

GST Direct: Pointing the way March 2012

Issue
12

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Finalising your 2011 income tax return? – Don't forget GST!

At this time of the year many businesses are finalising their 2011 income tax returns and will then calculate tax provisions to be included in current year financial statements. Here are some reminders about various GST adjustments that may impact on these processes.

Entertainment expenditure



Bad debts



Return period thresholds



Adjustment for apportioned supplies



Management fees



Insurance



Finalising your 2011 income tax return? – Don't forget GST!



Entertainment expenditure

For GST-registered businesses, the non-deductible portion of entertainment expenditure calculated for income tax purposes is consideration for a deemed supply. GST is payable on this deemed supply in the GST return covering the earlier of the date the income tax return is due or actually filed.

Remember also to adjust the 2011 income tax return to add back last year's GST adjustment on non-deductible expenditure included in the profit and loss account. This adjustment reflects the fact the GST charge in relation to this expenditure is non-deductible for income tax purposes.



Return period thresholds

With the income tax year end approaching, now is an opportune time to check that annual taxable supply thresholds that determine GST return periods remain valid.

For example, businesses with taxable supplies under \$500,000 in a 12-month period may file 6-monthly GST returns. Filing 6-monthly returns impacts provisional tax due dates as these GST filers are liable to make only two provisional tax payments each year. Businesses subject to this filing option should check that their level of taxable supplies in a 12-month period have not exceeded or are not expected to exceed the \$500,000 threshold. Penalties and interest could be applied to both GST and income tax if the threshold is exceeded and the proper return period is not used. There may even be a fine for committing a knowledge offence.

Larger businesses on a 2-monthly return period should check that taxable supplies are not more than \$24 million over any 12 month period. If so, they must change to filing monthly GST returns.

Bad debts

An income tax deduction can generally be taken if a bad debt is written-off prior to financial year end. A GST bad debt deduction may also be available where the original supply was subject to GST.



Management fees

Companies with intra-group administration or management charges often finalise the level of fees to be charged at year end. Special GST timing rules apply to associated persons – GST liability could be earlier than year end unless the companies are in a GST group.



Insurance

Insurance payouts during the past year may have income tax consequences. Generally there will also be a liability to account for GST on any claim received where the underlying insurance premium was subject to GST and relates to a loss incurred in carrying on a taxable activity. The GST liability can arise even if your business was not party to the contract of insurance.



Adjustment for apportioned supplies

31 March may be the end of the first "adjustment period" for GST-registered businesses required to apportion input tax deductions on goods or services acquired according to the percentage of taxable use.



A comparison of actual use and intended use of goods or services must be done at the end of each adjustment period. This will impact past GST recoveries and set the basis of recovery for the next adjustment period.

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GST on late payment fees

Oral submissions have been heard on the proposed rule change to impose GST on fees for the late payment of an account. The Finance and Expenditure Committee (FEC) is now considering the submissions from PwC and others on the re-introduced September 2011 Tax Bill.

If passed, the new law would broaden the GST base to include fees which have never previously been subject to GST. It is likely that most businesses will pass this new GST cost to consumers. Earlier issues of GST Direct cover the proposal in more depth.

The Bill currently provides the rule change will apply from 1 April 2012. As the Bill is unlikely to be passed by this date, we expect the implementation of any new rules will need to be pushed into 2013 to enable businesses time to make changes to customer arrangements and systems. The FEC report due on 18 May 2012 should clarify the position.

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Liquidators and receivers

The September 2011 Tax Bill proposes stopping liquidators and receivers changing from a payments GST accounting basis to invoice. This measure is intended to prevent GST deductions being claimed in relation to expenses which have not been paid. In many cases, GST will have been paid by the supplier. If the distressed entity is prevented from claiming a deduction, Inland Revenue may collect GST in preference over other creditors.

The FEC is due to report on the proposal on 18 May 2012.

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Qantas - Biggest Australian GST case heading to High Court

On 10 February 2012, the High Court of Australia (HCA) allowed the Commissioner's application for special leave to appeal to the HCA from the decision of the Full Federal Court in favour of Qantas regarding GST on forfeited airfares. The appeal is likely to be heard in the second half of the year. The case is the most significant GST case in Australia to date and will have significant implications for many businesses.

Background

In *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113, the Full Federal Court unanimously held that GST was not payable by Qantas when a person booked and paid for domestic air travel but subsequently cancelled the booking or did not turn up for the flight, and did not receive a refund.

At the heart of the litigation is the Australian GST definition of 'supply' which includes the creation of rights or the entry into an obligation to do anything.

The Commissioner had previously succeeded in the Administrative Appeals Tribunal (AAT) and Qantas appealed. The AAT held that payments retained by Qantas in "no show" situations (ie. where no travel took place because the passenger never turned up) were consideration for a supply. According to the AAT the promise to carry and the making of an airline reservation for a passenger met both the statutory definition of supply and the ordinary concept of supply (of a service) even though no travel took place.

The Federal Court disagreed finding that what each customer pays for is carriage by air, describing this as "the essence, and sole purpose of the transaction". The actual travel was the relevant supply, and if it did not occur, there was no taxable supply.

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New Zealand implications

Qantas is a landmark case on the characterisation of payments and the ambit of supply under the GST law. The case has implications for a wide range of taxpayers. New Zealand businesses will no doubt be following this case with some interest. Unlike the Australian GST legislation, the NZ GST Act does not define supply to include rights and obligations. New Zealand case law has traditionally given 'supply' a practical meaning.

We consider New Zealand courts would follow the Federal Court and not the AAT reasoning ie. there would be no supply as no travel took place.

We consider the references to “rights” and “obligations” in the Australian GST legislation only spring into relevant application when the mutuality for a supply as between the parties is satisfied. In airline travel cases, the mutuality arises at the point the passenger presents his or her boarding pass before stepping onto the plane. We also consider that only those “rights” that are the dominant object of the transaction are covered by the concept of supply eg. right to mine, option, easement, franchise licence.

In a general context, Inland Revenue's *Questions We've Been Asked in Tax Information Bulletin: Vol 17, No 4 (May 2005)* confirmed the forfeiture and retention of a deposit because of the purchaser's breach of the contract is an action against the purchaser and does not result in a supply of something to the purchaser.

We await with some interest the judgment of the HCA.

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Has Inland Revenue reviewed your GST position recently? – Chances are you could be next!

Businesses may have noticed the recent increase in Inland Revenue activity. This has been mostly in the form of reviews of GST returns in a refund position.

Use of non-standard month end cut-off days for GST accounting purposes has also been queried. In particular, whether the appropriate approval is held.

Entitlement to recover GST costs incurred has been another area of focus - queries directed at whether a taxable activity is being carried on to support the entitlement to deduct GST.

If you have not recently reviewed your GST processes and controls now is the time to do so. It may even be worth considering whether your GST manual needs updating.



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GST and loyalty schemes

Numerous loyalty schemes exist in today's market. Customers are usually rewarded either through a points system or a discount entitlement on the purchase of another product.

The GST implications of these schemes can be complex and the GST legislation only covers a narrow range of loyalty schemes. Loyalty schemes usually comprise a series of transactions involving retailers, customers, scheme operators and reward providers. Each transaction needs to be carefully considered to understand its GST implications, especially in light of the various rules that could apply. For example, the GST legislation includes rules that may be mistakenly applied to loyalty schemes, such as the issue and redemption of vouchers (typically vouchers are not a feature of loyalty schemes).

The correct GST treatment requires analysis of each supply being made in accordance with the contractual obligations and the consideration in respect of that supply. Due to the complexity of these schemes we encourage scheme operators to hit the pause button and seek advice. It may be appropriate to obtain assurance around the GST implications by applying to Inland Revenue for a binding ruling or an indicative view (non-binding) as appropriate.

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GST observations

Inland Revenue has published its briefing paper for the incoming Minister of Revenue. The Paper includes some interesting GST observations and statistics:

- **GST is the number 2 source of tax revenue in New Zealand.** For the year ended June 2010, GST was 24% of the tax take, compared to 48% for individual income tax and 13% for company income tax.
- **The New Zealand GST has the broadest base in the OECD.** Using statistics from 2009, GST was collected on 85% of consumption, compared to 48% in Australia and 44% in UK.
- **The amount of tax raised from GST is significant by international standards.** The GST collected in 2009 was 8.5% of GDP - the 6th highest in the OECD.
- **GST has a wide impact on New Zealanders** – 50% of New Zealand households do not pay any net tax other than GST (net tax is income tax paid less cash transfers received eg. Working for Families tax credits).
- Inland Revenue comments that **any further increase in the rate of GST** is likely to make it more difficult to maintain a relatively broad base with minimal exemptions.

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