

ANGST UPDATE



Tony Evans - Editor

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GST & GOING CONCERNS

Developments in the interpretation of the law!

The tax office has now had a chance to look at the application of this GST-free concession and apply some interpretations both through interpretative decisions and private rulings. However, these decisions only confirm the view that using this concession should be avoided except where both parties are certain they have a going concern.

1. Everything necessary for the continued operation of the enterprise.

When applying for a private ruling, the ATO requires that you complete a checklist to ensure that all the information they need to assess the private ruling is provided. One of the questions in this checklist asks taxpayers to identify those things **not necessary** for the continued operation of the enterprise.

THE GST concession treats everything supplied as a single supply provided it is considered necessary for the continued operation of the enterprise. However anything not considered necessary will need to have GST separately charged on the supply.

The ATO ruling seems to be generous and generally takes the view that if the thing supplied assists in the operation of the enterprise, it will be GST-free. This means that many peripheral things can be supplied GST-free if you rely on the ruling. However this is not what the law actually requires. Basically it only

allows the GST-free concession to those things that are necessary.

By having to identify those things not considered necessary in order to get a private ruling, taxpayers will be flagging that those items are taxable supplies. Taxpayers should ensure that the sales contract enables them to charge GST on those items and that GST can be recovered from the purchaser.

Taking a literal view, many things that we would consider useful may not be considered necessary. We would assume that trading stock was always necessary. However in a recent private ruling we obtained, the ATO considered that undeveloped land earmarked and purchased for development was not part of a going concern in relation to the sale of a property development business. Whilst this land is equivalent to the raw materials of a manufacturing company held ready for use, it is apparently not necessary for the continued operation of the property development enterprise.

This view caused a major heartache for our client. This meant that GST had to be charged on a large parcel of land and it reduced the potential profit margin the developer could achieve from the development of that land. It led to additional stamp duty liabilities. It also led to difficulties and conflicts in settling the sale of the property development business.

Apparently the ATO is consistently taking this view where the items of trading stock relates to high value assets and it is also evident that they are missing out on GST. Is this view correct – we think not. If trading stock is not considered necessary then few things would be! However, quite often the taxpayer is unwilling to challenge the matter and the ATO collects the tax..

We therefore believe that the ATO should provide some guidance on what they consider to be necessary and what

they consider is not. This may need to be provided both in general terms and on a specific basis for particular industries. They should at least, on a reasonable basis, rule some things like trading stock in and provide guidance on what they believe is not essential.

We also suggest that the ATO provide a safe harbour by saying that if the acquisition is intended to be used for fully creditable purpose in the enterprise, it should be considered essential to the supply and be GST-free under the concession.

2. What rights do you have as a purchaser if the ATO says it is not a going concern?

In relation to the transfer of a going concern, the GST taxpayer is the vendor. There is usually very little incentive for them to use the going concern concession and when they do, they usually put caveats in the contract

About the Editor

Tony Evans is a Chartered Accountant who has extensive tax consulting experience over 20 years working in the profession including overseas experience working with VAT in the UK. A director of GuSTAX Consulting Pty Ltd, he was previously a partner with a boutique tax division in one of the mid-tier accounting firms in Melbourne. Tony's diverse tax specialisation's include: -

- GST
- Employment taxes
- Corporate Taxes
- CGT
- PAYG
- Expatriate Taxation

He is also recognised as an excellent communicator and trainer and has conducted numerous technical sessions for the ICAA and members of the profession.

He is the Victorian representative on the ICAA Tax CPE Committee and also a member of the ICAA Indirect Taxes Committee ♦

Q & A – Commonly asked GST questions

Q: Can some supplies in a sale of a business be sold as a going concern and other items sold as taxable, GST-free or input taxed supplies by the one entity?

A: As it is a condition of obtaining the “going concern” concession that everything necessary for the continued operation of the enterprise is supplied, all things that are necessary must be GST-free. You cannot choose to supply something that is GST-free as a taxable or other supply and the concession must be taken. So GST cannot be charged. Where things are supplied that are not necessary for the continued operation of the enterprise, the GST status of those items will need to be determined separately and GST charged as appropriate. This may include assets not installed ready for use, assets held in reserve as well as assets not used in the enterprise. Care will be required in identifying these.

Q: I want to sell the business as a going concern including the underlying property. Can I have a fall back position to apply the margin method if the sale of the business is subsequently held not to be a going concern or the property is not considered an item necessary for the conduct of the enterprise?

A: Yes you can but you need to hedge your bets properly. Firstly you need to ensure the contract gives you this fall back position. Secondly, where a valuation is required, there needs to be an appropriate valuation in place prior to the end of the tax period when the supply is made. Keep in mind that as the vendor has the liability for the GST, the purchaser will need to ensure that they have everything required and the purchaser can also force the vendor to make the appropriate election. ♦

to enable GST to be recovered should the supply be held by the ATO not to be a GST-free supply. As long as they can recover the money from the purchaser, they don't really care if the supply is GST-free or taxable.

Usually the supplier wants the supply to be GST-free. The reasons for this are abundant and include:-

- Saves cashflow
- Saves stamp duty
- May allow the application of the margin method to the subsequent supply of the property thus providing a greater profit to them.

However, as the purchaser is not the taxpayer in relation to the transaction, they cannot challenge the ATO decision to treat it as taxable when this occurs. The only party that can do this is the vendor. Without sufficient clauses in the contract, the purchaser cannot force the vendor to fight the decision that the transaction is not GST-free. On large transactions, this will put the purchaser at a significant disadvantage.

Should the vendor decide not to object to the ATO decision, the purchaser can do nothing. Even if the purchaser can get the vendor to object, it will be an expensive exercise as the vendor will only take action against the ATO should their advisors agree to the objection.

3. What is the mischief if some of the items supplied are useful but not necessary?

If the items will be used in the ongoing enterprise for full creditable purpose, there is no mischief. Division 135 sets out adjustment rules that apply to the purchaser where any part of a GST acquisition made under the going concern rules is not used to generate taxable or GST-free supplies.

Basically, the purchaser is required to determine the value of that part of the acquisition that will not be used for those purposes. They are then required to pay 10% of that value to the ATO as an adjustment event on the purchase of the going concern.

Furthermore, they must monitor the use they put the acquisitions to over time (for up to eleven years if the price of the going concern exceeded \$500,000) and make adjustments based on the level of supplies made that are not GST-free or taxable over that time.

If the going concern is used as a guise to hide the purchase (and sale) of an asset that is never intended to be used in the enterprise, then it cannot be essential. However this will be obvious in all cases and the vendor and purchaser will not include it in the sale. If they do, it will be caught by the adjustment provisions or the anti-avoidance provisions.

4. Obtaining private rulings

Clearly it is in the best interests of both the vendor and the purchaser to get a private ruling confirming that the supply is a supply of a going concern. We only recommend that these rulings are obtained where the following can be met:-

- You are reasonably confident of the outcome.
- There is a significant benefit in obtaining the concession other than the cashflow savings.
- There is a reasonable time period before the matter must be resolved so the ATO will be able to provide a timely ruling.
- The facts and the items being supplied are reasonably clear and easy to establish.

It should be remembered that the ruling will only be as good as the information supplied. If any information is inaccurate the ruling may give you no protection at all.

Also don't be surprised if you get a totally different answer from the ATO compared to what you expected. The recent ruling we obtained is in our view badly flawed at law and represents a view based on maximising the revenue take for the ATO. It was a very unsatisfactory result and virtually impossible to challenge as it was

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obtained for the benefit of the purchaser who has no right of appeal.

5. When should you use the going concern provisions?

In our view, there are many risks for both the vendor and the purchaser in using this GST concession. We would only recommend its use where the parties were absolutely confident that the supply is a going concern.

required in the use of this concession where other things are being supplied.

By way of demonstration, we have provided an example of a supply of a motel which includes the freehold. The purchaser wished to buy the property using the margin method in this case as they intended to demolish the premises and build residential premises for sale. However the motel was to be operated for a short period of time prior to the development.

GST & THE MARGIN METHOD

It has become apparent to us that many people still do not understand how the margin method operates and the care

1. The margin method applies to real property only!

While it may seem obvious, the margin method only applies to real property. This would include the land, the buildings and the building improvements. Basically included in

the real property are those items permanently affixed to the land.

What is not included in the real property are the following:-

- Depreciable assets
- The liquor licence
- Trading stock and consumables
- Goodwill and trading names
- Gambling licences
- Customer deposits & advance bookings

By implication, unless the going concern concession is being used, all of these items will need to be considered separately for GST purposes and GST may need to be applied.

There is some debate as to whether the premises can be sold under the margin method and the other items sold GST-free. If the premises are sold separately and the motel business was sold with a lease to the premises, this is possible. Where the premises are supplied as part of the one supply between two parties, the premises are necessary for the continued operation of the enterprise and will be GST-free. Therefore they cannot be supplied under the margin method.

2. What is the tax status of the other supplies?

Care will be required here. Whilst the easy conclusion is that everything else is taxable, this may not be the case. The trading stock may include food which is GST-free. You cannot charge GST on a GST-free supply as this is in breach of the law. So you will need to identify those supplies that are GST-free.

Similarly, are customer deposits an input taxed supply or a taxable supply. Is it an advance payment of revenue or profit or is it a deposit under Division 99 and not a supply at all?

As the supply of plant and equipment will be taxable supplies, the purchaser and the vendor will now need to agree

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the consideration applicable to these. This causes a major problem in contacts where both parties want to keep their options open in relation to the amount of the consideration allocated to these assets. The vendor will not want a recoupment of depreciation where as the purchaser wants the highest depreciation base possible. Well, when the margin method is used for the real property, the parties have no choice. They will need to work out the taxable portion of the supply for plant and equipment and any other asset.

3. Drafting issues with contracts?

Many contracts deal with the concept of one supply and not a multitude of supplies. This causes problems as it may sometimes be impossible to split the supply to correctly apply the margin method. Other contracts do not envisage that some of the other supplies may be fully taxable or GST-free. This may mean that there is no ability of the vendor to recover GST on these items.

4. Issues with valuations

There are still some valuers around that do not know how to complete a GST margin method valuation. Advisors and taxpayers should review the valuations carefully as a result.

Common mistakes include:-

- The valuation includes plant, equipment, licences, goodwill etc. The valuation must be in respect of the real property only.
- The valuation does not use the comparable sales method usually required and fails to justify why that method was not used and why the method used is more appropriate.
- The valuation is dated 30th June 2000 when it should be date 1st July 2000.

The ATO has cracked down on these valuations and a careful perusal of GSTR 2000/21 and the appendices is required when checking the bona fides of a valuation. ♦

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