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The Tax Office's tough love approach to GST compliance

A recent speech given by Mr Jim Killaly (the Deputy Commissioner of Tax for Large Business and International) at the Australian Taxation Summit on 5-7 February 2007 highlights the Tax Office's current attitude towards GST compliance, particularly with regard to the large business sector.

The Tax Office's approach to GST compliance in the early years of GST was primarily one of education, with a focus on ensuring that entities understood their GST reporting and compliance obligations. However, some seven years after the implementation of GST, the approach has now moved to one of enforcement, evident in the Tax Office's policy on "wash transactions" (discussed below) and the significant increase in the use of penalties and interest as a matter of course, in order to deter and punish GST non-compliance by entities.

"Wash transactions" occur when an entity makes a taxable supply to another entity. Although the supplier has a GST liability in respect of the supply, the recipient entity generally has a corresponding entitlement to claim GST credits. In these circumstances, there is no net revenue impact to the Tax Office and the transaction is essentially a "wash". GST mistakes in respect of wash transactions often occur in relation

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to transactions between related entities. For example, where an entity provides management services to a subsidiary (and these entities are not grouped for GST purposes), that entity will have a GST liability on the supply. If it fails to remit GST on the taxable supply, it is the Tax Office's view that there are no grounds to limit penalties merely because the transaction is a wash. The Tax Office considers that each taxpayer's obligation and entitlement is separate. This is the case even where the two parties to the transaction are entitled to form a GST group. The adoption of this approach, even where there is no net cash impact to the Tax Office, is indicative of the new era of GST enforcement.

The new, harder enforcement approach is also evident in two Practice Statements, PS LA 2007/3 and PS LA 2007/4, which were recently released by the Tax Office. The Practice Statements advise that penalties will be imposed on entities for the failure to correctly issue tax invoices or adjustment notes, and for the failure to comply with GST registration obligations (including cancellation). Although the Tax Office has always had the power to issue penalties in respect of these types of compliance breaches, we have rarely seen it exercise these powers to date. In light of its recent and evident *Continued over page...*

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Furthermore, the Tax Office has emphasised that, when determining whether to remit penalties in respect of certain compliance breaches, an entity's compliance history will be a key factor in its decision to remit. For example, where an entity has a history of "non-compliance", clear evidence that the imposition of a penalty would be unjust or unfair will be necessary before any remission is considered. "Non-compliance" is also considered to extend to aggressive tax planning undertaken by an entity, even where that planning does not appear to be technically inconsistent with the provisions of the GST law. For example, where the Tax

Office considers that a resident entity has restructured its business activities or transactions to remove the apparent connection with Australia so as to avoid GST obligations, the Tax Office has confirmed that it will seek to tax those activities. This is notwithstanding that the provisions of the GST law clearly contemplate that some supplies made under certain arrangements will not be connected with Australia and therefore will not be subject to GST.

BDO comment: In light of the Tax Office's current harder enforcement approach to GST compliance, we consider it essential that large businesses ensure that they proactively manage their GST compliance activities and tax risk profile. The potential costs of failing to do so are significant in terms of penalties and interest and the administrative costs associated with targeted audits by the Tax Office.

Finalisation of retirement village ruling

The September 2006 edition of this GST News discussed draft GST Ruling 2006/D3, which dealt with retirement village premises and the use of communal facilities. As mentioned in that edition, the reason why this is an issue at all is because in 2004 amendments were made to the GST law to ensure that supplies of care services and accommodation within a retirement village were GST-free, as opposed to being input-taxed (as residential accommodation) or subject to GST.

One of the requirements for premises to be classified as a "retirement village" is that the premises include some communal facilities. The Draft Ruling sought to clarify what was meant by the term "communal facilities". This Draft Ruling has now been finalised as GST Ruling 2007/1.

The final Ruling differs little from the draft Ruling. As was the case with the draft Ruling, communal facilities recognised by the Commissioner include such things as a library, dining room, recreation room, pool or barbeque area. In the Commissioner's opinion, "communal facilities" must be "physical" (therefore, they are not merely services provided to residents) and must be provided within, attached to, or connected with the residential buildings or constructed on surrounding land. Additionally, they must be provided for the primary purpose for the communal use of residents, although it does not need to be for their exclusive use nor does there



need to be any evidence that the residents actually use the premises.

BDO comment: Retirement villages that do not meet the requirements of the ruling will have significant GST consequences, for example, they may be unable to claim GST credits on construction costs of the village. We recommend retirement villages review the GST treatment of their accommodation in the light of the Ruling.

Second mortgagee falls in the GST pit

A case heard last month demonstrates the weak position of second and subsequent mortgagees when a mortgagor goes bust. The case, *The Health Pit II Pty Limited v Lowe* [2007] NSWSC 67, concerned the mortgagee sale of land. The sale price was \$3.5 million plus GST. Under real property law, the second mortgagee is entitled to have access to the "surplus" from the sale, being the difference between the sale price and the amount loaned to the first mortgagee. The second mortgagee argued that the sale price was \$3.85 million (the GST-inclusive price), which would have increased the surplus to which this mortgagee would have access. The Supreme Court rejected this argument and found that the sale price was \$3.5 million.

BDO comment: This case is interesting as it is not actually a GST case but, rather, involves the interpretation of property law. The case demonstrates the technical difficulties that can flow on from the GST, and the need to ensure that all documentation is correctly prepared and reviewed. It also demonstrates the differing meanings that can and will apply to terms across different areas of the law—in this case, the Court held that the term "purchase price" means GST-exclusive price, while in other areas of the law (for instance, in stamp duty) the term "purchase price" means the GST-inclusive price. With these large dichotomies, it is no wonder that GST has become such a technical nightmare for ordinary business people.

GST February releases

Given the short month, and given that much of the Tax Office's and the Government's attention was elsewhere, such as on the new superannuation rules, there were few GST releases.

These releases were:

- Interpretive Decision ATO ID 2007/31 (GST and barter scheme/trade exchanges: making a taxable supply of trade credits);
- Interpretive Decision ATO ID 2007/3 (GST and barter scheme/trade exchanges: making a taxable supply of trade credits)
- Interpretive Decision ATO ID 2007/32 (GST and transaction information supplied by an ADI – client's own transaction); and
- Interpretive Decision ATO ID 2007/33 (GST and transaction information supplied by an ADI – not relating to a client's own transaction).

If readers would like more details of any of these documents, please contact the BDO office in your State.

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