

EXPLANATORY MEMORANDUM (EXPOSURE DRAFT)

Minute No. of 2012 – Assistant Treasurer

Subject - *A New Tax System (Goods and Services Tax) Act 1999*

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

Section 177-15 of the *A New Tax System (Goods and Services Tax) Act 1999* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

On 11 May 2010, the Government announced that the GST law would be amended to implement the recommendations arising out of Treasury's *Review of the GST Financial Supply Provisions*.

The proposed Regulations implement four of the seven recommendations agreed to by the Government. The other three recommendations are being implemented through proposed amendments to the Act contained in Schedule 3 of Tax Laws Amendment (2011 Measures No. 9) Bill 2011, which was introduced into Parliament on 23 November 2011.

The purpose of the proposed Regulations is to amend the *A New Tax System (Goods and Services Tax) Regulations 1999* (the Principal Regulations) to treat all components of a hire purchase transaction as taxable supplies, extend the availability of reduced input tax credits (RITC) relating to life insurance, lenders mortgage reinsurance and transactional fraud monitoring services, limit access to a RITC for bundled trustee and responsible entity services (trustee services) and clarify the language used in relation to guarantees and indemnities.

The proposed Regulations would amend the list of supplies that are financial supplies in the table in subregulation 40-5.09(3), the list of supplies that are not financial supplies in the table in regulation 40-5.12 and the list of acquisitions that attract RITCs in the table in subregulation 70-5.02(2) to give effect to the recommendations.

The proposed Regulations would further prescribe the percentage by which input tax credits are reduced for services acquired by managed investment schemes and certain superannuation funds.

Details of the proposed Regulations are set out in the Attachment.

The Act specifies no conditions that need to be met before the power to make the proposed Regulations may be exercised.

The proposed Regulations would be a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The proposed Regulations would commence on 1 July 2012.

The Minute recommends that the Regulations be made in the form proposed.

Authority: Section 177-15 of the *A New Tax System (Goods and Services Tax) Act 1999*

ATTACHMENT

Details of the proposed *A New Tax System (Goods and Services Tax) Amendment Regulations 2012 (No.)*

Regulation 1 – Name of Regulations

This proposed regulation would provide that the name of the Regulations is the *A New Tax System (Goods and Services Tax) Amendment Regulations 2012 (No.)*.

Regulation 2 – Commencement

This proposed regulation would provide that the Regulations commence on 1 July 2012.

Regulation 3 – Amendment of *A New Tax System (Goods and Services Tax) Regulations 1999*

This proposed regulation would provide that the Regulations amend the *A New Tax System (Goods and Services Tax) Regulations 1999* (the Principal Regulations).

SCHEDULE 1 – AMENDMENTS

Guarantees and indemnities

Item [1] – Subregulation 40-5.09(3), table, items 7 and 7A

Item [3] – Regulation 40-5.12, table, item 21

Existing item 7 of subregulation 40-5.09(3) suggests that indemnities, warranties, insurance and reinsurance are all forms of guarantees, when they are all legally distinct arrangements. A guarantee is an agreement under which one entity (the guarantor) agrees to be liable for the obligations of another if the other entity defaults. An indemnity, on the other hand, is an obligation to an entity (the creditor) assumed by another (the surety), under which the surety agrees to keep the creditor harmless from risks arising from dealings with a third party. A warranty for goods is also legally distinct from the concepts of guarantee and indemnity.

Item [1] would separate existing item 7 of the table in subregulation 40-5.09(3) into two separate items to clarify that guarantees and indemnities are legally distinct arrangements.

Item [3] would insert new item 21 into the table in regulation 40-5.12 to clarify that warranties for goods are not financial supplies. Insurance and reinsurance business is already listed in existing item 10.

It is not intended that these amendments would change the existing interpretation of the terms guarantee, indemnity or warranty as set out under item 7 of the table in subregulation 40-5.09(3). The amendments are merely made to clarify the existing treatment.

Hire purchase agreements

Item [2] – Subregulation 40-5.09(3), table, item 8

Item [3] – Regulation 40-5.12, table, items 19 and 20

Under the existing law, the GST treatment of the supply of credit under a hire purchase agreement depends on whether the supply is made for a separate charge that is disclosed to the recipient. Where the charge is separately identified and disclosed by the supplier, no GST is payable on the supply of credit, as it is an input taxed financial supply. On the other hand, where the charge for the supply of credit under a hire purchase agreement is not separately identified and disclosed by the supplier, the supplier does not make a financial supply and GST is payable on the total amount under the contract.

Currently under item 8 of the table in subregulation 40-5.09(3), the supply of credit made under a hire purchase agreement is a financial supply and therefore input taxed where it is separately disclosed.

Item [2] would amend existing item 8 of the table in subregulation 40-5.09(3) to specify that only supplies of credit made under hire purchase agreements entered into before 1 July 2012 are financial supplies. Similarly, item [3] would insert new items 19 and 20 into the table in regulation 40-5.12, resulting in all supplies made under a hire purchase agreement on or after 1 July 2012 being supplies that are not financial supplies.

This would have the effect of making all supplies under a hire purchase agreement entered into on or after 1 July 2012 fully taxable (subject to the normal GST rules) and would ensure that all hire purchase transactions are treated consistently, regardless of whether the interest charge is separately identified and disclosed. For example, a hire purchase agreement with a disclosed credit component would result in a taxable supply of goods and a separate taxable supply of credit (subject to the normal GST rules).

Amendments made on or after 1 July 2012 to an existing hire purchase agreement entered into before 1 July 2012 that does not amount to a new agreement will not be impacted by this change.

Item [10] – Schedule 7, Part 6, column 2

Item [10] would amend the example for the supply of credit made under a hire purchase agreement to agreements entered into before 1 July 2012, to reflect the change to item 8 of the table in subregulation 40-5.09(3).

Item [11] – Schedule 8, Part 7

Item [11] would insert the credit component of a hire purchase agreement entered into on or after 1 July 2012 to be an example for item 20 in the table in regulation 40-5.12.

Example 1

Stacey owns an accounting business and is registered for GST. On 23 April 2012, Stacey enters into a hire purchase agreement with Tim's Financial Services (TFS) to purchase a new computer system for her business for \$22,000 (GST-inclusive),

excluding the credit charges. The scheduled credit charges over the term of the hire purchase agreement total \$4,000.

Under the existing regulations, the supply of credit made under the hire purchase agreement for \$4,000 constitutes a financial supply and is input taxed. TFS would be required to remit GST of \$2,000 to the Commissioner in respect of the supply of the computer system. No GST would be payable on the supply of the credit, and TFS' input tax credit entitlement for acquisitions that relate to both the supply of the computer system and the supply of credit need to be apportioned.

On 25 August 2012, Stacey enters into a hire purchase agreement with Equipment Finance Co. to purchase office equipment for \$11,000 (GST-inclusive), excluding the credit charges. The scheduled credit charges over the term of the hire purchase agreement total \$2,200 (including \$200 of GST).

Under the amended regulations, the supply of credit under the hire purchase agreement for \$2,200 is not a financial supply. Equipment Finance Co. would be required to remit a total of \$1,200 of GST to the Commissioner in respect of the supplies made under the hire purchase agreement.

Example 2

Celia is registered for GST. On 30 September 2012, Celia enters into a hire purchase agreement with Magic Car Solutions, a finance company, to purchase a non fuel-efficient luxury car. The GST-inclusive price of the car is \$88,000 and the scheduled credit charges over the term of the hire purchase agreement total \$7,700 (including \$700 of GST).

The hire purchase agreement involves the supply of the luxury car and the supply of credit. In order to work out whether the car exceeds the luxury car tax threshold, Magic Car Solutions only includes the GST-inclusive price of the supply of the car, and does not include the GST-inclusive price of the supply of the credit.

Magic Car Solutions would be required to remit a total of \$8,700 of GST to the Commissioner, which is 1/11th of the price of the car (excluding any amounts of luxury car tax that may be payable) and 1/11th of the price of the credit charges.

Lenders mortgage reinsurance

Item [4] – Subregulation 70-5.02(2), table, item 12A

Under the current law, it is intended that lenders mortgage reinsurance falls within the scope of present item 12 of the table in subregulation 70-5.02(2) covering lenders mortgage insurance. Notwithstanding that the Commissioner has consistently treated lenders mortgage reinsurance as falling within the scope of item 12, concerns have been expressed that the present treatment is ambiguous.

Item [4] would insert lenders mortgage reinsurance into the list of reduced credit acquisitions which attract reduced input tax credits (RITCs) to confirm the treatment of lenders mortgage reinsurance.

Processing and assessing claims under life insurance policies

Items [5] and [6] – Subregulation 70-5.02(2), table, item 24 (h), (i)

Currently a life insurance entity that also operates a superannuation fund is able to obtain a RITC for assessing services related to life policies under item 26 of the table in subregulation 70-5.02(2). On the other hand, where the same service is acquired by a superannuation fund, the fund has been denied a RITC because items 23 and 24 do not refer to 'assessing'.

Items [5] and [6] would insert processing and assessing claims under life insurance policies into the list of reduced credit acquisitions which attract reduced input tax credits.

This amendment would allow all non-life insurers providing life insurance products to access RITCs for the same acquisitions that give rise to RITCs for life insurers providing equivalent products for eligible acquisitions made on or after 1 July 2012.

Trustee and responsible entity services

Item [7] – Subregulation 70-5.02(2), table, item 32

Item [8] – Subregulations 70-5.02(4) and (5)

Item [9] – Regulation 70-5.03

Whilst there are many valid commercial reasons for having single fee trustee arrangements, the present GST treatment advantages some trusts over other entities engaged in equivalent activities, including trusts adopting different payment arrangements. Bundling all costs incurred on behalf of the trust into a single 'trustee fee' allows these entities to claim a RITC for all acquisitions, including those not otherwise eligible for a RITC had these been acquired directly by the trust.

In addition there has been considerable uncertainty surrounding the capacity in which some acquisitions by the trustee were being made and these changes go some way to addressing that issue.

Item [7] would insert new item 32 into the list of reduced credit acquisitions to cover services acquired by a 'recognised trust scheme' to the extent they are performed on or after 1 July 2012. Item [9] prescribes a reduced RITC rate of 55% for services that are covered by item 32. The introduction of a lower RITC rate for trustee services was favoured for simplicity and clarity over other options that would have required the unbundling of the trustee fee into various components based on the type of acquisition being made and the capacity in which it was being made. These alternative options were seen as being complex and adding to administrative costs for taxpayers.

Item [8] would insert subregulation 70-5.02(5) to insert a new definition for 'recognised trust scheme' for the purposes of item 32 of the table. Item 32 would apply to services acquired by managed investment schemes under section 9 of the *Corporations Act 2001*, and approved deposit funds, pooled superannuation trusts, public sector superannuation schemes and regulated superannuation funds (other than self managed superannuation funds) within the meaning of the *Superannuation Industry (Supervision) Act 1993*.

Paragraph (a) in item 32 would provide that the item only applies where the entity acting in the capacity as trustee of the recognised trust scheme is carrying on, in its own capacity, an enterprise which makes taxable supplies to the recognised trust

scheme. Therefore item 32 would not apply where the trustee is not registered for GST in its own capacity.

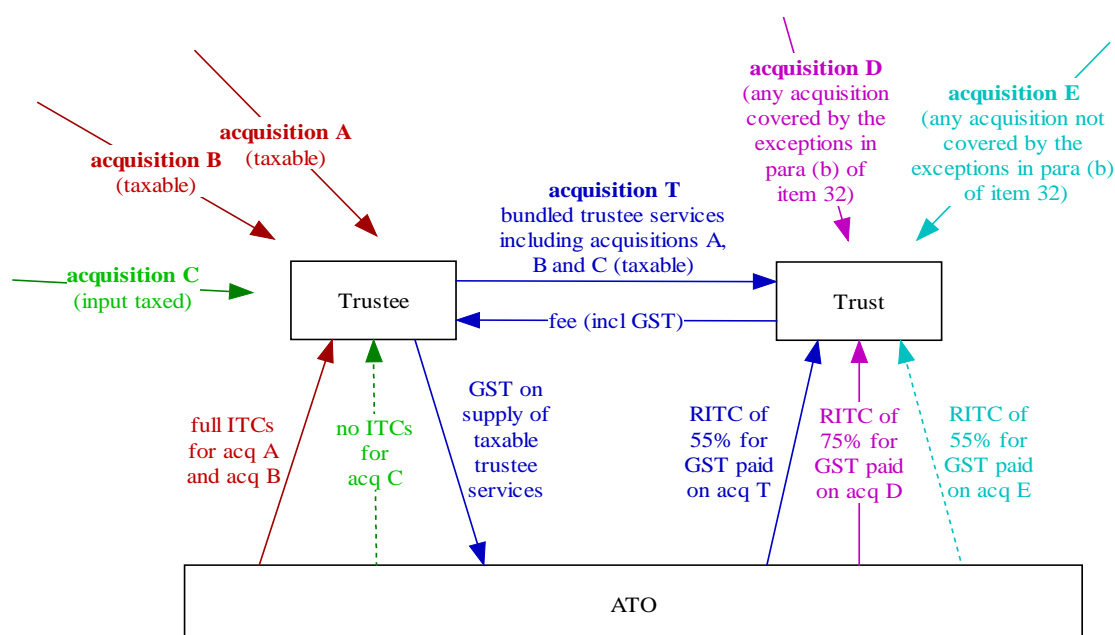
To ensure that item 32 properly targets the bundling issue only, paragraph (b) excludes the following items:

- brokerage services covered under items 9 or 21;
- investment portfolio management functions under item 23 excluding acting as a trustee or single responsible entity under paragraphs (c) and (d) of that item;
- administrative functions in relation to investment funds under item 24 excluding compliance activities where the service is acting as a trustee or single responsible entity under paragraph (h) of that item;
- custodial services covered under item 29; and
- master custody services covered under item 30.

Item [8] would insert a new subregulation 70-5.02(4) to provide that an acquisition which is covered by item 32 of the table in subregulation 70-5.02(2) is not covered by any other item in the table.

The new item would eliminate some of the advantages associated with bundling various acquisitions into a single acquisition of trustee services, to ensure neutrality in the RITC provisions.

The diagram below illustrates how various acquisitions by the trust or the entity acting as trustee for the trust are to be treated for services performed on or after 1 July 2012.



Example 3

Bron's Trustee Services Pty Ltd (Bron Co) runs a business that acts as the trustee of the MG Superannuation Fund (the Fund). Bron Co is registered for GST. Bron Co supplies trustee services in performance of its duties under the trust law and the trust deed which establishes the Fund. The Fund makes input taxed financial supplies.

Under the terms of the Fund's trust deed, Bron Co is entitled to be remunerated for acting as trustee. The product disclosure statement and offer documents provide that Bron Co is entitled to charge a fee and recover costs it incurs in administering the Fund. Bron Co issues a trustee fee invoice to the Fund which includes the trustee services Bron Co supplies to the Fund as well as the recovery of costs incurred in administering the Fund.

In the course of administering the Fund, Bron Co incurs rental, telephone, stationery and information technology costs in its own corporate capacity.

The supply made by Bron Co to the Fund is a taxable supply under section 9-5 of the GST Act. The acquisition of these services by the Fund is a reduced credit acquisition under item 32 of the table in subregulation 70-5.02(2) of the GST Regulations. The fact that the acquisition of the trustee services by the Fund relates to the Fund making financial supplies does not prevent it being for a creditable purpose to the extent that it relates to making financial supplies (see section 70-10 of the GST Act). The acquisition of the trustee services is a creditable acquisition to the Fund under section 11-5 of the GST Act. The amount of the reduced input tax credit is 55% of the GST payable on the supply of the trustee services made by Bron Co.

Example 4

All-in-one Trustee Services Pty Ltd (All-in-one) runs a business that acts as the trustee of a Managed Investment Scheme (the MIS). All-in-one is registered for GST. All-in-one supplies trustee services in performance of its duties under the trust law and the trust deed which establishes the MIS. The MIS makes input taxed financial supplies.

Similar to example 3 above, the amount of the RITC that MIS is entitled to is 55% of the GST payable on the supply of the trustee services made by All-in-one.

In the course of administering the MIS, All-in-one, on behalf of the MIS, engages Luke's Custodial Services to act as custodian in relation to the MIS's assets, which are securities. Luke's Custodial Services makes a supply of master custody services directly to the MIS and not to All-in-one.

The master custody services do not fall within item 32 of the table set out in subregulation 70-5.02(2) of the GST Regulations as the item specifically excludes these services. However, the master custody services fall within item 30.

The fact that the acquisition of the master custody services by the MIS relates to the MIS making financial supplies does not prevent it from being for a creditable purpose to the extent that it relates to making financial supplies (see section 70-10 of the GST Act). The acquisition of the service is a creditable acquisition of the MIS under section 11-5 of the GST Act. The MIS is entitled to a reduced input tax credit of 75% of the GST payable on the supply of the services.

Monitoring services

Item [7] – Subregulation 70-5.02 (2), table, item 33

Since the introduction of the GST, there have been a number of developments in the regulation of the financial sector. One new area of regulation has resulted in increases in the obligations on financial institutions to undertake measures to monitor and report on certain transactions.

Item [7] would also insert a new item 33 to allow a RITC for monitoring and reporting services required for compliance with the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth). Generally speaking, the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* requires a reporting entity (including, but not limited to, a bank, building society or credit union) to:

- enrol with AUSTRAC
- establish and maintain an anti-money laundering and counter-terrorism financing program;
- identify customers and verify customer identities;
- keep records of transactions and customer identification procedures;
- perform ongoing customer due diligence;
- report on international funds transfer instructions, threshold transactions, and suspicious matters;
- submit regular compliance reports to AUSTRAC;
- provide originator information in all electronic funds transfers; and
- adhere to obligations relating to correspondent banking relationships.

On this basis, services acquired by a reporting entity to directly fulfil the abovementioned monitoring and reporting obligations will typically qualify for a RITC under this item. The new item does not include the acquisition of taxation or auditing services.