challenger

Sydney

Level 15, 255 Pitt Street
Sydney NSW 2000 Australia
GPO Box 3698
Sydney NSW 2001
www.challenger.com.au

Telephone 02 9994 7000
Facsimile 02 9994 7777

24 February 2012

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

By email - FinancialSupplies@treasury.gov.au

Dear Ms Berkeley

Submission on Exposure Draft Regulations – GST Financial Supply Provisions

We refer to the Exposure Draft Regulations released on 13 January 2012 **("Draft Regulations")** in relation to the GST Financial Supply Provisions. Amongst other things, the Draft Regulations propose a new Item 32 to the list of reduced credit acquisitions in Regulation 70-5.02(2) of the *A New Tax System (Goods and Services Tax) Regulations* 1999 (**"GST Regulations"**).

Background

Established in 1985, Challenger Limited (Challenger) is an investment management firm that was listed on the Australian Securities Exchange (ASX:CGF) in 1987.

The foremost issuer of retail annuities in Australia, Challenger is the only financial services company dedicated to providing guaranteed, certain-return income stream products to both institutional and retail clients.

Today, the investment team in Challenger's APRA-regulated Life company, Challenger Life, manages over $8 billion in assets to secure income for approximately 60,000 clients.

In addition to making and meeting promises of guaranteed income and capital returns, Challenger is also a successful investment manager across various asset classes, has acquired interests in a number of leading boutique funds and acts as a gateway to other expert investment managers.

The comments in this letter are of particular interest to Challenger and its related entities and business activities.

In the interests of time, the comments made in this letter are high-level in nature. However, please do not hesitate to contact us for more details regarding specific comments or submissions outlined in this letter.

Challenger comments on the Draft Regulations

1. General comment – Draft Regulations seem far beyond addressing policy intent

It seems clear that the Draft Regulations are aimed at addressing the perceived advantages associated with "bundling" acquisitions into an acquisition of trustee services. However, addressing such an issue only requires that the reduced input tax credit (**RITC**) rate for trustee services only be reduced, rather than the wide range of other services currently listed in the GST Regulations that are proposed to be affected.

To the extent that the rate for RITCs for any service other than the trustee services mentioned in items 23(c), 23(d) and 29, the potential operation of the Draft Regulations would have adverse implications for taxpayers that are far beyond addressing the stated policy intent. A specific example is covered in the next point.

If the Draft Regulations are aimed at addressing the stated policy intent, it is suggested that item 32(b) should be clarified to refer positively to services covered by items 23(c), 23(d) and trustee services covered by item 29.

2. Operation of Draft Regulations is inconsistent with existing Government policy – "Competitive and Sustainable Banking System" package

Managed investment schemes can include mortgage funds whose assets that used to provide competitive loans to the public. Such funds may incur a variety of costs such as loan agency and mortgage broker costs, lenders mortgage insurance, loan application, management and processing services and debt collection services, which may currently qualify for 75% RITCs.

Where such costs are incurred directly by such entities, there is no bundling of services. Based on the stated policy intent, the GST treatment of such costs should not be affected by the Draft Regulations. However, under the Draft Regulations, the RITC rate for these services acquired by mortgage funds will be reduced to 55%.

The Draft Regulations would adversely affect the cost structure of lenders in trust form, making the cost of such services relatively more expensive than similar costs incurred by lenders in corporate form, which would include major banks and credit unions. In this context, the Draft Regulations appear to inappropriately discriminate against lenders in trust form in favour of lenders in corporate form, with no clear reason in policy for doing so. As a result, the Draft Regulations may have the inadvertent effect of inherently discouraging competition by lenders that are in trust form.

Such an outcome would be clearly inconsistent with the "Competitive and Sustainable Banking System" package announced by the Federal Government on 12 December 2010, which is in the process of being implemented in subsequent legislation. One of the stated aims is to "*... ensure that we have both a competitive and a sustainable banking system. It is absolutely central to our economic agenda. Now, there are three aspects to the reforms ... [the second aspect being] to help our smaller lenders to compete with the bigger banks ... this package is all about helping the customers ... and business so that we can build up competition in our banking system which will ensure that interest rates are lower over time ... smaller lenders play a vital part in this objective. We need our smaller lenders to be able to compete vigorously with the big banks, forcing them, if you like, to do better by their customers.*" (Transcript from Treasurer's Press Conference, Canberra, 12 December 2010). The second stream of that package is entitled "Stream Two: Support Smaller Lenders to Compete with Big Banks" (see the Treasurer's publication entitled "Competitive and Sustainable Banking System" dated 12 December 2010).

To the extent that the Draft Regulations would increase the relative costs of smaller lenders in trust form as against relatively larger lenders in corporate form, the Draft Regulations would operate in a manner that is

clearly inconsistent with the Government's own policy objectives as outlined above. Such an outcome could not have been intended as a matter of policy or application.

Proposed item 32(b) should be clarified so that items 11, 12, 13, 14, 15 and 17 are also excluded from those services that would attract the reduced 55% RITC rate under item 32.

3. Significant uncertainty on entities affected – managed investment schemes

The Draft Regulations impose a 55% RITC on certain acquisitions by "recognised trust schemes", which include any "managed investment scheme within the meaning of section 9 of the *Corporations Act 2001*": proposed subregulation 70-5.02(5)(a).

Such a concept raises significant uncertainty for all taxpayers in determining whether entities are managed investment schemes (as defined), particularly in circumstances where an assessment has not previously been required (e.g. where it is clear that a trust is not a registered scheme).

Reliance on the current definition of managed investment scheme introduces potentially arbitrary and inconsistent outcomes. For example, there may be an argument that:

- a unit trust owned beneficially within a corporate group could be a managed investment scheme merely because some units in the trust are held through an external trustee acting for another corporate group member. However, such a trust may not be a managed investment scheme if its units were held directly by another corporate group member; or
- a unit trust could be a managed investment scheme merely because it has a nominal unit held by an external entity outside a corporate group, even though all other remaining units are held within the corporate group. However, the unit trust may not be a managed investment scheme if all units were held within the corporate group.

As a result of such definitional issues arising under the Draft Regulation, individual trusts under similar structures may or may not be within the scope of proposed item 32, with no apparent policy reason for any difference in GST outcomes across such trusts.

Such uncertainty is considered to be clearly inappropriate and urgent clarification is required. Furthermore, imposing a new requirement to assess whether each trust entity is a managed investment scheme in circumstances where no such assessment has been previously required, would further jeopardise the ability of taxpayers to achieve timely compliance with item 32.

In order to provide greater certainty and facilitate a more timely identification of affected entities and implementation of item 32 by taxpayers, the definition of "recognised trust scheme" in subregulation 70-5.02(5)(a) should be clarified to refer to a registered managed investment scheme.

4. Clarification on services affected – management services

The policy intent under the Draft Regulations seems to be that management services will attract a 75% RITC while trustee or responsible entity services are to attract a 55% RITC.

Responsible entities are generally responsible for discharging all obligations of the trust including responsibilities to manage the assets and act as trustee. In these circumstances, if a responsible entity were to receive a single fee for discharging all responsibilities of the trust, it is assumed that policy intent would require that the trust be entitled to 75% RITCs *to the extent that* the broader services provided by the responsible entity comprise management services and 55% RITCs *to the extent that* those services are

trustee services that otherwise fall within item 32. (That is, the trust should not be seen as acquiring only trustee or responsible entity services that only qualify for 55% RITCs.) However, such an outcome is not sufficiently clear from the Draft Regulations or in the Explanatory Memorandum (e.g. examples).

Urgent clarification is requested to the Draft Regulations and Explanatory Memorandum to ensure that the acquisition of management services will continue to qualify for 75% RITCs, regardless of whether such services may be acquired in conjunction with other services.

5. Rate

From an implementation perspective, significant changes would be required to implement a reduction of RITC rate to 55% for certain services only. Furthermore, the choice of a non-standard percentage such as 55% may cause difficulties in the course of implementation due to its effect on systems, calculations, rounding and disclosure obligations.

It is submitted that a reduction of the RITC rate to a more rounded percentage such as 60% under Item 32 would facilitate a smoother and more timely implementation for taxpayers.

6. Other transitional issues

The changes proposed to be introduced by the Draft Regulations were only announced in January 2012 for implementation within a 6-month timeframe, and were not canvassed in the original options proposed in the Treasury consultation process. This is expected to create significant difficulties in implementation for the industry, noting other initiatives also being implemented by taxpayers in the Funds Management industry include Shorter PDS commencing in June 2012 and upcoming FOFA initiatives.

The main transitional issues include:

(a) **Systems and processes will be more complex** - Revising systems and processes to address multiple rates of RITCs for different services, also different rates of RITCs for the same services acquired by different entities and conducting appropriate apportionment as required. Such changes will be extremely difficult to implement, particularly in circumstances where the Draft Regulations are yet to be finalised and, once finalised, there will only be a period of several months to implement the changes.

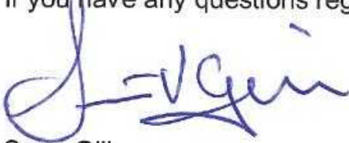
(b) **Inability to negotiate with suppliers** – Unlike other GST transitional arrangements (such as GST transitional rules and margin scheme amendments), the Draft Regulations may result in costs of acquiring certain services to increase for trusts, which are relatively unexpected (as mentioned above) and without any practical ability to renegotiate with suppliers in the lead up to the 1 July 2012.

(c) **Disclosure changes** – PDS and similar documents issued both before and after 1 July 2012 may need to be reissued in a timely manner in light of any potential changes to costs.

It is submitted that Treasury should consider:
1. introducing appropriate transitional rules to grandfather current arrangements under which fees spanning 1 July 2012 are unable to be renegotiated; and
2. given the extremely tight timeframes involved and other current law reform priorities affecting the financial services industry, an appropriate deferral of implementation by some period of time (say 1 January 2013).

challenger

If you have any questions regarding this letter, please contact Jeffrey Lum on (02) 9994 7287.



Sean Gill
General Manager – Taxation
Challenger Limited

Jeffrey Lum
Head of Indirect Taxes
Challenger Limited

10343/CG045/0408