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Tax Office widens the cross-border GST net

The April 2007 edition of GST News advised taxpayers to expect the release of a number of GST rulings over the next couple of months. One of these rulings, GST Ruling 2007/2 on “GST-free exports and effective use or enjoyment”, has now been released by the Tax Office and replaces a draft Ruling GSTR 2006/D2.

This exports Ruling is the final chapter and instalment in a series of Tax Office rulings on the GST impact of cross-border transactions, which includes some six GST rulings spread over 700 plus pages. The significant amount of commentary from the Tax Office in this area is indicative of the complexity of the GST export provisions and the uncertainties faced by businesses in accurately accounting for GST on these transactions.

The release of the final instalment represents the clarification of the Tax Office’s views in this area and reflects the Tax Office’s hard line approach to GST and cross-border transactions. While the Ruling was released nearly seven years into GST, the Tax Office will apply the Ruling from 1 July 2000, meaning that businesses may have retrospective GST liabilities. With the large amount of guidance released by the Tax Office, taxpayers are expected to understand and apply the Tax Office’s public position.

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Most businesses assume that no GST is charged on services supplied to non-residents. However, this assumption is often incorrect and a review of the examples provided in the Ruling demonstrates that the decision whether to charge GST on such services is complex and requires a detailed analysis of the contractual and commercial nature of the services provided.

The Ruling indicates that subtle differences in arrangements may result in different GST characterisations for otherwise apparently similar transactions. For example, in circumstances where a non-resident enters into a contract with a customer in Australia, under which it is obliged to provide certain services to that customer and subsequently sub-contracts another Australian entity to provide

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those services to the customer, the Tax Office considers that both the supply from the non-resident to the customer and the supply from the Australian supplier to the non-resident will be subject to GST.

Broadly speaking, it is therefore not always appropriate to implement a single default GST classification for non-resident customers in business accounting systems. The same also applies to a taxpayer's customers who are Australian residents. For example, in some circumstances a supply made to an Australian resident by an Australian resident will be a GST-free export.

Taxpayers should also take note of a significant change in the final Ruling compared to the draft in respect of a supply provided both to an entity in Australia and an entity outside Australia. In the draft Ruling, it was the Tax Office's view that such a supply could not normally be apportioned on the basis the supply was made to an entity in Australia (and therefore no part of the supply could be treated as GST-free). In the final Ruling, the Tax Office considers suppliers may now apportion such supplies on some fair and reasonable basis, so that part of the supply is treated as GST-free. Nevertheless, apportioning such supplies will not be an easy task.

BDO comment: Going forward, businesses will be expected to adopt a more consistent and technical



approach to the characterisation of services for GST, particularly with respect to those services made to non-residents. The release of the final instalment in the series of GST Rulings dealing with exports signals the consolidation of the Tax Office's views in this area and the necessity that businesses start getting it right. As has been highlighted by previous editions of this GST News, the Tax Office's current attitude towards the imposition of penalties and interest may result in significant costs for businesses that fail to correctly account for GST on these types of supplies.

Entitlement to an ABN

A recent case decided by the Administrative Appeals Tribunal, *Ajami and Commissioner of Taxation* [2007] AATA 1231, concerned a taxpayer's entitlement to an Australian Business Number (ABN). The taxpayer engaged in manufacturing and selling activities from the period July 2000 until 2005. He applied for and was granted an ABN in 2000. The business was not profitable. In 2004, the Registrar reviewed the taxpayer's ABN and concluded that the taxpayer had never carried on an enterprise. The Registrar therefore cancelled the taxpayer's ABN, with retrospective effect from 1 July 2000. This resulted in an obligation for the taxpayer to repay a sum to the Commissioner of Taxation. The Tribunal determined the taxpayer had been entitled to an ABN and that the ABN should be only cancelled

as at 31 December 2004. The Tribunal emphasised the danger of using hindsight when a business does not become profitable and that it is necessary for an application to be made for an ABN at the time a business is commenced, not after it has become profitable.

BDO comment: The decision in this case confirms that an entity is entitled to an ABN while it is carrying on a business with a reasonable expectation of profit, regardless of whether the entity is actually making a profit. However, it should be noted that consistent losses generated over a period of time might be used by the Commissioner to infer that a taxpayer no longer has a reasonable expectation of profit and gain.

Commissioner finally relates to taxpayers

The GST law places limitations on when businesses can claim GST credits. In particular, there are two main requirements that must be met before a business can claim a GST credit on an expense. First, the expense must be incurred in carrying on the entity's enterprise and must not be of a private or domestic nature. Second, the expense must not relate to input taxed supplies.

In relation to this second requirement, the main types of input taxed supplies are leasing residential property and financial supplies. Accordingly, the second requirement above is relevant to any property developers that lease out residential property, financial institutions (such as credit unions or share traders), holding companies, and businesses that undertake any type of financial transaction, such as a capital raising or share acquisition.

In relation to these issues, the Commissioner recently released a draft GST Ruling GSTR 2007/D2, titled "Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?". These are fundamental GST issues for many businesses and yet it has taken the Commissioner almost seven years after GST commenced to issue some commentary on the topic.

The draft Ruling sets out a number of propositions relevant to determining a connection between an expense and the carrying on of an enterprise; these propositions are primarily derived from income tax cases. In particular, it is necessary to determine the purpose of the entity in incurring the relevant expense. More importantly, the draft Ruling sets out the Commissioner's approach to determining a connection between an expense and any input taxed supplies a business makes. It discusses a number of scenarios, such as claiming GST credits on expenses of a capital nature and expenses provided to third parties, and also includes a significant number of examples.

The draft Ruling makes it clear that businesses undertaking a capital raising or acquiring another business by way of shares are generally not entitled to claim back GST credits on expenses associated

with these transactions. This is the case regardless of whether the business normally makes input taxed supplies. The approach differs from the Tax Office's previous position that a business could claim GST credits on expenses associated with these types of transactions until the business had made a decision to go ahead with the transaction, which would generally occur when the board of directors approved the transaction. Under the draft Ruling, the Commissioner considers that GST credits will generally not be available where the taxpayer seeks advice on a particular transaction, whether before or after the decision is made to go ahead with transaction.

While the draft Ruling provides some guidance for taxpayers, it is disappointing that the topic is dealt with in a superficial manner and does not cover a number of relevant issues. In addition, as is becoming common in GST rulings, the draft Ruling contains simple examples that do not reflect real world commercial arrangements.

Further, the draft Ruling requires taxpayers to apportion its GST credits on expenses in various circumstances, but does not provide guidance as to how this might be done. For example, a property developer acquiring a property for residential development may commission an adviser to determine whether it is preferable to rent out or sell the completed property—renting out residential property is input taxed, whereas the sale of such property is taxable. The draft Ruling indicates that the developer will be able to claim a partial GST credit on the advice but provides no guidance on how the expense should be apportioned.

BDO comment: This is an important draft Ruling, particularly for property developers, financial institutions, holding companies and businesses that undertake any type of financial transaction, such as a capital raising or share acquisition. The Commissioner has changed his position on a number of issues and it is therefore important for readers to consider the impact of the draft Ruling on their businesses. When released in final form, the Commissioner will apply the principles set out in the Ruling retrospectively from 1 July 2000, regardless of the fact that the Ruling took more than seven years to complete.

100% fruit keeps the taxman away



A case heard by the NSW Supreme Court last month demonstrates the hard-line approach taken by the Tax Office in respect of the GST-free beverage provisions of the GST legislation. The case, *P & N Beverages Australia v Commissioner of Taxation* [2007] NSWSC 338, concerned a non-alcoholic carbonated beverage consisting of juices of fruits and 1% to 2% non-fruit based additives.

The GST legislation provides that a non-alcoholic carbonated beverage will be GST-free if it consists wholly of juices of fruits or vegetables. The manufacturer of the beverage contended that the supply of its fruit drink was GST-free. It was submitted for the Commissioner that the ordinary meaning of the phrase “consists wholly of juices of fruits or vegetables” means 100%. The court confirmed the Commissioner’s view that the introduction of even 1% of non-fruit based additives means that the product does not fall within the relevant GST-free item.

BDO comment: The GST classification of “beverages” is a complex area of the GST law and many businesses often make the mistake of assuming their products are GST-free because they are similar to the products discussed in the GST-free provisions of the GST legislation. If in doubt, businesses are recommended to obtain GST advice on their product.

GST Statistics 2005-2006 financial year

The Tax Office has just released its GST statistics in respect of the 2005-2006 financial year. These are based on the Business Activity Statements lodged by entities during this period. The Tax Office specifically comments on the 1.5% rise in net liabilities in the construction sector, which, in the 2005-2006 period, represented 12% of GST liabilities. Further, the wholesale trade industry was the highest claimant of input tax credits. The Tax Office did not provide details of revenue earned from penalties and interest.

BDO comment: The Tax Office has made it clear that it will continue to focus on taxpayer activities involving property transactions. This is not surprising, given the fact that the construction industry contributes such a large portion of GST revenue. The Tax Office’s failure to provide statistics on penalties and interest revenue is interesting in the light of the hard-line approach adopted by the Tax Office towards GST non-compliance, which will see penalties and interest constitute an increasing proportion of the GST revenue from businesses in the future.

Costs assessments and GST

The issue in a recent case, *Hennessey Glass and Aluminium Pty Ltd v Watpac Australia Pty Ltd* [2007] QDC 57, was whether the legal and related outlay costs awarded to a plaintiff in relation to the matter should be reduced by one-eleventh, (that is, representing a GST component). This was on the basis that one-eleventh of the amount was GST and the plaintiff was not entitled to be reimbursed in respect of GST because it had already obtained an input tax credit in respect of its expenses. The plaintiff disputed the costs assessment of the registrar that had reduced the total amount payable by the defendant by one-eleventh. The Queensland District Court held that the one-eleventh reduction in costs in relation to services supplied prior to 1 July 2000 was incorrect on the basis that no GST would have been included in the cost of these services. Furthermore, the Court held that the sweeping application of a one-eleventh reduction to everything in the costs statement ignores the fact that some outlays were not subject to GST. Additionally, professional costs allowed in accordance with a scale of costs fixing a particular amount were fully allowed, on the basis the costs scale should not be affected by the input tax credits system. Individual

outlay costs subject to GST, (that is, costs not covered under the scale of costs), were reduced by one-eleventh on the basis that such costs are discrete expenditure and ordinarily fully recoverable from the other side.

BDO comment: The Tax Office previously released guidance in relation to GST and court settlements. This case demonstrates the difficulties that may arise when characterising the GST character of different types of cost settlements. Readers should always be alert to the impact GST may have on their business affairs.



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