

In this paper it will be assumed that readers have a basic familiarity with the GST. The GST system will be analysed in three distinct sections:

- The “legal” or rules areas;
- The “pricing”; and
- The “accounting”, or systems areas.



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The 'legal' or rules section

The Australian Taxation Office administers this legal or rules section.

A New Taxation System

The GST is part of a major tax reform package. The package has far ranging consequences. Practitioners will need to have an appreciation of the whole package and may need restructuring of the business. If insufficient time is allowed, or incorrect or only partial advice is taken, this may cause severe loss to the business.

It is not as simple as it looks

Australia will have a 10% GST commencing on 1 July 2000. The legislation package is voluminous and since the introduction of the GST Bill on 2 December 1998, there have been about 1,700 amendments to the draft legislation! These complexities are of the greatest concern to practitioners.

The effect of GST

Practitioners *must* have a working knowledge of the GST, and cannot afford to ignore it, and treat it like CGT and FBT, where these taxes were left to the "experts". Practitioners should realise that GST is like a stone thrown into a pond. The ripples go everywhere. All areas of a legal practice will be affected. These include the grass roots aspects of:

- Pricing software, compliance and audit and has to be tuned to get results that will not trigger inquiries from competition regulators and the Tax Office;
- Internal and customer communication systems have to be good enough to cope with sudden enquiry loads; and
- All sorts of long-term supply contracts will have to be re-written and checked for legalities.

Specific GST legislation

There are no provisions in the GST legislation that deal specifically with accountants and lawyers. The legislation however, does state that the provision of advice by accountants and lawyers is not a financial supply, that is, it is not excluded from the GST system. Pro bono work is thus not a taxable activity, that is, it does not attract GST, however, GST paid on expenses incurred in running the practice can be refunded.

A brief summary of the GST

The "Goods and Services Tax" is a new tax on sales of nearly all goods and services. In essence, it is the imposition from 1 July 2000 of a 10% tax, but to offset the extra tax the income tax rates are to decrease, and a number of taxes, including sales tax and NSW bed taxes are to be eliminated. However, stamp duty on conveyancing; and state payroll-tax will not be eliminated.

Only business clients who are registered for GST and now use the legal services for running their business may be able to obtain a refund of GST paid on their legal fees. This is not the case with plaintiffs who are not registered for the GST, and this includes personal injury victims, defamation cases etc. Thus, for these plaintiffs' legal fees will be higher with the GST.

Who pays the tax?

GST is imposed on "taxable supplies", that is, "sales" which covers nearly any activity which involves the supply of goods or services. The rule is that liability to pay the GST to the Australian Tax Office rests with the practitioner and not the client. The liability is 1/11th of the total consideration, including disbursements. The practitioner may shift the liability to pay the GST by contract to the client. Unless this is done, the practitioner will need to pay the GST. This depends upon when the original retainer was entered into. The 1/11th is calculated as follows:

FEE:	\$100	100%	10/11 th
ADD: GST @ 10%	10	10%	1/11 th
TOTAL (including GST)	\$110	110%	11/11 th

Example:

Barry Partners charges \$110 for litigation for XYZ Ltd. This includes disbursements. GST law assumes that the \$110 fee includes GST. Thus, 1/11th of the invoice represents GST. Thus, Barry Partners must send the Tax Office \$10 in GST, being 1/11th of the consideration. If the payer is registered for GST, it can obtain a refund of the \$10 GST paid.

GST AND SALES ("SUPPLIES")

General rule

GST is payable only on taxable sales (or as the legislation calls them: "taxable supplies"). Apart from a few exclusions, supplies will include the sale of most goods and services. GST will be applied to supplies of most things at a rate of 10%, starting from 1 July 2000. GST is payable by the "entity" (that is the party) making the taxable supply. The entity will ordinarily be "registered" with the Tax Office. It is first necessary to define what a "supply" is, and then determine which of the supplies are "taxable". It is vital to note that the liability to pay the GST rests with the supplier and not the customer.

The six steps to a taxable supply

If *all* of the six following steps are met there will be a "taxable" supply, that is, GST will apply to the transaction. The six steps are:

- (a) there must be a *supply* of something (this includes the provision of legal services);
- (b) there must be *consideration* (this is usually the case. Pro Bono advice will not be subject to GST as there is no consideration);
- (c) there must be an *enterprise* (this is; the business of supplying legal services);
- (d) there must be some *connection with Australia* (this is the case for advice given to clients in Australia);
- (e) the supplier must be *registered*, or should be registered (it is assumed that all legal firms will be registered, which is required if total fees of the law firm exceed \$50,000); and
- (f) the supply, or part of it, is *not excluded* from GST (legal services generally do not fall into a recognised GST-free or input taxed exemption).

Litigation fees

Fees and disbursements charged to a client will be subject to GST, as the above six steps will be complied with.

Example:

See the *Barry Partners* example, above.

Litigation settlements

There is currently doubt as to the GST effect of settlements and judgements. Some of the doubt revolves around the "supply" and "consideration" issues. The Australian Taxation Office has advised that in May 2000 it will issue a draft tax ruling regarding this matter. Until a final ruling is issued, which will probably take about 4 - 6 months from May 2000, there will be uncertainty.

PURCHASES

General rule: taxable supplies

The general rule is that any entity that is registered, or ought to be registered, is entitled to claim the GST paid on a purchase as "input tax credits". To be able to claim the GST paid on purchases the purchases of goods and/or services need to be:

- for *consideration*;
- to further the *enterprise*;
- "connected with Australia,"
- "registered" or require to be registered. and
- not of a category which is *excluded from GST*, for example:
 - expenses that relate to "input taxed supplies";
 - private and domestic purchases;
 - business expenses which are not tax deductible.

These rules mirror those of sales. Thus, most purchases by a law firm will fall into the definition of acquisitions, and thus any GST paid on the purchase will be refundable.

Example:

Sue Them is a firm of plaintiff solicitors. The firm is registered for GST and purchases a legal text for \$110, which includes \$10 GST. The firm thus can claim a refund of the \$10 GST paid on the purchase.

REGISTRATION

When should a business register for GST?

A firm of solicitors is required to be registered if its annual turnover exceeds \$50,000 pa. If you are under the threshold, you have the option as to whether you will register. "Turnover" includes all sales and disbursements.

Unregistered Entities

It is vital to realise that unregistered entities cannot collect GST from customers, and will not be entitled to GST credits for tax paid on inputs.

When to register?

Registration for existing businesses commenced on 1 November 1999 through until 31 May 2000. As the end of May approaches there will be a rush to

register, and there is a possibility that the Tax Office will not be able to provide an ABN in time, thus causing commercial confusion. It is therefore important to register for GST as soon as possible.



TAX PERIOD: MONTHLY OR QUARTERLY?

General rule

Every registered entity will have certain tax periods applying to it. With income tax it is annual, however, with GST it is either monthly or quarterly. A GST return must be lodged for each tax period, setting out the "net amount" due to be paid or refunded for the tax period.

When should you pay your GST?

GST returns must be filed monthly, or if the turnover from taxable supplies is under \$20m, then there is the option to file quarterly.

TIMING: THE LIABILITY TO PAY GST (CASH V ACCRUALS)

General rule

Once the liability to pay GST arises an entity needs to pay the GST in that "tax period", that is, the required monthly or quarterly period.

Timing of the liability:

There are two bases of determining the timing of the liability, and they are the cash and accruals systems.

Cash basis of accounting

If a firm's annual turnover is \$1,000,000 or less, it has the choice of using cash or accrual accounting for GST purposes. With the cash basis, the entity's GST liability arises when "consideration" (that is, payment) is received. This is the simplest system, and will reduce compliance costs. Here the firm can rely on their cash book to provide the essential data required for the GST return. A sample simplified cash book is provided later. Period end adjustments for creditors and debtors would not be required.

Accruals method of accounting

If an entity's annual turnover is over \$1,000,000 it must account for GST on the accruals basis. In this case, period end adjustments for creditors and debtors are required. GST is payable on the earliest of the following:

- payment received for a supply; or
- an "invoice" is issued.



Example of cash and accrual accounting

Assume a firm renders a \$1,100 (\$1,000 fee + \$100 GST) invoice on 1 December 2000 and the purchaser pays on 1 March 2001. There are two possible ways of accounting for the transaction:

- **CASH** Under cash accounting system the seller will *only* be required to remit to the Tax Office the GST *actually* collected. Thus, if in a period no payment was been received, then no GST needs to be remitted. If half of the sale price has been paid, then only \$50 GST needs to be remitted, and if all the sale price has been paid, as occurred on 1 March 2001, then the full \$100 GST needs to be remitted.
- **ACCRUALS** Under accruals accounting system the seller will be required to remit to the Tax Office by 21 January 2001, being 21 days after the end of the tax period, the GST collected on the sale. This is even though the sales proceeds have *not* yet been collected. Clearly, this may pose a cash flow problem.

TAX INVOICES & THE AUSTRALIAN BUSINESS NUMBER

General rule

There are two different types of "invoice". One is the traditional type that we are used to, and the other the new "tax invoice", as is required under the GST legislation.

The "traditional type" of invoice

It is important to note that "invoice" in this context is any document notifying an obligation to make a payment.

The "tax invoice"

A purchaser *cannot* obtain credits for the GST paid on its purchases over \$50 (EXCLUDING GST) if it does not have the original *tax* invoice in its possession. The tax invoice is similar to the traditional type of invoice, with some further requirements, which include:

- The invoice is called a "Tax Invoice";
- The supplier's Australian Business Number (ABN), being the GST registration number, is stated;
- The total amount states something to the effect "Total, including GST"; and
- If the total consideration is over \$1,000 (INCLUDING GST) then the following is required:
 - details of what was supplied: the item and quantity.
 - purchaser's name or ABN.



When to issue the tax invoice

There is no obligation to issue a tax invoice if the amount is under \$50 (GST excluded). If it is over that amount one needs to be issued only if it has been requested, and then it needs to be provided within 28 days. Furthermore, only registered entities can provide a tax invoice, and only a registered entity can claim the GST paid and noted on the tax invoice. For simplicity, a law firm which deals with both GST registered and non-registered clients should always issue a tax invoice to every client irrespective of the consideration, as this ▶

Economic loss reports?

Workers compensation valuations?

Commutation problems?

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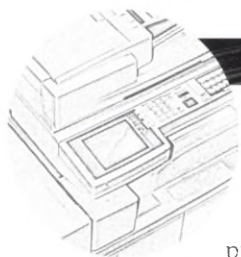
will save time and the necessity of having later to provide a tax invoice when requested.

Should you detail the amount of GST on a tax invoice?

Unless there is a good reason the GST should be separately stated on the invoice. When it is clearly itemised there is less potential for error or miscalculation by the person issuing the invoice, the recipient, the accountant who helps prepare the GST return, the Tax Office auditor.

What is the effect of not having a tax invoice?

Unless a purchaser has received an official "tax invoice", that purchaser *cannot* obtain a benefit of input tax credits. Exceptions include transactions for less than \$50. To save on the duplication of work, a firm's invoices should be converted to tax invoices.



ADJUSTMENTS

GST previously received

A law firm may be required to adjust the amount of GST it has previously received on a supply if that supply changes. It will need to provide an *adjustment note* to the customer to show the correct GST situation.

Adjustment events

An example is when the price of a supply is changed. That is, after an invoice has been paid, there has been a discount given.

Example:

Litigators Unlimited issues an invoice for \$1,100 (including \$1000 GST). The client is registered for GST and pays the \$1,100. Thus the law firm sends \$100 off to the ATO, and the client claims the \$100. Later, there is a dispute regarding the cost and the law firm gives a \$500 (half discount). Adjustments are now required by both parties. The law firm must provide an adjustment note, and the required GST adjustments are:

- *The law firm: it has overpaid the Tax Office. It has paid \$100 GST when it should only have paid \$50. It thus can claim a \$50 refund; and*
- *The client: it has overclaimed the GST refund. It has claimed \$100 GST when it should only have claimed \$50. It thus has to pay the Tax Office \$50.*

It is important to note that there will always be "equal and opposite" transactions.

Bad debts

If the firm writes off a bad debt and it has already paid the GST on the supply, the firm is entitled to obtain a refund of the GST paid on the debt. If the debt is later paid, then GST must be paid on the recovered amount.

Outstanding debts

If the debt is unpaid for over 12 months then the GST paid can be recovered. However, if the debt is finally paid GST must be paid on the recovered amount.

Transitional provisions

The government has introduced provisions that relate to long term contracts. That is, contracts that commence before 30 June 2000 and end after that date.

Timing rules

Goods and services provided before that date are not subject to GST, irrespective of when payment is made. However, any provision after that date will attract GST, irrespective of when payment is made. This relates to a number of types of contracts, including lease of office, lease of plant and equipment, lease of cars and retainer agreements with clients.

The general rules

The following general rules are now law:

- supplies made after 30 June 2000 under contracts entered into on or after 8 July 1999 (Royal Assent) will be subject to GST;
- the statutory obligation to pay GST is imposed on the supplier, not the purchaser, and the supplier stands to lose 1/11 of the purchase price if it fails to add an appropriate amount to cover GST; and
- the law firm thus should have a clause in its contract to clearly enable it to pass the GST obligation onto the client.

Pay-As-You-Go tax (PAYG)

The PAYG system is an amalgamation of a number of procedures. It is a quarterly payment; and comprises:

- A PAYG *withholding system* which includes the 48.5% withholding arrangements, where such an amount must be withheld if a contractor does not provide an ABN;
- A PAYG *instalment system* which will replace the current provisional tax and company tax instalment systems;
- An *extension of the existing running balance accounts* so that taxpayers can receive a single statement which tallies their net tax paying or tax refund position in respect of their taxation liabilities; and
- The effect of the PAYG system will be the abolition of 11 existing payment and reporting systems. The PAYE system will be incorporated into the PAYG system.

Groups

Provisions exist where an entity within a group can avoid the necessity to account for the GST. However, as the law currently stands this is not possible in a law firm as partnerships and their service companies/trusts cannot group together. Thus, the relationship between the two will attract GST, and it is important for the law firm to budget for the GST payable by the service company/trust.

ANTI-AVOIDANCE TAX AUDITS

General rule

Keep good records and an audit trail for when you are audited. Aggressive audit action is expected from the ATO. That is, be able to show the total dollar amount of how much GST you paid, and how much you collected. Be able to show supporting documents. Comply with requirements relating to returns etc.

Audit areas

It is anticipated that the Tax Office will be active from the audit viewpoint, and the areas of interest include:

- checking invoices to see if there have been errors in calculating the GST;
- the presence of tax invoices for claims of GST on purchases of \$50 and over.

GST and capital equipment

The purchase of capital equipment (computers, photocopiers, cars etc) will be subject to GST, and in addition, there are tracking rules which must be complied with. These relate to the tracking of the percentage business usage over a specified period.

Government assistance

Assistance is available for existing businesses with a turnover less than \$10M so that expenditure associated with gearing up for the GST and incurred before 1 July 2000 would attract immediate tax deductibility on the purchase of:

- new plant, equipment (for example point of sale/cash registers/computers etc); and
- new software (including upgrades).

In addition there are \$200 vouchers that are being offered to registrants.

The Pricing section

The Australian Competition and Consumer Commission (ACCC) administers this section.

How to price a law firm's prices

After the commencement of the GST on 1 July 2000, it is the law firm, which must remit 1/11th of its consideration on a taxable sale to the ATO. The supplier thus must reprice its goods. In order for the firm to avoid the large ACCC price exploitation penalties the business must determine its dollar margin before the 1 July 2000 GST introduction, and ensure that after that date whatever price is charged then the business still makes the same amount of dollar margin. Thus, when a business adds the extra costs incurred (for example compliance, new plant and equipment, suppliers charging more) to the price, and deducts cost reductions (for example the removal of sales tax, cheaper computers, or suppliers charging less) the dollar margin should not change. A law firm will generally have few savings due to the elimination of sales tax, however, it will have large one off and continuous compliance costs. Thus, there is a strong argument for the price rise to be near to the full 10% increase. Firms should keep records as to how it comes to the decision to reprice its goods. In any event, repricing is vital, for to use the same prices after 1 July 2000 as before will cause an unnecessary drop in margin, and this a drop in profits.



www.lawsocnsw.asn.au/practice/GST/faq/print-index.html

The accounting or systems section

The firm and/or its accountants administers this section.

Background

The "systems" or "accounting" issues are *more* important than the "legal" or "pricing" issues as the system ensures that the whole GST procedure will work. One must also remember that the law requires the GST return (the Business Activity Statement) to be lodged within 21 days after the end of the GST period, either monthly or quarterly. The firm's systems will need to cope with this regular lodgment, so that it can be done smoothly and efficiently.

What to do now?

This relates to the systems required: the physical implementation of the GST in a business. It includes the computers, software, accounting, bookkeeping, and ensuring that the paperwork is in such a situation that the monthly or quarterly GST return will be lodged on time. The firm needs to:

- appoint someone to take charge of the conversion to GST;
- address one-off "transitional" issues (such as long term contracts straddling the 8 July 1999 Royal Assent date and pricing considerations);
- install systems to meet ongoing invoice, accounting, record keeping, and return requirements; and
- address ongoing concerns such as technical issues, business contracts content, and staff training requirements.

Other important aspects

These include:

- Retainers: the need for a comprehensive retainer agreement to ensure that the GST can be passed on to the client;
- Fees are subject to GST: The normal activities of a professional accounting or legal practice fall into the GST taxable supply category, with the sole exception being pro-bono engagements;
- Tax Invoices: These need to be prepared so that they comply with the GST legislation;
- Stationery: Unless printed in-house, new stationery will need to be printed, including the ABN;
- Disbursements: For further assistance see www.lawsocnsw.asn.au/practice/GST/faq/print-index.html for a full discussion, including diagrams. In essence, the disbursement situation can be summarised as one needs to determine whether the law firm was acting as principal or as agent for the client.

Important contacts

Tax Office

- Internet: www.taxreform.ato.gov.au;
- Requests for rulings: Email: replyin5@ato.gov.au; and
- Telephone enquiries: 13 24 78

Other

NSW Law Society - which provides details regarding practice management, and includes a discussion on disbursements: www.lawsocnsw.asn.au/practice/GST/faq/print-index.html.