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General Manager
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The Treasury
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24 February 2012

Attention: Mr Rob Dalla-Costa

Dear Sir

A New Tax System (Goods and Services Tax) Amendment Regulations 2012 - Exposure Draft

Ernst & Young welcomes the opportunity to make this submission to Treasury in response to the release of the Exposure Draft of the *A New Tax System (Goods and Services Tax) Amendments Regulations 2012* (hereafter referred to as "the Exposure Draft") on 13 January 2012. In preparing this submission we have canvassed the views of a significant number of our clients within the superannuation and wealth management industry.

Our submission is restricted specifically to the proposed inclusion of Item 32 in subregulation 70-5.02(2) of the *A New Tax System (Goods and Services Tax) Regulations 1999* ("GST Regulations"), affecting reduced input tax credit ("RITC") entitlements for the acquisition of trustee and responsible entity ("RE") services. These are specifically covered in Items 7, 8 and 9 of Schedule 1 to the Exposure Draft.

In our view, the proposed reform of RITC entitlements for the acquisition of trustee and RE services as contemplated in the Exposure Draft represents the most significant GST change to affect the superannuation and wealth management sectors since the introduction of GST. This is due to the breadth of its application, potential flow-on impact upon existing commercial agreements, pricing structures, product disclosure requirements, administrative processes and operating systems for both trustees/REs and funds.

This submission therefore seeks to address those issues which we consider to be significant policy matters requiring clarification and address a number of other matters where the provisions in the Exposure Draft and their intended operation remain uncertain. We have also included other suggested refinements where we consider the operation of the provisions could be enhanced to better serve the policy objectives that have been expressed in the Explanatory Memorandum ("EM") to the Exposure Draft.

In summary our recommendations are outlined below:

- **Recommendation 1:** As the proposed Item 32 will apply more broadly than merely "protecting the GST base", it should be reconsidered from a policy perspective and better targeted to address the bundling issue given the expected impact the change could have on many trustees/REs that have not restructured their affairs since the introduction of GST and therefore have not bundled additional expenditure within their fee structures.

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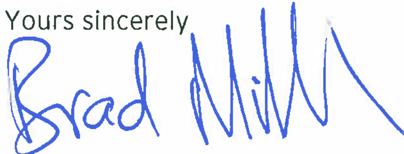
- **Recommendation 2:** We recommend that the requirement for the trustee/RE to be separately registered for GST be deleted.
- **Recommendation 3:** The language used in Item 32 to be amended to make it clear that it applies to both Trustees and Responsible Entity arrangements.
- **Recommendation 4:** That the Exposure Draft and EM be amended to make it clear that from a policy perspective apportionment of Trustee/RE fees can be undertaken purely by way of an accounting exercise without the need for changes to other contractual documentation, invoicing arrangements, etc.
- **Recommendation 5:** That the Exposure Draft be amended to make it clear as to whether the proposed changes are intended to apply to entities such as securitisation trusts.
- **Recommendation 6:** That paragraph (b) of Item 32 and subregulation 70-5.02(4) are re-drafted to expressly state that the 55% RITC rate only applies to the extent an acquisition is covered by Item 32.
- **Recommendation 7:** That the EM to the Exposure Draft includes further specific examples of acceptable approaches that can be adopted to apportion trustee and RE fees.
- **Recommendation 8:** That paragraph (b) of Item 32 of the Exposure Draft is re-drafted to preserve the existing 75% RITC entitlement for all services that currently qualify as RCAs to ensure the measures are specifically targeted at the issue of bundling trustee / RE services do not unnecessarily apply more broadly.
- **Recommendation 9:** That the proposed commencement date be deferred by 12 months to allow adequate time for taxpayers to assess the impact of the change and make necessary changes to the systems, published documentation, etc to comply with the new GST Regulations.

Our detailed comments and recommendations are included in Appendix 1 below. Once you have had an opportunity to consider the detailed comments attached and appreciate the significance of this proposed change to the industry, we believe you will appreciate the need to defer the commencement of these changes for 12 months.

Should you have any questions or would like to discuss our submission further please do not hesitate contact me directly on (03) 9655 2718.

Yours sincerely



Brad Miller
Partner - Indirect Tax

Att.

Appendix 1

Detailed comments

1. Policy issues

1.1. Intended policy objective

1.1.1. The Government's primary policy rationale underlying the proposed change is "*...protecting the GST base by reducing opportunities for businesses to inappropriately take advantage of the reduced input tax credit concessions by bundling services*"[1]. Although we note that in the EM to the Exposure Draft it states the purpose of the change is to "*...limit access to a RITC for bundled trustee and responsible entity services (trustee services)*"[2]. We understand this policy approach is to eliminate the perceived GST advantages obtained from 'bundling' a range of acquisitions within a single 'trustee fee' that may not have carried a RITC entitlement if they were acquired separately and directly by the trust, and to ensure neutrality in the RITC provisions[3].

1.1.2. We are of the view that the proposed changes (in their current form) go significantly further than what was intended to redress any advantage obtained by a minority of funds from 'bundled' or single trustee / RE fee arrangements. In our opinion this is acknowledged in the language in the EM, which has clearly not included the phrase "*protecting the GST base*", which was included in earlier announcements. It is our opinion that the proposed measures will go far beyond what was intended as part of the May 2010 announcements, as it will impact the overwhelming majority of investment funds with a RE or Trustee, and the majority of superannuation funds, many of which have not, in our experience, changed the way they have operated since prior to the original introduction of GST.

1.1.3. To provide further context to the above point, many in the wealth management industry determined the impact of GST upon their business at the time the GST was introduced (both the RE/Trustee and the funds for which they were responsible), and since then it has largely been a "set and forget" approach with regard to GST. In other words, they have not changed the nature of their activities to secure any additional GST benefits for those funds to which they are responsible. They have merely benefited from the 75% RITC regime that was originally established by the Government at the time to negate some of the GST costs to be incurred by the funds.

1.1.4. We consider the proposed Item 32 is a very blunt instrument in this regard as its application will be significantly greater than what is required to protect the GST base, and in fact is likely to significantly increase revenue over time, to the detriment to all investors and superannuation members.

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[1] See Budget Measures, Budget Paper No.2, 2010-11, 11 May 2010, page 26; and Media Release No.095, Assistant Treasurer Senator Nick Sherry, "Further Reduction in GST Compliance Costs for Business".
[2] Interestingly the effect of the Exposure Draft is to carve out a new RITC regime for such services and therefore technically there is still access to the RITC, just not the existing 75% RITC.
[3] See page 6 of the EM to the Exposure Draft.

1.2. Potential impact of proposed change

1.2.1. Whilst it is acknowledged that the current structure of Item 32 provides some up-side for certain funds (i.e. potentially being entitled to recover RITCs at 55% for other acquisitions that previously carried no entitlement), the majority of our clients expect to be adversely affected by the change. We consider this outcome to be especially relevant to RE services in particular as there appears to be a lack of recognition from a policy perspective that trustee services can differ from RE services. This is principally due to the commercial differences in the functions they perform for funds and where the incidence of 'bundling' has been far less prevalent in our experience.

1.2.2. Owing to the diverse range of fund and trustee/RE structures and fee arrangements that exist in the market, the direct financial impact of the proposed change (where it is expected to increase the overall irrecoverable GST expense for a fund) has generated significant uncertainty as to where the commercial risk associated with any increase in operating costs will fall. These considerations commence with determining whether the commercial risk through the increased GST cost is effectively borne by trustees/REs, or the funds themselves. This involves both referring to the Trust Deeds, as well as commercial considerations from the Trustee/RE's perspective. The next step involves consideration of the cascading pricing factors to determine the ultimate impact on fee structures (for example with retail funds that feed into wholesale funds and layered fund structures).

1.2.3. Further, we also understand that the proposed reduction in the RITC rate from 75% to 55% on the acquisition of trustee/RE services has the potential to affect strategic decisions relating to whether a fund should 'in-source' certain services currently being provided by third party trustees/REs. Ironically one of the key reasons the RITC regime was introduced was to remove the bias of "in-sourcing", which a number of our clients are now seriously considering as a direct result of these proposed changes.

1.2.4. Ultimately however, our clients expect that any sustained / ongoing increase in overall GST expense incurred by funds (without factoring in the immediate cost of implementing the change) will, in the main, be passed on to consumers through increased fees and reduced effective rates of return on funds under management. These consumers are ultimately individuals investing in funds (either directly or indirectly) and superannuation members. Given the crucial role played by taxpayers within this sector in building / preserving long term and retirement income, the majority of which have been operating consistently with the policy objective behind the RITC regime when it was originally introduced, we would question whether these practical outcomes were expressly contemplated by the Government and if it is aligned with the policy intention underlying the changes of *"protecting the GST base"*.

Recommendation 1: As the proposed Item 32 will apply more broadly than merely "protecting the GST base", it should be reconsidered from a policy perspective and better targeted to address the bundling issue given the expected impact the change could have on many trustees/REs that have not restructured their affairs since the introduction of GST and therefore have not bundled additional expenditure within their fee structures.

1.3. Scope of Item 32

1.3.1. In addition to clarifying the application from a policy perspective that the new Item is to apply to RE arrangements (see point below), we are unable to understand (from a policy perspective) why paragraph (a) of the proposed Item 32 is required at all. We understand that from a policy perspective part of the change around the introduction of Item 32 is to ensure neutrality in the operation of the RITC provisions and neutrality in taxation outcomes between different taxpayers engaged in the same commercial activity. In other words to have the same GST outcome where expenses are acquired through a trustee/RE as compared to where those expenses are acquired directly by the fund.

1.3.2. We submit that this policy objective is not achieved in all circumstances given the proposed restriction in the scope of the operation of Item 32 to trustees that are registered in their own capacity and are making taxable supplies to the recognised trust scheme. Whilst it is acknowledged that the issue of a fund's GST recovery on bundled trustee fees would only arise in circumstances where trustees/REs were making taxable supplies to funds, we note that the availability of the 55% RITC rate on other acquisitions made by a fund that are not currently eligible for RITCs (e.g. tax, legal etc) would not be available to a fund that had a trustee/RE that was not separately registered for GST. To the extent that the policy intention is to ensure neutrality in the operation of the RITC provisions and neutrality in taxation outcomes between different taxpayers engaged in the same commercial activity, we submit that this distinction is unnecessary and potentially distortive (acknowledging that unregistered trustees could voluntarily register for GST but would have additional reporting obligations).

Recommendation 2: We recommend that the requirement for the trustee/RE to be separately registered for GST be deleted.

1.3.3. In the instance our Recommendation 2 is not accepted, then this point on application of the proposed Item 32 is of relevance.

1.3.4. We note that the EM to the Exposure Draft implies that Item 32 will apply to RE services (by referring to both trustee and RE services as trustee services). However, the drafting of the Exposure Draft is restricted to trustees without any specific reference to REs.

1.3.5. In addition, while the proposed definition of "recognised trust scheme" includes entities that can only have a RE, as opposed to a trustee, we consider it should be made clear through the amendment to paragraph (a) of the proposed Item 32. In this regard paragraph (a) could read as follows:

> (a) the entity that acts in the capacity as trustee *or responsible entity* of the recognised trust scheme is carrying on, in its own capacity, an enterprise that includes making taxable supplies to the recognised trust scheme; and

Recommendation 3: The language used in Item 32 to be amended to make it clear that it applies to both Trustees and Responsible Entity arrangements.

1.3.6. Whilst we understand from our discussions with Treasury that the operation of Item 32 contemplates apportionment of trustee/RE fees between those components that attract the 75% RITC rate and the remaining component that would attract the 55% rate, we consider that the current language within both the Exposure Draft and the EM does not make this policy intention explicit and the uncertainty around this issue is compounded by the current drafting of Item 32. From a policy perspective it needs to be made clear what is required as a result of these proposed changes; do Trustees/REs need to revisit contractual arrangements, invoicing protocols, etc with the various funds, or is it simply an accounting exercise of apportionment required to comply with the new Item? Through our discussions with Treasury, we understand the latter (and our submission proceeds on this basis with further recommendations to achieve this), however we consider this needs to be made clear from a policy perspective.

Recommendation 4: That the Exposure Draft and EM be amended to make it clear that from a policy perspective apportionment of Trustee/RE fees can be undertaken purely by way of an accounting exercise without the need for changes to other contractual documentation, invoicing arrangements, etc.

1.3.7. The current definition of "recognised trust scheme" in the Exposure Draft includes a "managed investment scheme" ("MIS"), as defined in section 9 of the *Corporations Act 2001*. One of the difficulties associated with the reference to this definition is the types of entities which are caught as part of this definition. For example, a mortgage fund which has external investors should most likely be caught as a MIS, although a securitisation trust housing mortgages (for example) may not be caught. In fact, it is likely that some securitisation trusts may be required to be registered as a MIS, while others may not, depending upon how they are structured and established. As a result the reference to this definition can be unclear and result in different outcomes from the proposed Item 32 perspective, notwithstanding these entities may be engaged in the same business.

Recommendation 5: That the Exposure Draft be amended to make it clear as to whether the proposed changes are intended to apply to entities such as securitisation trusts.

2. Specific recommendations on current drafting of Item 32

Without prejudice to our comments above, to the extent that these proposed changes and/or the scope of Item 32 does not significantly change in its final form, we consider that the current drafting of Item 32 should be amended to provide greater certainty and reduce the administrative/compliance burden imposed on taxpayers by the introduction of the new Regulations.

2.1. Apportionment issues

2.1.1. As outlined above, we consider that the current drafting of Item 32 does not reflect our understanding of Treasury's intention with respect to allowing a fund to apportion trustee / RE fees. It is clear that the phrase "to the extent" needs to be incorporated within the proposed provisions.

2.1.2. In our view this issue should be addressed by the redrafting of paragraph (b) of Item 32 and subregulation 70-5.02(4) along the lines outlined below:

1. Inclusion of the words *"to the extent that"* to the start of paragraph (b) of Item 32 in subregulation 70-5.02(2) along the following lines:

> "32. Services acquired by a recognised trust scheme, to the extent the services are performed on or after 1 July 2012 and where:
>
> (a) the entity that acts in the capacity as trustee *or responsible entity* of the recognised trust scheme is carrying on, in its own capacity, an enterprise that includes making taxable supplies to the recognised trust scheme; and[4]
>
> (b) *to the extent that* the services acquired are not:
>
> (i) brokerage services..."

AND

2. Re-drafting subregulation 70-5.02(4) such that Item 32 would only apply to trustee / RE services along the following lines:

> *(4)* "*To the extent that* an acquisition is of the kind ~~mentioned in~~ *covered by* item 32 of the table in subregulation (2) and the acquisition is covered by another item of the table in subregulation (2), the acquisition is taken to be specified as a reduced credit acquisition only *to the extent it is covered by* item 32 of the table."

Recommendation 6: That paragraph (b) of Item 32 and subregulation 70-5.02(4) are re-drafted to expressly state that the 55% RITC rate only applies to the extent an acquisition is covered by Item 32.

2.1.3. In addition to expressly providing for the apportionment of services covered by item 32, we recommend that the EM accompanying the final Regulations should also contain further examples of acceptable approaches that can be adopted to apportion trustee fees (and a separate example for RE fees) to provide some guidance on this aspect to both taxpayers and the ATO with respect to the interpretation of the new Regulations from a practical business perspective.

2.1.4. Any examples around approaches to apportionment in the EM may also take into consideration the practical difficulties for investment funds to attempt to break down the fees levied by a trustee or RE. In this regard the analysis is most likely to apply at the trustee/RE level and be undertaken at a global level. Although even at this level this could be difficult given the trustee/RE may outsource all, or part of the services it is required to provide to a fund for which it is the trustee/RE. In this regard a trustee/RE may undertake an analysis and apply it consistently across the portfolio funds of which it is responsible, rather than attempt to over engineer the process and consider the apportionment on a fund-by-fund basis. We suggest an example contemplating such an approach would also be appropriate to include within the EM.

[4] Although as per our Recommendation 2 we believe this paragraph should be deleted.