Deloitte.

Tax highlights

31 March 2014

Contents:

Key developments this week

Board of Taxation discussion papers released:

- **Debt and equity tax rules:** On 25 March 2014, the Board of Taxation released a discussion paper on issues raised in connection with its post-implementation review of the debt and equity rules in Division 974 of the *Income Tax Assessment Act 1997* (ITAA 1997). The discussion paper sets out various issues, including:
    - General practical problems that have arisen in the operation and administration of Division 974
    - Particular concerns raised by stakeholders with the integrity provision in section 974-80 of the ITAA 1997. The discussion paper also describes a typical financier trust stapled security arrangement and uses this example to discuss a number of section 974-80 issues triggered by such arrangements
    - The intended interactions of Division 974 with other areas of the tax system, and any problematic issues, anomalies or inconsistencies of a technical or policy nature that have arisen
    - The impact of the structure and style of Division 974 on compliance and administration costs
    - The mismatches in the debt/equity classification of financial instruments between Australia and other jurisdictions' laws that can give rise to tax arbitrage opportunities.

  Submissions on the issues raised in the discussion paper are due by 23 May 2014.

- **Division 7A:** On 25 March 2014, the Board of Taxation released its second discussion paper on the post implementation review of Division 7A of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936). Division 7A was originally introduced to prevent private companies from making tax-free distributions of profits to shareholders and their associates in the form of payments or loans. However, the discussion paper suggests that in its current form, Division 7A fails in achieving its policy objectives, and can be a significant source of compliance costs for businesses, even those that operate in accordance with the policy intent of the provisions.

The discussion paper canvasses five proposed reforms to Division 7A with the aim of reducing compliance costs and making it easier for small business to reinvest business profits as working capital. The five proposed reforms consist of:

- ***A unified set of rules based on the principle of transfers of value:*** The discussion paper proposes a single set of common principles for dealing with loans, payments, debt forgiveness and the use of company assets – instead of the present system that leads to inconsistent treatment of cash-based transactions (loans, payments and debt forgiveness) and transactions involving the use of company assets
- ***A better targeted framework for calculating a company's profits:*** Rather than the present system which bases 'distributable surplus' on a company's asset values, the discussion paper proposes a system in which asset revaluations will not be required and unrealised profits will not be taken to be distributed because company assets have been used. Also, company profits would be tested each year to appropriately tax all transactions
- ***A simpler, more flexible and better targeted system of 'complying loans':*** The discussion paper proposes that the existing regime of 7-year unsecured and 25-year secured loans be replaced with a single 10-year maximum loan period with more flexible requirements for the repayment of principal
- ***Greater flexibility for trusts that reinvest unpaid present entitlements (UPEs) as working capital:*** The discussion paper proposes that trading trusts would have access to a 'check the box' type election to retain funds that have been taxed at the corporate rate, providing important working capital. However, trading trusts that make this election will be denied the capital gains tax (CGT) discount (like companies) except in relation to goodwill. The discussion paper also proposes removing the uncertainty surrounding the treatment of UPEs more generally by clarifying that all UPEs are loans for Division 7A purposes
- ***A self-correcting mechanism:*** It is proposed that taxpayers self-correct errors by putting in place complying loan agreements – the discussion paper suggests that this would reduce compliance and administrative costs and substantially reduce the number of cases that would require a decision by the Commissioner.

Submissions on the discussion paper are due by 9 May 2014.

OECD discussion draft on tax challenges of the digital economy: As part of the OECD's base erosion and profit shifting (BEPS) project, the OECD released on 24 March 2014 a discussion draft on the tax challenges of the digital economy. The discussion draft addresses Action Item 1 of the OECD's BEPS Action Plan, in which the OECD undertakes to "identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address those difficulties...". The OECD has invited public comments on the discussion draft to be submitted by 14 April 2014 (but 7 April if contributors wish to speak at the consultation meeting). A public consultation meeting is then scheduled to be held in Paris on 23 April 2014. This meeting will also be broadcast live on the internet and can be accessed on line.

Proposed options for change outlined in the discussion draft are:

- Amendments to the permanent establishment (PE) definition, either by modifications to the preparatory and auxiliary exemption in the model OECD treaty, defining PE to mean significant digital presence, or defining a "virtual" PE

- Imposing a withholding tax on digital transactions
- Broadening the collection of VAT either by reducing or eliminating the threshold for exemption for imports of low value goods, or via enhanced governmental enforcement activities in respect of non-resident suppliers.

A Deloitte United States Tax Alert which provides an overview of the discussion draft and sets out the potential options to address the broader tax challenges raised by the digital economy is now available – click here to view.

Taxation Determinations (TDs) released on fringe benefits tax (FBT): A number of key rates and thresholds for FBT were released last week:

- TD 2014/3: The indexation factors for the purpose of valuing non-remote housing for the FBT year commencing 1 April 2014 were released in this ruling
- TD 2014/4: The employer record keeping exemption threshold for the FBT year commencing 1 April 2014 is $7,965
- TD 2014/5: The benchmark interest rate for the FBT year commencing on 1 April 2014 is 5.95 per cent per annum
- TD 2014/6: The rates to be applied on a cents per kilometre basis for calculating the taxable value of a fringe benefit arising from the private use of a motor vehicle other than a car for the FBT year commencing on 1 April 2014 includes:
    - For engine capacity of 0 - 2500cc, rate per km is 50 cents
    - For engine capacity of over 2500cc, rate per km is 60 cents
    - For motorcycles, rate per km is 15 cents.

Back to top

Weekly tax news

Business tax

Bill awaiting Royal Assent: The following Bill was passed by the Senate last week and is now awaiting Royal Assent:

- **Export Market Development Grants Amendment Bill 2014**.

Bills on the move: The following Bill was passed by the House of Representatives and has now moved to the Senate:

- **Omnibus Repeal Day (Autumn 2014) Bill 2014:** This Bill has been referred to the Senate Finance and Public Administration Legislation Committee and a report is due by 14 May 2014.

Tax bill introduced: Tax Laws Amendment (2014 Measures No. 1) Bill 2014 was introduced into the House of Representatives last week. This Bill contains the following measures:

- Schedule 1 proposes to improve the operation of the Farm Management Deposit (FMD) Scheme by:
    - Eliminating the tax consequences of withdrawing and immediately redepositing FMDs

    - Increasing the amount of taxable non-primary production income an individual can earn before being excluded from making FMDs from $65,000 to $100,000
    - Excluding a FMD from becoming unclaimed moneys under the *Banking Act 1959*
- Schedule 2 proposes to ensure that overpaid goods and services tax (GST) is refundable only in certain circumstances by allowing taxpayers to determine their entitlement to a refund of excess GST rather than having to rely on the Commissioner exercising a discretion to refund an overpaid amount of GST – for further information see *Indirect taxes* below.

Progress of Bill to repeal the mining tax and other measures: The Minerals Resource Rent Tax Repeal and Other Measures Bill 2013 was negatived at the second reading stage in the Senate last week and will no longer proceed. This Bill included proposed measures to repeal the minerals resources rent tax, repeal loss carry-back, revise capital allowance concessions previously granted to small business and rephase the superannuation guarantee charge percentage increase. For more information on the proposed measures in the Bill, refer to *Tax highlights 18 November 2013*.

Bills referred for Committee report:

- **Australian Charities and Not-for-profits Commission (Repeal) (No. 1) Bill 2014:** This Bill has been referred to the Senate Economics Legislation Committee and a report is due by 16 June 2014.

Protection measure for announced but unenacted tax amendments – exposure draft (ED) legislation released: On 25 March 2014, Treasury released ED legislation and draft explanatory material seeking to give effect to the announcement of a legislated protection for taxpayers who self-assessed in accordance with announced (but unenacted) changes that the Government has decided will not proceed. The proposed legislative protection was originally announced on 6 November 2013.

The proposed protection is intended to apply where taxpayers have acted reasonably and in good faith on the basis of an announced change which will no longer be enacted. There is a list of specific announcements to which the new provision will apply. The legislation proposes to place a statutory bar on the Commissioner amending an income tax assessment to the extent that it reflects a taxpayer's anticipation of the impact of one of the listed announcements.

Protection will not be available in circumstances where:

- A taxpayer chooses not to have eligible particulars of an assessment protected
- The Commissioner is amending an assessment to give effect to an objection decision or a Tribunal or Court decision, or
- A taxpayer makes a statement in a later tax return that is inconsistent with the taxpayer's earlier anticipation of an announcement, where continuing to anticipate the announcement would give rise to a less favourable outcome for that later year.

Submissions on the ED are due by 21 April 2014.

Treasurers agree to boost infrastructure: On 28 March 2014, the Treasurer announced that the State and Territory Treasurers have endorsed in-principle an asset recycling proposal offered to them. Under the proposal, if a State or Territory sells assets and recycles the proceeds of these sales into new productive infrastructure, the Commonwealth will contribute 15 per cent of the assessed value of the proposed asset being sold for capital recycling. This arrangement will only be available for agreed,

bilateral transactions with the Commonwealth through until 30 June 2016. The payments made by the Commonwealth will only be available for five years through to 30 June 2019.

Government's agenda for tax policy: On 28 March 2014, the Parliamentary Secretary to the Treasurer delivered a speech on the Government's agenda for tax policy at The Tax Institute's 29th National Convention. Key points include:

- Treasury and the ATO have established a new joint committee with the private sector, the Tax System Committee, to address new and emerging challenges in tax policy and law design
- A working group (comprising Treasury, the ATO and representatives of the private sector) has been established to consider a statutory remedial power for the Commissioner to resolve unintended and anomalous outcomes. The outcome of the working group's consideration will inform Treasury's advice to the Government on whether such a power is appropriate, and if so, what form it could take
- The Government has requested that the Board of Taxation conduct a fast-track review of impediments in the tax system that unreasonably affect small business – for further detail, see *Individuals and family groups* below
- The appropriate taxation of trusts will be considered in the context of the tax white paper
- The Government will consult extensively with the community during the development of the tax white paper and intends to release an initial discussion paper inviting comments from the public. Any proposed tax changes flowing from the tax white paper will be taken to the next election
- The Government is expected to release soon a discussion paper to consult with business on the timing for implementation of the common reporting standard (a standard for the automatic collection of financial account information on non-residents) and how compliance costs can be minimised.

Draft Taxation Ruling (TR) released:

- TR 2014/D2: This draft TR considers the application of the provisions governing the calculation of the foreign income tax offset limit for an Australian resident taxpayer deriving gains and losses from foreign currency hedging transactions undertaken to mitigate the foreign currency fluctuation risk attached to the market value of a portfolio of assets. In particular, the draft TR considers when gains from foreign currency hedging transactions will be from a source other than an Australian source and when losses from foreign currency hedging transactions will be "reasonably related" to income covered by section 770-75(4)(a) of the ITAA 1997 (disregarded income) for the purposes of section 770-75(4)(b)(ii) of the ITAA 1997.

Taxpayer allowed deduction for copyrighted material: The Federal Court has held that a taxpayer was eligible for copyright deductions in relation to drawings, plans and other works under section 124R(5) of the ITAA 1936.

The taxpayer's claims were originally made in the 1998 income year under Division 10B of Part III ITAA 1936 and subsequently under Divisions 373 and 40 of the ITAA 1997. The taxpayer acquired a previously Victorian state government-owned electricity transmission business for a total purchase price of approximately $2.5 billion. The acquisition was made under an Asset Sale Agreement. The

assets acquired by the taxpayer under the Agreement included the copyright in numerous drawings, plans and other works. However, the Agreement did not specifically allocate part of the purchase price to the copyright or the other assets. Therefore any deductions to which the taxpayer was entitled in relation to the copyright depended upon the operation of section 124R(5) of the ITAA 1936. The main issue was whether the amount of the deductions depended upon the Commissioner's discretion or whether the section operated objectively.

In reaching its decision, the Federal Court held that section 124R(5) of the ITAA 1936 makes the presumption that it is possible to take part of the total price actually paid as an amount paid for the unit of industrial property (the copyright). It does not make the Commissioner's determination dependent upon discretionary considerations but only an inquiry of the amount properly attributable to the purchase of the copyright. The Court also referred to the statutory task of section 124R(5) of the ITAA 1936 as being to the effect of allocating or apportioning part of a known purchase price and then allowing the taxpayer deductions based on that allocated amount, rather than basing the deductions on the independent value of the item.

In considering the value of the copyright, the Court held that the use of copyright in the drawings was crucial to the conduct of the taxpayer's business. The Court held that the replacement cost methodology was the best in capturing the amount required by section 124R(5) of the ITAA 1936, as the cost of acquisition of the copyright would likely be reflected in the costs that would be required to be incurred to recreate the copyrighted material.

In concluding, the Court held that the taxpayer was entitled to copyright deductions under section 124R(5) of the ITAA 1936, as it was possible to determine that part of the overall acquisition price was able to be allocated to the copyrighted material, and the Commissioner must determine the price based on an objectively ascertainable portion – click to view *SPI PowerNet Pty Ltd v Commissioner of Taxation* [2014] FCA 261 (25 March 2014) .

Taxpayer's R&D offset reduced: The Administrative Appeals Tribunal (AAT) has affirmed the Commissioner's objection decision and held that the taxpayer was only entitled to a research and development (R&D) offset under section 73AJ of the ITAA 1936 for some of the expenditure incurred on developing a children's toy using an experimental and novel injection moulding manufacturing process.

The main issue before the AAT was whether certain expenditure incurred by the taxpayer was expenditure incurred "directly in respect of research and development activities" such that the expenditure was "research and development expenditure" during the relevant income year for the purposes of section 73B(1) and (14) of the ITAA 1936.

The taxpayer argued that all of the expenditure incurred (including contract payments and payments to an entity which provided design and mould making services, expenditure for the production of a DVD, domestic and overseas travel, and marketing expenditure) was "research and development expenditure" because AusIndustry had considered the taxpayer's R&D project and found that it complied with the relevant statutory requirements and registered it.

The AAT rejected this submission noting that just because a company applies to AusIndustry to have an R&D project registered for a particular year and it is granted that registration, that does not mean

that all of its business expenditure in that year will automatically constitute "research and development expenditure" for the purposes of section 73B(1) of the ITAA 1936. The AAT also found that the taxpayer was unable to provide (because the records had been lost or destroyed) accurate records or documentary evidence to demonstrate that certain expenditure was incurred "directly in respect of" its registered "research and development activities" and accordingly the expenditure could not be taken into account in the R&D offset calculation under section 73J of the ITAA 1936. In respect of penalties, the AAT rejected the Commissioner's submission that the taxpayer's behaviour was "reckless". Rather, the AAT considered that the taxpayer had failed to take "reasonable care" and, having regard to the evidence in the particular circumstances, remission of the penalty in part was appropriate – click to view *Tier Toys Limited and Commissioner of Taxation* [2014] AATA 156 (20 March 2014).

Appeals update:

- ***Pratt Holdings:*** The taxpayer's application for special leave to appeal against the Full Federal Court decision in *Pratt Holdings Proprietary Limited v Commissioner of Taxation* [2013] FCAFC 82 is scheduled to be heard by the High Court on 11 April 2014. The Full Federal Court dismissed the taxpayer's appeal and upheld the Federal Court's decision in *Pratt Holdings Proprietary Limited v Commissioner of Taxation (No 2)* [2012] FCA 1118 that in claiming a balancing adjustment deduction under Subdivision 330-J of the ITAA 1997, the calculation of the balancing adjustment did not include expenditure which was deemed to be 'allowable capital expenditure' under Subdivision 330-C of the ITAA 1997
- ***Ludekens & Anor:*** The taxpayer's application for special leave to appeal against the Full Federal Court decision in *Commissioner of Taxation v Ludekens* [2013] FCAFC 100 is scheduled to be heard by the High Court on 11 April 2014. The Full Court held that each respondent contravened section 290-50(1) of Schedule 1 of the *Taxation Administration Act 1953* (TAA 1953) in dealing with their respective investors in a particular managed investment scheme and were accordingly liable to civil penalties under the promoter penalty regime.

Reinventing the ATO – Commissioner's address to The Tax Institute: On 27 March 2014, the Commissioner delivered a speech at The Tax Institute's 29th National Convention. Key points included:

- The Public Groups and International area is exploring a new initiative for undertaking assurance work through the External Compliance Assurance Process project. This provides certain taxpayers with turnovers of between $100 million and $5 billion with the opportunity to use their company auditors (instead of the ATO) to review factual matters. The ATO will consult with a sample of key taxpayers about the design, impacts and user experience. Recommendations on the concept are expected in late May
- The success of the implementation of independent reviews for income tax audits for large businesses has resulted in its expansion to goods and services tax (GST) matters
- The ATO is working more closely with partner tax agencies in several countries to investigate the global tax planning of multinational enterprises in the digital economy. This has resulted in an Aggregated Risk Report which identifies global e-commerce business structures and tax risks, as well as patterns and trends of the digital economy. It has also provided information about the specific global tax planning arrangements of a handful of companies which will be used by audit teams

- The ATO has commenced a four-year compliance program on International Structuring and Profit Shifting, focusing on companies which have undertaken an international business restructure or have significant related party cross border arrangements. The ATO has screened 233 such companies and have identified an initial 86 higher risk cases
- The ATO's offshore voluntary disclosure initiative which involves a new amnesty for Australian taxpayers with undeclared offshore income and assets – for further detail, see *Individuals and family groups* below.

AusIndustry releases an R&D Guide to Interpretation: AusIndustry has released a guidance and education publication that they have developed to set out how it interprets the key elements of the definition of 'R&D activities'. The focus of the guide is on helping potential claimants of the R&D tax incentive understand whether they have undertaken eligible R&D activities and the scope of the eligible activities.

The guide sets out and analyses how AusIndustry interprets the component parts of the definition of core R&D activities and the linkage between the different requirements. The guide then goes on to explain the aspects that must be considered in identifying supporting activities. Finally, the guide explains AusIndustry's interpretation of the activities that are excluded from being core R&D activities.

The scope of eligible expenditure incurred on registered eligible R&D activities is not covered in the publication. Such expenditure would need to be separately identified and claimed on the ATO R&D tax schedule as part of the company's income tax return.

Reminder – R&D tax incentive registration application deadline for 30 June balancers: To access the R&D tax incentive, companies must register their R&D activities with AusIndustry annually at the end of each income year in which their activities were conducted. The deadline for lodging an application for registration of R&D activities is ten months after the end of a company's income year. This means that companies with a standard income year of 1 July 2012 to 30 June 2013 who wish to apply for the R&D tax incentive must lodge their registration application with AusIndustry by 30 April 2014.

ATO's Business Communicator – March 2014: The March 2014 edition of *Business Communicator* (the ATO's news bulletin for businesses with an annual turnover between $2 million and $250 million) is now available.

Back to top

Individuals and family groups

Project DO IT – Commissioner announces amnesty for disclosed offshore income: On 27 March 2014, the Commissioner announced a new amnesty (albeit with penalties) for Australian taxpayers with undeclared offshore income and assets. Operating until December 2014, *Project DO IT: disclose offshore income today* ("the initiative") offers taxpayers a level of certainty and an opportunity to get their tax affairs in order regarding any offshore income and assets.

- ***Why the new initiative now?*** In recent years, the ATO has expanded its data-matching capabilities, linking Australian taxpayers with their offshore income and assets. At the same time, the ATO has received a significantly increased quantity of information from overseas tax authorities and will soon be automatically exchanging information.

In this changing global environment, it is perhaps not a question of 'if', so much as 'when' Australian taxpayers with income and assets outside of the Australian tax net will become the focus of ATO compliance activity. In the absence of full compliance and disclosure under the new initiative, taxpayers risk the ATO issuing amended assessments for an unlimited number of years, with significant shortfall penalties and interest.

- ***What certainty does the new initiative offer?*** Under the new initiative, the ATO will:
    - Only amend those tax years which are currently open (usually the last four years for taxpayers with offshore income and assets)
    - Impose shortfall penalties of 10 per cent (and not impose penalties for lesser $ value voluntary disclosures) and levy shortfall interest
    - Not assert "fraud or evasion" (which would allow the ATO to amend beyond those open tax years) or investigate (or refer) matters for criminal prosecution
    - Provide assistance and certainty to taxpayers wishing to 'wind up' their offshore structures, including by entering a deed of settlement if necessary
    - Not allow offshore losses from years not open for amendment to be used under this initiative, or carried forward.

  In return, taxpayers are required to make full disclosure of offshore income and gains (and over-claimed deductions), disclose all offshore structures and assets, and provide details of advisers who assisted in establishing or maintaining their offshore structures.

- ***What action should taxpayers be taking?*** Australian taxpayers with offshore interests should conduct a review of their compliance with their Australian tax obligations. Taxpayers with undeclared offshore income and assets should make use of the certainty offered by this initiative by making full and true disclosure to the ATO as soon as possible.

Board of Taxation review on small business: The Parliamentary Secretary to the Treasurer (in his speech at The Tax Institute's 29th National Convention) and the Minister for Small Business have both announced that the Government has requested that the Board of Taxation conduct a fast-track review of impediments in the tax system that unreasonably affect small business. The Board of Taxation will use its extensive links with tax professionals, consult with key business groups and draw on existing work in the course of undertaking this review. The Board of Taxation is expected to report back to the Government by 31 August 2014.

Small business benchmarks: The ATO has updated its small business benchmarks with data from the 2011-12 income year. The ATO may use these benchmarks to:

- Identify businesses that may be avoiding their tax obligations by not reporting some or all of their income
- Determine income that has not been reported if a business does not have evidence to support their tax return.

These benchmarks are published for businesses with different turnover ranges across more than 100 industries and are generally published as a range. Both performance benchmarks (financial ratios for different industries) and input benchmarks (expected range of income for tradespeople based on the labour and materials they use) are published for the small business sector.

Back to top

Indirect taxes

GST measures in Tax Laws Amendment (2014 Measures No.1) Bill 2014: As mentioned above, Schedule 2 of this Bill proposes the introduction of a Division 142 into the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), being effectively a new set of rules for determining whether taxpayers who have overpaid GST to the ATO are entitled to a refund. Division 142 would replace the current provision, section 105-65 of Schedule 1 to the TAA 1953, which gives the Commissioner a discretion to decide whether to allow refunds or not.

The current rules apply only where an overpayment of GST is as a result of a taxpayer incorrectly treating a supply or arrangement as taxable to any extent. By contrast, the new rules would apply where excess GST is paid for any reason whatsoever, including as a result of incorrectly treating a supply as fully or partly taxable or as a result of miscalculating the amount of GST payable on a supply.

The new rules in Division 142 are more restrictive than those in section 105-65 of TAA 1953. Their effect would be to treat any amount that has been paid to the ATO in excess of a taxpayer's actual GST liability and which has been 'passed on' to another entity, as having always been payable by the taxpayer. The new rules would allow taxpayers to claim a refund of such "excess GST" only if there has been no passing on in the first place or, if passed on, the other entity has been reimbursed. Although the new rules would also give the Commissioner the discretion to otherwise allow a refund, this discretion would only be exercised in exceptional circumstances where the application of the rules to deny a refund would be "inappropriate".

A previous Bill to replace section 105-65 of the TAA 1953 and introduce a not-dissimilar Division 142 into the GST Act lapsed when Parliament was prorogued for the 2013 election. Unlike the previous Bill, the new rules in Schedule 2 are proposed to only take effect prospectively. The Bill provides for the new rules to apply to tax periods commencing on or after the day after Royal Assent.

Schedule 2 also proposes to amend the TAA 1953 to allow taxpayers to seek a merits review of decisions of the Commissioner under section 105-65. This amendment would address the decision in *Naidoo and Commissioner of Taxation* [2013] AATA 443 in which the AAT decided that a decision made by the Commissioner under section 105-65 of the TAA 1953 was not part of the assessment process and therefore did not qualify for merits review under Part IVC of the TAA 1953. A further amendment proposed to the TAA 1953 would allow taxpayers who have not previously sought review of a decision made by the Commissioner under section 105-65 to do so after Royal Assent.

GST – Australian tour arranger's supplies fully taxable: The Full Federal Court has disallowed the taxpayer's appeal and allowed the Commissioner's cross-appeal against the decision of Bennett J in *ATS Pacific Pty Ltd v Commissioner of Taxation* [2013] FCA 341.

The taxpayer is an in-bound tour operator whose business involves booking (and paying for) domestic tour components (Products) as requested by overseas travel agents on behalf of their clients (Tourists) who were planning to travel to Australia. At first instance, the primary judge ruled that the arrangements between the taxpayer and overseas travel agents involved the taxpayer making two separate supplies to the overseas travel agents:

- The giving of a contractual right or promise that the taxpayer would ensure that the Products it had arranged with Australian providers (Providers) would be supplied to the Tourists when

the Tourists presented themselves in Australia to the Providers. Her Honour described this supply as the "critical" supply

- The service of booking and arranging the Products.

The taxpayer charged overseas travel agents a fee comprising the cost of the booked Products plus a margin.

At first instance, her Honour concluded that the supply of the contractual right or promise was a taxable supply and that the taxpayer was liable for GST on so much of the fees that were for the cost of the Products. Relevant to this, her Honour found that the supply of the right or promise could not qualify for GST-free treatment under section 38-190 of the GST Act.

Her Honour's finding that the arranging service was something sought by the overseas travel agents for its own sake, and that it was "*not merely ancillary or incidental to the supply of the Products*", led her Honour to conclude that it qualified for GST-free treatment under section 38-190 (i.e. as a service consumed, by the overseas travel agents, outside of Australia). Accordingly, her Honour found that the margin component of the fees paid to the taxpayer did not attract GST.

The Full Court (Edmonds J, with Pagone and Davies JJ agreeing) agreed with the primary judge's characterisation of the ("critical") supply made by the taxpayer as being the supply of a promise that it would ensure that Tourists were provided with the Products by the Providers during their tour in Australia. The Full Court also agreed with the conclusion that this supply failed to qualify as a GST-free supply, although it considered it necessary to address some perceived gaps in Her Honour's reasoning on this aspect.

The Full Court went on to find that it was not open to the primary judge to find that the taxpayer made two distinct supplies to the overseas travel agents. The Full Court held that, when deciding whether the arranging service comprised a distinct supply by the taxpayer, the primary judge had erred by asking herself the wrong question (i.e. whether the arranging service was ancillary or incidental **to the supply of the Products**). The Full Court noted that it was the Providers, not the taxpayer, who supplied the Products. The Full Court found that the taxpayer made only one supply – the "critical" supply in the form of the promise to ensure that Tourists were provided with the Products by the Providers – or, if that supply embodied a supply of arranging services by the taxpayer, then the arranging services were no more than incidental or ancillary to that "critical" supply. As a mere incident of the "critical" supply, the arranging service was therefore subject to the same 'taxable' GST treatment and could not qualify as GST-free – click to view *ATS Pacific Pty Ltd v Commissioner of Taxation* [2014] FCAFC 33 (27 March 2014).

Appeals update – *MBI Properties:* The Commissioner's application for special leave to appeal against the Full Federal Court decision in *MBI Properties Pty Limited v Commissioner of Taxation* [2013] FCAFC 112 is scheduled to be heard by the High Court on 11 April 2014. In that decision the Full Court found that the taxpayer did not have a GST 'increasing adjustment' under section 135-5 of the GST Act in relation to the enterprise it acquired from a vendor as a GST-free going concern (i.e. apartments leased to a serviced apartment operator) because the taxpayer did not intend that any input taxed supply of residential premises would be made by it through the enterprise. The Full Court ruled that the requirements of section 135-5(1)(b) of the GST Act were not satisfied because there were no supplies being made through the enterprise acquired by the taxpayer from the vendor. The Full Court held that the existence of a continuing lease did not equate to a continuing supply. It held

that what was supplied by the vendor to the operator was the grant of the lease in each case, and that the supply was complete upon the lease coming into existence and did not continue beyond the grant. The Full Court's decision has raised significant GST issues for entities selling or purchasing property subject to lease as well as for tenants.

ATO Practice Statement Program – Indirect taxes – updated as at 21 March 2014:

Practice statement scheduled for release within the next two months	
Topic	**Planned issue date**
Exercise of the discretions under sections 48-71 and 51-75 of the GST Act to approve an 'early day of effect' for membership of GST groups and participation in GST joint ventures.	2 May 2014

Draft goods and services taxation determination (GSTD) expected to be released 2 April 2014:

- GSTD 2014/D1:In what circumstances is the supply of a credit card GST-free in section 38-190(1) of the GST Act?

Back to top

International tax

Dbriefs: BEPS Central: Deloitte Dbriefs Asia Pacific has developed a one-stop shop for information on the OECD base erosion and profit shifting (BEPS) project. The new Dbriefs: BEPS Central web page provides links to all official OECD documents as well as related Deloitte comments.

Dbriefs Bytes: Deloitte Dbriefs Bytes is a short weekly video summary of the significant international tax developments impacting the Asia Pacific region – click to view the latest Dbriefs Bytes.

Back to top

Contacts

David Watkins
Partner – Tax Services
Email: dwatkins@deloitte.com.au
Tel: +61 (0) 2 9322 7251