27 February 2012

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

Attention: Rob Dalla-Costa

Dear Sir/Madam

Re: Goods and Services Tax (GST)
Exposure Draft Regulations GST Financial Supply Provisions (EDR)

The FSC welcomes the opportunity to provide comments in relation to the EDR issued by Treasury on 13 January 2012. In particular these comments are made in relation to changes to the reduced input tax credit (RITC) for trustee and responsible entity services.

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has 128 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please contact Blake Briggs or myself on 02 9299 3022 if you have any further questions in relation to this submission.

Yours sincerely

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Director of Policy

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Summary

FSC members understand the EDR reflects Government policy to amend subregulation 70-5.02(2) (subregulation (2)), that is, to remove the perceived advantages associated with bundling various services into a single acquisition of trustee services. To this end, all acqusitions of services by a recognised trust scheme will be subject to a 55% RITC under the new Item 32 of subregulation (2). However, eligible fund manager, administration, custodial and brokerage functions will continue to qualify for a 75% RITC in their own right, given that there is no bundling advantage for these services.

As noted in our previous correspondence on this issue, the FSC disagrees that these amendments are warranted on policy grounds. Notwithstanding this, our comments reflect a constructive approach to ensure the final legislation reflects Government policy and is administratively workable.
In summary we propose that:

- The timing of the implementation of the measures should be deferred 12 months

- Item 32 needs to be changed to expressly contemplate apportionment of single fees

- Subparagraph (b)(i) of Item 32 should be expanded to at least cover acquisitions that fall under item 27 (brokerage/commissions)and the new item 33 (monitoring services).

- Additional examples need to be provided in the final Explanatory Memorandum to provide clarity to the legislative intent.

- The definition of recognised trust scheme may result in certain commercial trusts being inadvertently impacted. We recommend that the definition of recognised trust scheme be limited to trusts that are required to be registered with ASIC and the scope of paragraph (b)(i) of item 32 be broadened

FSC comments in relation to the above are set out below.

Timing of Implementation

The proposed reform will require the wealth management industry to undertake the most significant changes to the GST treatment of services provided in the industry since the introduction of GST in 2000. In particular, the reforms will require considerable changes to be made to existing administrative practices, legal documentation, product disclosures and operating systems.

Despite the fact that nearly 3 years have passed since the government first announced its intention to change the GST treatment of trustee services, the scope of the government's preferred solution has not been made clear to industry. Accordingly, there is significant uncertainty within the industry and an inability at this time to implement any changes to existing processes and systems.

An implementation date of 1 July 2012 represents a very short timeframe, compounded by the fact that the wealth management industry is currently in the process of implementing the Future of Financial Advice (FOFA) reforms from 1 July 2012. The FOFA reforms themselves are the largest change to the industry since the Financial Services Reforms in 2004 (under which the government provided a two year transition period).

In addition to the above, trustees have obligations under the *Superannuation Industry (Supervision) Act 1993 (Cth)* (SIS) that need to be considered in the context of these reforms. For example, under SIS, a trustee of a superannuation fund has an obligation to act in the best interests of members. Where a trustee is unable to comply with these reforms from 1 July 2012, there is a risk that the superannuation trustee could be in breach of SIS where it does not recover an appropriate amount of GST on taxable trustee services supplied to the superannuation fund.

In order for these reforms to achieve the government's policy objective, the FSC recommends that the commencement date be delayed until 1 July 2013 to ensure an effective transition and to minimise the cost and impact of these reforms.

Apportionment of single fees

Item 32 needs to expressly contemplate apportionment. This will ensure we avoid significant potential uncertainty.

Currently, item 32 does not expressly address apportionment. Its effect is that a RITC rate of 55% will apply for services acquired by a trust scheme, however a 75% RITC rate will remain for excluded services (paragraph (b) of subregulation (2)) which are to be excluded from the operation of paragraph (a). This policy makes sense on the basis that these excluded services would qualify for a 75% RITC in their own right.

What is open to interpretation under the current wording is:

- When an excluded service (eg. Investment management) is supplied by a trustee/RE, is it part of a single supply of trustee/RE services, is or one of many supplies by the trustee/RE?

- If it is a single supply, it is open to interpretation whether the entire fee would be classified as a trustee/RE fee (i.e. a 55% RITC would apply), or a manager fee (in which case a 75% RITC rate would apply)

- If the fee is to be apportioned, on what basis is the apportionment to be made?

- When excluded services are supplied by external supplies, to who is the supply made? That is, the supply made to the trustee/RE in its own capacity or is it made to the trustee/RE in their capacity as trustee/RE of the trust? Does or should this make a difference for the purposes of the new Item 32

The most expedient way to address these difficulties is for apportionment to be specifically contemplated in them 32. In this regard, we propose that the words *"to the extent"* be added to at the beginning of paragraph (b) of subregulation (2).

Such a change would recognise that single fee structures which may be termed "management" or "responsible entity" do include an element of trustee services. It should be noted that in the MIS industry, the main part of the fee will represent remuneration for investment management services.

Commission and Monitoring Services

Commission

Item 32(b)(i) only excludes brokerage under item 9 and 21 and does not extend to commissions under item 27. With the legislative implementation of the FOFA reforms, commissions will be largely banned. Consequently, a change the RITC rate from 75% to 55% for commissions would cause significant problems in repricing pre existing agreements. We consider this to be largely a legacy issue that should not be impacted by the proposed changes. To the extent that commissions continue to be paid under FOFA grandfathered arrangements or as permitted, we strongly recommend that the RITC treatment remains undisturbed. We therefore recommend that the words *"or services that a are covered by item 27"* be added to the end of sub paragraph (b)(i).

Monitoring Services

In addition to the above, the EDR contemplates a new Item 33 in relation to monitoring services in subregulation (2). It is recommended that *services covered by Item 33* also be included in the excluded services as a new subparagraph (b)(vii) of subregulation (2)

Examples for the EDR Explanatory Memorandum (EM)

By way of further background, in the ordinary course of events, an investment manager carries out the role of trustee which of itself involves three primary roles in fulfilling responsibilities to the unit holder of a trust. The three roles are those of trustee, administrator and Responsible Entity (RE).

The attached table provides a detailed list of various functions particular to the role of trustee, these are carried out annually, monthly or on an ad hoc basis. Further, the table includes an indication as to where those services would fall in relation to the operation of the new Item 32.

In the view of members the final EM should provide examples which acknowledge the need to apportion certain single fee arrangements for the purposes of the new Item 32. The following examples are illustrative of some typical investment manager scenarios and whilst not exhaustive, would supplement those examples already set out in the EM.

Example 1

Pursuant to a settled trust deed (deed), Investment Managers Australia (IMA) is a Responsible Entity (RE) and trustee for a trust known as Wholesale Fund (WF trust). WF Trust only makes input taxed supplies.

Under the deed IMA is entitled to an RE fee that is expressed as:

- A Management Fee equal to 3.0% of the value of trust property
- A Custody fee of 0.3% of the value of trust property

In addition to the above IMA is entitled to recover various charges and expenses reasonably incurred as Outgoings in relation to its duties in relation to the trust. These Outgoings are charged on an ad hoc basis.

The amount of RITC that WF trust is entitled to for the management and custody fee set out above to is 75% as these acquisitions are excluded services for the purposes of the proposed Item 32.

Outgoings charged by way of ad hoc fees to WF trust will, prima facie be entitled to 55% RITC, for the purposes of paragraph (a) of subregulation (2).

Notwithstanding the above, there may be cases where it will be clear the Outgoing/ad hoc fee will specifically relate to excluded services such as processing of contributions to unit holders. In this case WF trust will be entitled to a 75% RITC on GST charged as part of a fee for these services.

Example 2

Similar to example 1, IMA charges a single RE fee (described in the trust deed as a Management Fee) equal to 4% of total fund assets.

However, in this case IMA does not charge a separate fee to WF trust on account of either custody or Outgoings, notwithstanding the trust deed may allow for the recovery of outgoings.

Whilst IMA is recovering the cost of custody, trustee, ad hoc and various management expenses it is not specifically invoiced to the trust. For the purposes of the new Item 32 it will be necessary for the Management Fee to be apportioned to the extent that it relates to excluded items such and those that remain as trustee services.

The method of apportioning the Management fee might be determined with reference to the nature of costs of IMA in performing its services to the WF trust. For example, to the extent that IMA incurs:

- In-house compliance team
- Legal fees
- Audit & Tax fees
- Director/key management personnel costs
- ASIC fees
- APRA fees
- Any other costs indicated as 55% RITC in the attached table (2)

These costs could be expressed as a percentage over total manager costs to arrive at the extent to which the Management Fee must be apportioned between services eligible for RITC claimable at 55% and 75%.

Recognised Trust Schemes

One of the changes proposed in the ED introduces a new Item 32 into subregualtion 70-5.02(2). That Item 32 applies to certain acquisitions made by "recognised trust schemes". Pursuant to proposed subregulation 70-5.02(5), the term "recognised trust scheme" is defined to include a "managed investment scheme" within the meaning of section 9 of the *Corporations Act 2001*.

We have a concern that the use of the section 9 definition of "managed investment scheme" is likely to broaden the concept of "recognised trust scheme" (and, by extension the operation of Item 32) beyond that which is intended by the proposed amendments.

Importantly, under the *Corporations Act*, not every "managed investment scheme" within the meaning of section 9 of that Act is required to be registered with ASIC. The provisions of Chapter 5C of the *Corporations Act,* and the regulatory regime that they establish, relate only to those managed investment schemes which are required to be registered under section 601ED.

Therefore, there are many structures which would constitute "managed investment schemes" within the meaning of section 9 but are not "registered schemes" for the purposes of Chapter 5C.

The definition in section 9 is very broad. It includes any scheme in which people contribute money (or money's worth) as consideration for rights (defined as 'interests') so that the contributions can be pooled or used in a common enterprise for the benefit of those who hold interests in the scheme, in circumstances in which the members do not have day to day control over the management of the scheme.

Indeed, this definition is so broad that it could extend to trusts which are used in securitisation arrangements. As discussed above, this appears to be outside the intended operation of the amendments.

Securitisation trusts are typically formed by a Trustee pursuant to the terms of a Master Trust Deed. The Trustee will become the Trustee of the "Series Trust". The Master Trust and the Series Trusts are generally structured as unit trusts, with the beneficial interest being divided into a number of income and capital units. Typically, the unitholders in the trusts are not responsible for financing the operations of the trust. Any contributions they make in consideration for the issuance of their units are at most nominal. Rather, the funds which are used to buy investment assets are obtained through the issuance of notes by the Trustee in its capacity as trustee of the relevant Master Trust or Series Trust.

As such, the beneficial owners of the trusts are not 'pooling' contributions for use in a common enterprise. They are generally related bodies responsible for establishing the securitisation structure.

However, the terms of the section 9 definition of "managed investment scheme" are so broad that the noteholders could be "members" holding "interests" and thereby the requirements of the definition could be satisfied. Importantly, an issue of debentures by a body corporate would be specifically excluded from being a "managed investment scheme" pursuant to paragraph (j) of the definition in section 9 of the *Corporations Act*. No corresponding exclusion is provided for the issuance of debentures by a trust.

It is submitted that bringing securitisation trusts within the scope of "recognised trust schemes" is a result that is unlikely to be the intended outcome of the amendments.

It is noted that where all the interests issued in a managed investment scheme would not have required the giving of a Product Disclosure Statement (if indeed the scheme had have been registered at that time) the scheme is not required to be registered under Chapter 5C: section 601ED. As such, it is considered that the intention of the amendments would be better served if the term "managed investment schemes" for the purposes of the definition of "recognised trust scheme" under proposed regulation 70-5.02(5) is limited to those managed investment schemes which are required to be registered under Part 5C.1 of the *Corporations Act*.

Whilst limiting the definition of recognised trust scheme as proposed above may go some way to avoiding unintended consequences, there could remain situations registered trusts are unfairly disadvantaged compared with other entities, particularly where trusts undertake commercial activities that are also undertaken by companies and other types of entities. Some examples of this inconsistent treatment are as follows:

- At present, where an entity conducts a capital raising or IPO, it is entitled to claim a 75% RITC on investment banking fees. Under the EDR as currently drafted, trusts conducting a capital raising / IPO will only be entitled to claim a 55% RITC on investment banking fees, whereas companies and other types of entities will continue to be entitled to a 75% RITC.
- Under the EDR, mortgage trusts (that provide loans and finance to customers) will only be entitled to claim 55% RITC on the 'Loan services' RITC items (items 11 to 15), including property valuations, loan statement preparation costs and lenders mortgage insurance. In contrast, corporate entities that provide finance (such as banks and credit unions) will continue to be entitled to a 75% RITC on such costs.
- Under the EDR, cash management trusts will only be entitled to claim 55% RITCs on the 'Banking and cash management services' and 'Payments and fund transfers services' RITC items (items 1 to 5 and 6 to 8), including transaction processing and switching, acquisitions of chequebooks and statement preparation. Corporate entities that provide deposit and similar accounts (such as banks and credit unions) will continue to be entitled to a 75% RITC on such costs.
- At present, listed companies and trusts are entitled to claim a 75% RITC on share and unit registry costs (item 10). Under the EDR as currently drafted, trusts will only be entitled to claim a 55% RITC on unit registry costs, whereas companies will continue to be entitled to a 75% RITC on share registry costs.

This treatment appears contrary to the policy of treating taxpayers consistently, which we understand is the policy rationale underpinning the EDR. If the consequences listed above are unintended, we would be pleased to work with Treasury to develop amendments to the EDR that resolve these concerns, this would best be achieved by including items, 11, 12, 13, 14, 15 and 17 to the excluded services shown at paragraph (b) of item 32.

If the consequences listed above are intended, we note the significant adverse financial impact that the EDR will have on trusts that undertake commercial activities that are also undertaken by other types of entities.

Table of Trustee Functions

Function	*Excluded Services*	*Item 32*
<u>Annual</u>	*75% RITC*	*55% RITC*
RE licensing		
Risk Management Statement/ Plan	*Yes*	
Fit and Proper Policy	*Yes*	
Adequacy of Resources Policy	*Yes*	
Outsourcing Policy		*Yes*
Statement of Financial Resources		*Yes*
Other		
Conflicts of Interest Policy		*Yes*
Trustee Director and Responsible Officer training		*Yes*
Approval of Delegations		*Yes*
Annual Superannuation Compliance Plan		*Yes*
Audit reports		*Yes*
Annual Reports to members		*Yes*
APRA returns		*Yes*
Tax returns		*Yes*
Regulatory reporting		*Yes*
<u>Monthly</u>		
Complaints Reporting	*Yes*	
Claims Reporting (including litigated , SCT and FOS matters)	*Yes*	
Customer Service reports (e.g. service standards for client services and contact centre).	*Yes*	
<u>Other Ad-hoc</u>		
Product enhancements	*Yes*	
Trust Deed Amendments		*Yes*
Unit Pricing Policy		*Yes*
Compensation Policy		*Yes*
AML Compliance Policy		*Yes*
Investment Review Committee recommendations in relation to Investment Strategy	*Yes*	