THE TAX INSTITUTE

24 February 2012

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

Email: FinancialSupplies@treasury.gov.au

Dear Sir,

***A New Tax System (Goods and Services Tax) Amendment Regulations 2012 (No.) -* Exposure Draft**

We refer to the *A New Tax System (Goods and Services Tax) Amendment Regulations 2012 (No.) -* Exposure Draft ("**Exposure Draft Regulations**")–and accompanying Explanatory Memorandum released on 13 January 2012 and make the following submissions in respect of:

- Reduced Input Tax Credits ("**RITC's"**) for Recognised Trust Schemes
- Changes to the alteration of input tax credits for hire purchase arrangements.

1. RITC's FOR RECOGNISED TRUST SCHEMES

Description of change

While an announcement was made in May 2010 that there would be changes to the GST treatment of trustee and responsible entity services, the Exposure Draft Regulations significantly change the RITC treatment for entities caught by the proposed regulations.

The Tax Institute recommends that the Explanatory Memorandum describe the changes more appropriately (i.e. RITC's for Recognised Trust Schemes ("**RTS**")) as the changes apply to many acquisitions other than Trustee and Responsible Entity services.

Commencement date

The commencement date for the proposed regulations is for acquisitions made from 1 July 2012.

The Exposure Draft Regulations were only released on 13 January 2012 and we envisage that the regulations will not be tabled in to Parliament until May this year.

There is insufficient time for entities, even if they have already commenced making changes, to implement the changes pre 1 July 2012. In addition, commercially many entities are not prepared to incur large costs until proposed changes become law.

Many superannuation funds and investment funds have outsourced administrators who undertake the GST accounting services for them. These outsourced providers have IT systems which rely on software provided by IT software suppliers.

Some of the IT software only allows one RITC rate. It is inconceivable that the IT software will be able to be changed and that trustee and responsible entities will be able to provide the appropriate instructions to their outsourced providers pre 1 July 2012. Our understanding is that one major IT software provider will take at least six months to amend the software.

In light of this, many entities will incur significant costs in creating work around solutions until the systems are updated. Not only will this create significant expense, it will also create a significant risk of poor GST compliance. This is not desirable from either a taxpayer's perspective or from a revenue authority's perspective.

In addition, the Product Disclosure Statements ("**PDS**") for investment funds and superannuation funds commonly refer to a 75% RITC rate and calculate the Management Expense Ratio ("**MER**") based on an after GST costs basis.

Many trustees and responsible entities ("**RE's**") have recently issued PDS's and are not scheduled to issue further PDS's pre 1 July 2012. Significant costs will occur if they are forced to issue new supplementary PDS's pre 1 July 2012.

The Tax Institute strongly recommends that the implementation date be postponed to at least 1 January 2013.

Overall design of the Exposure Draft Regulations

Rather than changing the regulations in respect of the trustee and RE fees, the draft regulations have been drafted in an all-embracing way that captures services acquired by RTS. The draft regulations then provide exclusions in respect of various types of acquisitions that will maintain the 75% RITC.

This approach creates significant risk, namely:

- entities which are not meant to be caught are caught;
- acquisitions that should be eligible for a 75% RITC are only eligible for a 55% RITC; and
- acquisitions that should be entitled to a 55% RITC do not get one.

We have outlined below some of the problems that we have identified, and we are concerned that there will be other problems which will need to be addressed.

Entities which are not meant to be caught – Definition of RTS

The Tax Institute is concerned in respect to the definition of a managed investment scheme ("**MIS**") being used within the definition of an RTS.

In particular the definition of MIS in section 9 of the *Corporations Act* 2001 (Cth) is very broad and includes schemes which are both registered and unregistered. As a result, the RTS definition has the potential to catch MIS's that may not have been intended to be caught, for example, Investor Directed Portfolio Services ("**IDPS**").

The Tax Institute is further concerned that the definition includes unregistered managed investment schemes. Generally, unregistered MIS's are not regulated as MIS's. In addition, it is unclear and is not generally necessary to determine, whether some trusts subject to alternative regulatory regimes are in fact unregistered MIS's.

For example, there is uncertainty as to whether certain securitisation trusts are unregistered MIS's or not and there is a view that some securitisation trusts are unregistered MIS's. These trusts should not be caught by the new regime.

The Tax Institute recommends that the definition of an RTS be amended. One possibility is for the definition to only include registered MIS's, another possibility is for regulations to specifically list the types of trusts intended to be captured by these amendments. Another alternative is to exclude certain specified trusts: IDPS, securitisation trusts etc.

Acquisitions that should be eligible for 75% - Further exceptions

The proposed Item 32(b) exceptions were probably drafted with equity trusts and superannuation funds in mind. Insufficient consideration may have been given to the exceptions which are required for other entities.

As an example, we note that mortgage trusts, which are registered MIS's, are caught by the new regime and that under the proposed regulations there will be costs such as mortgagee insurance, loan recovery costs, etc. which will only be entitled to a 55% RITC. These acquisitions are currently eligible for 75% RITC's.

In addition, we note that the proposed regulations will catch property trusts and infrastructure trusts. While these entities would generally only make taxable supplies, it is not uncommon for them to engage investment banks to facilitate capital raisings and make acquisitions of units and shares.

The Tax Institute recommends that Treasury determine what entities are caught and then expands the 75% exemptions to include items such as items 5, 9, 11-15, 17 and 27.

As the above examples are unexpected abnormalities, they were probably not factored into the revenue calculation and can therefore be included in the 75% exemption list without impacting on the revenue projections.

The Tax Institute also recommends that paragraph 32(b)(i) not be limited to "brokerage", which is not a term actually used in items 9 and 21, but should cover all acquisitions under item 9 and 21.

Acquisitions that should be entitled to a 55% rate - Services

Draft regulation 32 applies to "services" acquired by an RTS.

In contrast with various overseas jurisdictions, "services" is not a defined term for Australian GST purposes. For example, in Canada the term "services" is defined to include "anything other than property". The scope and application of the term "services" is clear in those jurisdictions in which the term is defined for GST/VAT purposes.

We consider that use of the term "services" may be burdensome from a compliance perspective in attempting to determine precisely what acquisitions the regulation applies to.

The absence of a definition for "services" in Australia may result in classification issues and uncertainty as to what the draft regulation applies to. For example, it may be difficult to determine whether some marketing or IT expenditure is a service or not.
The lease of an office premises does not appear to be a service but should be eligible for a 55% credit. If it is not, then there will be a bias towards bundling accommodation costs within trustee services.

The Tax Institute recommends that the term “services” be:

- replaced by the term “supply”. If considered necessary, the supply of goods could be excluded;
- specifically defined.

Recognised Trust Scheme – Proposed paragraph 32(a)

The proposed paragraph 32(a) requires that the trustee of an RTS must carry on, in its own capacity, an enterprise that includes making taxable supplies to the RTS.

The Tax Institute does not understand why paragraph 32(a) exists. It does not appear to serve any valid purpose.

It is not uncommon for there to be arrangements where there is no taxable supply being made to an RTS by its trustee and therefore, item 32 would not apply. For example, it is not uncommon:

- for a trustee of a superannuation fund to also act as trustee of a trust controlled by a superannuation fund. The trustee commonly charges a fee solely to the superannuation fund. The trust does not fall within the proposed item 32 as the trustee’s enterprise does not include making taxable supplies to the trust. [We note also that the trust may not be an RTS; refer below.]
- for a trustee of a superannuation fund not to be registered for GST purposes as all the expenses are incurred by the superannuation fund.

Whether an RTS falls within paragraph 32(a) depends, among other things, on whether consideration is charged. It keeps alive the issue as to whether a trustee is incurring costs in its capacity and on-charging or incurring the costs in the capacity of a superannuation fund.

The proposed paragraph may therefore still create a bias between how superannuation funds incur costs. It creates an opportunity for entities to determine which RITC regime they fall within.

The Tax Institute recommends that consideration be given to excluding paragraph 32(a) from the proposed item 32.

Voluntarily opting into a new regime

We note that there will be circumstances where the new regime, as currently proposed, will apply to a superannuation fund or a trust, but one or more controlled entities (possibly wholly owned or grouped by the trust or superannuation fund) will have the existing RITC regime applying to them. For example, you could have item 32 applying to a superannuation fund and item 32 not applying to a unit trust, whose units are owned 100% by the superannuation fund which is grouped with the fund. In this scenario, there is complexity for the group to comply with the GST laws and there is a bias between which entity is charged.

The Tax Institute recommends that the proposed regulations be amended to allow RTS’s to make an election that entities controlled by them can also be treated as RTS’s, or alternatively that RTS’s be defined to include entities controlled by an RTS as currently defined.

Unbundling of Fees

We understand that it is Treasury's intention that, under the proposed regulations, fees charged by a trustee or an RE will still be entitled to a 75% RITC to the extent that the fee relates to an item listed in the proposed paragraph 32(b).

We note that the Explanatory Memorandum, however, indicates in the diagram that there is only a 55% RITC entitlement for charges from a trustee and example 3 specifically indicates that there is only a 55% RITC in respect of the costs of the Trustee administering the fund; it is therefore not clear whether the administration costs fall within item 24.

The Tax Institute strongly recommends that:

- the regulations clearly indicate that it is possible to treat services from a trustee or RE as being a mixed acquisition, with the services set out in paragraph 32(b) being subject to 75% RITC and other services being subject to 55% RITC.
  This could possibly be achieved by inserting the words "to the extent" at the start of paragraph 32(b).

- the Explanatory Memorandum be amended to overcome the inconsistency identified above.

- the Explanatory Memorandum give guidance as to how in practice this unbundling would occur.

2. HIRE PURCHASE ARRANGEMENTS

The Exposure Draft Regulations propose amendments to ensure that credit given under hire purchase agreements entered in to after 1 July 2012 in relation to goods is not a financial supply.

As a consequence of this amendment, a question has been raised as to what the GST treatment of a credit provided under a hire purchase arrangement for GST-free goods such as medical equipment will be.

One view is that a hire purchase arrangement constitutes the hiring of goods with an option to acquire the goods at the end of the arrangement. Even if the credit charge is separately disclosed, then arguably it still forms part of the hire of the GST-free goods and hence the credit charge is also free from GST.

If the credit charge is not part of the supply of hiring, then it may well be a taxable supply as it may not fall within another GST-free provision such as section 9-30(1)(b) i.e. the supply of the right or option to receive a GST-free supply.

The Tax Institute recommends that it be confirmed, preferably by the way of legislative amendment, that credit relating to the hire purchase of GST-free goods is GST-free.

If you would like to discuss this matter, please contact me on (02) 8223 0011 or the Tax Institute's Tax Counsel, Stephanie Caredes, on (02) 8223 0059.

Yours sincerely

Ken Schurgott
President