is clearly stated in the law.

## Proposal – Non-profit sub-entities

### Principle

2.7.8 Non-profit sub-entities can access the same GST concessions as their parent entity.

### Commentary

2.7.9 This principle will codify the Commissioner's existing practice.

2.7.10 A statement may be included to say that, for the avoidance of doubt, the non-profit registration threshold of \$150,000 applies to non-profit sub-entities.

2.7.11 The associate provisions in Division 72 should continue to operate in the way they currently do.

### Principle

2.7.12 A supply by a parent entity to its non-profit sub-entity will only be GST free under section 38-250 to the extent that:

- on-supplies by the non-profit sub-entity are GST free or taxable; or
- the acquisition by the non-profit sub-entity is used to make supplies that are GST free or taxable.

### Commentary

2.7.13 This principle will ensure consistency in the GST treatment of supplies and acquisitions where the parent entity chooses to create a non-profit sub-entity.

#### Focus questions:

Q.7A Is any further clarification required to ensure that non-profit sub-entities are able to access the same GST concessions as their parent entity?

Q.7B Are there any transitional issues which need to be addressed?

### Application date

2.7.14 The amendments will apply from the start of the first quarterly tax period after Royal Assent.

## 2.8 PAYMENT OF REFUNDS OF OVERPAID GST

### Government decision

The GST law will be amended to clarify that the Commissioner has a discretion to refund the GST where appropriate.

### Background

#### Operation of existing law

2.8.1 Section 105-65 of Schedule 1 of the TAA sets out the circumstances in which the Commissioner is not required to provide a credit for or refund of an overpayment of GST. The policy intent behind the provision is to prevent a taxpayer obtaining a windfall gain from a refund of GST that has been borne by the recipient of the supply. Broadly, it provides that the Commissioner 'need not' pay a refund in particular circumstances.

2.8.2 The Commissioner takes the view that section 105-65 provides a residual discretion to allow a refund in circumstances where the Commissioner thinks a refund is appropriate, notwithstanding that the restriction on the payment of the refund contained in section 105-65 applies.

2.8.3 While, on balance, the Commissioner considers that the words 'need not' are sufficient to support this view, it is not entirely free from doubt.

2.8.4 Moreover, it is unclear whether section 105-65 currently provides for the Commissioner to make a partial refund of an overpaid GST amount where appropriate. Partial refunds will be considered where the refusal to refund would result in a party to the transaction being adversely affected but the making of a full refund would result in a loss to the revenue. For example, the supplier might be able to demonstrate that it bore the economic cost of 50 per cent of the GST that was paid on the transaction. In such a case, a refund of 100 per cent of the GST would result in a windfall gain, but it may be appropriate to refund 50 per cent of the GST.

### Proposal – Refunds of overpaid GST

#### Principle – Commissioner's discretion

2.8.5 While section 105-65 of Schedule 1 to the TAA restricts the refund or credit of overpaid GST in certain circumstances, the Commissioner has a residual discretion to refund or credit so much of the GST as appropriate.

#### Commentary

2.8.6 The intention of this principle is to instil greater confidence in the operation of this provision by clarifying that the Commissioner has a discretion to refund the GST where appropriate. While the words 'need not' in section 105-65 of the TAA imply the existence of a discretion, this discretion is not clear on the face of the existing legislation. Therefore, it is intended that an additional subsection or note be added that clarifies the Commissioner has a discretion to refund GST where a refund is not otherwise applicable by the operation of subsection 105-65(1).

2.8.7 The authority to pay refunds is provided for by section 8AAZLF of the TAA in combination with the residual discretion allowed in section 105-65.

2.8.8 As mentioned above, clarification is also required that the Commissioner may make partial refunds where appropriate. The words 'so much' in the principle are intended to clarify that the Commissioner may make a partial refund of 'so much of the GST' as he thinks appropriate in the circumstances.

2.8.9 The payment of a refund when section 105-65 applies will be the exception, rather than the norm and the Commissioner would only exercise his discretion where the taxpayer was able to provide clear and compelling evidence that the tax had not been passed on. Examples of circumstances where the Commissioner might exercise his discretion include where:

- the supplier can show that it negotiated a price with the recipient of the supply on the mutual understanding that GST was not payable on the transaction, but the supplier subsequently made an error and treated the supply as taxable in the activity statement.;
- the overpayment of GST has directly resulted from actions of the Commissioner. In particular, where the supply was originally treated as non-taxable, the Commissioner has assessed the supplier on the basis that it is taxable, but the assessment is overturned on objection or appeal.

2.8.10 Factors weighing against the exercise of the discretion in particular cases may include: administrative and compliance costs; potential for windfall gains to arise and asymmetry issues. Asymmetry issues may emerge where the recipient of the supply has claimed input tax credits but the Commissioner is unable to recoup those credits.

#### Focus questions:

Q.8A Will the proposed amendment to the legislation provide sufficient clarification of the Commissioner's discretion to refund the GST where appropriate?

Q.8B Does section 105-65 of the TAA deal appropriately with circumstances in which there:

- are mixed supplies;
- has been a miscalculation by the parties of the amount of GST payable in relation to a supply (for example in applying the margin scheme or in the case of mixed supplies);
- are multiple revisions to an activity statement for over and under-payments such that the taxpayer is not entitled to a refund;
- has been an overpayment by a different entity; or
- are delayed refunds.

If not, what changes should be made to ensure that the provision operates effectively?

#### Application date

2.8.11 This measure will apply from the date of Royal Assent.