

A simplified GST accounting method for cafés, restaurants & caterers

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The task of GST accounting for trading stock can prove to be a laborious, time consuming and costly exercise for most café, restaurant and caterer owners. Accordingly, the ATO has recently released a *Determination* on section 123-5 of the GST Act designed to simplify the accounting methodology that can be used by the catering industry. In particular, the new *Determination*, i.e. *Simplified Accounting Method (SAM) Determination (No. 1) 2006* came into force on 1 October 2006.

In this publication, we examine the new GST accounting method and assess the effects of the methodology.

Background

Briefly stated, the goal of the *Determination* is to provide a quick and simple accounting method for owners of catering businesses to calculate the amount of input tax credits (ITCs) they are entitled to claim on their acquisitions of trading stock. Absent such a methodology, trading stock accounting is burdensome and time-consuming for business owners as they need to separately identify and record ITCs obtained under each tax invoice.

Under SAM, separate identification is replaced by the more efficient system of **estimation**, using samples of acquisitions over 4-week periods (i.e. sample periods). Using these sample periods, an estimate of the percentage that represent GST-free acquisitions can be determined. Using the percentage, the GST-free acquisitions and ITCs for each tax period can then be calculated using a simple formula.

Who can use SAM?

The table below outlines how SAM applies to cafés, restaurants and catering businesses:

Who is eligible?	What are the requirements?	How does SAM apply?
SAM is aimed at small and medium sized business operators of cafés, restaurants and caterers	<p>There are 3 conditions that need to be met:</p> <ul style="list-style-type: none"> ▪ the entity must be registered for GST throughout the tax period; ▪ during the period, the entity operates a café, restaurant or catering business; and ▪ the entity's annual turnover does not exceed \$2 million (GST inclusive). 	<p>If an entity is eligible, it is not compulsory for the entity to use SAM.</p> <p>The entity has the option to use SAM to calculate ITCs on the acquisitions of its trading stock for a tax period.</p> <p>Or, alternatively, the entity may use old accounting methods if it wishes.</p>

How does SAM work?

Below we set out how the SAM method works, using a step-by-step guide.

Step 1: determine sample period

Sample periods must be determined in order to provide an estimate of the amount of GST-free trading stock for the tax period(s) in each financial year.

In each financial year, **2 sample periods** are required. The sample periods must be **6 months apart**. However, there are various methods of determining an entity's sample period, depending on when the entity adopts SAM and the status of its business. This is set out in the table below:

Status of business	Date of SAM's adoption	Sample period
Already existing	From 1 June to 31 July or from 1	<ul style="list-style-type: none"> ▪ Select a continuous 4-week sample period between 1 June and 31 July; and

	December to 31 January	<ul style="list-style-type: none"> Select another continuous 4-week sample period between 1 December and 31 January.
Already existing	Any date other than 1 June to 31 July or from 1 December to 31 January	<p>The first sample period is:</p> <ul style="list-style-type: none"> a 4-week period in the tax period in which the entity starts to use the SAM; or a 4-week period during either 1 June to 31 July or 1 December to 31 January, whichever has just elapsed.
Just started	Part way through the financial year	<p>The first sample period:</p> <ul style="list-style-type: none"> must be in the first 2 months of trading, when the entity starts selling food to customers.

Step 2: calculate the amount of trading stock of sample period

Once the sample periods have been determined, the amount of trading stock that was purchased during each 4-week sample period is then calculated. There are 2 calculation methods, depending on whether cash accounting is being used by the entity. The following table illustrates the position:

Accounting system	Calculation method
Cash	The amount of trading stock is the total consideration that the entity provided during the 4-week sample period.
Accruals	<p>The amount of trading stock is the total price of trading stock for whichever is the earlier of the following, during the 4-week sample period:</p> <ul style="list-style-type: none"> the entity provided any of the consideration; or an invoice was issued for the acquisition.

Step 3: determine amount and percentage of GST trading stock in sample period

From the amount calculated as trading stock in step 2, the entity should determine the amount of trading stock that relates to **GST-free acquisitions**. That is, the amount of the entity's GST trading stock. The percentage of the entity's GST

trading stock is then determined using the following formula, expressed as a percentage:

$$\frac{\text{GST trading stock}}{\text{Trading stock}} \times 100$$

It should be noted, however, that 2 calculations of the GST-free percentage need to be done (about 6 months apart) for each financial year.

Step 4: calculate amount of trading stock in a tax period

Once steps 1-3 have been completed, the entity can then go on to calculate its trading stock and GST trading stock for the given **tax period** (i.e. January-June or July-December).

The amount of trading stock is calculated by the same methods as step 2, except these will need to be applied to a given tax period, as opposed to the sample period. That is, the entity will need to calculate the amount of trading stock that was purchased during the whole of the tax period.

Step 5: determine the amount of your GST trading stock in a tax period

Using the percentage of GST-free trading stock determined at step 3 and the amount of trading stock in a tax period (at step 4), the entity can then calculate its GST-free stock in the given tax period, as shown in the following table:

Tax period	Calculation method
July-December	Multiply the percentage of GST-free trading stock from the sample period during 1 June to 31 July (step 3) by the amount of trading stock purchased during the tax period (step 4). The result is an estimate of the entity's GST-free stock in the tax period.
January-June	Multiply the percentage of GST-free trading stock from the sample period during 1 December to 31 January (step 3) by the amount of trading stock purchased during the tax period (step 4). The result is an estimate of the entity's GST-free stock in the tax period.

Step 6: determine ITCs entitlements for a tax period

The entity's ITCs entitlements can now be calculated by subtracting the estimated GST-free acquisitions from its total acquisitions and multiplying the difference by 1/11th. The entity's ITCs entitlement for the acquisitions of a tax period is calculated using the following formula:

$$\text{(Result of step 4 - result of step 5) } \times \text{ 1/11}^{\text{th}} = \text{ITCs for given tax period}$$

For the net amount for the tax period, see Division 17 of the GST Act.

Conclusion

The new accounting method introduced by the recent *Determination* will definitely reduce the time and cost of complying with the GST provisions. Instead of recording each transaction, business owners can simply make an estimate of their GST-free acquisitions using a sample period, and then apply a simple formula to work out their ITC entitlements in a tax period.

The problem with the scheme is that the estimates produced by using sample period(s) may not be a true reflection of GST-free acquisitions for the entire tax period. That is, there may be specific instances during a sample period which lead to high levels of GST-free acquisitions, resulting in a greater GST-free trading stock percentage and thus lower ITCs entitlements on trading stock for tax periods.

However, overall, SAM is a positive effort by the ATO to streamline accounting methods for small business owners in the café, restaurant and catering industry. In particular, once a system has been implemented to use SAM, significant time and cost can be saved by business owners in the industry.