THE LAW SOCIETY OF NEW SOUTH WALES
young LAWYERS

30 August 2010

The General Manager
Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: Financialsupplies@treasury.gov.au

Dear Sir/Madam

Submission on Implementation of Amendments to GST Financial Supply Provisions

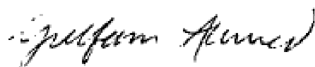
Thank you for your invitation to provide submissions on the implementation of the recommendations of Treasury's review of the GST financial supply provisions.

The NSW Young Lawyers Tax Committee is pleased to provide the attached submission.

NSW Young Lawyers is a division of the Law Society of New South Wales. Membership of the NSW Young Lawyers is free and automatic for all NSW lawyers under 36 years and/or in their first five years of practice, and law students. Membership of its committees is voluntary.

If you would like to discuss any of our comments, or have any questions, please contact Robyn Thomas on (02) 9191 9180 or Adam Ahmed on (02) 9926 0270.

Yours faithfully



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Submission on Implementation of Amendments to GST Financial Supply Provisions

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Submission to Treasury

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References to the “Discussion Paper” are to the discussion paper published by Treasury titled Implementation of the recommendations of Treasury’s review of the GST financial supply provisions, dated June 2010.

Financial Acquisitions Threshold

We strongly support the increase of the financial acquisitions threshold (FAT) which has remained unchanged since the introduction of the GST. We agree that increasing the FAT will reduce compliance costs for businesses that make a small number of low value financial supplies. We also note that the compliance burden will be eased for some taxpayers who make exceptional and infrequent financial acquisitions or supplies (for example, capital raising). Further, it is appropriate that those entities that engage in relatively minor financial supply activities will not be required to apply complex apportionment methodologies in order to deny input tax credits.

We submit that a more in-depth review should be carried out in respect of the FAT and how it is applied. For example, Treasury acknowledges in the Discussion Paper that “businesses that are falling on the borderline need to monitor their compliance on a monthly basis, which results in increased compliance costs for these businesses”. When the FAT is increased from $50,000 to $150,000 the compliance burden will shift to a different set of taxpayers who fall on the borderline. While the increase will assist some taxpayers in remaining below the threshold, others will be required to monitor their activities more closely. It would be appropriate for legislative amendments to be introduced that decrease this burden by reducing the periods for which a taxpayer must look forward and back from 11 months to a period that is more manageable (e.g. six months).

Finally, we support making the amendments to the legislation, provided this is done in a way that is easily followed by taxpayers. Compare with the confusion created by the GST registration turnover threshold, in respect of which taxpayers must refer to both s. 23-15 of the *A New Tax System (Goods and Services Tax) Act* (***GST Act***) and reg. 23-15.01 of the *A New Tax System (Goods and Services Tax) Regulations 1999* (***GST Regulations***).

Hire Purchase

Focus question (i): Are hire purchase arrangements limited to transactions between businesses, or are there instances where hire purchase is used in consumer finance? Will consumers be affected by the change to make hire purchase fully taxable?

Overview

Hire purchase arrangements are also used in consumer finance. We submit that consumers would be adversely affected if the rules were changed to make hire purchase fully taxable, because consumers would bear the burden of GST on both the asset and the finance effectively provided to purchase that asset (as opposed to limiting the GST to the asset). Finance being subject to GST would be an extremely unusual situation, and inconsistent with the GST treatment of financial supplies more generally. In many, if not most cases, those consumers would be unable to recoup this additional expense by claiming input tax credits.

This would reduce choice for consumers by creating a disincentive to use hire purchase. Given hire purchase arrangements have other benefits (particularly to do with security

and circumstances where a consumer finds themselves unable to pay), this reduction in choice will be highly disadvantageous to consumers.

We submit that hire purchase arrangements should remain financial supplies, but rules should be introduced that clarify the disclosure requirements, to provide greater certainty and consistency to the parties involved in these kinds of transactions.

Increased cost

There is some degree of flexibility on how a hire purchase arrangement will be structured, but hire purchase arrangements will commonly involve a bullet or balloon payment at the end prior to legal title being transferred to the consumer. Consider, for example, arrangements in respect of motor vehicles. Typically this balloon payment will be slightly less than the market value of the vehicle, thereby providing an incentive for the consumer to purchase the vehicle. The finance provider will often recoup the cost of finance to the consumer earlier on in the term.

If a hire purchase is fully taxable, the consideration for the taxable supply will include both the purchase price of the asset and the implicit interest rate, being the cost of funds. The consumer therefore bears the burden of GST on both the asset and the interest. The consumer would probably not be able to claim input tax credits.

Were the same consumer to purchase the asset using a standard chattel mortgage, then the consumer would not bear the burden of GST on the interest.

This would create an incentive for a consumer to purchase the vehicle using a chattel mortgage, and would be a disincentive to using hire purchase arrangements.

Security

Consumers who use hire purchase have the benefit of not being required to purchase the asset should their financial circumstances change and the asset become unaffordable. While there would be, in some circumstances, a financial incentive to do so, they could simply opt not to purchase the asset.

By contrast, should a consumer borrow funds to finance the purchase of an asset, then the consumer will have already purchased the asset and be obligated to pay back the loan. It might be the case that the asset itself does not provide adequate security for the loan, and that other security must be provided or a loan might be provided that only covers part of the cost. These issues do not necessarily arise with a hire purchase.

Further, the ramifications of pulling out of the arrangement are different for chattel mortgages and hire purchase. For the former, there would be immense damage to a consumer's credit rating. For the latter, this would not necessarily be the case.

Disclosure

We submit that the hire purchase should not be made fully taxable. However, given the rules are currently being looked at, we would recommend that the disclosure requirements be clarified.

There are currently two requirements under the regulations:

a. the credit for the goods is provided for a separate charge; and
b. the charge is disclosed to the recipient of the goods.

This disclosure requirement is clearly important, but it raises a number of questions, namely - what is disclosure and when must this disclosure be made?

The decision in Freight Transport Leasing Ltd v CCE [1991] VATTR 142 in the UK, in relation to the UK VAT legislation (which refers to "the provision of the facility of instalment credit finance in a hire-purchase, conditional sale or credit sale agreement for which facility a separate charge is made and disclosed to the recipient of the supply of the goods") interpreted the disclosure requirement as follows:

> "*...by the time that the transaction was entered into, the customer knew (a) the price of the vehicle, (b) the period of the agreement (which was usually, though not always, 24 months), and (c) the amount of the monthly repayments.*"

It would be beneficial if disclosure were explained more fully, perhaps to say that for the supply to be a hire purchase, it is necessary to disclose, at the beginning of the transaction, the price of the vehicle, the period of the agreement and the amount of the monthly repayments.

The ATO have provided some clarity on this issue in Goods and Services Tax TPP 026 and in response to Issue 1.2 of the Financial Services Questions and Answers but have not clarified when the disclosure must be made. However, it takes a broad view of what would be the "hire purchase agreement" - possibly taking into account all sorts of documents (even tax invoices), not just the hire purchase agreement itself (see Private Ruling Authorisation Number 37577).

There would clearly be an incentive for a vendor to ensure that the hire purchase requirements are satisfied, because if the credit component is input taxed, the price will be slightly less than if it is a taxable supply and subject to GST.

Focus question (ii): Will the removal of the existing item 8 in Regulation 40-5.09 from the list of supplies that are financial supplies have any consequences beyond the direct imposition of GST?

Yes - the removal of item 8 will also affect the claim of input tax credits by the supplier. If we take the example of a larger finance provider, the finance provider may only be able to claim reduced input tax credits for certain supplies made to it in relation to the supply under the hire purchase because they would be above the financial acquisitions threshold. If the whole supply is taxable, then obviously they will effectively be able to claim input tax credits in relation to providing finance. It would be unusual for a larger financier (i.e. one that is above the financial acquisitions threshold) to be able to claim input tax credits in relation to providing finance. This would give the financier an incentive to use hire purchase arrangements more frequently.

Making hire purchase fully taxable will be advantageous for a financier that is unable to claim input tax credits for the provision of finance. However, this would be to the detriment of consumers who would pay more under the arrangement. It is unlikely that the availability of the input tax credit would be sufficient to offset the increase in the GST payable such that the financier would be able to maintain the same the overall cost of the hire purchase for the consumer without reducing their profits.

Focus question (iii) In addition to removing item 8 in Regulation 40-5.09 from the list of supplies that are financial supplies, is it necessary to also add an example in Regulation 40-5.12?

We support the inclusion of examples to explain the effect of any changes to the rules. Without knowing what those changes may be, we are not in a position to provide an example of such an example.

Reduced Input Tax Credits

Focus question (iv): What specific examples of services should be included in the ambit of transactional fraud monitoring services?

We support the proposals set out in section 2.3.3 of the paper and believe that these will address some of the concerns and ambiguity that the relevant taxpayers face.

In response to focus question (iv), we make the observation that transactional fraud monitoring services may encompass a broad range of services, from advisory services in relation to the corporate strategy surrounding policy, internal controls and protocols in the monitoring/identification of and the prevention of transactional fraud activity to implementing the relevant IT systems for the identification and interception of any fraudulent transactional activity and other risk management systems. Part of those services may also include services in relation to any personnel which are involved in the credit risk management teams / other associated services acquired in relation to transactional fraud monitoring services.

We agree with the general approach taken in respect of principle 3 of section 2.3.3. This is because many of these services can be performed in-house or by members of the same GST group and therefore are not likely to attract GST. As many of the financial institutions acquire transactional fraud monitoring services in connection with the provision of input taxed supplies, we believe that by including these acquired services in the list of reduced credit acquisitions, this will create a more even playing field for smaller financial institutions who outsource some or most of these transactional fraud monitoring services where the supplier has passed on the GST cost to the recipient financial institution.

However, where these financial institutions acquiring transactional fraud monitoring services do not meet the financial acquisition threshold (especially assisted by the introduction of the proposed higher threshold set out in section 2.1 of the Discussion Paper), the concerns set out in the preceding paragraph may be a non-issue. Consideration should be given (and perhaps input from the major providers of transactional fraud monitoring services) regarding the typical costs of these services to determine whether the cost of these services will easily contribute to a financial institution in meeting the current and/or proposed new financial acquisition threshold.

Limiting Reduced Input Tax Credits for Bundled Trustee Services

No Reduced Input Tax Credits (RITC) for acquisitions bundled with trustee services:

Overview

We strongly support the move to obtain clarity on which costs can be legitimately 'bundled' in respect of 'trustee services' that are acquired by a trust.

In GSTR 2002/2 the Commissioner has provided the following guidance on the source of 'trustee services':

> "*Where a trust has been established by a deed, the deed will normally set out the rights, duties and obligations of the relevant parties to the trust, including the trustee. As such, the duties carried out by the trustee in compliance with the terms of the deed are defined as trustee services*"[1]

We submit that 'trustee services' are quite broad are not limited to those services stipulated in a trust deed. Accordingly, any definition drafted should not be unfairly narrow.

A 'trust' is itself an 'entity' for GST purposes.2 However, at general law a trust is not a legal person and cannot itself be a party to legal proceedings nor have other obligations placed on it. The Commissioner recognises that it is the trustee which is the appropriate party for GST purposes.3 In this regard, section 184-1(2) of the GST Act, provides that the trustee in that capacity is taken to be the trust entity.

The source of the issue addressed in the Discussion Paper, stems from the application of section 184-1(3) of the GST Act, which provides that a trustee can act for GST purposes as a different 'entity' in both its personal capacity and as trustee of a trust. We consider that from a practical perspective, ascertaining what capacity a trustee is operating in is often difficult. The Commissioner has recognised this difficulty in GSTR 2002/2 at paragraph 676:

> "*in practice, some entities may experience difficulty in characterising dealings that occur between an entity acting its corporate capacity and acting on behalf of the trust. Where the entity adds a mark-up for the on-supply of the thing to the trust, this may indicate that the entity is supplying something to the trust in its own capacity, rather than acquiring it on behalf of the trust and seeking recovery through an indemnification clause*".

The ability of a trustee to act in its personal capacity, has in some cases resulted arrangements being entered into whereby, supplies are made to the trust that allow greater Reduced Input Tax Credits (RITCs) obtained by the trust than it would otherwise be entitled.

Pursuant to Regulation 40-5.12 (item 15) of the GST Act, trustee services are not financial supplies. Item 29 of regulations 70-5.02(2) allows for a Reduced Input Tax Credit (RITC) the supply of trustee and custodian services to entities that make financial supplies.

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[1] GSTR 2002/2 paragraph 666.

[2] Section 184-1(1)(g) of *A New Tax System (Goods and Services Tax) Act 1999*.

[3] See the Commissioners comments in ATO ID 2007/7.

Ordinarily, supplies in the nature of accounting, taxation and audit are not eligible for a RITC. However, as noted above, the supply of trustee services can give rise to a RITC. This has allowed for bundling of trustee services to include supplies that are not eligible for a RITC.

While we support changes in the law to provide clarity on this issue, we consider that any amendments introduced should be practicable and not administratively burdensome on taxpayers.

Focus question (v): Are there any cases where applying one of the principles could create inappropriate outcomes?

Option 1: Made and provided test

We submit that this option may result in complexity and lack of certainty in its application to the trustee/trust relationship. It involves the identification of the entity in which the supply is 'made' and the entity to which the supply is 'provided'. As highlighted above, it is often difficult for a trustee to determine what capacity they are making an acquisition. We therefore consider that it would be significantly more difficult for a trustee to ascertain whether a supply is 'provided' to the trust and/or to themselves in their personal capacity.

As outlined in the Discussion Paper, this option finds its origins to the 'made or provided' test embodied in section 38-190(3) and as explained in GSTR 2005/6.

We question the strength of the contention that '*the close relationship between the trustee and trust eliminates much of the potential complexity around obtaining information that can arise in the cross-border context*'.[4]

Instead, we submit that it is this close relationship that has the potential to result in much ambiguity when applying the 'made and provided test'.

Paragraph 79 of GSTR 2005/6 provides guidance in applying the 'made or provided' test:

> "*A strong indicator that the supply is provided to another entity is that the contracting entity has no further interaction with, or participation in, the provision of the supply beyond contracting and paying for the supply*".

Due to the nature of the trustee/trust relationship, there are instances where the trustee in order to fulfil its fiduciary and general obligations, has on going interaction with the supply, especially when advice has been 'provided' to the trust. In such cases, the application of the made/provided test would be difficult to apply.

Any apportionment methodology under Option 1 may also present practical difficulties, especially when a supply is 'provided' to both the trust and trustee and the supply also relates the fiduciary duties of the trustee. Under this option, apportionment will need to occur to the extent the supply does not relate to fiduciary duties.

Section 14A (4) of the Trustees Act 1921 (NSW) which imposes a statutory duty on a trustee to *"at least once in each year, review the performance (individually and as a whole) of trust investments*"[5]. This is an example of where certain expenses (such as advisory services) may relate to the statutory duties of trustees and also to the trust as it would concern its property/investments. In such instances, would Option 1 require a trustee to dissect their costs and apportion to the extent that it is 'provided' to the trust?

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[4] Implementation of the recommendations of Treasury's review of the GST financial supply provisions, Discussion Paper (2010) page 14.

[5] 14A (4) of the *Trustees Act 1921 (NSW).*

Furthermore, is it possible to argue that the supply is not a mixed supply but a composite supply? Will the trustee need to calculate the proportion of the value of the composite supply that the taxable supply in relation to their services represents? Clarity on such issues is pertinent.

Option 2: Substance and character

We suggest that if Option 2 is to effectively operate, a proper explanation in a public ruling is needed to explain its application and to avoid the lack of clarity that is currently experienced by this approaches' application to unauthorised contributions.

Focus question (vi): Could some trust arrangements be more or less disadvantaged under one of the options?

We will not be commenting on this focus question and consider that it is best suited to specific industry bodies to provide comments.

Focus question (vii): If you are in favour of Option 3, are there categories of acquisitions that should be excluded from the definition of trustee services?

We are of the view that Option 3 is the simplest option presented in the Discussion Paper. Option 3 is less burdensome as it does not require the trustee to apply an ambiguous principle. This option, defines trustee services to exclude specific services and we submit that it is not only the most practicable option but it also correlates with the general approach under the GST law of 'excluding' services from being eligible from RITCs.

We submit that any services excluded from trustee services should be determined by reference to the key principles of providing RITCs:

> "*RITCs should be made available on the acquisition of listed supplies used for making input taxed financial supplies. The RITC was designed to reduce the bias to insource and limit any pressure to extend input taxation up the supply chain*" (Commonwealth of Australia *Explanatory Memoranda, A* New Tax System (Goods and Services Tax) Act 1999).

We therefore agree that the following should be excluded from the definition of trustee services:

- Taxation services;
- Advertising services;
- Auditing services;
- Accounting services.