

2004

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (LONG-TERM NON-REVIEWABLE CONTRACTS)
BILL 2004

A NEW TAX SYSTEM (GOODS AND SERVICES TAX IMPOSITION
(RECIPIENTS)—GENERAL) BILL 2004

A NEW TAX SYSTEM (GOODS AND SERVICES TAX IMPOSITION
(RECIPIENTS)—CUSTOMS) BILL 2004

A NEW TAX SYSTEM (GOODS AND SERVICES TAX IMPOSITION
(RECIPIENTS)—EXCISE) BILL 2004

EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Peter Costello MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
Commissioner	Commissioner of Taxation
GST	goods and services tax
GST Act	<i>A New Tax System (Goods and Services Tax) Act 1999</i>
GST Imposition Acts	<i>A New Tax System (Goods and Services Tax Imposition – General) Act 1999, A New Tax System (Goods and Services Tax Imposition – Customs) Act 1999 and A New Tax System (Goods and Services Tax Imposition – Excise) Act 1999</i>
GST Transition Act	<i>A New Tax System (Goods and Services Tax Transition) Act 1999</i>

General outline and financial impact

Long-term non-reviewable contracts

Schedule 1 to this bill amends the *A New Tax System (Goods and Services Tax Transition) Act 1999* (GST Transition Act). These amendments provide suppliers with certain pre-existing contracts, that will not have had a review opportunity by 1 July 2005, a mechanism to negotiate with the recipient of their supplies to take into account the impact of the New Tax System changes.

In addition, three new Imposition Bills are also being introduced to impose the goods and services tax (GST) on the recipients of these supplies. The GST will be payable by the recipient where they notify the supplier that they elect to pay the GST or where the recipient has not accepted an arbitrated offer of a price change from the supplier. The three new Imposition Bills are:

- A New Tax System (Goods and Services Tax Imposition (Recipients) – General) Bill 2004;
- A New Tax System (Goods and Services Tax Imposition (Recipients) – Customs) Bill 2004; and
- A New Tax System (Goods and Services Tax Imposition (Recipients) – Excise) Bill 2004.

Date of effect: These amendments to the GST Transition Act apply from the date of Royal Assent. The Imposition Bills apply from 1 July 2005.

Proposal announced: This measure was announced in the former Minister for Revenue and Assistant Treasurer's Press Release No. C109/03 of 21 November 2003.

Financial impact: There will be a negligible gain in GST revenue, however all GST revenue is paid to the States and Territories.

Compliance cost impact: Parties may incur once-off costs in negotiating an appropriate price change. Recipients will need to report and pay the GST if they do not accept an offer of an appropriate change made by the supplier.

Summary of regulation impact statement

Regulation impact on business

Impact: The main impact will be deciding whether to negotiate an appropriate price change, and incurring the costs of the negotiations. These costs will depend on the decisions taken by the parties to the contract.

Main points:

- Suppliers may incur once-off costs in negotiating an appropriate price change with the recipient. However, these compliance costs are only incurred if the supplier seeks to take into account the impact of the New Tax System changes on the supplies and the recipient does not voluntarily elect to pay the GST.
- Recipients will need to report and pay the GST if they do not accept an offer of an appropriate price change made by the supplier. There should be no significant compliance costs for registered recipients. Unregistered recipients will be subject to the same reporting and payment obligations as registered recipients. However, these obligations can be avoided by accepting an offer of an appropriate price change which will place the contract under the general GST rules.
- There should be no disproportionate impact on small business.

Chapter 1

Long-term non-reviewable contracts

Outline of chapter

1.1 Schedule 1 to this Bill amends the *A New Tax System (Goods and Services Tax Transition) Act 1999* (GST Transition Act). These amendments provide suppliers with certain pre-existing contracts, that will not have had a review opportunity by 1 July 2005, a mechanism to negotiate with the recipient of their supplies to take into account the impact of the New Tax System changes.

1.2 Schedule 1 also makes consequential amendments to:

- *A New Tax System (Goods and Services Tax) Act 1999* (GST Act);
- *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*;
- *A New Tax System (Luxury Car Tax) Act 1999*;
- *A New Tax System (Wine Equalisation Tax) Act 1999*;
- *Taxation Administration Act 1953*; and
- *A New Tax System (Goods and Services Tax Imposition – General) Act 1999*, *A New Tax System (Goods and Services Tax Imposition – Customs) Act 1999* and *A New Tax System (Goods and Services Tax Imposition – Excise) Act 1999* (GST Imposition Acts).

1.3 Three new Imposition Bills are also being introduced to impose the goods and services tax (GST) on the recipients of these supplies. These are:

- *A New Tax System (Goods and Services Tax Imposition (Recipients) – General) Bill 2004*;
- *A New Tax System (Goods and Services Tax Imposition (Recipients) – Customs) Bill 2004*; and
- *A New Tax System (Goods and Services Tax Imposition (Recipients) – Excise) Bill 2004*.

GST will be imposed on the recipient where they notify the supplier that they elect to pay the GST or where the recipient has not accepted an arbitrated offer of a price adjustment from the supplier. These circumstances are dealt with in Subdivision B.

Context of amendments

1.4 When the GST legislation was introduced, there were numerous pre-existing contracts where the supply was to be made on or after 1 July 2000. The prices in these contracts were likely to have been determined without regard for the GST. If the GST had been applied immediately to these contracts, suppliers would have had to remit the GST on their supplies. In most cases, suppliers would have had no ability under the contract to pass that cost on to recipients because there was no opportunity to review the consideration in the contract. In contrast, many recipients would have received an input tax credit, despite paying consideration for the supply that excluded the GST, thereby receiving a windfall gain at the expense of the supplier.

1.5 The transitional rules in the GST Transition Act allow supplies under contracts entered into before a relevant date (generally 8 July 1999, but where the recipient would not have been entitled to a full input tax credit, 2 December 1998) to remain GST-free until a review opportunity arises. GST will apply normally to those supplies from that point, as suppliers will have had the opportunity to adjust prices to take account of GST, or their prices will reflect a market with GST-inclusive prices. The transition period ends on 30 June 2005, at which point remaining supplies would, under the legislation as it currently stands, become subject to the GST in the normal way.

1.6 If suppliers under these long-term non-reviewable contracts are unable to negotiate a change in the consideration to take account of the GST, they will have a GST liability from 1 July 2005 without the ability to recover the GST from their recipients.

1.7 All suppliers with pre-existing contracts should be able to negotiate to take account of the impact of the New Tax System changes with the recipient and these recipients should, if they are so entitled, receive input tax credits, or reduced input tax credits. This is consistent with the design of the GST, which is intended to be a tax that is passed down the supply chain to the final consumers of goods and services. However, the Bill will not override a clause in a pre-existing contract that was drafted to provide that the consideration is not to be changed to take account of GST or a similar value added tax on the supply.

Summary of new law

- 1.8 This measure will:
- insert Division 2 into Part 3 of the GST Transition Act to modify the transitional rules so that suppliers with long-term non-reviewable contracts can negotiate with the recipient to take account of the impact of the New Tax System changes on the supplies; and
 - amend section 13 of the GST Transition Act to ensure that after the commencement of this Bill, renegotiations of the contract price to apply from 1 July 2005 will not result in the supply losing its GST-free status before the transition period ends on 30 June 2005, unless the parties agree to change the consideration from an earlier date.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Pre-existing contracts that will not have had a review opportunity by 1 July 2005 will become subject to the GST from that date. However, suppliers will have a method of negotiating a price adjustment with the recipient. Possible outcomes of the negotiations include:</p> <ul style="list-style-type: none"> • The parties renegotiate the contract price, either voluntarily or through arbitration. The supplier can make an initial offer to adjust the price which may be accepted by the recipient. If not accepted, the supplier can make an arbitrated offer to adjust the consideration. If accepted, the supplier remits $\frac{1}{11}$th of the renegotiated contract price and the recipient receives input tax credits, according to their usual entitlement. 	<p>Pre-existing contracts that will not have had a review opportunity by 1 July 2005 will become subject to the GST from that date. The liability for the GST will be on the supplier.</p> <p>Unless the supplier is able to renegotiate the contract price, they will effectively bear the GST amount with no ability to recover this from the recipient.</p> <p>The contract will become taxable from 1 July 2005. The supplier will remit $\frac{1}{11}$th of the consideration on the contract and the recipient will receive input tax credits, according to their usual entitlement.</p>

<i>New law</i>	<i>Current law</i>
<ul style="list-style-type: none"> • The GST becomes payable by the recipient because they do not accept an arbitrated offer from the supplier. The recipient will be responsible for paying this GST amount directly to the Commissioner of Taxation (Commissioner). Registered recipients will be required to remit the net amount of the GST payable (taking their input tax credit entitlements and adjustments into account) on their relevant GST return. Unregistered recipients will be required to report to the Commissioner on a GST return and pay the GST accordingly. • The recipient of the supplies may make an irrevocable written election to pay the GST. Again, the recipient will be responsible for paying this GST amount directly to the Commissioner. 	

Detailed explanation of new law

Part 3, Division 1

1.9 Part 3 of the GST Transition Act will have two Divisions. Division 1 will contain the existing GST transitional rules for agreements spanning 1 July 2000.

1.10 Section 13 currently applies where:

- there is a written agreement specifically identifying a supply and identifying the consideration in money, or a way of working out the consideration in money, for the supply; and
- the agreement was made before 8 July 1999 (the day on which the GST Transition Act received Royal Assent), or where the recipient is not entitled to a full input tax credit for the supply, the agreement was made before 2 December 1998.

1.11 Such a supply is GST-free to the extent it is made before 1 July 2005 or the day on which any review opportunity arises, whichever is the earlier. Supplies are also GST-free beyond 30 June 2005 until a review opportunity arises (if any) if all of the consideration for the supply was paid before 2 December 1998.

1.12 The section is amended to ensure that:

- commencing the offer and arbitration process set out in Subdivision C of Division 2; or
- changing the consideration for supplies made on or after 1 July 2005 that are specifically identified by an agreement,

will not result in the supplies identified in that agreement made before 1 July 2005 from losing their GST-free status. [*Schedule 1, item 13, subsection 13(4C)*]

1.13 However, if the change in consideration applies to supplies made before 1 July 2005, and the change is made after the commencement of the subsection, supplies made on and after the day the change takes effect will become taxable. The supplies will only become taxable to the extent that such a price change applies to them. This will ensure that in a contract for a continuous supply, such as a lease, only that part of the supply made after the price change takes effect will become taxable. [*Schedule 1, item 13, subsection 13(4B)*]

1.14 ‘Change’ is defined in new subsection 13(4D). **Change**, to the consideration for a supply, means a change to that consideration (including a change to the method by which the consideration is worked out) not provided for in the agreement. [*Schedule 1, item 13, subsection 13(4D)*]

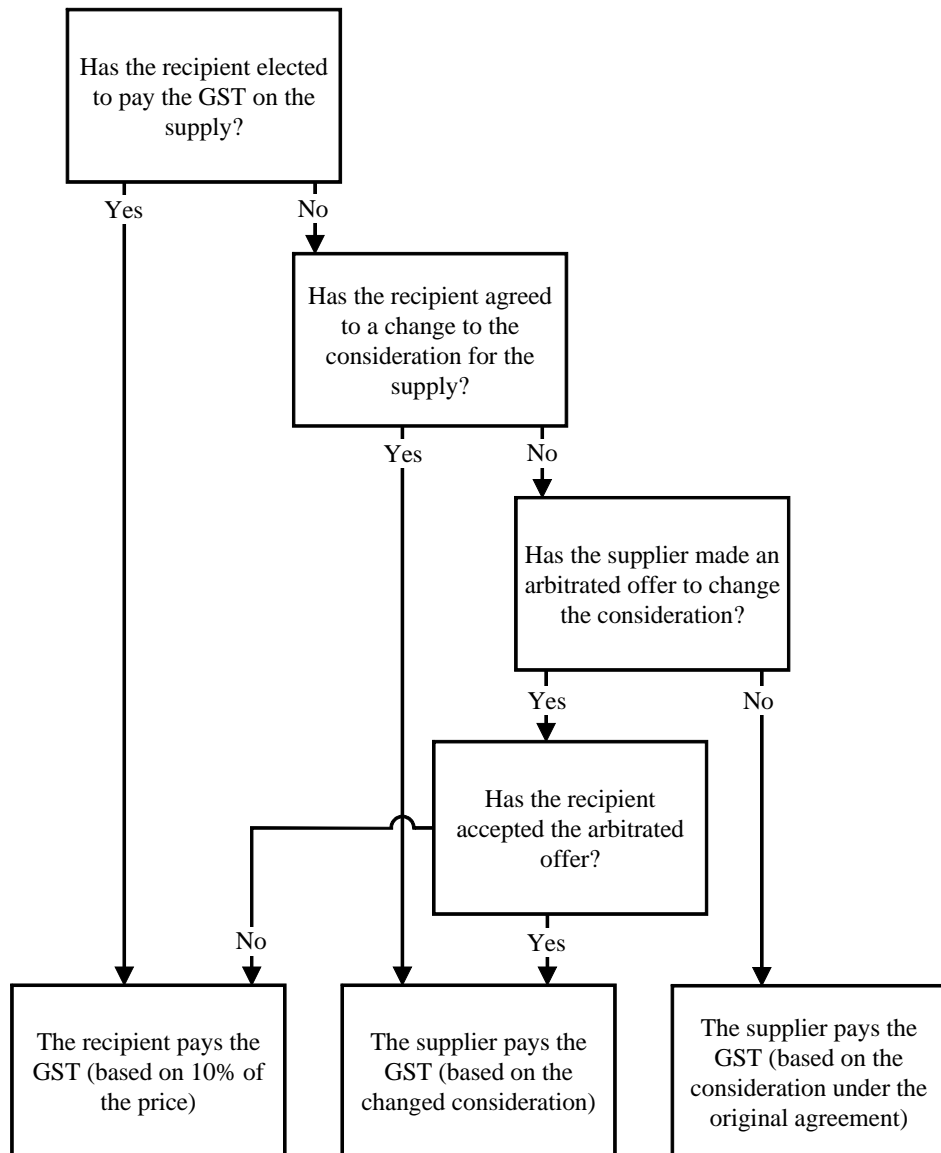
Part 3, Division 2

1.15 Division 2 deals with agreements that also span 1 July 2005, and is inserted at the end of Part 3 of the GST Transition Act. This Division facilitates the application of Division 1 so that suppliers with existing agreements that also span 1 July 2005 can negotiate to take account of the impact of the New Tax System changes with the recipient of the supply. This Division only applies to long-term contracts that are GST-free immediately before 1 July 2005. The existing rules in Division 1 still apply to determine which existing agreements are considered long-term contracts and whether a review opportunity has arisen. Where a review opportunity has arisen before 1 July 2005, or the parties have otherwise renegotiated the contract price applying before that date, the supplies under the contract will no longer be GST-free.

1.16 There are three possible ways in which the GST can apply to supplies under these contracts from 1 July 2005. Diagram 1.1 outlines how the supplier can arrive at each of these outcomes. These outcomes are derived as a result of the provisions in Division 2 and from the general provisions in the GST Act. [Schedule 1, item 14, section 15A]

Diagram 1.1

Long-term non-reviewable contracts: taxable supplies on or after 1 July 2005



1.17 Firstly, it is possible that the GST will be payable by the recipient, and not payable by the supplier as is the usual case. The recipient may elect to pay the GST. Alternatively, the recipient may not have accepted an arbitrated offer of a price adjustment from the supplier. In these situations, the recipient will be responsible for paying this GST amount directly to the Commissioner. Registered recipients will be required to remit the net amount of GST payable (taking their input tax credit entitlement into account) on their relevant GST return. Unregistered recipients will be required to report to the Commissioner on a GST return and pay the GST accordingly.

1.18 Another possible outcome is that the supplier pays the GST on the contract price. In this case, the existing rules in Division 1 apply. This will occur if the supplier accepts the GST liability, without requiring a price adjustment. Supplies made under the contract from 1 July 2005 will become taxable under the general rules in the GST Act. The supplier remits $\frac{1}{11}^{\text{th}}$ of the consideration payable under the contract and the recipient receives input tax credits, according to their usual entitlement.

1.19 The final possible outcome is that the supplier pays the GST on an adjusted price. The price adjustment may occur because the recipient accepts an offer of a price change from the supplier, or the parties may voluntarily renegotiate the contract price. In these cases, the general rules in the GST Act apply. From 1 July 2005, these supplies become subject to the GST. The supplier must remit $\frac{1}{11}^{\text{th}}$ of the consideration and the recipient will receive input tax credits according to the general rules.

Subdivision B

1.20 Subdivision B provides for the payment of the GST by the recipient. This is an exception to the general rules in the GST Act because normally the GST is payable by the supplier.

1.21 This Subdivision will apply to:

- supplies specifically identified by an agreement:
 - that is of a kind referred to in subsection 13(1); and
 - the agreement does not provide that the consideration for the supply is not to be changed to take account of the GST or a similar value added tax imposed on the supply (i.e. if the contract specifically precludes a change in price to take account of a value added tax, the GST will not be payable by the recipient under Subdivision B); and

- those supplies would have been GST-free under section 13 of the GST Transition Act had they been made immediately before 1 July 2005.

[Schedule 1, item 14, paragraphs 15C(1)(a) and (b)]

1.22 The GST will be payable by the recipient in two situations. The first is where the recipient elects to pay the GST. The recipient may elect to pay the GST without the supplier needing to propose a price adjustment. The relationship between the parties or State taxes applying to contract changes might make this approach attractive. This election must be given to the supplier in writing and it is irrevocable. *[Schedule 1, item 14, subparagraph 15C(1)(c)(i), subsection 15C(7)]*

1.23 The other situation is where the recipient has not accepted an arbitrated offer of a price adjustment from the supplier. The recipient is taken to have failed to have accepted an arbitrated offer of a price adjustment from the supplier if the recipient gives to the supplier a written rejection of the offer, or if the recipient has not accepted the arbitrated offer within the final offer period (21 days or a longer time frame specified by the supplier when the offer is made). *[Schedule 1, item 14, subparagraph 15C(1)(c)(ii), subsection 15C(4), section 15M]*

1.24 In either of these circumstances, the GST will only be payable by the recipient to the extent that the taxable supply is made on or after the applicable day. Where the recipient has notified the supplier in writing that they have elected to pay the GST, the applicable day is the later of the day on which the recipient notifies the supplier or 1 July 2005. Where the recipient has not accepted an arbitrated offer, the applicable day will depend on whether the recipient has given to the supplier a written rejection of the offer or whether the final offer period has expired without the recipient having notified the supplier that they accept the offer.

1.25 If the recipient has given a written rejection of the offer, the applicable day will be the day they give that rejection or 1 July 2005, whichever is the later. If the final offer period has expired, the applicable day is the day the offer expired or 1 July 2005, whichever is the later. If the recipient has given a written rejection of the offer, and the final offer period has expired without the recipient notifying the supplier that they accept the offer, it is the earlier of those days that is to be used in the applicable day test. If that day is later than 1 July 2005, that day is the applicable day. Otherwise, it is 1 July 2005. *[Schedule 1, item 14, subsections 15C(2), (4) and (5)]*

Example 1.1

ABC has made a 20 year lease of commercial premises to DEF. The lease began in 1995 and the contract does not provide an opportunity

to review the price. On 23 June 2005, ABC makes a final (arbitrated) offer to DEF. ABC gives DEF until 15 July 2005 to accept the offer. (The final offer period must be at least 21 days.)

DEF chooses not to accept the offer. On 8 July 2005, DEF gives ABC written rejection of the offer. 8 July 2005 becomes the applicable day because it is a date before the offer period expires, and it is after 1 July 2005.

1.26 In situations where the parties have not reached an agreement or the arbitration process has not been completed by 1 July 2005, the supplies under the contract still become taxable from 1 July 2005. To the extent that the supply is made from 1 July 2005, the supplier remits $\frac{1}{11}$ th of the consideration and the recipient receives input tax credits (where entitled). If the recipient becomes required to pay the GST, the recipient, rather than the supplier, will be responsible for reporting and paying this GST amount to the Commissioner for supplies made on or after the applicable day.

1.27 Where a pre-existing contract provides for a continuous supply, this will mean that only that part of the supply made on or after the applicable day will be subject to the GST payable by the recipient. Where the applicable day arises after 1 July 2005, the supplier will be liable for the GST up until the day before the applicable day and the GST will only be payable by the recipient on that part of the supply made on or after the applicable day. Therefore, the liability to pay the GST on a supply or part of a supply will not fall on both the supplier and the recipient at the same time.

1.28 Unlike GST payable by the supplier, GST payable by the recipient does not form part of the price. The amount of GST payable by the recipient on the taxable supply is calculated as 10 per cent of the price of the supply. Price retains the meaning given by section 9-75 of the GST Act. This is because consideration for the supply does not include GST payable by the recipient. Where an agreement provides for continuous supply, the amount of GST payable will be calculated only on that part of the supply arising on or after the applicable day. [*Schedule 1, item 14, section 15D*]

Example 1.2

ABC has also made a 20 year lease of commercial premises to GHI. The rental each month is \$1,000. The lease began in 1995 and the contract does not provide an opportunity to review the price. However, GHI elects to pay the GST from 1 July 2005. It writes to ABC notifying them of this election.

From 1 July 2005, the rent remains \$1,000 but GHI must pay the GST. The GST is \$100. This is calculated as 10 per cent of the price. GHI still pays ABC \$1,000 each month, but GHI must also pay \$100 to the Commissioner.

1.29 Consistent with Division 72 of the GST Act, special rules apply to supplies between associates. These rules ensure that supplies to associates without consideration and supplies to associates for inadequate consideration are properly valued for GST purposes. However, these rules do not apply if the recipient is registered or required to be registered and the supply is solely for a creditable purpose as there will be no detriment to the revenue in these cases. [*Schedule 1, item 14, section 15D*]

1.30 When the GST becomes payable by the recipient, the recipient is responsible for paying this GST amount directly to the Commissioner. Registered recipients are required to remit the net amount of GST payable on their GST return according to the general rules in the GST Act. The amount of GST paid to the Commissioner and any entitlement to input tax credits and adjustments is included in the net amount of the recipient's GST return for the relevant tax period.

Example 1.3

In Example 1.2, GHI is now required to pay \$100 each month to the Commissioner. GHI is registered for the GST and uses the building to make taxable supplies. As it has made a creditable acquisition in respect of this supply, it also claims an input tax credit of \$100 on the GST return.

Recipients who are not registered or required to be registered

1.31 Section 15E sets out the rules for recipients who are not registered or required to be registered but are required to pay the GST under this Division. These unregistered recipients will be subject to the same reporting and payment obligations as registered recipients. New subsection 15E(2) ensures that the normal tax periods in the GST Act will apply to these recipients.

1.32 Generally, the tax periods that will apply will be each period of three months ending on 31 March, 30 June, 30 September and 31 December. These recipients will have access to the same alternative tax periods that are available to registered recipients. *[Schedule 1, item 14, subsection 15E(2)]*

1.33 Subsection 27-40(1A) of the GST Act provides that if an entity ceases to carry on an enterprise, the entity's tax period at the time is taken to have ceased at the end of the day on which the cessation occurred. It is not appropriate for this subsection to apply for unregistered recipients because the requirement to pay the GST under this Division does not depend on whether or not the recipient carries on an enterprise. Subsection 15E(3) overrides subsection 27-40(1A) of the GST Act for these recipients. This will mean that the unregistered recipient will continue to report liabilities and entitlements that arise under this Division, using normal tax periods, even if they cease to carry on an enterprise. *[Schedule 1, item 14, subsection 15E(3)]*

1.34 Division 31 of the GST Act contains rules for entities that are registered or required to be registered regarding the giving of GST returns to the Commissioner for each tax period. Subsection 15E(4) provides that these rules apply to unregistered recipients who are required to pay the GST under this Division. Generally, this will require an unregistered recipient to lodge a GST return with the Commissioner in accordance with the table in section 31-8 of the GST Act. These recipients will be subject to the same penalties for failing to comply with these obligations as entities that are registered or required to be registered. *[Schedule 1, item 14, subsection 15E(4)]*

Special rules for when the recipient pays the goods and services tax

1.35 Subsection 27-40(2) of the GST Act provides that if an entity's registration is cancelled, the entity's tax period at the date of the effect of the cancellation (the cancellation day) ceases at the end of the cancellation day. New subsection 15F(2) ensures that subsection 27-40(2) continues to apply in relation to the recipient's GST liabilities, input tax credit entitlements and adjustments that arise otherwise than because of Division 2. The recipient will attribute their liabilities and adjustments that arise because of Division 2 to the same tax periods that would apply if they were unregistered. *[Schedule 1, item 14, subsection 15F(2)]*

1.36 Rules are provided to deal with bad debts that arise in respect of taxable supplies that are subject to the GST under Division 2. These rules affect the following provisions of Division 21 of the GST Act:

- Section 21-5 of the GST Act provides for a decreasing adjustment if a taxable supply is made, and all or part of the consideration for that supply has not been received, and all or part of the debt is written off as a bad debt or all or part of the debt has been overdue for 12 months or more. The amount of the decreasing adjustment is $\frac{1}{11}$ th of the amount written off or overdue for 12 months or more. However, decreasing adjustments are not available for those who account for GST on a cash basis.
- Section 21-10 of the GST Act provides for an increasing adjustment where a decreasing adjustment applied under section 21-5 for a debt, and part or all of the debt is subsequently recovered. The amount of the increasing adjustment is $\frac{1}{11}$ th of the amount recovered.

1.37 In cases where the GST becomes payable by the recipient as a result of Division 2, it would be inappropriate for such adjustments to arise for the entity who made the supply (i.e. the supplier). This is because the GST is payable by the recipient, not the supplier. New subsection 15G(2) provides that section 21-5 of the GST Act does not apply in these cases. *[Schedule 1, item 14, subsection 15G(2)]*

1.38 New subsection 15G(3) provides that the recipient of a taxable supply for which the GST is payable by them as a result of Division 2 has a decreasing adjustment where the whole or part of the consideration for the supply has not been received by the supplier, and the supplier has written off as a bad debt all or part of the debt, or all or part of the debt has been overdue for 12 months or more. The amount of the decreasing adjustment is equal to 10 per cent of the amount written off or overdue by 12 months or more (as the case requires). This mirrors the calculation of the recipient's GST liability on the supply under section 15D. However, the recipient does not have a decreasing adjustment if they account for the GST on a cash basis. *[Schedule 1, item 14, subsection 15G(3)]*

1.39 Similarly, new subsection 15G(4) provides that a recipient has an increasing adjustment if they had a decreasing adjustment under subsection 15G(3), and subsequently pay the supplier all or part of the amount written off or all or part of the amount that has been overdue for 12 months or more. The amount of the increasing adjustment is 10 per cent of the amount paid. Again, this mirrors the calculation of the recipient's GST liability on the supply under section 15D. However, the recipient does not have an increasing adjustment if they account for the GST on a cash basis. *[Schedule 1, item 14, subsection 15G(4)]*

Special rules about tax invoices and adjustment notes

1.40 Section 15H removes the requirement for the supplier to issue tax invoices and adjustment notes when the GST is payable by the recipient. New subsection 15H(3) removes the requirement for the recipient to hold a tax invoice to claim an input tax credit for a creditable acquisition where that acquisition constitutes a taxable supply on which the GST is payable by the recipient. Similarly, new subsection 15H(4) removes the requirement for the recipient to hold an adjustment note to attribute an adjustment that arises from an adjustment event relating to a taxable supply on which GST is payable by the recipient. [*Schedule 1, item 14, section 15H*]

Special rules for attributing the goods and services tax

1.41 Where an entity makes a supply that is specifically identified in an agreement of a kind to which subsection 13(1) applies, and that supply is for a period or progressively over a period, section 13 in its current form will apply to treat that supply as GST-free until 1 July 2005 or when a review opportunity arises, whichever is the earlier. To the extent the supply is made on or after that day, it will be subject to the GST. In some cases, the supplier will have been required to attribute that GST to a tax period before 1 July 2005.

Example 1.4

ABC has made a 21 year lease of commercial premises to JKL for \$23.1 million. The lease began on 1 July 1999 and did not have a review opportunity. JKL was required to pay all of the consideration for the lease on that day.

The lease will be GST-free up to 30 June 2005. It will be taxable to the extent that the supply was made from 1 July 2005.

In the July 2000 tax period, ABC was required to attribute the GST (\$1.5 million) payable on the taxable part of the supply. ABC reported this GST liability on its GST return for July 2000 and paid the GST to the Commissioner.

1.42 Where section 15C applies, the GST payable on the supply is payable by the recipient of the supply, and is not payable by the supplier. The supplier will have reported on their GST return, and paid to the Commissioner, an amount that is not legally payable as GST.

1.43 In some cases, revising their GST return to remove this amount will result in the supplier being entitled to a refund under section 35-5 of the GST Act for that tax period. However, section 36 of the *Taxation Administration Act 1953* may operate to remove any entitlement to a refund. For example, where the supplier has failed to notify the Commissioner of their entitlement within four years after the tax period. New section 15IA will ensure that section 36 will not apply to a refund in respect of a tax period to the extent that the refund arises because the GST on a taxable supply was attributable to that tax period and was payable by the supplier, and the recipient of the supply becomes liable for the GST on the supply because of section 15C. Section 15IA will apply to tax periods starting on or after 1 July 2000. [*Schedule 1, item 15, section 15IA*]

1.44 Where section 15C operates to make the GST on a taxable supply payable by the recipient of the supply, the recipient will be required to attribute this GST in accordance with the attribution rules in the GST Act. In some cases, these rules may require the recipient to attribute the GST to a tax period before the applicable day.

1.45 However, having the recipient attribute the GST to a tax period before the applicable day is likely to lead to compliance costs for the recipient in revising their GST return for that tax period. New subsection 15I(1) ensures that where a recipient would ordinarily be required to attribute the GST to a tax period before the applicable day, they must instead attribute the GST to the first tax period starting on or after the applicable day. [*Schedule 1, item 14, subsection 15I(1)*]

Example 1.5

In Example 1.4, JKL elects to pay the GST on the supply and notifies ABC in writing on 1 July 2005. The GST payable on the supply (\$1.5 million) is now payable by JKL.

JKL does not account for the GST on a cash basis, and would ordinarily be required to attribute the GST payable to the July 2000 tax period. However, it now attributes the GST to the first tax period starting on or after the applicable day.

1.46 However, where Division 156 of the GST Act (which is about supplies and acquisitions made on a progressive basis) applies, recipients will be able to continue to attribute the GST in accordance with that Division. [*Schedule 1, item 14, subsection 15I(2)*]

Subdivision C

1.47 There are several steps that are required before the GST becomes payable by the recipient because the recipient has failed to

accept a final offer. A final offer is an arbitrated offer if it meets the requirements in Subdivision C.

- Step 1 – the supplier makes an initial offer. This must remain open for at least 28 days.
- Step 2 – the supplier applies for an arbitrator to appoint an assessor who determines an appropriate price change.
- Step 3 – the supplier makes a final offer using the assessor's determination of an appropriate price change. The final offer remains open for at least 21 days.

1.48 Subdivision C sets out the requirements that must be followed by the supplier to make an arbitrated offer to change the consideration. 'Change' is defined in section 15B. A **change** includes a change to the method by which the consideration is worked out. These requirements apply if the supplier does not want to merely absorb a GST liability from 1 July 2005 and intends to adjust the consideration under Division 2. It is open at any time during this process for the parties to abandon the arbitration process in favour of reaching an agreement on an adjusted price (in which case the GST on the supply remains payable by the supplier) or for the recipient to elect to pay the GST on the supply.

Initial offer

1.49 If the supplier intends to adjust the consideration to take account of the impact of the New Tax System changes, the supplier must make an initial offer to the recipient. The initial offer must be in writing and contain an offer of a price adjustment. The initial offer must also state how long the offer remains open. This initial offer period must be at least 28 days. [Schedule 1, item 14, section 15K]

1.50 It is open to the parties to negotiate a price adjustment during the period of the initial offer. Again, the parties may abandon the arbitration process in favour of reaching an agreement on an adjusted price, or the recipient may elect to pay the GST on the supply. However, if at the end of the initial offer period the parties have not settled on a price adjustment in writing, or the supplier has not received notification that the recipient will pay the GST, the supplier is entitled to begin the arbitration process. If the recipient rejects the offer before the initial offer period lapses, the supplier can commence the arbitration process from that earlier date. [Schedule 1, item 14, section 15L]

Arbitration process

1.51 Once the initial offer period has lapsed, or the recipient has rejected the initial offer, the supplier may apply to an 'arbitrator' for an

independent assessor to be appointed to determine an appropriate change in the consideration. ‘Arbitrator’ is defined in section 15B. An **arbitrator** is a person or body specified in the regulations. [*Schedule 1, item 14, sections 15B and 15L*]

1.52 The assessor will be a person whom the arbitrator is satisfied is suitably qualified to determine an appropriate change in the consideration for the contract and is independent of both parties. In determining an appropriate change, the assessor must only take into account the impact of the New Tax System changes on the supplier’s costs and expenses.

1.53 ‘New Tax System changes’ has the same meaning as in Part VB of the *Trade Practices Act 1974*. Essentially, the factors to consider in working out the impact of the New Tax System changes include the direct cost to the supplier of the imposition of the GST on the supplies and the cost reductions of the supplier arising from the abolition of other taxes when the GST was introduced. Generally it is expected that the supplier’s net dollar margin should not be increased as a result of this change in the consideration. [*Schedule 1, item 14, paragraph 15L(1)(c) and subsection 15L(3)*]

1.54 The assessor’s determination of an appropriate change must be in writing and signed and dated by the assessor, or in the form specified in the regulations. [*Schedule 1, item 14, paragraph 15L(1)(d)*]

Final (arbitrated) offer

1.55 Once the supplier has received the assessor’s price determination, the supplier can make a final offer to the recipient. The final offer must be in writing and set out the assessor’s determination of an appropriate change as the change to the consideration. The final offer must also state how long the offer remains open. This final offer period must be at least 21 days. The final offer will be an arbitrated offer if the requirements of sections 15J, 15K, 15L and 15M have been met. [*Schedule 1, item 14, sections 15J and 15M*]

1.56 If the recipient accepts the offer, the GST remains payable by the supplier taking into account the change in consideration for the supply. If the recipient does not accept this final offer within the specified offer period, they will have failed to accept an arbitrated offer by the supplier to change the consideration for the relevant supply. The recipient must now pay the GST. [*Schedule 1, item 14, subsection 15C(1)*]

Application and transitional provisions

1.57 The amendments to the GST Transition Act apply from the date of Royal Assent to these amendments. This will ensure that suppliers have sufficient time to make an arbitrated offer before the transition period ends on 1 July 2005. However, new section 15IA will apply to tax periods starting on or after 1 July 2000.

1.58 The three new Imposition Bills apply from 1 July 2005 because the GST can only become payable by the recipient from this date.

Consequential amendments

1.59 Schedule 1 will make consequential amendments to the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* so that the definition of 'GST Imposition Acts' includes the three Imposition Bills that impose GST on the recipient of the supplies. Subparagraph 2(1)(b)(ii) will be repealed so that the commencement date of the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* is not affected. *[Schedule 1, items 1 and 2, subparagraph 2(1)(b)(ii) and section 4]*

1.60 Schedule 1 will make a consequential amendment to the GST Act so that the definition of 'GST' includes the three new Imposition Bills. *GST* is defined within the GST dictionary to mean tax that is payable under the GST law and imposed as goods and services tax by any of the GST Imposition Acts. This measure will amend the definition of 'GST' so that it includes the three new Imposition Bills that impose the GST on the recipient of the supplies. These are:

- A New Tax System (Goods and Services Tax Imposition (Recipients) – General) Bill 2004;
- A New Tax System (Goods and Services Tax Imposition (Recipients) – Customs) Bill 2004; and
- A New Tax System (Goods and Services Tax Imposition (Recipients) – Excise) Bill 2004.

[Schedule 1, item 5, section 195-1]

1.61 Schedule 1 will also make consequential amendments to the three GST Imposition Acts so that they take into account the three new Imposition Bills. *[Schedule 1, items 6 to 11]*

Tax Laws Amendment (Long-term Non-reviewable Contracts) Bill 2004
A New Tax System (Goods and Services Tax Imposition (Recipients)—General) Bill 2004
A New Tax System (Goods and Services Tax Imposition (Recipients)—Customs) Bill 2004
A New Tax System (Goods and Services Tax Imposition (Recipients)—Excise) Bill 2004

1.62 This measure will make a consequential amendment to subsection 70(1) of the *Taxation Administration Act 1953* so that recipients who pay the GST are required to keep sufficient records. [Schedule 1, item 18]

1.63 Schedule 1 will make consequential amendments to the GST Act, the *A New Tax System (Luxury Car Tax) Act 1999* and the *A New Tax System (Wine Equalisation Tax) Act 1999* so that the definition of ‘customs duty’ does not include a duty of customs imposed under the *A New Tax System (Goods and Services Tax Imposition (Recipients) – Customs) Bill 2004*. [Schedule 1, items 16 and 17]

Imposition Acts

1.64 Three new Imposition Bills are required to impose the GST on the recipients of the supplies. Section 55 of the *Commonwealth of Australia Constitution Act* requires that laws imposing taxation shall deal only with the imposition of taxation and shall deal with one subject of taxation only.

REGULATION IMPACT STATEMENT

Background

1.65 When the GST legislation was introduced, there were numerous pre-existing contracts with prices that had been struck without regard for the GST. If the GST had applied immediately to these contracts, suppliers would have had to remit GST on their supplies, with no ability under the contract to pass that cost onto recipients. In contrast, many recipients would have received an input tax credit, despite only paying what was effectively still a GST-free price – receiving a windfall gain at the expense of the supplier.

1.66 Consequently, supplies under contracts without specific GST clauses remain GST-free until a review opportunity arises. GST would apply normally to those contracts from that point, as their prices would reflect a market with GST-inclusive prices. On 1 July 2005, all remaining contracts would, under the legislation as it currently stands, become subject to GST in the normal way.

1.67 Ideally, the parties would voluntarily renegotiate the contract price to reflect the impact on the supplier of the New Tax System changes. However, this would immediately take the contract out of the transitional provisions and so there is an incentive for recipients to continue to receive supplies at what are effectively GST-free prices, and receive the windfall input tax credit from 1 July 2005.

1.68 On 3 May 2000, the Government announced its intention to modify the transitional provisions to address this issue. The Government announced that the supplier will be able to adjust their prices to recover the net impact of the New Tax System changes from the recipient of the supply.

1.69 However, the measure would not have applied to contracts where the recipient is not entitled to full input tax credits because there would not be an offsetting credit to compensate the recipient. This raised considerable concerns during consultation.

1.70 The Government addressed these concerns by announcing on 21 November 2003, that it had revised the way GST will be applied to pre-existing contracts that will not have had a review opportunity by 30 June 2005. All suppliers with these long-term contracts, including those where the recipient is not entitled to input tax credits, can negotiate with the recipient to recover the net impact of the New Tax System changes on the supplies.

Policy objective

1.71 The policy objective for this revised measure was to find a unified solution for contracts with recipients that are not entitled to input tax credits, contracts where the recipient is entitled to full input tax credits and contracts where the recipient is only partly entitled to input tax credits.

1.72 The revised measure should:

- ensure the pass-through of the net impact of the New Tax System changes;
- avoid a cost to revenue; and
- preserve ‘sanctity of contract’ by not imposing changes to contracts that have not been agreed by the parties.

1.73 It would also be highly desirable to avoid using special arrangements that will impose additional administrative and compliance

costs, especially where such arrangements have the potential to be in place for extended periods. Ideally, parties would be encouraged to renegotiate their contracts to reflect the impact of tax reform on the supplier, which would then place those contracts under the general GST rules.

Implementation options

1.74 The original proposal announced in the Treasurer's Press Release No. 36 of 3 May 2000 would only have applied to contracts where the recipient was entitled to full input tax credits. While, with increased complexity the measure could have been extended to contracts with partly input-taxed recipients, this would still leave the GST remaining with suppliers to the extent that their recipient is not entitled to input tax credits. Extending this proposal to these contracts would breach the sanctity of contract between the supplier and recipient without there being an offsetting input tax credit that could compensate the recipient. For this reason, there were strong doubts about the legality of such a proposal.

1.75 An alternative approach would be to explicitly transfer the tax from the supplier to the recipient, rather than relying on the supplier being able to recover the tax through a price adjustment. This may overcompensate the supplier because no allowance would be made for the savings arising from tax reform. Nevertheless, the opportunity arises to use the potential transfer of the tax liability from the supplier to the recipient to encourage the parties to agree on an appropriate price change. This would have the double benefit of 'normalising' the GST treatment of the contract by taking it out of the transitional arrangements.

1.76 Such a model could make the transfer of liability contingent upon the supplier offering an appropriate price change to the recipient. Should the recipient accept this offer, the contract would become taxable under the normal rules and the need to transfer the liability would ultimately not come into effect. Only where the recipient failed to accept the supplier's offer of an appropriate price change would the tax liability be transferred to the recipient. In this case, a 10 per cent tax would be applied to the contract price, which itself would remain unaltered.

1.77 A formal assessment mechanism would be needed to determine the appropriate price change. Parties would be encouraged to negotiate an appropriate amount, with recourse to an independent assessor. Under the measure the determined amount would, at the supplier's discretion, be applied as a contract price adjustment. It would serve as an offer to the recipient which, if refused, would trigger the transfer of a tax liability.

1.78 The supplier would retain the option of not seeking a price change and simply accepting the GST obligation. The revised measure would extend a similar option to the recipient, who would be free to simply accept the transfer of liability without a price change being proposed, in which case the contract would be unaltered. The relationship between the parties might make this approach attractive, for example, where offsetting benefits could arise under other contracts. Similarly, State taxes applying to contract changes could also discourage price changes to the contract.

1.79 If the tax liability is transferred and the GST becomes payable by the recipient, the supplier would no longer be required to collect and remit the GST. Essentially, their reporting requirements for this supply would cease.

1.80 The recipient would now be responsible for paying this GST amount directly to the Commissioner. Registered recipients would be required to remit the net amount of GST payable (taking their input tax credit entitlement into account) on their relevant Business Activity Statement (BAS). Unregistered recipients would be required to report to the Commissioner on a GST return and pay the GST accordingly.

1.81 This approach was the only one identified that could achieve all of the policy objectives. The Government originally considered another option for transferring the tax liability that would retain the supplier as the party responsible for remitting the tax, even though the legal liability had been transferred to the recipient. However, strong doubts about its legality arose after the precise details for implementing this collection mechanism had been developed.

Assessment of impacts

1.82 The impact of the measure will depend on the decisions taken by the parties to the contract. Ideally, the parties will agree to an appropriate price change if the recipient is not entitled to full input tax credits. Recipients entitled to full input tax credits are likely to accept the GST liability because the net effect will be the same as it is now.

1.83 The GST should only become payable by recipients not entitled to full input tax credits where the parties dispute the impact of the New Tax System changes on the supplier (necessitating a formal assessment process), and the recipient views the amount determined by the assessor as insufficient to warrant adjusting the contract price. The administrative and compliance costs discussed below should therefore be seen as occurring in the ‘worst case’ scenario.

Impact group identification

1.84 The measure will affect suppliers and recipients under pre-existing long-term contracts that will not have had a review opportunity by 30 June 2005. The majority of these contracts involve commercial property but other areas are also affected, such as agricultural managed investment schemes, infrastructure contracts and trustee agreements. However, as these contracts are not yet within the GST system, there is insufficient information available to determine the number of contracts that will be affected.

1.85 The measure will affect small businesses that are parties to pre-existing agreements, but there should be no disproportionate impact on small business. The analysis below for suppliers and recipients applies to small businesses that fall into that category.

Analysis of costs and benefits

Government

1.86 There will be a negligible gain in GST revenue, however all GST revenue is paid to the States and Territories.

1.87 Under the current legislation, the transitional arrangements will end at 30 June 2005 and GST would apply normally to all contracts. The benefit from this would be the normalisation of GST arrangements. The benefit from the revised measure would be to deliver an outcome more consistent with the design principles of the GST to the full range of pre-existing non-reviewable contracts, regardless of the recipient’s entitlement to input tax credits.

1.88 It is anticipated that there will not be any significant administrative costs arising from this measure. While the ATO compliance strategy will involve an education program to ensure that GST obligations are met, no significant compliance costs or enforcement issues should arise as a result of the GST being collected from the recipient.

1.89 As no changes are required to the current BAS, the ongoing administrative arrangements will be the same as those applying to normal taxable supplies. However, in cases where the recipient is not registered, the ATO may be required to develop a form for those recipients to fulfil their GST reporting requirement. This should only be a minor administrative arrangement, as it is expected that many of these recipients will accept the appropriate price change rather than paying a 10 per cent tax.

Suppliers

1.90 The original proposal of May 2000 would have benefited suppliers by allowing them to pass on the cost of their GST obligations (less savings they enjoy from indirect tax reform). The revised measure provides similar relief, with coverage extended to suppliers with recipients that are not entitled to full input tax credits.

1.91 The major advantage with this measure is that once a supplier has made an offer of an appropriate price change and the offer is not accepted, there are no further reporting obligations on the supplier. Therefore, there should be no on-going compliance costs for suppliers if the GST becomes payable by the recipient.

1.92 Suppliers will incur a once off cost in negotiating or having the appropriate price change independently assessed. However, this cost would have been incurred in the previously announced policy for a contract price override and the revised measure only extends this cost to suppliers with input-taxed recipients.

1.93 The supplier will be responsible for initiating negotiations to change the price, applying to have an assessor appointed and making a formal offer. It should be noted that under the price exploitation provisions that applied when the GST was introduced, all suppliers raising prices to recover the costs of the New Tax System changes were required to undertake an informal assessment of the savings they had received. Although suppliers who have benefited from accessing the transitional rules will, under the proposed changes, be required to undertake a more formal assessment, to a significant extent this would constitute a normal cost deferred, rather than an additional cost.

1.94 The option for a supplier to simply accept the GST liability without proposing a price change effectively places a cap on the compliance costs they will incur. This ensures that suppliers should not lose from the revised measure relative to the existing legislation.

Recipients

1.95 The primary purpose of the measure is to allow suppliers to negotiate to recover the net impact of the New Tax System changes from the recipient of their supplies. However, from this starting point, recipients will benefit from the pass-through of any cost savings the supplier has received from tax reform. A significant proportion of these long-term contracts are commercial property leases. As the properties would have been constructed or purchased prior to the introduction of the GST, large savings from tax reform are unlikely.

1.96 Where the supplier has not enjoyed significant cost savings, the price adjustment may be close to 10 per cent. Under the original May 2000 proposal, the supplier could require the contract to be amended to adjust the price accordingly. The revised measure allows the recipient the option to accept a 10 per cent price rise (in the form of the GST liability) without incurring the costs of amending the contract. For example, these costs could include State stamp duties that apply to contract changes.

1.97 The revised measure will require registered recipients to report the recipient tax and any input tax credit entitlements on the BAS. Unregistered recipients will need to report and pay GST if they do not accept an offer of an appropriate change made by the supplier. However, these costs could be avoided by accepting this offer which will place the contract under the general GST rules.

Consultation

1.98 Following the May 2000 contract override proposal, a discussion paper was released. Key stakeholders including property owners, tenants and trustees were included in the consultations. The key issue raised in response to the consultation document was the absence of relief for suppliers that make supplies to recipients that are not entitled to claim full input tax credits.

1.99 The revised measure, announced in the former Minister for Revenue and Assistant Treasurer's Press Release No. C109/03 of 21 November 2003, addressed this concern. The press release indicated that the precise details for implementing this measure would be developed in consultation with industry groups. A discussion paper was then circulated to industry groups and was also available on the Department of the Treasury website. The proposal outlined in the discussion paper had the supplier remitting the GST on their BAS even when it was payable by the recipient.

1.100 Overall, the revised measure was well received even though some parties raised minor concerns about how a supplier would recover the GST amount if the recipient refused to pay the tax, and about the calculation of the New Tax System changes. These concerns have been addressed respectively by developing a collection mechanism which makes the recipient responsible for the reporting requirements when the GST liability is transferred to them, and by defining the meaning of the New Tax System changes.

1.101 On 29 October 2004, the Minister for Revenue and Assistant Treasurer announced in Press Release No. 009 that a further round of consultation would be undertaken on the draft amendments. The draft amendments were available on the Treasury website and a number of smaller industry groups were contacted seeking their views.

Conclusion

1.102 Transferring the GST liability when the recipient fails to accept the supplier's offer of an appropriate price change is the preferred option for all pre-existing contracts that have not been reviewed by 30 June 2005. When compared to the contract override proposal of May 2000, this measure provides the best outcome with the lowest compliance costs, and avoids breaching sanctity of contract.

1.103 For the large majority of contracts where the recipient is entitled to full input tax credits, the net GST outcome is effectively the same as it is currently. For the remaining contracts, it should achieve the desired outcome of bringing contracts into the normal GST rules, as it provides a strong incentive for both parties to agree to an appropriate price change.

1.104 In the event of the desired negotiated outcome not being achieved, the GST liability being formally transferred to the recipient should generally provide an outcome much more consistent with the GST design principles than leaving the GST cost with the supplier.

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