

Are you entitled to a GST refund?

If your customers prepay you for your services and are not entitled to a refund if they ultimately don't take up the service, then a new court case opens the way for a potential GST benefit.

A large number of businesses, particularly those in the services sector, receive prepayments from customers for future services - in some cases these are deposits and in others, part or full payment for the anticipated service. Often the contract terms provide that there is no refund of the prepayment if, ultimately, the customer does not take up the service.

If the customer does not ultimately take up the service, what is the GST position on the prepayment?

Historically, much of the thinking was that despite the fact that the service was not ultimately supplied, the prepayment would still be in respect of a taxable supply and the vendor would account to the ATO for 1/11th of the sale price. Certainly this is the ATO view.

A recent case involving Qantas however has raised doubts over this treatment. The case related to non-cancellable pre-paid airfares where the customer did not turn up for the flight. In this case, they were not entitled to a refund of the fare so effectively Qantas received the consideration but never made a supply to the customer. Qantas applied for a refund of the GST from the ATO on the basis that no taxable supply had been made. The ATO disagreed with the position and the matter ended up in court.

In September this year, the Full Federal Court found in favour of Qantas. The court ruled that the supply for which the customer made the payment was for air carriage – the seat on the plane to be taken to their destination. Where this did not occur, there was no taxable supply, and hence no GST liability.

Applying these principles to other situations you need to look closely at the arrangements you have entered into with your customers and also the agreements or contracts covering the pre-payments they make to you. Where these agreements are that the service for which the prepayment is made is non-cancellable and there is no right of refund, and if subsequently the customer does not take up the service and the prepayment is forfeited, you may have a similar situation to Qantas. If there has been no taxable supply then perhaps no GST is payable.

There are a lot of scenarios and supplies to which this could apply. Before you get too excited it is worth noting that the Commissioner has applied for leave to appeal the decision to the High Court. So, there might be more to come on this.

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Christmas in July? The ups and downs of Christmas marketing

The Christmas decorations started going up in shops just after Father's Day in September. If it gets any earlier we'll be experiencing Christmas in July.

As many client focussed businesses know, Christmas has a psychology of its own. Christmas, and the embedded message of gift giving (code for 'spending'), is stretching well beyond the traditional Christmas months.

For retailers, the earlier they can get consumers into the Christmas spirit the more likely it is that they will 'spend up' in preparation – both in gifts and fixing up the home ready for entertaining. Sales and packaging also help impulse buying because "it was on sale."

As a consumer, with all of the Christmas lights, decorations and advertising around the shops it's hard not to think about Christmas.

While we won't deny the retailers any opportunity they can get, what happens to all the other businesses? For many, Christmas is a slow-down period. The longer the Christmas period stretches, the more sluggish sales become in the last quarter of the calendar year. Customers influenced by the Christmas spirit delay decisions or put off purchases "until the New Year."

If you're in this market take a close look at what you can do to pull sales forward before the New Year and the poor cash flow months of February and March. This might be a special offer or packaging, or payment plans to lock things in. Even if the sales don't eventuate this year, some clever and targeted marketing will give you a good base to start off in the New Year.

Are you entitled to a GST refund *continued*

In the meantime, and if you accept prepayments from customers, it might be worth having a look at your own facts and see how it lines up with the Qantas decision. You should take professional advice on this – the devil will be in the detail. We can review your position with you. Keep in mind too that there is a time limit on seeking GST refunds. You have 4 years from the relevant tax period. After that, even if you are entitled to a refund, you are out of time.

It makes sense to see whether you might have an entitlement, and then based on the advice you receive, give notice to the Commissioner of an intention to seek a GST refund. It is unlikely that the ATO will act on any requests until the legal position is finally resolved. Once they are on notice though, your position is protected.

Buying a business: More than just the sale price

If you thought reaching an agreement on price was difficult, wait until you get to the fine details of buying or selling a business.

So you've reached an agreement on price. But, there are differences between the parties on how the sale price should be apportioned across different assets.

A solution that's sometimes proposed is to simply show the sale price on the contract and let both sides manage their own apportionment but this depends on what assets you are buying. Try and avoid this trap.

In a typical business you might be buying plant and equipment, goodwill and stock. These assets will have different tax treatments and this is why there are differences between the way a vendor and buyer wish to allocate the price.

The goodwill is a capital asset. The vendor will calculate a capital gain or loss on the sale of the business. Even with a capital gain they may be able to reduce the tax to nil using the CGT small business concessions. For the purchaser, there is no tax deduction on the purchase of goodwill; it becomes a capital asset and a tax offset will only be available if and when the business is later disposed of.

The plant and equipment is also a capital asset. The vendor will account for their tax position on these assets based on their written down value. Where the assets have been substantially depreciated there will be more of an income adjustment. For the purchaser, the plant is normally a depreciable asset and will be written off over its effective life. So, you get a tax write-off but it takes time.

The stock is on revenue account. For the vendor, they will account for the stock in their assessable income in the year of sale. For the purchaser, the stock is deductible as it is sold.

With this mix the tendency is for vendors to want to push more of the sale price into the goodwill as it will create a better tax outcome for them. Purchasers will want to take full value in the stock and plant as this will give a faster tax write-off. For the purchaser, this may be about timing of the tax benefit; over time it may equalise, although there are circumstances where tax benefits can be lost.

Try to avoid the position where the contract is silent on the apportionment of the price and both parties make up their own minds. The Tax Office has a strong data matching capability and where they detect a difference between how the price was accounted for by the parties this is likely to trigger further investigation. The price should be apportioned on a fair market value basis and the ATO does have the power to allocate price where they believe there has been an artificial apportionment to achieve a tax benefit.

While they can do this even where the contract shows the apportionment, they are less likely to take this step where the parties are dealing at arms-length.

So, it's worth working through an agreement on price. It could save some later tax headaches.

Quote of the month

*"Commitment is an act,
not a word."
Jean-Paul Sartre*