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

By email: gstpolicyconsultations@treasury.gov.au

Dear Sir / Madam

Exposure Draft - GST and the Sale of a Corporation's Property by a Mortgagee or Chargee

We welcome the call for submissions on the exposure draft of the Tax Laws Amendment (2012 Measures No. 3) Bill 2012: "GST supplies by representatives who are creditors". In response, it is our view that it would be better to resolve the conflict that exists between Divisions 58 and 105 by addressing the inherent difficulties that exist with Division 58, rather than imposing a tie-breaking rule which may lead to further unintended consequences. It is also an opportune time to give consideration to the unresolved issues with the application of Division 105. To this end, we refer to our response to the Consultation Paper (attached as Appendix A).

Our main concern relates to the inclusion of the term "controller" in the definition section of the GST legislation. A "controller", as defined by s 9, includes *(a) a receiver, or receiver and manager, of that property; or (b) anyone else who (whether or not as agent for the corporation) is in possession, or has control, of that property for the purpose of enforcing a charge.* Accordingly, as we noted in our original submission, the inclusion of the term controller is redundant in the definition of "*representative*" provided by s 195-1. More specifically the conflict with Div 105 would be removed if that definition was amended to remove the inclusion of the term "controller". In detail we argue it should be removed for the following reasons:

1. Division 58 is aimed at imposing the liability for GST on representatives who are acting on behalf of an incapacitated entity.
2. As we point out in para 8 of our original submission, if a person is appointed as "receiver" or "receiver and manager", they are taken to be in possession of assets of the company but as agent of the company rather than the mortgagee or secured creditor. Therefore, Division 58 should apply to a receiver, including a receiver and manager, but not necessarily other types of controllers, as they act as agent of the secured creditor and are therefore covered in Division 105.
3. It is the inclusion of the term "controller" that has created the inconsistency between Divisions 58 and 105.
4. If it was the intention of the legislation to ensure that Division 58 would apply to both receivers acting as agents of the company *and* controllers acting as agents of the mortgagee or secured creditor, then the proposed exposure draft would not be necessary. However, if it is the intention of the legislation to ensure that Division 58 applies to the exclusion of controllers, who by operation of law would be acting as agents of the

> mortgagee or secured creditor, then a more straightforward mechanism would be to exclude "a controller (within the meaning of section 9 of the *Corporations Act 2001*)" from the definition of "representative" in s 195-1 of the GST Act.

By amending the legislation in the proposed manner, there is a risk that further unintended consequences may arise. For example, the tie-breaking rule as currently drafted does not have general application. Instead, it would exclude the operation of Division 58 only when "*you supply the property of another entity (the debtor) to a third entity in or towards the satisfaction of a debt that the debtor owes to you*" as stated by s 105-5(1)(a). Thus the tie-breaking rule will only apply when property is supplied in satisfaction of a debt owed to a creditor, or the creditor's agent. It will not apply to the provision of services, as we pointed out in para 10 of our original submission. Furthermore, as the proposed tie-breaking rule can only apply when the there is a debt owed to a creditor, or creditor's agent, it would have no application when a mortgagee in possession (regardless of the term used) is acting as an agent for the incapacitated entity, rather than creditor. In other words, where a representative is acting on behalf of the incapacitated entity, the tie-breaking rule has no application and Division 58 would prevail. If this is the case, then the inclusion of the term "controller" in the "representative" definition is redundant, as the only situation in which a person can be a representative of the incapacitated entity, as pointed out above, is where the representative is a receiver. However, if this was not the intention of the legislation, then there may be unintended consequences from the current drafting approach. It is also unclear what is meant by the wording of the notes to Division 105 which state that the division would override Division 58 "the extent that the creditor is a representative of the debtor and the debtor is an incapacitated entity". This note does not appear to be consistent with Division 105 and the proposed amendment to Division 58.

Therefore, it is our view that the proposed insertion of s 58-95 is unnecessarily problematic and that the better way deal the inconsistencies between Divisions 58 and 105 is to remove the trigger for the operation of Division 58 in circumstances covered by Division 105. Namely remove the reference to controller from the definition of "representative" in s 195-1(ca).

Yours faithfully

Colin Anderson, School of Law, Queensland University of Technology, Brisbane

Catherine Brown, School of Law, Queensland University of Technology, Brisbane

Appendix A – Submission to the Consultation Paper

Comments on the Australian Treasury: *Consultation Paper - GST Treatment of Property in Possession of a Mortgagee*

1. We thank the Treasury Department for allowing a late submission and more generally the opportunity to comment on this proposal.
2. It is our view that there remains some difficulty with Division 58 of the *A New Tax System (Goods and Services Tax) Act 2000* (GST Act) despite clarifying amendments in the *Tax Laws Amendment (2009 Measures No. 5) Act 2009* (2009 amendments).
3. We submit that the better way forward is to deal with the difficulties that remain in Division 58 rather than insert a provision that overrides Division 58.
4. Division 105 is a deeming provision that effectively provides that a creditor is liable for the GST payable on taxable supplies of a debtor's property where that supply is in satisfaction of a debt owed to the creditor.[1] Division 105 was enacted to deal with those situations where the holder of a secured charge takes control of the asset subject to the charge. By virtue of the general law of principal and agent it also has the effect of dealing with circumstances where an agent for the mortgagee enters into possession. The typical example is where a mortgagee in possession exercises its power of sale, and that sale is normally subject to GST, then GST is payable by the mortgagee even though that transfer is of the debtor's property.
5. It would seem that the difficulty here stems from the change in the definition of "incapacitated entity" which was given effect to in the 2009 amendments. Prior to the 2009 amendments the definition of an incapacitated entity included, in the case of a company, one that had gone into liquidation or receivership as well as one that had a representative appointed. The word "representative" was subsequently defined in s 195-1 to include trustees in bankruptcy, liquidators, receivers and administrators of both a voluntary administration and a deed of company arrangement. Somewhat oddly, it also included a person appointed or authorised to manage the affairs of the entity because it was unable to pay its debts. Whatever that particular phrase may mean, it would seem that this inclusion and the definition more generally did not include a person who was simply an agent for the

[1] See for example ATO ID 2010/224 "GST and mortgagees in possession: selling the property of a corporation".

mortgagee in possession. This was understandable as there was already div 105 dealing with that situation.

6. However, in enacting Division 58, there was a change to the definition. What is surprising is that in amending the legislation to correct the problems with the former Division 147, it was felt necessary to include the term "controller" in the definition of representative. In adding that term, the explanatory memorandum stated:

A consequential amendment will be made to the definition of 'representative' in Division 195 to include a reference to a 'controller'. A controller is a form of external administrator relating to corporations and should therefore be included as a representative for the purposes of the GST Act.[2]

7. Thus the explanatory memorandum is of little assistance in knowing why the term was inserted. This is particularly so when the definition did not remove the term receiver. This suggests a lack of understanding of the operation of Part 5.2 of the *Corporations Act 2001* where the terms "receiver" and "controller" are used. As the heading to Part 5.2 of the *Corporations Act* indicates, both receivers and other controllers deal with the property of corporations. The definition of "controller" in s 9 of the *Corporations Act 2001* is as follows

"controller" *, in relation to property of a corporation, means: (a) a receiver, or receiver and manager, of that property; or (b) anyone else who (whether or not as agent for the corporation) is in possession, or has control, of that property for the purpose of enforcing a charge;*

If we look to the definition of "*representative*" in s 195-1 of the GST Act, it can be seen that it now includes in paragraph (c), "*a receiver*" and in paragraph (ca) *"a controller within the meaning of s9 of the Corporations Act 2001"*. Therefore at least one of these is redundant in the definition.

8. The problem identified in the Consultation Paper arises because the term *"controller"* is used in Division 58. What would be the impact if there was removal of the term controller and reversion to receivers or receivers and managers in that Division? It is clear that the term "controller" is used in the *Corporations Act 2001* in order to ensure that certain obligations regarding reporting etc are met by mortgagees in possession. The purpose of Division 58 is to deal with what is termed "*incapacitated entities*". Whilst we have some difficulty with the use of the word *"incapacitated*", it is certainly the case that Division 58 is

[2] Tax Laws Amendment (2009 measures No. 5) Bill 2009 (Cth) Explanatory Memorandum at [98].

dealing with the situation where an external administrator is appointed to the *company*. A receiver, receiver and manager, liquidator or voluntary administrator is appointed to a *company* in the sense that each of them acts as agent of the company.[3] On the other hand an agent for the mortgagee in possession is by definition not an agent of the company. He or she is not able to bind the company by way of contract or otherwise. The responsibility for transactions, within the scope of the agency, rest with the principal. As is accepted this will include any liability that arises for GST. Hence, an agent for the mortgagee is not a representative of an incapacitated entity in any sense under the general law. In the typical case, the agent in these circumstances will be in control only of certain assets or aspects of the company. By way of accepted definitions[4] of the term receiver or receiver and manager, the term will apply to situations where the possession of assets of the company are taken but as agent of the *company* rather than the *mortgagee*. Therefore there is no need for the personal liability of the insolvency practitioner which is created within Division 58 as an agent for the mortgagee has the mortgagee as principal, standing behind any transaction. The mortgagee, unlike an insolvent debtor company in Division 58, is likely to have the capacity to pay amounts due for GST on transactions its agent has effected on its behalf.

9. The *Corporations Act* does extend certain powers of sale to receivers in s 420 (as does the instrument of the appointment usually) but there is no such legislative extension to controllers. Given that Division 105 covers the position of a creditor selling a debtor's property where it is in satisfaction of a debt, it is difficult to understand the need to extend the definition of 'representative' and hence 'incapacitated entity' in this way. Whilst the proposal to expressly provide for Division 105 to prevail would be effective, it would make much more sense to eliminate the source of the problem.
10. It has been suggested[5] that Division 105 is limited by the term "property" and that it

> *.. would not apply to the provision of services (eg, where a mortgagee in possession carries on the undertaking of a company which is a service provider).*

Hence, it is suggested that Division 105 would not catch this type of sale of services. Would this justify including a controller in Division 58? We argue against this as the definition of controller in s 9 of the *Corporations Act 2001* (provided above) is in terms of control or possession of *property* of the corporation. Whilst the term property is also defined in s9 of the *Corporations Act 2001*, it is by no means clear that the term controller would cover the

[3] See s 437B in the case of administration, in the case of liquidation see s 477 and *Re Farrow's Bank* [1921] 2 Ch 164 and in the case of receivership it will depend upon interpretation of the mortgage agreement but this is a fundamentally standard clause: see for example *Gaskell v Gosling* [1896] 1 QB 669.
[4] See O'Donovan J., ThomsonReuters, *Company Receivers and Administrators* (at 17 May, 2011) [10.50].
[5] Perez, M at http://www.aar.com.au/pubs/tax/tax1nov01.htm

situation described in the quote above either. Typically in such circumstances a receiver would be in control of the company and be exercising the powers like those in s 420. These would be as agent of the *company*. Further, as noted above if an agent for the mortgagee is conducting such a business as described in the quote, the obligation for GST will fall as a matter of general law on the principal – that is the mortgagee.

11. There have been doubts cast upon the effectiveness of Division 105 in the context of a sale by an agent for the mortgagee and perhaps by the mortgagee themselves because it is argued that there is no supply as such by the mortgagee or its agent.[6] We are not certain that such a difficulty exists on the present wording. However, if there is a problem it would seem that merely amending the legislation to provide for Division 105 to prevail over Division 58 in the circumstances would not resolve the problem. Specifically we submit that this difficulty, if it exists, needs to be overcome by way of a change of the wording of Division 105 to make certain that a sale effected by a mortgagee or an agent for the mortgagee in possession on behalf of a debtor is a supply of property by the mortgagee or their agent.
12. In summary, we argue the best way to deal with the issue of the possible operation of both Division 105 and Division 58 is to remove the trigger for the operation of Division 58 in circumstances covered by Division 105. Namely remove from the definition of "representative" in s 195-1 paragraph (ca) –controller. As we show above, this will remove duplication as well as allow both Divisions to continue to work in the areas that they are intended to operate within. There would be no loss of impact in Division 58.

In addition, if it were felt necessary to remove all doubts about Division 105, it may be amended to specifically deem any disposal effected by the mortgagee or agent of the mortgagee to be a supply of property by the mortgagee.

Colin Anderson, *School of Law, Queensland University of Technology, Brisbane*

Catherine Brown, *School of Law, Queensland University of Technology, Brisbane*

David Morrison, *T C Beirne School of Law, The University of Queensland, Brisbane*

[6] See for example Sommer A., Schofield R., and Gates S., *Tax & Insolvency* (ThomsonReuters, 3rd ed.,, 2011) [14 370] and Perez, M at http://www.aar.com.au/pubs/tax/tax1nov01.htm .