

**A National Tax Publication**

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Differing opinions over cancellation fees

Following on from a GST-filled April where the Commissioner issued a massive list of Rulings (all of which were discussed in last month's edition of this GST News), May was very quiet with almost no GST rulings, decisions or cases. One GST ruling that had been scheduled for release on 31 May 2006 was the Commissioner's opinion of the GST treatment of cancellation fees. However, this ruling did not arrive.

The GST treatment of cancellation and similar fees is one of the more complex GST issues. It is clearly an issue that is currently troubling the Tax Office. A draft GST ruling on cancellation fees was first notified on the public rulings program in April 2005. At that time, it was intended to issue in October 2005. It has been deferred numerous times, including the latest to 31 May 2006 and our understanding is that it is to issue at the end of June 2006.

The difficulties that arise from a GST perspective is best explained through an example. Assume a private school charges a \$1,000 enrolment fee for students to enrol in the school. The fee is payable approximately one year in advance of the student starting school and it is non-refundable. The Tax Office's GST Education Industry Partnership Issues Register (correctly) indicates that the fee is paid for a right to receive a GST-free supply (education) and is therefore GST-free. This analysis is relatively straightforward and not controversial.

In this Issue

- Differing opinions over cancellation fees
- GST & the Budget
- Legislation update

However, what happens if the student withdraws his or her enrolment from the school before the start of term? The Tax Office's current thinking is that, if all or part of enrolment fee is forfeited, the school should include one-eleventh of the amount forfeited in its BAS. In other words, the fee has suddenly transmogrified from being GST-free to taxable. There is no explanation from the Tax Office as to how it reached this conclusion.

In reality, the issue is far more complex than the Tax Office confesses to. The correct GST analysis will depend on the contractual and other arrangements between the parties. There are a number of options from a GST perspective. The first (and preferred) analysis is that the enrolment fee is originally paid for a right to receive a GST-free supply and is therefore GST-free. At the time the student withdraws, there is no supply that is made by the school from a GST perspective and, therefore, the forfeiture of the fee has no further GST consequences.

A second option is that the forfeiture is akin to a damages or compensation payment (which is not subject to GST). A third option is that forfeiture triggers a GST adjustment event that gives the school a GST liability. A fourth option is that the forfeiture involves some form of supply by the school that is subject to GST. *Continued over page...*

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As indicated above, which option applies will depend on the exact arrangements.

Hopefully, the Tax Office's draft ruling on cancellation fees will canvass these possibilities. Nevertheless, the Tax Office has put itself in a difficult position. The GST ruling on security deposits (discussed in the BDO Client Alert issued in April 2006) adopts the position that forfeited deposits are always subject to GST. If the Tax Office were to adopt a different position in relation to cancellation fees, this would result in forfeited deposits having a different GST treatment from cancellation fees, which is less than satisfactory.

The issue affects any business (including taxable businesses) that charges cancellation or similar fees, for example, a video store that charges a fee for a video that is returned late. The analysis above equally applies to suggest that such fees may not be subject to GST. This may result in an opportunity for GST savings for such businesses.

Therefore, in conclusion, we note that any business that charges cancellation or similar fees may have unexpected GST exposures or opportunities. Such businesses should ensure their arrangements are reviewed from a GST perspective.

GST & the Budget

Whilst the Budget was not entirely silent on the GST front, there was not much in it unless you are a diplomat from Jordan (and a few other countries); a telecommunications company; or a charitable fund, funding a deductible gift recipient. However the Treasurer did reconfirm some earlier measures that impact the property sector. Most of the Budget announcements were discussed in our special Budget Newsletter, which was issued the morning after the Budget. It would be useful for readers, however, to recap on the GST-specific Budget announcements.

In summary the GST measures are:

- amendment to the voucher provisions;
- simplified accounting arrangement for vouchers;
- amendments to the GST treatment of residential premises;
- small business changes;
- GST and the sale of real property (no specific announcement, other than to say that Treasury are still considering tax integrity measures concerning the interaction of the margin scheme with the GST-free going concern and the GST-free farm land provisions);
- GST and representatives of incapacitated entities (other than announcing that the measures will not have a revenue impact and are designed to bring about certainty, there is no detail as to the proposed amendments);
- registration of non-charitable public ancillary and prescribed private funds (measures announced to allow non-charitable public ancillary and prescribed private funds to register and operate as enterprises for GST purposes); and
- GST concessions for diplomatic and consular missions (existing provisions allow for refunds

for GST in relation to certain countries' diplomatic and consular representation under the Indirect Tax Concession Scheme; the government has extended the group of countries eligible under the scheme).

The amendment to the voucher provisions was in fact announced in last year's Budget but never enacted. The government now proposes to amend the voucher provisions so as to ensure that GST does not apply to "bonus supplies", such as bonus credits and text messages provided by telecommunication companies to customers of prepaid cards. Previously prepaid cards were taxed on their face value, so GST could arguably have been levied on the bonus supplies. The measure applies retrospectively from 1 July 2000.

The "simplified accounting arrangement" for vouchers appears to contemplate an extension of existing provisions that deal with sales between principal and agents, so that they now cover vouchers. Broadly, these measures may allow the agent to act as a reseller and would not require the agent to separately account for GST on their commission on the sale of the vouchers. Amendments also apply retrospectively from 1 July 2000 and, therefore, readers should be aware that the relevant provisions currently require there to be an agreement between the principal and agent, which may limit the retrospective application of these provisions.

Regarding residential premises, these amendments were previously announced on 7 February 2006 and were mentioned in previous editions of GST News. The measures are intended to confirm that supplies involving properties, such as serviced apartments and strata units leased to hotel operators, remain *Continued over page...*

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input taxed (that is, not subject to GST, but no input tax credits available). The measures, once enacted, will apply from 1 July 2000 and, depending on the current GST treatment being applied, could have important implications for developers and investors in serviced apartments and hotel operations.

Regarding the "small business changes", the cash threshold that applies to some small businesses will be increased to \$2 million, but will now include input taxed supplies (that is, residential property and financial supplies). This change needs to be carefully considered by the Government. If enacted as proposed, it will require every residential property investor with a turnover greater than \$50,000 to register for GST. Entities with a turnover of less than \$2 million will now be entitled to account for GST on a cash basis. The reform is intended to align income tax (under the simplified tax system) and GST thresholds, as well as increase the number of taxpayers entitled to account for GST on a cash basis. We are waiting to review the actual wording of the legislation, as amendments to the definition of turnover could have other significant ramifications.

For a full analysis of the Budget, including non-GST announcements, please download our Budget Newsletter at www.bdo.com.au.

Legislation update

Following on from the Budget, the *Tax Laws Amendment (2006 Measures No 3) Act 2006* was introduced into Parliament. This Bill contains a shopping list of changes to the tax laws that will affect some, but not all, taxpayers.

The GST-relevant changes were an amendment to the GST treatment of residential premises, and an amendment to the GST treatment of deductible gift recipients. Both of these were announced in the Budget, as mentioned above. They differ in minor respects from the proposed amendments.

Despite considerable lobbying by the industry and profession, Treasury decided to proceed with the amendments concerning the GST treatment of residential premises. This included the controversial retrospective aspects.

Tax Seminars

BDO conducts a series of bi-monthly seminars around the country, focusing on issues topical within the tax world. July's seminar will focus

on managing corporate tax risks. The seminars will be held in the 3rd and 4th weeks of July. The BDO National Tax Technical Group will present this event. If you would like to attend or would like more information about upcoming seminars, please contact your local BDO office.

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