Australian Unity

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By email transmission: gstpolicyconsultations@treasury.gov.au

Dear Sir /Madam,

Review into the Goods and Services Tax (GST) treatment of property in possession of a mortgagee

We at Australian Unity Limited (AU) thank you for the opportunity to make a submission in respect of the prospective amendment to the law with regards to the GST treatment of property in possession of a mortgagee.

AU is a national healthcare, financial services and retirement living organisation. We are both a public company and a mutual organisation with a heritage dating back 170 years. Our Australian Unity Investments division provides specialist mortgage products to a wide range of investors ranging from individuals to property developers.

One of the proposed amendments in the 2011-12 Federal Budget handed down on 10 May 2011 is clarification to *A New Tax System (Goods and Services Tax) Act 1999*[1] (GST Act) that when a mortgagee in

[1] All references are from the *A New Tax System (Goods and Services Tax) Act 1999* unless otherwise stated.

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possession or control sells the property of a corporation, Division 105[2] of the GST Act will operate to the exclusion of Division 58[3]. This is proposed to be effective prospectively from 1 July 2012 and we understand that the purpose is to reduce compliance costs for those in the mortgage lending sector by allowing GST obligations to be reported under a single registration[4].

To give effect to this announcement, the Consultation Paper of 7 June 2011 proposes that definitions that are currently contained in section 195-1 of the GST Act be amended to expressly provide that Division 105 will operate to the exclusion of Division 58 where a mortgagee in possession or control sells the property of a corporation.

At this juncture we submit that Treasury should clarify that not only does a mortgagee in possession sell the property of a 'corporation', it could sell the property of any 'entity' and therefore it should cover all kinds of legal persons.

AU welcomes this review and acknowledges that there is a need for clarification on the overlap between Division 105 and Division 58 as this will add certainty for entities engaged in the business of mortgage lending. In particular, AU has set out below a number of additional comments and observations, which in our view will better achieve Government's intended policy objective.

1. Which 'Division' takes precedence

We acknowledge that the intention of the proposed amendment is very clear. That is, when a mortgagee in possession or control falls within the ambit of both Divisions 58 and Division 105 of the GST Act, Division 105 (being more specific) is to prevail over Division 58 (which is a more general provision).

By way of background, as a result of the Federal Court decision in *Deputy Commissioner of Taxation v PM Developments Pty Ltd* [2008] FCA 1886, *Tax Laws Amendment (2009 Measures No.5) Bill 2009* was introduced on 4 December 2009 to replace Division 147 with Division 58. At the time, the proposed Division 58 sought

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[2] Which is about 'Supplies in satisfaction of debts'

[3] Which is about 'Representatives of incapacitated entities'

[4] Budget Paper No.2 (Budget Measure 2011-12)

to clarify the GST characterisation of supplies and acquisitions that are made by the representative of an incapacitated entity. The design was to ensure that the GST consequences of supplies and acquisitions made during an appointment are tested against the attributes of the incapacitated entity, and not the representative; but nevertheless deem the representative to be personally liable for any GST payable during the representative's appointment.

Similarly, Division 105 that is already in place deals with supplies made by creditors (i.e. a lender) of property belonging to a debtor (i.e. a borrower) where the supply is made in satisfaction of a debt owed to the creditor. In the circumstance that the supply would be a taxable supply if the debtor were to make it, the supply would be treated as a taxable supply in the hands of the creditor[5]. Therefore, the creditor is liable for any GST payable on the supply of the debtor's property.

At the same time that Division 58 was introduced, an amendment was made to the definition of 'representative' to include 'a controller (within the meaning of section 9 of the *Corporations Act 2001*)'. As a result, circumstances could arise where a creditor could technically fall under both Division 58 and Division 105 as the mortgagee in possession of a property of a corporation can be by definition a 'representative' for the purposes of the Corporations Act 2001.

Therefore, we agree with the proposed review by Treasury and we submit that Division 105 should take precedence over Division 58. We reiterate that Division 105 should continue to equally apply where the entity is a 'corporation' as well as all other legal entities. We believe that this achieves the policy objective of Government of reducing compliance costs[6].

We strongly recommend that the preferred way of achieving this policy objective is not via amending the definitions in section 195, but rather through an additional 'exclusion' subsection at section 58-10(2). We believe this to be the appropriate and logical place for this amendment given that this sub-section already refers to other provisions of the GST Act, being Division 83, 84 and 100.

[5] For completeness, the supply will not be a taxable supply if the requirements under subsection 105-5(3) are satisfied.

[6] There is at the very least an administrative saving of not having to separately register for GST.

On the basis that Government has agreed to make changes we now take the opportunity to bring to light below the current difficulties with administering Division 105 and we set forth our recommendations to provide more clarity to taxpayers.

2. Clarity is needed in the application of the exclusions under Division 105-5(3)

AU proposes that Treasury provides clarity on the practical operation of subsection 105-5(3) of the GST Act for the purposes of determining whether or not a supply is a taxable supply. We submit that clarity could be obtained by the inclusion of clear examples in the notes to this subsection as a benchmark for the appropriate level of information required in order to qualify for this exclusion to a taxable supply.

Subsection 105-5(3) provides that a supply is not a taxable supply if either:

> (a) the debtor has given you a written notice stating that the supply would not be a taxable supply if the debtor were to make it, and stating fully the reasons why the supply would not be a taxable supply; or
>
> (b) if you cannot obtain such a notice – you believe on the basis of reasonable information that the supply would not be a taxable supply if the debtor were to make it.

We note that paragraph 6.178 of the Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998* makes it clear that this subsection was intended to ensure that when applying any GST provisions relevant to determining whether or not the supply is a taxable supply, the creditor as the mortgagee in possession can treat a supply as if the debtor were to make it. The ATO has also expressed the same view in various rulings or interpretative decisions[7].

How a property could be sold

Therefore, Division 105 operates such that the creditor (being the mortgagee in possession) is taken to be 'standing in the shoes of the debtor' when the creditor makes the supply in satisfaction of a debt owing.

Based on this premise, a creditor is required to consider the manner in which the debtor may have sold the property and therefore is required to consider the various GST characterizations that may apply to a sale of

[7] See ATOID 2001/112 Goods and Services Tax: GST and mortgage in possession and ATOID 2004/35 Goods and Services Tax: GST and renting property by a property

real property. Treasury would be well aware that a sale of a property could be characterised in a number of ways, and the list below is not intended to be exhaustive:-

(i) A taxable supply of new residential premises under section 40-65(2)(b); or

(ii) A taxable supply of commercial residential premises under section 40-65(2)(a); or

(iii) A taxable supply to which the margin scheme could apply under Division 75; or;

(iv) *Prima facie* a taxable supply but one that qualifies for GST-free going concern status under section 38-325; or

(v) An input taxed supply of not 'new' residential premises under section 40-65(1).

We additionally comment that with regards to the margin scheme, Treasury would be well aware of the complexities of these set of provisions. From a practical view point, it is difficult for a creditor to ascertain whether a supply would be eligible or not[8] for the margin scheme. The difficulty is compounded where the debtor may have acquired the property before 1 July 2000 (pre-GST) and is therefore required to have an 'approved valuation' to substantiate the calculation of the margin. The creditor may not have access to such information. Furthermore, even if the property was acquired post 1 July 2000 and the 'consideration method' applies, the debtor could refuse to supply the creditor with the original property purchase contracts as the relationship between debtor and creditor has usually deteriorated by then.

The above complex sets of considerations for the creditor are hinged on the assumption that the creditor would have all the necessary information available to them as if they were the debtor.

A creditor is additionally required to consider whether the debtor meets the GST turnover requirements under Division 188. Where the debtor is in voluntary administration or is bankrupt, we have found many instances where the debtor is no longer registered for GST around the time the property is to be sold. Therefore, there is an added layer of complexity for the creditor in that it is required to determine if the debtor would have been required to be registered for GST if it were to supply the property.

We additionally note that there is great difficulty for the creditor in considering whether the supply might be excluded under section 188-25[9] as the creditor would need to make a reasonable assessment as to whether the debtor is ceasing to carry on an enterprise or is substantially and permanently reducing the

[8] Section 75-5(3) GST Act

[9] Which is about 'transfer of capital assets, and termination etc. of enterprise, to be disregarded'

size of or scale of an enterprise. A creditor may not have adequate information in order to be able to make a proper assessment.

The reality of all the above decisions and permutations that a creditor has to consider will practically mean that it will end up paying GST, whereas if it had all the relevant information to base its decision on it may find that no GST was in fact payable. This is commercially detrimental to the creditor as it would be required to significantly increase its provision for loan losses in its accounts.

Reliance on the written notice provided by the debtor

We believe that greater certainty could be provided to a creditor if Treasury can clarify section 105-3(a). Specifically, we believe that there is scope for Treasury to define what the 'written notice' is and how that is to be expressed in writing by the debtor. In particular, we recommend that a standard prescribed 'form' could be issued and administered by the ATO that would constitute an acceptable written notice that would not be subject to challenge.

We mention the above as even though the ATO has set out situations in the context of a GST-free supply of a going concern in GST Ruling GSTR 2002/5, where subsection 105-5(3) would treat the supply as being not a taxable supply, the ruling does not offer any helpful guidance as to the form of the written notice or the level of details required to be compliant with the concept of 'stating fully the reasons' as to why the supply would not be a taxable supply.

Similarly, the legislation in section 105-3(b) contemplates a hypothetical or notional supply by the debtor and if the actual information cannot be obtained from the debtor, there is no guidance on what would constitute the required 'reasonable information' in order to make an assessment if 'the supply would not be a taxable supply if the debtor were to make it'. We reiterate that clarity could be obtained by providing clear examples in the notes to this subsection or via an ATO product ruling or factsheet.

We submit that the above recommendations are appropriate for Treasury to consider and we do not believe that they have any adverse consequences to tax revenue.

In the absence of any further clarification and guidance from Treasury, the requirements for the contemplated relief under Division 105 to reduce compliance costs for taxpayers are difficult to satisfy in practice.

[Our response to Focus Question 1]

To reiterate, we submit that Division 105 is the appropriate division and should take precedence over Division 58. Therefore, we agree with the proposed amendments to state this. We strongly recommend that the preferred way of achieving this policy objective is not via amending the definitions in section 195, but rather through an additional 'exclusion' subsection at section 58-10(2). We believe this to be the appropriate and logical place for this amendment, given that this sub-section already refers to other provisions of the GST Act, being Division 83, 84 and 100.

Should you have any questions in relation to any of the above, please do not hesitate to contact Mark Bird, Head of Group Taxation Services on (03) 8682 6004.

Yours sincerely

A. V. Connon
Chief Financial Officer &
Public Officer