

Government Tax Newsletter

Welcome to the PwC Government Tax newsletter, which brings you commentary and analysis on tax issues relevant to the public sector including GST, employment taxes, National Tax Equivalent compliance issues, customs and fuel tax credit opportunities.

The public sector environment is particularly dynamic right now with elections coming thick and fast across the nation. Tax developments for government have also been interesting in the last six months and will remain so as government specific issues are finally being considered judicially and the GST administrative reforms are implemented.

April 2010

PRICEWATERHOUSECOOPERS 

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Back to the drawing board for GST exempt funding

From the very beginning of GST, the original architects of the tax were always clear that the non-commercial activities of government should not be subject to GST.

For the last ten years since the introduction of GST, government agencies, advisors and the Australian Taxation Office (ATO) have all grappled with the distinction between their commercial and noncommercial activities, particularly with respect to the vast payments paid between agencies and the different levels of government to drive service delivery.

However, in terms of the drafting of the GST Act itself, the ‘non-commercial’ intention was reduced to section 9-15(3)(c), which provides that:

a payment made by government related entity to another government related entity is not the provision of consideration if the payment is specifically covered by an appropriation under an Australian Law.

The questions that arise for agencies in properly applying this section are many and varied, and include:

- Given that any amount received and spent by a core budget agency by definition must be appropriated, what does ‘specifically covered’ mean?
- If any guidance is to be given by the ATO, how can the different budget and appropriating processes across the States, Territories and Commonwealth be taken into account?



- How do you provide certainty when the receiver of money needs to have reference to the Budget documentation of the giver of the money in order to determine its own GST liability?
- How do you avoid the situation where documents produced to support the most fundamental government administrative and legislative process – the budget and appropriation cycle – need to be drafted as tax compliance documents?

After a number of ATO attempts and much consultation, *GSTR 2006/11 Appropriations* provided a workable (though onerous) framework for agencies to determine when payments would be out of scope of the GST. While broadly based on Commonwealth processes and budgetary concepts, the ruling was nonetheless clear as to what documents could be regarded as supporting specific coverage by an appropriation and at least put a number of the more contentious issues to rest.

However, the recent Full Federal Court case *TT-Line Company v Commissioner of Taxation*, regarding rebate payments made by the Commonwealth to TT-Line in respect of the ferry service between Tasmania and the mainland, has sent the ATO back to the drawing board.

In the case, payments had been made from one government-related entity to another and were listed in Portfolio Budget statements (and would have fallen within the ambit of s 9-15(3)(c) under the ATO public ruling). However the payments were held not to be 'specifically covered by an appropriation'.

The reasoning behind the judgments included:

- as TT-Line was merely a conduit of the funds, the payments were not made for the benefit of TT-Line but for the passenger of the service, and
- as a payment under the program could also have been made to a non-government entity, to treat the payment as out of scope for the government related entity and subject to GST for other entities would result in discrimination contrary to the general policy of GST.

These tests have never been a factor in the ATO's interpretation of the provision. In fact, the 'benefit' test



appears to contradict the ruling's approach to 'administered' funds which, under the ruling, were likely to be covered by section 9-15(3)(c). Not surprisingly, the ATO has advised that it will begin the long consultative process to rewrite the public ruling, which is likely to take up to 12 months. In the meantime, we understand that agencies can still rely on GSTR 2006/11 but should ensure that they have their register of appropriations up to date with clear references to the provisions within the ruling upon which they are relying.

However comprehensive the consultative process may be, the court's interpretation of s 9-15(3)(c) will make it harder than ever for agencies to determine their GST liabilities. Isn't it time the actual provision itself was revisited to give effect to the drafter's original intent?

Employment taxes – the revenue authorities are focused on contractors... are you?

Determining whether a worker is an employee or contractor is complex, with the employment tax (PAYG Withholding, Payroll Tax, Workers' Compensation and Superannation Guarantee) implications and considerations differing for each tax. In our experience, employment tax compliance on contractors is a significant area of exposure – equally for public and private organisations.

There is currently unprecedented focus on contractors by both the ATO and the various State Revenue Authorities, through targeted questionnaires and audit programs. This is in addition to the Superannation Hotline, which facilitates workers reporting employers where they consider they should have been paid superannation. Our understanding is that this hotline is utilised regularly.

Organisations often make the mistake of assuming that independent contractor payments do not give rise to the various employment tax obligations. Common misconceptions include:

- If an individual has an ABN and is an independent contractor, they are not entitled to Superannation.
- If an individual is engaged through an incorporated entity, payroll tax liability is avoided.
- If an individual is an independent contractor, they do not need to be covered by Workers' Compensation insurance.

One particularly common misconception is that, as long as a worker does not do more than 80 per cent of its work for one engagement, they are an independent contractor and employment taxes do not apply. This 80 per cent rule is a myth!

Another key risk is the absence of effective contractual documentation, placing doubt over the contractor classification of the worker. This is a particular risk where the contractor claims to operate through an interposed entity. The ATO, in particular, has a clear view on 'sham' contractor arrangements.



If you consider that your organisation has contractors under control, ask yourself the following question – are your processes and systems to identify, record and report contactor payments as robust as your payroll processes and systems to accurately identify, record and report employee payments? Experience shows that many organisations may not even be aware of how many contractors they have, who within the organisation has engaged them or where they are located, let alone having specific data to assess whether payroll tax or superannuation guarantee applies.

Our experience shows that most employers struggle to produce the necessary documentation to demonstrate an efficient system for managing contractor payments. Organisations engaging contractors need a 'contractor management system'. Without a tailored contractor

management system, supported by appropriately drafted contractual documentation and guidance materials, organisations are unlikely to comply with their employment tax obligations. When organisations are approached by the ATO or State Revenue Office, they need to be able to demonstrate such a system and produce the requested data in a reasonable timeframe. Under current employer obligation audits, the ATO is requesting the information below (from up to six years ago!) in relation to contractors:

- contracts
- tax invoices
- accounts records of contractor payments made
- timesheets, rosters and attendance registers, and
- cheque butts, EFT advices, bank statements, cash books, cash payments journals and petty cash vouchers.

GST administration reform update – will RCTIs become simpler?

In the last two months we have seen some significant developments in the GST administration reform process, which arose from the Board of Taxation's review of the legal framework for the administration of the GST.

Of the 41 recommendations by the Board of Taxation which were originally accepted by the Government, around a dozen are still intended to apply from 1 July 2010. For eight of these we have legislation, Bills before Parliament, or exposure draft legislation. We have also seen the proposed legislation for a further five measures with start dates other than 1 July 2010. As a result, there is now sufficient information for organisations to start considering how they will be affected by the proposed amendments, including whether there are transitional issues which need to be considered prior to 30 June 2010.

A number of reforms included in the Tax Laws Amendment (2010 GST Administration Measures No 2) Bill 2010 may be of interest for government organisations. The Bill contains a number of amendments effective from 1 July 2010, but most notably for government, it includes measures to:



- include indirect tax rulings within the general tax rulings system so that many 'public rulings' (e.g. the Charities Consultative Committee minutes, State and Territory Industry Partnership, etc) that have appeared on the ATO website will no longer be able to be relied upon
- allow entities to self-assess their eligibility to form, change and dissolve a GST group or GST joint venture

- allow members of a GST group to enter into indirect tax sharing agreements with the representative member to limit the indirect tax law liabilities of the members for tax periods for which they are a member of the GST group (which may need to be considered by government agencies in the context of Machinery of Government changes), and
- simplify the requirements for a document to be a tax invoice, by replacing the current prescriptive list with equivalent, but more flexible, principles. It also integrates and streamlines the special requirements for tax invoices that are recipient created tax invoices (RCTIs).

The effects of the introduction of the new ruling system and the usefulness of indirect tax sharing arrangements for MOG changes will emerge over the next little while. But in light of the ambitious policy intention to reform and simplify GST, we were encouraged and optimistic about the intention to simplify RCTI arrangements. Given the importance of RCTIs for the administrative streamlining of many grant programs, such changes could mean a real reduction in the administrative burden for funding agencies.

However, now that the Bill has been released, it appears the changes will have minimal effect in practice.

In summary, the key changes applicable to RCTIs under the GST administration measures ratified by the government are:

- RCTIs must include the identity or ABN of the recipient, even where the total value of the supplies included in the document is less than \$1,000.
- It is also a requirement that the document clearly indicates that the GST is payable by the supplier.
- Finally, it must be clear from the document that it is intended to be a recipient created tax invoice.

Significantly, the determination regarding RCTIs (which appears as a Schedule to GSTR 2000/10) will continue to be valid until such time that it is deemed to be otherwise. This means that, while the form of the RCTI itself may be less strict, agencies will still be required to enter into the very specific terms of the agreement provided by the determination.

Therefore, if agencies have effective, well understood RCTI processes, arrangements and documentation in place with their service providers, there seems to be no practical point in changing current procedures in response to the reforms.

National Tax Equivalent Regime (NTER) – A status check on compliance activity and current issues

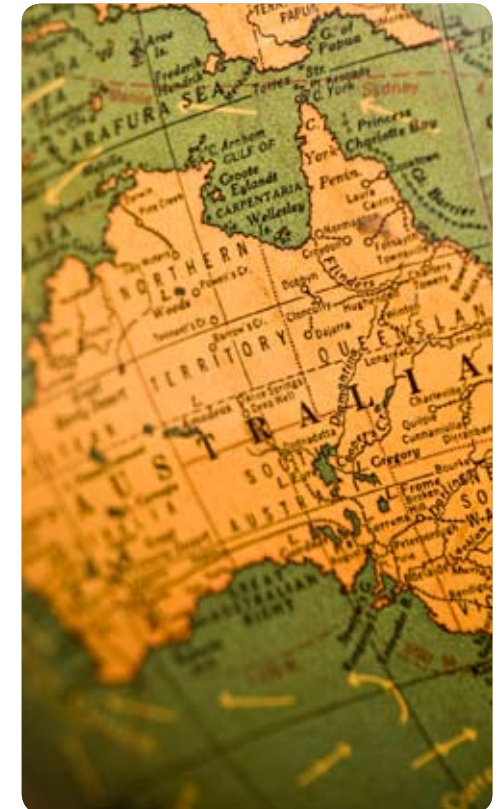
Last month, Peter Maher of the Large Business & Investigations area of the ATO and Administrator of the National Tax Equivalent Regime, and Mike Hogan, Assistant Director, Budget and Financial Management of the Victorian Department of Treasury, presented to 22 Victorian NTER taxpayers at a workshop held in our Melbourne office.

The presentation by the ATO and Victorian Department of Treasury was well received and we are planning a program of follow up NTER events dealing with issues highlighted as of interest by the NTER participants at the workshop.

Areas of focus in the ATO presentation included:

- the conclusion of and learnings from the round of client risk reviews undertaken by the NTER Administration Cell of NTER entities over the last three years
- an acknowledgement that this review process did not touch some of the smaller NTER entities

- the future adoption of a larger scale program of book to tax reviews, and
- the range of contentious tax issues (including unbilled income and



capitalisation of labour costs – refer below) relevant to NTER entities that will be allowed to play out in the Federal tax arena before being picked up by the NTER working party (comprising the ATO and the State DTF administrations).

It was also explained that the NTER Administration Cell had issued advice, including 16 private rulings, on a range of issues including:

- capital allowances – Division 40 and Division 43
- capital allowance deductions – Subdivision 40F (irrigation water providers)
- government and industry grants
- government equity contributions (para 104 and 105 of the NTER Manual)
- blackhole expenditure (section 40-880)
- assessability and timing of derivation of developer headwork's contributions
- tax-neutral treatment of government imposed restructures (para 103 and 103B of the NTER Manual)
- gains/losses made on transfer of investment assets
- foreign currency translation rules (para 122 of the NTER Manual)
- grandfathering provisions (paras 93-99 of the NTER Manual)
- research and development claims.

With respect to the range of contentious tax matters that the ATO NTER Administration Cell is considering, it was acknowledged that the tax treatment of capitalised labour was not settled and that there was some level of inconsistency in the tax treatment adopted by NTER taxpayers. While the ATO has its view that the costs should be capitalised, ongoing presentations and forums are planned to further consider this issue.

With respect to the second material tax matter, relating to the tax treatment of unbilled income, the ATO proposition is that “the derivation of the income generally occurs at the time of supply and the technology employed by a business to measure what is supplied should not be determinative of when income is derived. An actual reading of the meter is not necessarily required”.

To the extent that the final positions with respect to these issues is contrary to the current ATO positions, the NTER Working Party (including representatives of the DTF of each of the States) will need to consider how this is managed in terms of priority amendments of returns and consequential refunds of NTER tax collections.

Watching brief

One of the questions raised by PricewaterhouseCoopers at the NTER workshop was whether a review of the NTER regime was envisaged given the impending release of the Henry Review report, and the eventual impact of the reforms on the tax profiles of NTER entities and extent of State NTER collections. Peter Maher advised that the ATO NTER Administration Cell had not yet developed its thinking around this.

Stay tuned!

Tip:

Given the future focus of NTER reviews on book to tax reviews, greater care should be taken by NTER entities to ensure consistency in the tax adjustment disclosures reflected in the NTER returns lodged with the NTER Administration Cell. Work papers should also be prepared with a focus of providing an explanation of major book to tax differences and disparities with the prior year disclosures.

Fuel Tax Credits – opportunities for street sweepers for local councils

In recent months, local councils have received letters of warning that the that the ATO may be targeting for attention those Councils who are claiming Fuel Tax Credits.

ATO sources have confirmed some councils were visited in the past year as part of an educational piece to assist them with calculating their claims correctly but also confirmed the ATO has not highlighted Councils/ street sweepers as being a key audit focus area under its 2009/10 compliance review program.



Nevertheless, there are a number of issues to be taken into account when identifying eligible fuel use and calculating Fuel Tax Credits (FTC's) for street sweepers.

These include:

1. the type of sweepers (eg pavement/mall type sweepers, road/gutter sweepers)
2. the gross vehicle mass (GVM) of each type of sweeper
3. whether they are registered for use on a road
4. the type of fuel used in each sweeper (eg petrol, diesel, LPG), and
5. use of an appropriate claim methodology.

Most councils would be entitled to claim FTCs from 1 July 2006, with respect to some fuel used in their fleet of street sweepers. In addition, FTC entitlements may increase for some councils due to the expanded eligibility rules that came into effect on 1 July 2008.

Tip:

Is your works department identifying all eligible uses of fuel? Why not put together an FTC equipment eligibility template to help them?

Australian projects: Customs Duty Concessions

The Department of Innovation, Industry, Science and Research's AusIndustry division administers the Enhanced Project By-laws Scheme (EPBS). EPBS is a program that encourages the use of Australian industry in large capital works projects through providing duty concessions to applicants on imports of eligible goods for their project.

To qualify, projects must have a capital expenditure of over \$10 million and be in the mining, resource processing, food processing, food packaging, manufacturing, agriculture and gas supply industry, power supply or water supply industries.

To qualify for concessions, project proponents must lodge an application and an Australian Industry Participation Plan (AIPP) outlining how they intend to ensure that a full, fair and reasonable opportunity to tender for goods and services related to the project is afforded to Australian businesses. To obtain the concession, evidence of the provision of a full, fair and reasonable opportunity to tender must be provided in the form of an Implementation Report.

Government agencies are currently not eligible to participate in the scheme,

which seems to contradict one of AusIndustry's operating principles: 'protecting the taxpayer's dollar'. Through lobbying the Minister's office, government agencies could seek to have the scheme apply to local and state projects, provided they meet the capex threshold and can evidence a full, fair and reasonable opportunity to tender has been afforded to Australian industry. This should not prove to be a difficult task given that the Minister of Innovation announced in December 2009 that as of 1 January 2010, tenderers for Australian Government work will have to demonstrate how they'll give small and medium enterprises (SMEs) a fair go when bidding for major Government contracts.

Starting this year, all new contracts over \$20 million put out to tender will require the inclusion of an approved AIPP with any bid – setting out how suppliers will give SMEs full, fair and reasonable opportunity to supply goods and services.

The Rudd Government has already put the requirement for the AIPP in place, however government agencies currently do not receive the duty concessions that private industry

receives. In effect, this means that taxpayers will continue to pay millions of dollars in import duties for goods Australia needs to support infrastructure improvements and government projects.

It may be in the interest of government agencies to lobby for the same concessions that industry receives, given that the similar requirements for an AIPP are now in place in both the private and public sectors.



The EPBS is currently undergoing changes to ensure that the scheme is being effectively administered so that Australian industry and workers will get a fairer go at winning government and private sector contracts. Several new proposed measures to create a stronger industry participation framework are due to be put into place in 2010, following the review of submissions on the EPBS consultation paper which was published for public comment in September 2009. If government agencies are interested in receiving the same concessions that private industry receives for

preparing an AIPP, the there is no better time than the present to lobby the Minister of Innovation for these benefits.

Watching brief

The Federal Government's response to the Henry Review will be delivered on 2 May.

Keep a lookout for our overnight edition of *TaxTalk Business Tax Reform - Australia's Future Tax System Review*. To register for this publication click [here](#).



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