27 October 2014

Dr Ian Walker
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ACTON ACT 2601

Dear Ian

Re: ATO Residential Colleges GST Tool
Colleges that have failed to report bundled student meals

You have asked for advice on the circumstances in which colleges and halls (**Colleges**) that have elected to use the ATO's *Residential Colleges GST Tool* (**GST Tool**) to determine how much Goods and Services Tax (**GST**) to remit to the Australian Taxation Office (**ATO**), have a taxation liability if they fail to report bundled student meals to the Tool.

This issue does not apply to self-catered Colleges. It only has potential application to Colleges that are partially or fully catered.

Catered colleges potentially exposed to this issue are those that have elected to use the GST Tool and have answered '**No**' to question 17 in the contracts worksheets in cases where students are subject to mandatory charges for meals.

These Colleges will generally have to pay back to the ATO the over claimed input tax credits (**ITCs**) plus interest. They run the risk of penalties if subject to a GST audit by the ATO.

Colleges with a GST liability under this issue are encouraged to timely enter into voluntary disclosure with the ATO to obtain a reduction in penalties otherwise applicable.

Colleges caught up in this issue that have engaged in accommodation related capital works projects or capital refurbishments (such as to communal bathrooms) over the past decade or more, should give this matter urgent attention as the unpaid GST liability could be material.

This advice helps Colleges determine if they have an exposure to this issue, how to quantify the exposure and what to do about it.

For convenience throughout the remainder of this advice the issue facing catered colleges that have failed to report their bundled meals at question 17, is referred to as the '**Question 17 issue**'.

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1. Background to the GST Tool

The GST Tool is an ATO product that Colleges may elect to use to work out the net amount of GST to remit to the ATO in each taxation period. It was developed by the ATO in consultation with the residential colleges sector over the 2005 through 2008 years inclusive. University Colleges Australia (**UCA**) provided funding and support for these consultations.

The GST Tool was first released on an official basis by the ATO on 5 January 2009 and applies to supplies by Colleges attributable to taxation periods commencing on or after 1 January 2009 and ending on or before 31 December 2016.

There have been various versions of the GST Tool, the most recent of which was issued by the ATO on 15 October 2014 and that only applies to the 2015 and 2016 calendar years.

2. What to do if your college has not received the most recent version of the GST Tool

The ATO no longer provides written advice via regular mail to Colleges, regarding the GST Tool. The most recent version of the GST Tool was distributed electronically and not via regular mail with enclosed CD as was done for the earlier releases. Some Colleges have not received the most recent version of the GST Tool.

If your College has not received the most recent version of the GST Tool and the related *Instruction Guide* (the ones issued 15 October 2014), where the ATO makes clear its position on the Question 17 issue, you may obtain one (along with any future advice to be provided electronically by the ATO regarding the GST Tool) by sending an email with the subject heading "GST Tool" to the ATO at the following email address:

ITXR&IGovt/NFP@ato.gov.au

In the body of the email to the ATO it is recommended you:

- provide a general email address for the College or university finance/taxation section as an individual-specific email address may become obsolete due to College or university staff changes;
- advise the full legal name and ABN of the College; and
- ask for a copy of the *GST Tool 2015 and 2016* (Excel 2010) and the related *Instruction Guide* (NAT 72724-10.2014) to be supplied to you via return email.

The ATO will also, on request, either email you or mail to you via regular mail (with enclosed CD if necessary):

- any of the earlier versions of the GST Tool and the related *Instruction Guides*; and

- any of the past letters the ATO has sent to you regarding the GST Tool, being their letters dated:
    - 5 January 2009;
    - 30 July 2009;
    - 8 February 2011;
    - 16 December 2011;
    - 1 February 2012;
    - 9 July 2012; and
    - 10 December 2013.

It is recommended Colleges keep on file copies of all past correspondence from the ATO regarding the GST Tool and all past CD copies of the GST Tool provided by the ATO. If you do not have a complete file on these documents/CDs you may follow the above instructions to request them directly from the ATO.

Colleges should not be concerned about making contact with the ATO to request their name be added to the relevant ATO list to be provided electronically with future information and updates regarding the GST Tool. The ATO already has a complete database with contact details for all Colleges nationally. Avoiding contact with the ATO will not in any way reduce the likelihood of your College being subject to a future tax audit.

Colleges that do have concerns about making direct contact with the ATO may contact us directly and we will provide you at no charge with the relevant documents/CDs without providing your details to the ATO.

3. How to determine if your College has an exposure under the Question 17 issue

For your College to have an exposure under this issue the college must have elected to apply the recommendations of the GST Tool for supplies attributed to a tax period ending on or after 1 October 2010 and during some or all of that tax period the College:

- must have applied a mandatory charge for the contracted supply of meals to a student in residence;
- not included that charge when calculating the answer to question 7 (to do with the fee charged) in the relevant contract worksheet of the GST Tool;
- not included the meals subject to the mandatory charge when providing the answers to any of questions 17 to 23 (to do with meals) in the relevant contract worksheet of the GST Tool; and
- remitted a lower net amount of GST to the ATO than would otherwise have been payable had all of the above questions been answered correctly.

For a catered College a simple way to determine if there may be an exposure to the Question 17 issue is to check that Question 17 has not been answered as '**No**' where there are meals supplied and where the meals part of the charge is or was mandatory, for any of the completed GST Tools for calendar years 2010-14 inclusive.

If your College is exposed to the Question 17 issue it is important you determine the extent of the actual or contingent taxation liability now faced by the College and take appropriate and timely steps to bring the College into compliance with its obligations under the GST law. The remainder of this advice will guide you through that process.

4. Where does the ATO say it is mandatory to declare bundled meals to Question 17?

For reasons provided below, Colleges electing to use the GST Tool have always been required to report all mandatory student charges to the GST Tool. If meals form part of the mandatory charges this amount must be included in the answer to question 7 and question 17 must be answered as '**Yes**', in the contracts worksheets.

The various official versions of the GST Tool *Instruction Guide* (ATO Publications NAT 72724-11.2008 and subsequent) (***Instruction Guide***) issued since November 2008 have all made it clear that all mandatory charges must be declared to Question 7.

To put this matter beyond any doubt (not that it ever has been) the ATO instructions in the *Residential Colleges GST Tool 2015 and 2016* as released nationally by the ATO on 15 October 2014, state in both the Excel comment box (hover your cursor over the little red triangle in the GST Tool contracts worksheet) and in the *Instruction Guide* (see pages 17 & 19) in relation to Questions 7 and 17:

> ***Question 7***
>
> *Type the fee for the full year, including mandatory charges, that residents are required to pay.*
>
> *The fee to be used is the full amount (GST inclusive). If meals form part of the mandatory charges, this amount must be included and Question 17 must be answered as **Yes**. ..*
>
> *..*
>
> ***Question 17***
>
> *If meals form part of the mandatory charges, you must answer **Yes**.*

Furthermore page 5 of the GST Tool *Instruction Guide* states:

How does the tool work?

The tool apportions the total fee under a contract into amounts that relate to the following supplies, if applicable:

- *accommodation*
- *meals*
- *tertiary residential college courses.*

The *Instruction Guide* makes it clear that the GST Tool undertakes the apportionment of the total fee – this is not something that the College can do and then only declare a residual part (the accommodation) of the total fee to the Tool.

There is a simple and obvious reason bundled meals must be declared to Question 17. To have it otherwise would give Colleges a free pass to in nearly all cases avoid input taxation of student accommodation, regardless of the circumstances of the supply. Clearly this was not the intent of the legislation and it has never been agreed to by the ATO.

It is untenable to argue that earlier releases of the GST Tool *Instruction* Guide (to that released by the ATO on 15 October 2014) did not make it sufficiently clear that bundled meals must be declared when answering Question 17.

It is considered unlikely the ATO will accept this line of argument as an excuse for Colleges to be exempted from having to repay all of the GST (plus interest) that would otherwise have been payable.

5. Failure to declare meals to Question 17 – an example of a case which is non-compliant

An example of circumstances where a failure to declare meals to Question 17 is in clear breach of the ATO's instructions for using the GST Tool, is provided below.

Example A: College "A" charges each of its students $15,000 for a 40-week contract to reside in the College on a fully-catered (21-meals per week) basis. For all students the meals part of the fee is compulsory. The College provides no 'tertiary residential college course'(s) as defined in the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (**GST Act**).

The College elects to adopt the recommendations of the GST Tool for the year in question.

The College examines its accounts, prepares a detailed costing of how much it costs to prepare and supply each contracted student meal and concludes this cost is $6.00 per meal.

The College then determines on the basis that each student is entitled to receive 840 meals during the contract period (calculated as 40 * 21), that the meals part of the bundled fee is $5,040 (calculated as $6.00 * 840) and the accommodation part of the bundled fee is the balance of $9,960.

The College then decides it will not declare its bundled meals to Question 17. It answers (incorrectly) 'No' to Question 17 and answers (incorrectly) $9,960 to Question 7.

The College remits GST on meals to the ATO in the amount of $458.18 (calculated as $5,040 / 11) and asserts on the basis of the results under the GST Tool (where it answered 'No' to Question 17) that the student accommodation part of the supply is GST-*free*.

The above approach is clearly in breach of the ATO's instructions for the use of the GST Tool.

What the College should have done is to declare the bundled meals to Question 17, answered Questions 18-23 and answered $15,000 to Question 7.

If that means the meals part is taxable and the accommodation part is input taxed then that is the basis upon which the College must calculate the net amount of GST to remit to the ATO under the recommendation of the GST Tool.

6. Are there exemptions to the requirement to declare meals to Question 17?

Meals that are not bundled and that do not attract a mandatory charge, do not need to be declared to Question 17. Certain types of variable meal plans do not need to be declared to Question 17.

Example B: College "B" charges it students in a particular wing $14,000 for a 40-week contract to reside in the College on a self-catered basis. Each of the student rooms contains a fully equipped kitchen the student may use to prepare his/her own meals.

College "B" has another wing where it charges its students $20,000 for a 40-week contract to reside in the College on a fully-catered (21 meals per week) basis. None of the student rooms in this catered wing contain any cooking facilities and there are no communal kitchens these students have access to for purposes of preparing their own meals. The College prepares the meals for these students and they dine in a communal dining room.

The students under the $20,000 fully catered contract are not permitted to opt out of the meals part of the contract and adopt the variable meal plan.

The student rooms in the self-catered wing contain en-suite bathrooms and are air-conditioned. The student rooms in the catered wing have communal bathrooms and are not air-conditioned.

The College decides to offer a variable meal plan to the students in the self-catered wing.

Under the variable meal plan the relevant students may purchase a smart card and take meals in the main dining rooms whenever they wish on a pay-as-you-go basis for a GST-inclusive fee of $10.00 per dinner or $6.00 per lunch or breakfast. The meal charges are just added to the student's account with the College based on the number of meals consumed. There is no contractual obligation on the self-catered student to take any meals in the main dining room and they only pay for the dining room meals they elect to attend.

The College elects to adopt the recommendations of the GST Tool for the year in question.

In these circumstances the College would have one contract in the GST Tool for the students in the self-catered wing and a different contract for the students in the fully catered wing.

The College must declare its meals at question 17 in the contract for the students in the fully catered wing but must not declare its variable meal plan meals at question 17 in the contract for the students in the self-catered wing.

In some extremely limited circumstances and preferably with the prior consent of the ATO it may be permissible to not declare bundled meals to Question 17.

One of these exceptional circumstances is where the college operates material numbers of both catered and self-catered rooms and where the two different room types and their contract terms are identical (this requirement being crucial) in all respects except for the catering.

Example C: College "C" charges it students in a particular wing $8,000 for a 34-week contract to reside in the College on a self-catered basis. The students in this wing have access to a communal fully-equipped kitchen and dining room and appropriate separately lockable (for each student) food storage/refrigeration facilities.

College "C" has another wing where it charges its students $15,000 for a 34-week contract to reside in the College on a fully-catered (21 meals per week) basis. The College prepares the meals for these students and they dine in a

communal dining room separate to the one for the self-catered wing. For the students in this wing the meals part of the fee is compulsory.

The student rooms in the self-catered wing are identical in all respects to the rooms in the fully-catered wing. The rooms are in both cases of the same size, have communal bathrooms, have no in-room cooking facilities, have no air-conditioning and otherwise have the same overall level of amenity, furnishings and décor. In both cases the same sporting facilities, internet, utilities and car parking are provided for no additional charge.

The College elects to adopt the recommendations of the GST Tool for the year in question.

In these exceptional circumstances it may be permissible for the College to **either**:

- have one contract in the GST Tool for the students in the self-catered wing and a different contract for the students in the fully-catered wing with the meals supplied to the students in the fully-catered wing being declared to Question 17. The Question 7 answer would be $8,000 for the self-catered wing and $15,000 for the fully-catered wing; **or**
- have only one contract in the GST Tool for both the self-catered wing and the fully-catered wing with the meals supplied in the fully-catered wing not being declared to Question 17. The Question 7 answer would for both wings be $8,000. The College would assess the meals part of the bundled fee for the fully-catered wing, to be $7,000 calculated as $15,000 - $8,000.

Given the approach of not declaring the bundled meals to Question 17 in this extreme case would clearly be contrary to the instructions in the GST Tool *Instruction Guide* and given it could potentially distort results under the GST Credits worksheet part of the Tool (if input taxation is recommended) this approach should not be adopted without prior written consent from the ATO.

In all except the above extremely limited circumstances it is mandatory to declare bundled meals to Question 17.

We would be pleased to provide written advice (free of charge to UCA members) on the issue of whether or not it is acceptable in the particular circumstances applying at an individual College, to not declare bundled meals to Question 17. Additional advice or advice to other than UCA members, would be chargeable at our normal rates.

Colleges may also if they wish approach the ATO directly for advice on their particular circumstances on whether or not it is mandatory to declare bundled meals to Question 17, by telephoning the ATO on (07) 3213 8650.

7. How to work out the extent of the GST liability under the Question 17 issue

Colleges that have failed to report their bundled meals under any of questions 7 and 17-23 inclusive, run the risk that when these meals are reported the GST Tool's characterization of their student accommodation supply may switch from being GST-*free* to being input taxed, thereby:

- denying the College an entitlement to certain of the ITCs previously claimed from the ATO; and
- making the College liable for increasing GST adjustments (payments to the ATO) under the provisions of Division 129 of the GST Act (which in cases where there have been major capital works or capital refurbishment projects over the past decade or more may result in major additional liabilities to the ATO).

Further, when Colleges report their bundled meals to the GST Tool they may find the Tool assesses the contracted student meals are taxable but that the amount of GST that must be charged on each student meal is lower than the amount of GST the College has previously determined must be charged on the meals.

Any GST overcharged on meals (excess GST) cannot be claimed back from the ATO unless it is first refunded to the students concerned so to the extent that GST was overcharged on meals it cannot be netted against ITCs over claimed in the same BAS. Colleges are not permitted to (after the event) make windfall gains from over-charging GST on taxable supplies such as meals.

To work out the extent of the GST liability update the previously completed GST Tools for all of the calendar years 2010 through 2014 inclusive in which there has been misreporting of meals and for all taxation periods commencing on or after 1 October 2010 calculate the relevant adjustments (inclusive of those due under Division 129) to label 1B of the BAS returns.

We would be pleased to provide written advice under our normal schedule of fees to any Colleges subject to the Question 17 issue and that wish to determine the full extent of their liability to the ATO arising from this issue (inclusive of Division 129 liabilities).

8. Potential flow on consequences under GST Division 129 from the Question 17 issue

Where a College has an exposure under the Question 17 issue there are potentially adverse flow on consequences that can occur under Division 129 of the GST Act.

In relation to Division 129, page 8 of the *Instruction Guide* for the GST Tool states:

> *If the GST outcome for supplies of accommodation differs to the GST outcome for the same supply for a previous year, the residential college will need to examine the change in the extent of creditable purpose (Division 129 of the GST Act) for relevant prior capital acquisitions in accordance with relevant goods and services tax rulings, determinations, fact sheets and guides. This may result in the residential college having to make an increasing or decreasing adjustment in relation to GST credits claimed for these acquisitions.*

Section 129-1 of the GST Act states:

> ***129-1 What this Division is about***
>
> *The extent to which an acquisition or importation is for a creditable purpose affects the amount of the resulting input tax credit. When the extent of creditable purpose is changed by later events, adjustments (for the purpose of working out net amounts under Part 2-4) may need to be made.*

The operation of Division 129 is explained in more detail in ATO Goods and Services Tax Ruling GSTR 2006/4: *determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose* (**GSTR 2006/4**). As of 27 October 2014 a copy of GSTR 2006/4 could be obtained from the ATO web site at:

http://law.ato.gov.au/atolaw/view.htm?docid=GST/GSTR20064/NAT/ATO/00001

Division 129 operates to ensure that if a GST registered entity that has claimed the input tax credits associated with a creditable acquisition subsequently experiences a change in the extent of creditable purpose on the acquisition (such as when the accommodation switches from being GST-*free* to being input taxed) then the entity can be required to repay to the ATO some of the input tax credits previously claimed.

Capital acquisitions for a GST-exclusive amount of $500,000 or more can be subject to ten annual adjustment periods (fewer adjustment periods apply for acquisitions below this threshold) under Division 129 – the result being that if a College has made a large capital acquisition in the past 10 years or more and has claimed back the GST on that acquisition then switching from GST-*free* to input taxed accommodation can result in a requirement to repay to the ATO part of the GST previously claimed. Division 129 adjustments can be either to or from the ATO depending upon the circumstances.

Division 129 does not apply where the GST characterization of the original capital acquisition was incorrect and the error is now beyond the reach of the Commissioner due to the four-year rule that limits the time in which the Commissioner may amend a BAS return.

For example, if the College originally claimed claimed back in error or without a proper basis from the ATO the GST paid on the construction of a new wing five years earlier and if the BAS return in which the claim was made is now beyond the reach of the Commissioner under the four-year rule, then Division 129 increasing adjustments cannot apply if the accommodation supply in the new wing is subsequently input taxed.

Where the GST characterization of the original capital acquisition was correct then Division 129 adjustments can in certain circumstances apply for ten years or more after the date of the tax invoice of the original capital acquisition.

Colleges that have an exposure under the Question 17 issue and that have also engaged in the construction of new accommodation wings or that have engaged in substantial capital works projects such as (for example) refurbishing communal bathrooms at any time over the past ten years, can have potentially major (adverse) exposure to Division 129 increasing adjustments. It is important these Colleges quantify the extent of their overall exposure to the Question 17 issue as it may be major.

GST Division 129 annual compliance can be onerous – particularly where there have been a large number of accommodation related capital acquisitions for amounts of more than $1,000 GST-exclusive each, over the past decade or so.

To calculate the amount of Division 129 adjustments Tertiary Balance Pty Ltd has developed a proprietary product known as the *Division 129 Calculator*. This product was first released in 2009 and has been subject to on-going product development and investment over the past five or more years. It is designed to operate in conjunction with the ATO GST Tool.

We would be pleased to advise affected Colleges (at our scheduled fees) on the extent of any GST Division 129 liabilities they may have arising from the Question 17 issue.

9. Should Colleges subject to the Question 17 issue engage in voluntary disclosure

A voluntary disclosure to the ATO does not relieve the taxpayer of an obligation to the pay the correct amount of tax (GST in this case), but it does give a reduction in penalty otherwise applicable.

The *Instruction Guide* for the GST Tool does provide for certain concessions in relation to the application of penalties when Colleges elect to use the GST Tool. Specifically clauses 3.2 and 3.3 of the GST Tool License Agreement at page 6 of the *Instruction Guide* provide that:

> ***3.2*** *If you follow our information in the residential colleges GST tool and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.*
>
> ***3.3*** *If you make an honest mistake in trying to follow our information in the residential colleges GST tool and you owe us money as a result, we will not charge you a penalty. However, we will ask you to pay the money, and we may also charge you interest.*
>
> [underlines added]

The ATO assert there was nothing incorrect or misleading in any of their various official GST Tool *Instruction Guides* issued on or after 5 January 2009, in relation to their instructions that if meals form part of the mandatory charges this amount must be included in the answer to question 7 and question 17 must be answered as '**Yes**'.

At page 7 of the *Instruction Guide* the ATO invited Colleges that had any questions about the GST Tool to phone them on (07) 3213 8650 or to write to them at the address provided.

Given the unambiguous nature of the instructions in the *Instruction Guide* and the ATO invitation to take phone calls or respond to letters to answer any questions about the GST Tool it would be risky, in our view, for Colleges that failed to report their bundled meals to the GST Tool to assume the ATO will accept the Colleges or their advisors just made an honest mistake.

Although the ATO has a history of taking a generally concessionary approach to the application of penalties in the charitable sector (of which the Colleges are part) we nevertheless consider it prudent for Colleges with liabilities under the Question 17 issue, to operate for the time being on the assumption that penalties will apply.

In nearly all cases Colleges that have failed to report their bundled meals to the GST Tool are likely to be regarded as having made a false or misleading statement that has resulted in a shortfall amount of tax. This is best shown by way of an example.

Example D: The facts of the case are the same as for Example A above with the added factor that there are 300 students, where the College charges each of its students $15,000 for a 40-week contract to reside in the College on a fully-catered (21-meals per week) basis.

For all students the meals part of the fee is compulsory. The College provides no 'tertiary residential college course'(s) (as defined in the GST Act),

The College elects to adopt the recommendations of the GST Tool for the year in question.

The College decides it will not declare its bundled meals to Question 17. It answers 'No' to Question 17 and answers $9,960 to Question 7 (when in fact it should have answered $15,000 to Question 7 and should have answered 'Yes' to Question 17 and then answered all of Questions 18-23).

The College remits GST on meals to the ATO in the amount of $458.18 (calculated as $5,040 / 11) per student and (incorrectly) asserts on the basis of the results under the GST Tool that the student accommodation part of the supply is GST-*free*. The College incorrectly remits $137,454 (calculated as $458.18 * 300) to the ATO as GST on meals and claims all ITCs on things acquired to make the student accommodation supply.

Had the College answered Questions 7 and 17-23 correctly the GST Tool would have advised that the meals part of the bundled supply was taxable and was $4,000 GST-inclusive (of which $363.64 is GST calculated as $4,000 / 11) and that the accommodation part of the bundled supply was input taxed and was $11,000.

The College should have remitted $109,091 as GST on meals, it should not have claimed back from the ATO a total of $95,000 in ITCs on things acquired to make the input taxed accommodation supply and finally it should have made a GST Division 129 increasing adjustment in the June BAS for $55,000 to account for the change in the GST outcome on the student accommodation supply from one year to the next (consistent with page 8 of the GST Tool *Instruction Guide*).

In effect by paying an additional amount of $28,363 (calculated as $137,454 – 109,091) in GST on meals the College has (incorrectly) avoided remitting an additional net amount of $150,000 (calculated as $95,000 + 55,000) in GST to the ATO.

In these circumstances the College has made a false or misleading statement that has resulted in a shortfall amount of tax (expressed in this case as a shortfall net amount of GST) of $121,637 (calculated as $150,000 – 28,363).

The gross shortfall amount of GST plus interest is payable to the ATO in the amount of $150,000 because the College cannot claim a refund on the $28,363 GST over remission on meals until after all the students concerned have each been refunded the $94.54 (calculated as $28,363 / 300) in GST over charged on meals. Windfall gains on GST over-remitted on taxable supplies are not permitted.

The application of penalties for making false or misleading statements that result in shortfall amounts is governed by ATO Practice Statement Law Administration PS LA 2012/5 (**PS LA 2012/5**). As of 27 October 2014 a copy of PS LA 2012/5 could be obtained from the ATO web site at:

http://law.ato.gov.au/atolaw/view.htm?DocID=PSR/PS20125/NAT/ATO/00001

There is a safe harbor exemption (see paragraphs 39-43 of PS LA 2012/5) where the taxpayer and their tax agent (if relevant) took reasonable care in making the false or misleading statement. The meaning of the phrase 'reasonable care' is explained (see paragraphs 40-49).

Engaging a tax agent does not, of itself, discharge the taxpayer's obligation to take reasonable care (see paragraph 50). A higher standard of care applies to tax agents (see paragraph 55) and also applies where the shortfall amount is substantial (see paragraph 47).

For Colleges that have failed to report their bundled meals to the GST Tool under advice from a tax agent or for Colleges where the shortfall amount is substantial we question whether the safe harbor exemption to penalties would apply, given the higher standard of care that is applicable.

For these purposes a shortfall amount in excess of $100,000 we think would be 'substantial' for purposes of paragraph 47. A shortfall amount in excess of $100,000 would be easy for any medium sized College to run up where the Question 17 issue applied to multiple years.

Colleges with the largest shortfall amounts will be those that have incorrectly claimed the GST on an accommodation related construction project as a result of the Question 17 issue. For example if the College in Example D above built a new accommodation wing in the year in question for $11,000,000 GST-inclusive and then incorrectly claimed the $1,000,000 in GST paid on the construction. Or if there were a large Division 129 event arising in the year in question, from a capital works accommodation project undertaken in the past decade.

PS LA 2012/5 provides guidance on how the ATO determines how much penalty applies in which cases (see paragraphs 77-110). Penalties are greater for intentional disregard of a tax law or for recklessness, than for a failure to take reasonable care (see paragraph 99).

In our view penalties in the Question 17 issue cases are unlikely to be any more onerous than those that apply for 'failure to take reasonable care' or 'recklessness' – but these penalty rates can still be material given the base penalty amount under the 'reasonable care' heading is 25 per cent and under the 'recklessness' heading is 50 per cent of the shortfall amount.

Importantly there are major reductions in these penalties for voluntary disclosure by the taxpayer (see paragraphs 135-154). If the voluntary disclosure is made before the taxpayer is notified by the ATO of a tax audit the reduction is 80 per cent and if made after being

notified of a tax audit the reduction is 20 per cent. It is obviously preferable to disclose before being notified of a tax audit.

There is a ruling on voluntary disclosures and how they impact upon administrative penalties – which is ATO Miscellaneous Taxation Ruling MT 2012/3: *administrative penalties: voluntary disclosures* (**MT 2012/3**). As of 27 October 2014 a copy of MT 2012/3 could be obtained from the ATO web site at:

http://law.ato.gov.au/atolaw/view.htm?DocID=MXR/MT20123/NAT/ATO/00001

Colleges with an exposure under the Question 17 issue and that have acted under advice from a tax agent or where the shortfall amount is above $100,000 (the cases where we consider there is a risk of penalties) are advised to consider voluntary disclosure (prior to any tax audit) to take advantage of the (generous) 80 per cent reduction offer from the ATO.

We consider it important Colleges with a Question 17 issue do not try to hide or conceal their circumstances from the ATO. The ATO has contact details for all affiliated and university owned Colleges nationally and is more than capable of identifying and pursuing all of the Question 17 shortfall amount cases in due course.

The Commissioner has the power to remit all or part of any residual penalties left whether after voluntary disclosure or otherwise (see paragraphs 155-196 of PS LA 2012/5). There are various grounds under which penalties can be remitted.

Colleges that have entered into a voluntary disclosure will in our view likely obtain full remission of any residual penalties. Where there has been no voluntary disclosure before a College with an exposure under the Question 17 issue is notified by the ATO of a tax audit, we consider there is a material risk there would not be full remission of penalties.

We would be pleased to advise affected Colleges on a fee basis on the benefits and mechanics of voluntary disclosure and on any subsequent application(s) for remission of penalties and general interest charges (see below) that may be needed, in these cases.

10. Will Colleges subject to the Question 17 issue be subject to general interest charge

The ATO punitive general interest charge (**GIC**) applies to shortfall amounts as well as to any penalties that have been applied by the ATO.

The ATO will not charge a College GIC in certain circumstances where the ATO provides information about the GST Tool that is incorrect or misleading and the College makes a mistake as a result and ends up owing money to the ATO. Provided the College *acted reasonably and in good faith* in these circumstances GIC will not be applied (see Clause 3.2 of the GST Tool License Agreement at page 6 of the *Instruction Guide* provided earlier).

The ATO does not consider it has provided information on the Question 17 issue that is incorrect or misleading. The GIC exemption at Clause 3.2 of the License Agreement therefore does not apply in these cases.

Where a College makes an '*honest mistake*' in trying to follow the information in the GST Tool *Instruction Guide* and ends up owing the ATO money as a result the ATO states the tax will remain payable but leaves open the possibility that GIC might not be applied (see Clause 3.3 of the GST Tool License Agreement at page 6 of the *Instruction Guide* provided earlier).

As noted earlier, given the unambiguous nature of the instructions in the *Instruction Guide* and the ATO invitation to take phone calls to answer any questions about the GST Tool or to reply to letters it would be risky, in our view, for Colleges that failed to report their bundled meals to the GST Tool to assume the ATO will accept the Colleges or their advisors just made an honest mistake. That is, it would be risky in this case to assume the ATO will not apply GIC.

The GIC is calculated for the taxpayer by the ATO after amended BAS returns (to address shortfall amounts) are lodged. In some (limited) cases it may be possible to address (small) shortfall amounts by amending a future BAS return in which case no GIC applies.

For Colleges with an exposure to the Question 17 issue and wishing to calculate how much GIC they might be subject to, the GIC daily compounding rate with effect from 1 October 2014 and expressed on an annual basis is 9.63 per cent. The GIC rates for all periods from July 1999 to the present were as of 27 October 2014 available on the ATO web site at:

https://www.ato.gov.au/rates/general-interest-charge-(gic)-rates/

The Commissioner may remit all or part of the GIC where the Commissioner considers it fair and reasonable to do so. The extent of any remission granted must take into account the individual circumstances of a case.

ATO Practice Statement Law Administration PS LA 2006/8: *remission of shortfall interest charge and general interest charge for shortfall periods* (**PS LA 2006/8**) covers GIC remission. As at 27 October 2014 PS LA 2006/8 was available on the ATO web site at:

http://law.ato.gov.au/atolaw/view.htm?Docid=PSR/PS20068/NAT/ATO/00001&PiT=99991231235958

Colleges with an exposure under the Question 17 issue and that have entered into a voluntary disclosure before being notified by the ATO of a tax audit, will in our view have a better chance of obtaining GIC remission than those that have not.

We are unsure whether any GIC remission will be granted, even in cases of voluntary disclosure (for shortfall amounts under the Question 17 issue). It is considered likely GIC will apply in all of these cases.

11. Can Colleges subject to the Question 17 issue retrospectively opt out of the GST Tool

Use of the GST Tool by Colleges is not mandatory. The ATO has previously advised that Colleges may retrospectively opt out of the GST Tool for a given year in which it was permissible to elect to use the Tool to calculate the amount of GST to remit to the ATO.

If a College has an exposure under the Question 17 issue, one option open to the College is to opt out of use of the GST Tool for the year(s) to which the exposure relates.

In these circumstances the College would have to retrospectively apply the guidance from the Commissioner that is contained in the ATO Charities Consultative Committee Resolved Issues Document (**CCCRID**) and in other relevant rulings and determinations such as GSTR 2001/1, GSTR 2001/8, the Commissioner's letter to University Colleges Australia dated 5 May 2005 (reference GST/DAN/4128739) and GSTD 2013/4. As of 27 October 2014 the CCCRID could be obtained from the ATO web site at:

http://law.ato.gov.au/atolaw/view.htm?locid=%27GII/GSTIICC2/NAT/ATO%27&PiT=99991231235958

Where the College could not qualify the student accommodation supply as GST-*free* under the cost of supply test at subparagraph 38-250(2)(b)(i) of the GST Act the College could still seek to qualify the supply as GST-*free* under the market value test at subparagraph 38-250(1)(b)(i) of the Act, under the CCCRID guidance.

One potential difficulty with application of the student accommodation market value test under the CCCRID guidance and applying the test to past years is that relevant comparable market rental evidence from prior years may no longer be available. The further back in time one goes the more difficult this issue of stale evidence becomes.

Some of the valuations firms maintain historical databases of market rents in the student accommodation sector of the market and may possibly for some states or territories be able to supply certified valuations with a valuations date in a past year. These firms include Colliers, Urbis and Jones Lang La Salle.

Colleges can make their own assessment of market value for a prior year under the CCCRID guidance (and self-assess on that basis) but without access to professional valuations advice and an authoritative database of past comparable market rental evidence this approach could entail considerable taxation compliance risk.

There would be nothing stopping a College wishing to pursue this path from either appointing a professional valuer or alternatively making its own assessment of market rental value for a past year and then submitting a GST Private Ruling request to the Commissioner to confirm or otherwise the GST status on the accommodation part of the bundled supply in the earlier year(s).

Where a College adopted this approach and did not seek a GST Private Ruling the position may well be that the College ends up with an uncertain taxation position for the year(s) in question.

12. What if the College exposed to the Question 17 issue already has a GST Private Ruling?

Some Colleges with an exposure to the Question 17 meals issue already have a GST Private Ruling.

In circumstances where input of the correct answers to Question 7 and 17-23 lead to the GST Tool determining the student accommodation supply is not GST-*free* but is instead input taxed the GST Tool contracts worksheet accommodation GST status override button can in certain circumstances where the College has an existing favourable GST Private Ruling, be used to manually override the input taxed result to ensure a GST-*free* result. Refer to page 14 of the *Instruction Guide*.

There may be limitations on which years or for how many years after its issue, a GST Private Ruling may be relied upon or may be used to manually override the GST Tool accommodation test result.

As already noted, some Colleges with an exposure to the Question 17 meals issue may be able to eliminate the exposure by seeking prospectively a GST Private Ruling from the ATO for the years in question (potentially on any one of a number of grounds) to ensure that no additional net GST is payable to the ATO.

Any such new GST Private Ruling request would have to be lodged before the College concerned is notified by the ATO that it is to be subject to a GST audit.

We would be pleased to advise further in these cases if Colleges with an exposure to the Question 17 issue and without GST Private Rulings wish to know whether they have grounds to pursue this option.

13. Are Colleges with uncertain taxation positions required to advise the external auditor?

For some Colleges with an exposure to the Question 17 meals issue it may take some time to determine the extent of the taxation liability and what to do about it. Pending resolution of the issue one way or the other some Colleges may have a contingent taxation liability.

Where Colleges have a contingent taxation liability it is generally advisable to declare the liability to the external auditor. It is the job of the external auditor to determine materiality and whether or not a note should be made to the audited accounts.

Where Colleges or universities have formally adopted Australian accounting standard AASB 1037: *Provisions, Contingent Liabilities and Contingent Assets* there may be an obligation to report the contingent taxation liability in the financial statements.

14. Conclusion

The Association (UCA) or its predecessor (AHAUCHI) has over the past decade made a considerable investment firstly in putting the case to the ATO in October 2004 that a product-based solution to the GST complexities facing Colleges was needed and subsequently to collaborate and consult with the ATO during the four years the GST Tool was under development by the ATO and leading up to the Tool's official release in January 2009.

Successive National Presidents of the Association from Professor Hugh Collins (2004) going forward have at various times intervened with the ATO at Assistant or Deputy Commissioner level to ensure the sector's on-going access to the certainty of outcome that is afforded Colleges under the GST Tool.

If the GST Tool is not used by the sector in accordance with the ATO's instructions there is a risk the ATO will withdraw the product. It is in the interests of the sector overall as well as those of the individual Colleges with an exposure to the Question 17 meals issue, that any non-compliance around this issue be cleaned up in an orderly manner.

If you have any questions on the above advice please call or email me using the contact details at the head of this letter.

Yours sincerely

Peter McDonald, FIPA
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