



Legal briefing

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GST – still on your corporate radar?

Around the millennium, Australian Government departments and agencies were gearing-up for the new GST law coming into force. Contracts were reviewed for transitional purposes, clauses drafted for standard agreements, training courses made available, new financial systems implemented, and a range of advisers engaged. The ATO indicated it would be sympathetic to a degree on compliance generally, given the novelty and complexity of the new regime. There remained a perception, however, that GST would have little practical impact on governments and their activities.

Things have changed. The government sector generally has been identified as one where a potentially low level of GST compliance may persist.

Already there are now at least 30 decided cases dealing with GST issues. The law, its interpretation and public rulings have all moved on significantly since year 2000. There is a strategic need, therefore, for departments and agencies to re-focus on their GST management. GST needs to be on your corporate radar, both when you contract with third parties and when you self-assess for BAS purposes. The reasons for this are discussed below, illustrated where possible by recent Australian cases.

The GST landscape

GST is a tax on domestic consumption. It is imposed on 'taxable supplies' – that is, supplies for consideration made by an entity conducting an enterprise which is registered or required to be. Registered entities claim input tax credits on holding tax invoices for taxable supplies to them according to the extent the supply is used for a creditable purpose. Exemptions from GST are divided into two main categories. Entities making GST-free supplies (food, health, education, exports etc.) pay no GST, but retain full input tax credit access. Entities making input taxed supplies (residential premises, financial supplies etc.) also pay no GST, but are denied input tax credits on supplies to them – cf. *Marana Holdings Pty Ltd v FCT* [2004] FCA 233. These entities are subject to what is called input taxation. A range of government taxes, fees and charges are put beyond the scope of GST.

At one time, there were doubts about the validity of any law imposing GST – for example, Dabner (1992) 1 *Taxation in Australia (Red Edition)* 70 (at 76). These revolved around an inability on the part of the Commonwealth to tax State property, and the fact that laws imposing taxation must 'deal with one subject of taxation only' – s 55 of the Constitution. However, the



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Federal Court has now upheld validity on two occasions – *Halliday v Commonwealth* (2000) 45 ATR 458, *O'Meara v FCT* 2003 ATC 4406. This confirms that GST will be part of the fiscal landscape for years to come – perhaps forever. Agencies need to review and refine their GST management strategies for the long term.

The GST law applies to agencies in very much the same way as it does to commercial and other entities. It is true a range of taxes, fees and charges are put beyond the scope of GST by a determination under s 81-5(2). However, a number of other provisions impose additional requirements on government entities. That agencies are only subject to GST on a 'notional' basis under s 177-1 does not mean the GST law is some 'toothless tiger' in its application to them. General tax exemptions found in earlier legislation are invariably excluded by s 177-5.

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What, then, are departments and agencies now faced with? It may be conceded that the GST law is well-structured and drafted in a modern accessible style. To say that it is lengthy and complex, however, is not to overstate things – cf. Richardson & Smith 30 *Federal Law Review* 47. Overseas, routine commercial transactions are being observed to produce often exotic VAT and GST outcomes – *Peugeot Motor Company plc v CEC* [2003] STC 1438 (at 80) illustrates. An English appeal judge recently described the arguably simpler VAT law, for example, as a 'kind of fiscal theme park in which factual and legal realities are suspended or inverted' – *Royal & Sun Alliance Insurance Group plc v CEC* [2002] BTC 5046 (at 5058).

We also see the GST law producing somewhat exotic results. Agencies need to be aware that GST can affect them, as well as the programs they administer, in sometimes remote or unforeseen ways. A series of social security benefit cases illustrate this – *Re Downs* (2003) 73 ALD 235, *Re Ford* (2002) 69 ALD 534, *Re Stephens* (2001) 32 AAR 430, *Secretary v Allan* (2001) 66 ALD 147, *Re Giannakas* (2001) 66 ALD 787, *Re Coxon* [2001] AATA 294, *Van Welsem v Secretary* (2003) 74 ALD 772. So does the public ruling on the GST treatment of grants – GSTR 2000/11.

Real money is at stake

GST is imposed on suppliers for taxable supplies made by them, calculated as 1/11th of the consideration provided. Ordinarily, the supplier will collect an amount *on account* of GST from the recipient, which is on-paid to the ATO via BAS processes. Assuming no input taxation, a registered recipient will be entitled to an input tax credit for the GST amount involved. In commercial minds, the 'GST' travels in a little circle of tax neutrality between registered parties and the ATO – the 'money-go-round', as some have called it. For legal purposes, however, the tax liability and credit entitlement are quite separate. In no legal sense does a supplier collect GST from the recipient on behalf of the ATO – cf. *CSR v Royal & Sun Alliance Insurance Australia Ltd* 2003 ATC 4998 (at 5013).

Agencies need to understand fully the precise GST basis on which they are contracting for, or providing, supplies.

What is important for agencies at this most basic of levels is that they understand fully the precise GST basis on which they are contracting for, or providing, supplies. Is your agency paying amounts on account of GST in addition to the agreed price for procurements or under a lease? Are you sure the GST inclusive amount you will charge for any services provided fully factors in the extent of your GST liability? Parties to any agreement need to ensure they are in all respects 'on the same page' when it comes to their GST position on pricing – cf. *Howard Smith & Co Ltd v Varawa* (1907) 5 CLR 68 (at 76), *Air Great Lakes Pty Ltd v K S Easter (Holdings) Pty Ltd* (1985) 2 NSWLR 309 (at 335).

Recent Australian cases show how easy it is for parties to be at cross purposes on price. They testify to the legal angst which may result if the issue cannot be resolved peaceably. In one case, the supplier was adamant the price negotiated for certain mining work was always GST exclusive – *Eroc Pty Ltd v Amalg Resources NL* [2003] QSC 74. The customer argued mutual and unilateral mistake based largely on extrinsic factors (notes of telephone conversations, and the like) for GST inclusivity. In the end, the customer had to pay an extra \$261,000 for the work. In another case, the agent for a lessor mistakenly told the solicitor that rent was GST inclusive (contrary to an earlier agreement). Technical rectification arguments failed and the lessor was left out-of-pocket – *Cermak v Ruth Consolidated Industries Pty Ltd* [2004] NSWSC 38. Communication breakdown can exact its own toll in GST terms.

The 'but you get it all back' fallacy neglects the fact that the recipient of a taxable supply is entitled to an input tax credit in any case.

In yet another case, an option agreement over five properties stated 'all GST is for the account of the [purchaser]', though the underlying sale contract had said 'price includes GST (if any) payable by the vendor' – *Fineglow Pty Ltd v Anastasopoulos* 2002 ATC 5158. Not having focused on this 'fine print', the purchaser had to pay an extra \$140,000. This episode shows the need for GST consistency in documents, and for all parties to ensure that they know exactly where they stand on GST matters. This may be a problem in government contracts incorporating a range of documents with schedule overlays, or where a number of people are responsible for different elements in a negotiation.

In response to these types of situations, some are attracted by the 'but you get it all back' idea. It is true registered entities 'recoup' GST amounts paid (assuming no input taxation). But the net financial impact involved depends on the base price to which GST is added. In *Fineglow Pty Ltd v Anastasopoulos*, for example, the purchaser was always entitled to an input tax credit for 1/11th of the price. On a GST inclusive price of \$1.4m, a credit of \$127,273 leaves the purchaser paying a net \$1,272,727 for the properties. Having to pay GST on top of \$1.4m made the purchaser worse off by \$127,273 in net terms. The 'but you get it all back' idea neglects the fact that the recipient of a taxable supply is entitled to an input tax credit. Agencies need to be alert to this.

In more complex arrangements, like infrastructure acquisitions and major offshore procurements, agencies also need to be aware of types of GST planning strategies which may sometimes be promoted by commercial and financial parties. This will typically arise where such a party is denied input tax credits for third party acquisitions on the basis that they are used to make financial supplies. Strategies of this nature, particularly where they operate to transfer GST risks, need to be scrutinised carefully and in advance of signing. The deliberately extended scope of GST anti-avoidance provisions should also be kept in mind in this context.

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Both in the design of tender documentation and later evaluation of bids, care has to be taken to ensure the GST position is clear, and that all bids are evaluated on the same GST assumptions. In an early case involving residential land in Canberra, there was confusion among both tenderers and evaluators regarding the basis on which bids were made and the potential impact of the GST law on the transactions – *MBA Land Holdings Pty Ltd v Gungahlin Development Authority* [2000] ACTSC 89. As a result, Higgins J set aside the tender award, and new development lease provisions were inserted into the GST law. Failure to analyse GST outcomes had the effect of invalidating the tender, causing undue expense and setting back the land release by over 12 months.

Inclusive and exclusive pricing

Something also needs to be said about whether pricing to or by agencies should be on a GST inclusive or GST exclusive basis. There is a belief in some quarters that the ordinary law requires all prices to be set on a GST inclusive basis. The ACCC guidelines once mandated GST inclusivity in retail contexts, but it was never the case that general pricing under commercial agreements must conform to that model. An agency engaging a consultant, for example, is free to agree that the price paid for the services is GST exclusive, then to concede recovery of GST amounts in addition to of this base price – cf. *Network Distributors Pty Ltd v Proctor and Gamble Australia Pty Ltd* [2002] QSC 425 (at 15).

GST exclusive pricing is also the most natural approach to adopt in most situations, as well as the one least susceptible to simple error. Parties habitually negotiate by reference to the net amount they bargain to receive or will be out-of-pocket. GST inclusivity can often lead to ‘silly numbers’ which make no commercial sense and are difficult to remember. The net figure of \$1,272,727 in the *Fineglow Pty Ltd v Anastasopoulos* example above illustrates this. In retail contexts, the main yardstick is that treatment of GST must not be ‘misleading or deceptive’ under s 52(1) of the *Trade Practices Act 1974* – *ACCC v Signature Security Group Pty Ltd* (2003) 52 ATR 1, *ACCC v Goldy Motors Pty Ltd* (2001) ATPR ¶41-801. The critical thing on which to be absolutely clear is that prices either include or exclude GST.

Tax invoices and cash equivalence

Agencies should be in no doubt about the importance of tax invoices in their GST management. A tax invoice for a taxable supply to an agency is virtual cash. Being on an accruals basis for GST accounting purposes means agencies can claim input tax credits as soon as they physically hold a tax invoice – cf. *Lancut (Aust) Pty Ltd v FCT* 2003 ATC 2204 (at 2206). Section 11-5(c) of the GST law allows credits to be claimed on the basis that the entity is simply ‘liable to provide’ consideration. It does not matter that the supply is yet to be paid for. It is important, therefore, that agreements compel the giving of tax invoices in correct terms to agencies up front as a pre-condition to payment – cf. *ETO Pty Ltd v Idameneo (No 123) Pty Ltd* 2004 ATC 4013 (currently on appeal). The cash-flow advantages of such a strategy should be clear enough.

The GST law obliges the giving of tax invoices within 28 days of a request being made by the recipient – section 29-70(2), cf. *Ambience (Arnccliffe) Pty Ltd v CCSR* 2002 ATC 2257 (at 2261). An agreement which obliges the supplier to give an agency the tax invoice up-front enables the agency to realise the benefit of the credit sooner than it perhaps otherwise would. Transactions have been structured so the recipient gets the benefit of the input tax credit from the ATO *before* having to pay the GST amount to the supplier. It does not matter that an agency may not have any GST liabilities against which the credit is offset in its BAS return. The ‘net amount’ is paid electronically by the ATO into the bank account nominated by the agency, as required by s 35-5.

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Outsourcing and double-dipping

Double-dipping on input tax credits may occur in diverse situations. One example is where the consultant to an agency in a reimbursement context seeks to pass on the GST inclusive amount of out-of-pocket expenses to which a further amount on account of GST is then added. Doing the calculations, the net effect is that the consultant has just made a 10% windfall gain at agency expense. If the accommodation being reimbursed cost the consultant \$2200 GST inclusive, for example, that person is obtaining an extra \$200 for nothing. The reason for this is that, while the reimbursement attracts GST as part of the services provided, the consultant has already had (or will be entitled to) the benefit of an input tax credit for the \$200 from the ATO. In major outsourcing contexts, double-dipping which goes undetected over a long period can impose significant and ongoing budgetary burdens on government agencies.

The ACCC guidelines cautioned against double-dipping by this means. It may also be a practice against which the general law would provide a remedy. Arguments against the practice may also arise on the terms of a particular contract. The best and most direct way to deal with the issue, however, is to prohibit double-dipping altogether in a way which provides a contractual remedy up-front to the agency. Nothing elaborate in terms of clauses is necessary to achieve such a desirable outcome.

Something along the following lines will be adequate in most cases – *'Neither party may claim from the other an amount for which the first party may claim an input tax credit'*. It should be noted that the prohibition on claiming in this regard is usually invoked on the mere basis an input tax credit may be claimed. An agency should not be prejudiced by laxity or other delay in claiming practices adopted by the consultant. Nor should the agency be put in the position of having to get back amounts after an event of which it will have no independent knowledge. Double-dipping is an issue which underscores the need for tight and effective systems to be in place for managing GST compliance.

An agency should not be prejudiced by laxity in claiming procedures adopted by the consultant.

Countertrade and valuations

The GST law explicitly recognises that 'consideration' for a supply may be monetary or non-monetary. This means GST can be payable by reference to things other than money. The provision of software development services in return for an IP licence over what results is an example of countertrade (often also described as barter, 'in-kind' or contra). Each leg of the transaction itself is both a 'supply' and 'consideration'. The IP licence is 'consideration' for the services and vice versa. GST is payable by each party on the 'GST inclusive market value' of what is received. How should GST compliance be managed here?

Importantly, the ATO accepts that, where parties are at arm's length, in most cases the 'GST inclusive market value' of what they each receive from the other may be equated – GSTR 2001/6 (at 138), cf. *Solomon Pacific Resources NL v Acacia Resources Ltd* (1996) 131 FLR 179 (at 186), *Re Matine Ltd* (1998) 28 ACSR 268 (at 290), *Allstate Explorations NL v Beaconsfield Gold NL* (1996) 20 ACSR 165 (at 168). If the things exchanged are deemed to be of equal value, the parties may simply swap tax invoices and net out their respective GST liability and input tax credit in their next BAS return. Simple, straightforward clauses can be used to facilitate this result, and no money at all need change hands.

The only thing left in such an exercise is to attribute market value to what is provided. For tangible assets, the classical approach is to ask what price willing but not anxious parties would agree on – *Spencer v Commonwealth* (1907) 5 CLR 418 (at 432), cf. *Orti-Tullo v Sadek* 2001 ATC 4688 (at 4696). Comparable sales is the preferred benchmark. However, a discounted cashflow approach may be acceptable for intangible assets like IP licences above – cf. *Albany v Commonwealth* (1976) 12 ALR 201 (at 206). But what about an obligation to abide by some code of conduct, or to provide limited assistance on a needs basis? Some things are inherently difficult to value, if not impossible.

Valuation texts suggest that, in fixing a value for intangible assets, those assets must first be ‘capable of being both individually identified and specifically brought to account’ – for example, Lonergan *Valuation of Businesses, Shares & Other Equity* (at 136). In a similar vein, the ATO accepts that some acts, rights and obligations can be disregarded for GST purposes ‘as they do not have economic value and independent identity separate from the transaction’ – GSTR 2001/6 (at 80). This practical approach assists generally by protecting the exclusion for compliance purposes of trivial, remote and non-economic things which may each be technically a ‘supply’ under s 9-10(2) of the GST law.

Such an approach relieves any need for agencies to try to account for what may be described here as ‘peripheral’ supplies in countertrade and other contexts. However, this would not exclude the need to market value either the software development services or the IP licence in our example above. What it means in practice is that most of the peripheral rights and obligations which go to make up the ‘legal machinery’ of agreements can generally be disregarded for GST purposes.

The final point is that things provided which merely facilitate supplies in return are not regarded as resulting in countertrade, and are not independently taxable for this reason. A common situation of this type occurs where an agency makes available computer facilities and office space for the consultant it has engaged. These things can be valued, of course, but they are not regarded as being provided by the agency ‘for consideration’ as s 9-5(a) requires – cf. *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13187 (at 13193), *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15075 (at 15081). The ATO accepts that nexus requirements are not met in these circumstances – GSTR 2001/6 (at 91–92). This means minor facilitation of consultants can be disregarded.

Scope of ‘supply’ concept

Leaving aside the limited exemptions and countertrade situations just discussed, most agencies are aware that GST may be imposed on almost anything which is a ‘supply’. This key term is defined in s 9-10(2) to include things far removed from the traditional categories of ‘goods’ or ‘services’ – cf. *O’Meara v FCT* 2003 ATC 4406 (at 4409). Back in year 2000, advisers were concerned GST may be payable independently on each and every thing which was technically a ‘supply’. Long and worrisome clauses were drafted

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with this in mind. If (say) 37 separate supplies could be identified in a contract, some advisers were suggesting the total consideration had to be apportioned to each of these with GST being payable according to when the right or whatever was activated or performed. Had this approach proved to be the correct one legally, GST compliance would have been all but impossible.

One factor which relieves against such a result is 'single supply theory', a doctrine borrowed from VAT law. UK courts have long been against the artificial dissection of transactions for VAT purposes – *CEC v Pippa-Dee Parties Ltd* [1981] STC 495 (at 501), *Card Protection Plan Ltd v CEC* [2001] 2 WLR 329 (at 337). On this practical basis, supplies which are properly incidental to an identified principal supply are not to be taxed independently – *CEC v Wellington Private Hospital Ltd* [1997] BVC 251 (at 266). The usual test to be applied in this context is whether the minor supply does 'not constitute an object for customers or a service sought for its own sake, but a means of better enjoying the principal service' – *CEC v Madgett & Baldwin* [1998] STC 1189 (at 1206).

The ATO, by embracing this doctrine in a public ruling, has simplified GST compliance to a degree – GSTR 2001/8. Australian courts are yet to be asked to adopt single supply theory, though one tax judge has already indicated a measure of extra-judicial acceptance – Hill J (2000) *The Tax Specialist* 304 (at 307–308), cf. *Cordell v Second Clanfield Properties Ltd* [1969] 2 Ch 9 (at 16–17), *Zeta Force Pty Ltd v FCT* 98 ATC 4681 (at 4690). Agencies can generally rely on the 'safe harbour' tests which GSTR 2001/8 provides. Attempted GST compliance based on technical disaggregation of diverse supplies is not normally called for. In cases involving any degree of complexity, however, it is recommended that GST outcomes be verified before documents are signed.

Another important principle has also emerged to qualify the 'supply' concept. This is that some *voluntary* conduct is necessary before there can be a taxable supply – *Shaw v Director of Housing* (No 2) 2001 ATC 4054 (at 4057–4058), *Interchase Corporation Ltd v ABN 010 087 573 Pty Ltd* 2000 ATC 4552 (at 4554), *Walter Construction Group Ltd v Walker Corporation Ltd* (2001) 47 ATR 48 (at 49). Payment in satisfaction of a court order, for example, results in no 'supply' by either party, because the payee does nothing in return. Neither does the compulsory acquisition of property under provisions like s 41 of the *Lands Acquisition Act 1989*, as the ATO now acknowledges – ID 2003/1173. The need for voluntary action is a significant qualification to the 'supply' concept.

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Offshore connection issues

Agencies procuring equipment from overseas need to keep in mind that GST is not imposed only on 'taxable supplies' but also on 'taxable importations'. Two taxing points, therefore, arise in most offshore procurement contexts. How these are managed from a GST point of view can have important implications for agencies. This may arise most commonly where the offshore supplier imports the equipment prior to performance testing but that party is not GST registered and cannot claim the input tax credit. If the unrecovered liability on the importation is simply reflected in the raw price, the agency will be paying a premium for the equipment. Care needs to be taken at the negotiation and drafting stages to minimise any financial 'black hole' which may arise in this way.

If the offshore supplier is simply obliged by the contract to meet all Australian taxes other than GST (which is common), an appreciation of importation consequences on the part of the supplier may lead to cost-reduction in other areas – development or manufacture, for example. Offshore parties are often loathe to register for GST purposes. In these situations, there are options available within the GST law which can prevent loss of the input tax credit attaching to the importation. One involves having title to the equipment pass prior to importation. In such a case, the agency as the importer (assuming access to the deferral scheme) would generally net out the liability and credit in its next BAS return. If installation and testing is to occur before handing over, other structuring options need to be considered. In all cases, appropriate attention needs to be given to the transfer of risk and insurance.

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Another offshore issue for agencies to be aware of is that services physically provided in Australia will be GST-free where they are 'directly connected with goods or real property situated outside Australia' – item 1 of the s 38-190(1) table. The direct connection required in a real property context means that, in effect, the work done must relate specifically to an identified site offshore – GSTR 2003/7 (at 32), cf. *Trustees for the MacMillan Cancer Trust* [1998] BVC 2320 (at 2324–2325). Valuation services provided in Australia by a registered entity specifically in relation to an embassy site already acquired by the Australian Government in a foreign country, for example, pass the statutory test in this regard.

In all export (and certain other) contexts, the special definition of 'Australia' needs to be borne in mind. It does not include any external Territory, but extends to installations deemed by s 5C of the *Customs Act 1901* to be part of Australia. Supplies to foreign embassies in Australia are not exports – cf. *Radwan v Radwan* [1972] 3 All ER 967 (at 973), *R v Turnbull, Ex parte Petroff* (1971) 17 FLR 438, *Minister v Magno* (1992) 37 FCR 298 (at 321), *Brannigan v Commonwealth* (2000) 110 FCR 566 (at 573). However, GST law references to a 'non-resident' need to be approached carefully, given section 17(a) of the *Acts Interpretation Act 1901* and cross-links to definitions in the income tax law.

Correcting GST errors

A type of 'precautionary' practice may have evolved in some areas in response to the perceived complexity of the GST law, difficulties in predicting GST outcomes, and the need to minimise compliance costs. This practice is designed to ensure that no supply between registered entities which *might* be taxable escapes the payment of GST. The idea is that, if everything is treated as taxable, no-one will under-assess their GST position for BAS purposes, and no-one may be held to account for not paying GST. After all, the ATO will not have been deprived of any revenue (quite the opposite in many cases), the 'money-go-round' described above will operate, and no party is out-of-pocket to any extent.

... the GST is not some sort of 'discretionary tax'

The short answer to those who would promote this idea is that the GST is not some sort of 'discretionary tax' – cf. *General Practitioners Society v Commonwealth* (1980) 145 CLR 532 (at 561). It is imposed on entities by reference to the legal effect of transactions tested against criteria in the GST law. Despite perceived policy attractions, there is no room for the 'precautionary' practice mentioned. Its adoption may also put the entity involved at a competitive disadvantage in the market. The legal position is

that parties have a general obligation to unwind GST compliance steps where they get things wrong. An example of this is provided by the GST-free valuation services described above. If GST had been charged in this situation, unwinding may require lodgment by each of the parties of a substitute BAS return or a correction entry in the next BAS return due.

However, the ATO does allow reliance on a practice statement avoiding the need in many cases to unwind where there is no prejudice to revenue and certain other conditions are met – PS 2002/12. The policy statement applies where parties treat as taxable a supply which is not so (either because it is GST-free, input taxed, or ‘out-of-scope’). The danger for many recipients of supplies who adopt the ‘precautionary’ practice described in these circumstances lies in the fact that they will have over-claimed input tax credits. This creates an immediate exposure to the general interest charge, though not for the Commonwealth or its authorities – s 8AAB(3) of the *Taxation Administration Act 1953*. This, however, does not relieve agencies of the need to properly assess supplies they contract for, to correct any GST compliance errors detected, and to rely on the practice statement wherever possible.

Amounts ‘on account of’ GST paid to a supplier under mistake of law may also be recoverable from that party even where input tax credits have been claimed by the recipient – *Fazzolari v Couchouron* (2003)

V ConvR ¶158-572 (at 65203), cf. *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 185 ALR 335 (at 343), *CSR v Royal Insurance Australia Ltd* (1994) 182 CLR 51 (at 75). In *Fazzolari v Couchouron*, a lessee had paid separate GST amounts on top of rent to the lessor in the mistaken belief the lease did not attract transitional relief. The fact that the lessee had claimed input tax credits equal to the separate GST amounts paid over earlier made no difference to the position.

Settlement of disputes

A number of cases decided relate to what GST may become payable in litigation contexts. In the first one, decided the week before the GST law came into force, an application for a GST indemnity in negligence proceedings was refused on the basis that payment of the judgment sum involved no ‘supply’ to anyone – *Interchase Corporation Ltd v ABN 010 087 573 Pty Ltd* 2000 ATC 4552 (at 4554), cf. *Osriv Investments Pty Ltd v Woburn Downs Pastoral Pty Ltd* (2001) 48 ATR 184 (at 236). Since then, it has been accepted generally by the ATO that settlement of damages disputes involve no taxable supplies – GSTR 2001/4 (at 110–111), cf. *CMC Cairns Pty Ltd v Macrossan* [2003] QSC 249.

In dispute contexts, it is prudent in a *settlement deed* to set out the understanding of the parties and to provide for what should happen if a court or the ATO was to take a contrary view. It also ‘tells the story’ for tax audit purposes. Such a clause can appear in the operative part or in the recitals. Where parties are in dispute over the price for an earlier supply, settlement of the dispute may give rise to adjustment events. An agency settling a claim by a consultant for a lesser sum on the basis that not all the work was done will have an ‘increasing adjustment’ (assuming input tax credits were claimed). Correspondingly, the consultant will have a ‘decreasing adjustment’ (assuming GST was paid), and the *settlement deed* should require payment of this back to the agency involved.

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Another thing to keep in mind in settlement situations is the potential for ‘double-dipping’ on input tax credits. Where a party is being reimbursed for legal or other costs (preparation of expert witness reports perhaps) in a damages action, for example, an ability of that party to claim input tax credits for the things to which those costs relate means that only the GST exclusive amount of those costs should be reimbursed. Where the other party cannot claim input tax credits, the full GST inclusive amount should be paid over. It is advisable in almost every litigation situation to independently verify that the GST treatment to be adopted is correct. After the settlement is in place may be too late to revisit GST issues.

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Long term arrangements

Four years ago, departments and agencies were reviewing their agreements to identify which ones attracted transitional relief from GST. Access to relief depended on two main things – when the agreement was made, and when any ‘review opportunity’ arose. If the recipient would have been entitled to a full input tax credit for the supply, the agreement had to have been made before 9 July 1999 (the day the legislation received Royal Assent). In other cases, it had to be made before 2 December 1998 (the day the draft legislation was first publicly released). A long term lease of commercial office space, for example, had to be entered into before 9 July 1999 to attract transitional relief.

A review opportunity is an ability arising ‘under the agreement’ for the supplier to ‘change the consideration directly or indirectly because of the imposition of GST’ or to conduct a ‘general review, renegotiation or alteration of the consideration’. If one arose *before* 1 July 2005, transitional relief would be lost, with GST payable by the supplier from the date the opportunity arose – *Orti-Tullo v Sadek* 2001 ATC 4688 illustrates. If the parties merely re-negotiated the contract, that would automatically operate to make relief cease in most cases. If no review opportunity arose, relief would cease in any case from 1 July 2005 – *Fazzolari v Couchouron* (2003) V ConvR ¶158-572 illustrates. Suppliers would then be subject to GST from 1 July 2005 without any ability to recoup GST amounts from recipients. Those recipients entitled to input tax credits, however, would make windfall gains to that extent.

The government has recently announced, therefore, that it would ‘introduce an arrangement that will accommodate all suppliers with pre-existing long term contracts ...’ Unless the recipient agrees to accept an ‘appropriate price adjustment proposed by the supplier’, GST at the ordinary rate of 10% will be imposed on the recipient from 1 July 2005 but collected by the supplier and remitted to the ATO via BAS processes ... as happens generally in Canada – cf. *Pebruk Nominees Pty Ltd v Woolworths (Vic) Pty Ltd* 2003 ATC 4932 (at 4940). What is ‘appropriate’ is determined by the ‘net impact of the *New Tax System* reforms’ in which the following factors will be taken into account:

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- direct cost to the supplier of the imposition of GST on the supplies
- net recurrent GST compliance costs of the supplier, and
- cost reductions to supplier arising from abolition of other taxes.

Available data suggests compliance costs have been high in most industry sectors, with cost reductions being both minimal and difficult to isolate.

Except in clear cases where suppliers have benefited significantly from *New Tax System* reforms, it is likely recipients will agree to a flat 10% price increase. The announcement envisages new regulations will define more precisely what is an 'appropriate price adjustment', and that this is to be determined in individual cases by an independent assessor. This person will be agreed by the parties or appointed externally.

Agencies with long term arrangements covered by the recent announcement need to consider the options to be made available in the coming legislation. These may be summarised as follows:

- A – amend the agreement to allow the supplier full GST recovery
- B – accept 'appropriate price adjustment' by independent assessor, or
- C – maintain position and subject recipient to GST liability.

Suppliers will naturally want to pass on the full tax burden imposed on them. Both A and C achieve that general outcome, but A is preferable given that C results in a direct liability being imposed on the recipient. The chance an independent assessor might find something less than a 10% increase to be 'appropriate' makes B an attractive option for many recipients. It seems remote that an increase above the GST rate of 10% could properly be considered 'appropriate' in this context.

Agencies may be party to agreements to which the new legislation will apply in a vast variety of situations. Long term commercial leases of premises to them are but one possible example. In all situations, of course, agencies need to consider the options in order to secure the most favourable GST outcome going forward from 1 July 2005. The first step will involve identifying agreements which will become subject to the new amendments. It may then be necessary to seek further advice on what to do, with an eye to the final form of the new amendments.

Ensure that GST is on your radar

The range of practical issues discussed in this *Legal briefing* should be sufficient to put departments and agencies on notice that GST should be constantly on their corporate radar. It cannot be safely assumed that an approach adopted in year 2000 continues to meet all compliance obligations. The GST law, its interpretation, decided cases, and public rulings have all moved on substantially. In many instances, those who were responsible for GST management in government agencies will also have moved on. Discontinuity in this respect, plus indications the government sector generally has lower compliance rates, should serve as a timely reminder of the importance of GST management in the longer term.

Agencies with long term arrangements covered by the recent announcement need to consider the options to be made available in the coming legislation.

It cannot be safely assumed that an approach adopted in year 2000 continues to meet all compliance obligations.

Gordon Brysland is a Senior General Counsel based in AGS Canberra. He was recently recruited to AGS after a number of years in private practice, where he specialised in complex GST advising and structuring. Gordon's clients have included major domestic and multinational corporations, as well as government departments, agencies and those who deal with them. He is now involved in the delivery of GST advisory and other services to AGS clients. Gordon has published widely in GST, other taxation fields, and various public law areas. He is also the founder and convenor of an independent GST discussion group in Canberra called the Reverse Charge Club.

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