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GAAR comes to GST

In a case in September, *VCE and Federal Commissioner of Taxation* [2006] AATA 821, the Commissioner of Taxation for the first time (successfully) applied the GST “general anti-avoidance rules” or “GAAR”, contained in Division 165 of the GST Act. Division 165 is similar to Part IVA of the income tax law, and applies to any scheme where an entity (prejudicially titled “the avoider”) gets a “GST benefit” (which is not obtained under a valid GST election or choice) and (after taking into account a number of objective factors) it can be concluded that either:

- an entity (not necessarily the avoider) entered into the scheme for the sole or dominant purpose of the avoider obtaining the GST benefit; or
- the principal effect of the scheme was that the avoider obtained the GST benefit.

The case concerned an arrangement whereby one of the shareholders (referred to in the case as “SH1”) of a company (referred to in the case as “VCE”) transferred land to VCE for \$770,000, inclusive of GST. The reasons were varied, and include asset protection and the provision of a benefit to SH1’s wife, who was also a shareholder in VCE. The land was subject to a mortgage and not actually valued as high as \$770,000. The terms of the arrangement were such that the consideration was payable in four (unequal) instalments over a fifteen year period, with the majority being payable at the end of the fifteen years. Title to the property would not vest until 2018 (the end of the fifteen year period).

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The GST advantage arose because SH1 was registered for GST and elected to account for GST on a cash basis. Therefore, the GST liability of \$70,000 would only be payable when the cash was received in 2018. However, VCE, which was also registered for GST purposes, had elected to account for GST on an accruals basis. This meant that VCE would be entitled to the input tax credit when the tax invoice was issued, being when the arrangement was entered into. This would have a significant advantage, providing VCE with \$70,000 up front, well before it was required to pay any consideration for the sale.

Not surprisingly, the Commissioner did not like this arrangement and sought to apply the GAAR. In doing so, he cancelled the input tax credits of \$70,000 and sought to levy penalties. The Administrative Appeals Tribunal agreed. In a relatively detailed case, the Tribunal found that there was a “GST benefit”, by accepting that the “counterfactual” (being the facts that would have applied had the scheme not been entered) would be that the property would not have been sold in the first place. There was some discussion on whether a “counterfactual” should even be considered due to various discussions in earlier *Continued over page...*

Continued from previous page... Part IVA cases but, in the end, the Tribunal considered that the legislation supported an analysis based on this counterfactual.

The Tribunal then went on to analyse whether the benefit arose under a GST election, the various objective factors outlined in the legislation, and the dominant purpose of the scheme. All pointed to the scheme being in breach of the GAAR, thereby allowing the Commissioner to cancel the input tax credits in their entirety. The Tribunal also upheld the imposition of a 50% penalty by the Commissioner.

BDO comment: Part IVA of the 1936 Income Tax Act has come into its own in the last few years, since the High Court decision of *Commissioner of Taxation v Hart* [2003] HCA 26, which upheld the Commissioner's invocation of those provisions to strike down a split-loan facility. There have been a significant number

of cases since *Hart*, where the Commissioner has successfully applied Part IVA, and only a small number of cases where the Commissioner has been unsuccessful. The case of *VCE* is the first where the Commissioner has successfully applied Division 165, the GST Part IVA-equivalent and, if this case is anything to go by, it appears that Division 165 will prove equally as powerful a weapon as Part IVA.

Division 165 is slightly different in its drafting than Part IVA. For instance, Part IVA has no equivalent to the "principal effect" condition mentioned above. However, much of the wording is similar and it would appear that the courts and tribunals would undertake a similar kind of analysis when approaching both types of GAAR. For taxpayers, the message is clear: do not get involved in any arrangement in order to avoid tax, as the Commissioner can and will strike down such arrangements, with the support of the courts.

Commissioner continues tough stance on GST evasion

Previous editions of this GST News have warned of the tough stance of the Commissioner in relation to GST enforcement. Due to the high potential loss to revenue, the Commissioner has come down hard on GST non-compliers. Last month was no exception.

In the case of *Trade World Enterprise Pty Ltd v Deputy Commissioner of Taxation* [2006] VSCA 191, the Victorian Court of Appeal upheld a decision to grant summary judgment against the taxpayer for \$1.1 million, representing unpaid tax, penalties and interest. The taxpayer operated a duty-free business selling to travelers departing Australia. Most of the unpaid tax related to GST. A director of the taxpayer was charged with defrauding the Commonwealth through tax evasion. Summary judgment had been obtained against the taxpayer company. The Court of Appeal refused special leave to appeal this summary judgment, as there was no real possibility of the appeal succeeding.

On the other hand, in the case of *Perkins v Commissioner of Taxation* [2006] NTSC 66 the Northern Territory Supreme Court overturned a monetary penalty and jail term. The magistrate had levied a penalty of \$3,550 and had jailed a taxpayer for five years for non-lodgment of five business activity statements.

that this was a minimum penalty. Additionally, in relation to the criminal conviction, the Court found that the magistrate had erred in not taking into account that the actions were that of the taxpayer's bookkeeper. The taxpayer was placed on good behavior for two years, with a \$1,000 bond.

The Tax Office also announced on 12 September 2006 that a nightclub manager had been jailed for three years for GST fraud totalling in excess of \$3 million. In addition, the Tax Office announced on 26 September that a company director had been jailed for five-and-a-half years for falsely claiming GST refunds.

BDO comment: The above four cases all indicate that the Commissioner and the Tax Office view GST evasion in a very dim light. Taxpayers can and will be jailed for GST evasion and the courts will in many cases uphold those penalties (even in *Trade World Enterprises*, a director had been charged with defrauding the Commonwealth). *Perkins* was an interesting case in that the sentence was overturned. However, what is more interesting was that the taxpayer had originally been convicted for a five-year jail term for the taxpayer's bookkeeper's mistake, and it had been necessary for the taxpayer to go to the Supreme Court to overturn this conviction.

GST September updates

In September there were a number of Releases and other documents issued concerning GST. On the legislative front, *Tax Laws Amendment (2006 Measures No 5) Bill 2006* was passed by the House of Representatives without amendment. As mentioned in previous issues of this GST News, this Bill contains amendments ensuring cars and pharmaceuticals are GST-free for certain Defence Force personnel and persons on certain Disability Pensions.

The documents relevant for GST that were issued in September include:

- The Tax Office has released its view on the Court decision of *Commissioner of Taxation v DB RREEF Funds Management Limited* (2006) 62 ATR 699.
- A New Tax System (Goods and Services Tax) Waiver of Tax Invoice Requirement - Government Undercover Agents Determination (No 1) 2006. This determination provides waiver from the requirement to produce a tax invoice to undercover agents.
- Addendum to GST Ruling GSTR 2000/16 (which discusses transitional arrangements on GST-free supplies under existing agreements)
- Addendum to GST Ruling GSTR 2000/19 (which discusses making certain adjustments under Division 19 for "adjustment events").
- Addendum to GST Ruling GSTR 2001/3 (which discusses how GST applies to supplies of fringe benefits).
- Addendum to GST Ruling GSTR 2004/8 (which discusses when does an entity have a "decreasing adjustment" under Division 132).
- Interpretive Decision ATO ID 2006/245 (GST and super fund: supply of information about a member spouse's interest to a non-member spouse in accordance with the *Family Law Act 1975*).
- Interpretive Decision ATO ID 2006/246 (GST and super fund: supply of information about a member's interest to the member in accordance with the *Family Law Act 1975*).
- Interpretive Decision ATO ID 2006/247 (GST and agricultural: managed investment scheme - sale of a grower's business).
- Interpretive Decision ATO ID 2006/255 (GST and calculating the margin on the granting of a long term lease of land that was acquired before 1.7.2000).
- Tax Office information sheet: "GST treatment of residential premises".
- Tax Office information sheet: "GST registration and carrying on an enterprise".
- Tax Office information sheet: "GST-free supplies to overseas residents".
- Tax Office information sheet: "Discretion to treat a document as a tax invoice/adjustment note".
- Tax Office information sheet: "GST rulings update - 1 May to 31 July 2006".
- Tax Office information sheet: "Simplified GST accounting methods".
- Tax Office information sheet: "GST - completing your activity statement - purchases snapshot method".
- Tax Office information sheet: "GST-free supplies - Education".
- Tax Office media release: "ANZ reaches agreement with Tax Office on innovative Forward Compliance Arrangement" (29 September 2006).
- Minutes of 24 May 2006 meeting of the GST sub-committee of the National Tax Liaison Group. At the meeting, the sub-committee discussed new "centre of excellence" arrangements for GST, arrangements for provision of written advice, property and international issues, financial and superannuation issues; registration and administration issues.

Of note are the Tax Office's views on the court decision in the DB RREEF case. This case was previously discussed in the May 2005 edition (at first instance) and the July 2006 edition (the appeal decision) of this GST News. It involved the application of GST to a lease that was in existence prior to the commencement of GST. Under transitional provisions, no GST was payable on this lease. The Commissioner had argued that the transitional provisions no longer applied, as there was a rent review clause. The Federal Court rejected this argument.

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

Tax Office bulletin on car expenses

In September, the Commissioner issued GST Bulletin GSTB 2006/1 on claiming input tax credits for car expenses, and consequently withdrew the earlier bulletin on the same topic, GSTB 2000/2. The issue that arises in respect of cars is that, in many cases, a car is used for both business and private purposes and, therefore, it is difficult to determine the level of input tax credits that can be claimed. Under the income tax law, four methods are used to determine deductible car expenses – “cents-per-kilometre”, “12% of original value”, “one-third of actual expenses” and “logbook”. The Bulletin accepts that any of these methods can also be used to determine the input tax credits on car expenses. Additionally, it notes that it is not necessary that the same method be used for both income tax and GST purposes.

There is also a possibility of an “annual apportionment election”, which allows a taxpayer to claim input tax credits on all car expenses, and to then incur an “increasing adjustment”, to back-out the private portion. The Bulletin outlines when such an election can be made and also notes that the increasing adjustment is made after the end of the year (when the private proportion is then calculated).



The Bulletin goes part of the way in overcoming the issues that can arise when trying to calculate input tax credits on cars used partly for creditable and partly for non-creditable (usually private) purposes. Even so, it can still be a difficult exercise in documentation and compliance for a taxpayer.

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