

Introduction

Referral of the Bill

- 1.1 On 24 November 2011 the Selection Committee requested the Committee to inquire into and report on the Tax Laws Amendment (2011 Measures No. 9) Bill 2011.
- 1.2 Given that only two schedules of the Bill have been of concern to stakeholders, while others have attracted support, the committee has focussed on these schedules. The schedules of interest are Schedule 3(3) and Schedule 4.
- 1.3 Schedule 3(3) allows 'taxpayers who account on a cash basis to treat an acquisition made under a hire purchase agreement as though they do not account on a cash basis'.¹ The aim is to equalise the GST treatment of hire purchase and chattel mortgage and thus remove a tax-induced market distortion.
- 1.4 Schedule 4 is aimed 'to ensure that sales or long-term leases of new residential premises by a registered entity are taxable supplies and that sales or long-term leases of residential premises (other than new residential premises) are input taxed supplies'.² The aim is to reverse the decision in the *Gloxinia Investments* court case in May 2010 and restore the original policy intent of the legislation.

1 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 6.

2 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 6.

Contents and structure of the Bill

- 1.5 Schedule 1 of the Bill amends the *Retirement Savings Accounts Act 1997* and the *Superannuation Industry (Supervision) Act 1993* to enable certain superannuation fund members to electronically request the consolidation of their superannuation benefits through the Australian Taxation Office.³ This will assist ‘lost’ superannuation members once they are reunited with their superannuation benefits.
- 1.6 Part 1 of Schedule 2 amends the *Income Tax Assessment Act 1997* to ensure entities in a restructure can use a share or interest sale facility to deal with foreign held interests without Australian tax residents automatically failing a key requirement of certain capital gains tax (CGT) roll-overs.⁴ The amendments are either of no disadvantage to taxpayers or are beneficial to them.
- 1.7 Part 2 of Schedule 2 excludes an entity from being a member of a demerger group if the entity is a corporation sole or a complying superannuation entity.⁵ The amendments are beneficial to taxpayers.
- 1.8 Part 3 of Schedule 2 amends the *Income Tax Assessment Act 1997* (ITAA 1997) to expand the existing CGT roll-over for the change of a body to an incorporated company. The expanded roll-over applies to entities that change incorporation to become a *Corporations (Aboriginal and Torres Strait Islander) Act 2006* corporation. The expanded roll-over also covers a taxpayer’s rights associated with a body, as well as their ownership interests, and situations where a body is wound up and replaced by a new company incorporated under a different law.⁶
- 1.9 Part 3 also amends the ITAA 1997 to allow for tax neutral consequences for CGT, depreciating, revenue and trading stock assets of a body that is wound up and replaced by a new company incorporated under a different law, and these assets are transferred to the new company.
- 1.10 Schedule 3 amends the *A New Tax System (Goods and Services Tax) Act 1999* to implement three of the seven recommendations agreed to by the Government in Treasury’s *Review of the GST financial supply provisions*. The measures requiring legislative change and included in this Bill are:

3 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 9.

4 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 17.

5 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 25.

6 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 31.

- increasing the first limb of the financial acquisitions threshold from \$50,000 to \$150,000, to allow more small businesses to come under the threshold and decrease compliance costs;
- excluding financial supplies consisting of a borrowing made through the provision of a deposit account by an Australian authorised deposit-taking institution from the current concession for borrowings; and
- allowing taxpayers who account on a cash basis to treat an acquisition made under a hire purchase agreement as though they do not account on a cash basis, to remove the market distortion between hire purchase and chattel mortgage.

1.11 The other four recommendations in Treasury's review are expected to be implemented through changes to the *A New Tax System (Goods and Services Tax) Regulations 1999*. On 13 January 2012, the Assistant Treasurer released an exposure draft of *A New Tax System (Goods and Services Tax) Amendment Regulations 2012* to this effect. Submissions are due by 24 February 2012. The draft regulations:

- deem hire purchase not to be a financial supply, and therefore simplify its tax treatment by making it fully taxable;
- extend the availability of reduced input tax credits (RITCs) relating to life insurance, lenders mortgage reinsurance and transactional fraud monitoring services;
- limit access to a RITC for bundled trustee and responsible entity services to reduce opportunities to inappropriately take advantage of the RITC concessions; and
- clarify the language used in relation to guarantees and indemnities.⁷

1.12 Schedule 4 amends the *A New Tax System (Goods and Services Tax) Act 1999* to ensure that sales or long-term leases of new residential premises by a registered entity are taxable supplies and that sales or long-term leases of residential premises (other than new residential premises) are input taxed supplies.⁸ This will reverse the decision in *Gloxinia Investments* and restore the original policy intent of the legislation.

1.13 Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* to update the list of deductible gift recipients (DGRs) by adding one entity as a DGR, and changing the name of another listed entity.⁹

7 A New Tax System (Goods and Services Tax) Amendment Regulations 2012, *Explanatory Memorandum*, p. [1]; Australian Government, *Implementation of the recommendations of Treasury's review of the GST financial supply provisions, Discussion paper*, June 2010, p. 12.

8 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 65.

9 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 77.

- 1.14 Schedule 6 to the Bill makes technical corrections and other minor and miscellaneous amendments to the taxation laws. These amendments are part of the Government's ongoing commitment to the care and maintenance of the tax system.¹⁰

Policy background

GST on financial supply

Board of Taxation

- 1.15 In 2009 the Board of Taxation reported to the Treasurer on its review of the Legal Framework for the Administration of the GST. The Board had held public consultations in Sydney, Brisbane, Melbourne, Darwin and Perth. It had also met with representatives of the States and Territories and sought the views of small businesses through small business forums convened by the Commissioner of Taxation.¹¹
- 1.16 The Board found that the GST system was operating effectively and achieving its policy objectives. Businesses generally have a good level of awareness of their obligations under the GST law.
- 1.17 The Board also identified a number of opportunities to reduce compliance costs and to streamline and improve the operation of the legal framework for the administration of the GST and remove anomalies in its operation.
- 1.18 Most importantly, in its *Review of the Legal Framework for the Administration of the Goods and Services Tax* the Board recommended that:

The Government should undertake a review of the financial supplies provisions with a view to reducing their complexity and introducing more principled rules, while maintaining the existing policy.¹²

10 Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 79.

11 Board of Taxation, *Review of the Legal Framework for the Administration of the Goods and Services Tax*, December 2008. This is available at: http://www.taxboard.gov.au/content/reviews_and_consultations/legal_framework_for_administration_of_gst/report/downloads/legal_framework_for_administration_of_gst_report.pdf.

12 Board of Taxation, *Review of the Legal Framework for the Administration of the Goods and Services Tax*, December 2008, recommendation no. 23.

Treasury review

1.19 In response to this recommendation, Treasury undertook its *Review of the GST financial supply provisions*.¹³ The Treasury review looked at existing financial supply provisions under the GST law and related regulations to:

- reduce their complexity and inconsistencies;
- introduce more principled rules to ensure the law better reflects underlying policy; and
- improve the operation of the reduced credit acquisition system in a manner consistent with maintaining the existing policy.

1.20 One of the messages from the review was that industry favoured refinement of the current system, rather than fundamental reform because the current system is working reasonably well and is reasonably certain. The Government's summary of the review stated:

Submissions suggested that, after almost ten years of operation, the current legislation and its general application is generally well understood and compliance with the law is being maintained at an acceptable cost. It was thought that significant changes to the legislative framework could lead to uncertainty, confusion, distortions and an increase in compliance costs, particularly associated with any transition to a new legislative structure.¹⁴

1.21 The options identified in the consultation process informed the drafting of the present Bill, which is ultimately designed to reduce compliance costs and rationalise the administration of the GST.

Market distortion between hire purchase and chattel mortgage

1.22 Hire purchase and chattel mortgage are similar credit arrangements, but they have an important difference which carries into their tax treatment. In both cases, the purchaser obtains use of an asset up front in return for a series of instalment payments. In hire purchase, ownership does not transfer until the final instalment is paid. In chattel mortgage, ownership instead transfers up front.

1.23 Treasury advised that, all else being equal, hire purchase is preferred over chattel mortgage. The latter represents an increased risk for the lender because title has already passed and follow-up action in the case of default, such as repossession, is either not available or more difficult.

¹³ Tax Laws Amendment (2011 Measures No.9) Bill 2011, *Explanatory Memorandum*, p. 5.

¹⁴ The Hon. Senator Nick Sherry, Assistant Treasurer, 'Further Reductions in GST Compliance Costs for Business', Media Release No. 95, 11 May 2010.

Further, hire purchase is more straightforward and less costly to implement in terms of legal fees and stamp duty.¹⁵

- 1.24 However, chattel mortgage has largely replaced the use of hire purchase for small business since the GST was introduced. This is because GST operates differently for the two systems. Small businesses with an annual GST turnover of less than \$2 million annually can account for GST on a cash basis, compared with larger businesses, which must account for GST on an accrual basis. Generally, cash accounting is simpler and reduces compliance costs for small business. The tax effect is that larger firms account for their GST liability and input tax credits for hire purchase agreements up front, whereas businesses that account for GST with cash account for it and access their input tax credits when each payment is made.¹⁶
- 1.25 Under chattel mortgage, title passes up front and, importantly, so do the GST input tax credits for both cash and accrual taxpayers. The Australian Finance Conference and the Australian Equipment Lessors Association advised the committee that, 'Chattel mortgage was largely unused prior to GST, but as a direct consequence of this distortion now accounts for almost half of equipment finance'. The total equipment finance market in Australia is \$90 billion.¹⁷
- 1.26 This means that the GST has made chattel mortgage more financially attractive to small business, despite its increased risk and greater administrative complexity.¹⁸

Gloxinia Investments case

- 1.27 In May 2010, the Federal Court handed down its decision in the case of *Commissioner of Taxation v Gloxinia Investments (Trustee)*. The facts in the case were that Gloxinia had a long term lease over a site from the Woolhara Municipal Council in Sydney. The terms of the lease included payments to the Council from Gloxinia. Gloxinia had rights and obligations to carry out some works and subdivisions on the site, including constructing apartments. After these were completed, the Council granted strata lot leases over the residential premises. The question before the court was whether Gloxinia was liable for GST when it sold these leases.

15 Mr Rob Dalla-Costa, Treasury, *Committee Hansard*, Canberra, 16 December 2011, p. 7.

16 Australian Government, *Implementation of the recommendations of Treasury's review of the GST financial supply provisions, Discussion paper*, June 2010, p. 5.

17 Australian Finance Conference and the Australian Equipment Lessors Association, *Submission 3*, pp. 1-2.

18 Mr Rob Dalla-Costa, Treasury, *Committee Hansard*, Canberra, 16 December 2011, p. 6.

- 1.28 The general policy intent for GST on residential properties is that the sale of existing homes is not subject to GST, but that newly constructed homes are liable. As a matter of policy, Gloxinia should have paid GST on the sales. In legal terms, however, the case revolved around the definition of new residential premises. Section 40-75(1) defines new residential premises as those which:
- (a) have not previously been sold as residential premises and have not previously been the subject of a long term lease; or
 - (b) have been created through substantial renovations of a building; or
 - (c) have been built, or contain a building that has been built, to replace demolished premises on the same land.
- 1.29 The Court had to decide whether the apartments were subject to a long term lease. If they were, they would be exempt from GST. The ATO sought to argue that the economic reality of the arrangements was that Gloxinia was bearing the risk and would obtain the benefits of the development, rather than the Council. Further, under the leases, Gloxinia was under the same responsibilities as if it were the owner of the premises. However, the Court found that the strata lot leases from the Council to Gloxinia were a supply and that the premises were legally subject to a long term lease from the Council to Gloxinia as per section 40-75(1).¹⁹ The ATO lost the case.
- 1.30 This decision has implications for land that is tenured via long-term lease: the process of building, 'strata titling' and selling new residential premises on such land activities might result in those sales being treated as input taxed and not therefore not capable of attracting GST.²⁰ This outcome is contrary to the policy intent of the GST legislation to tax the sale of newly constructed residential premises by GST registered entities who are in the business of selling these premises.²¹
- 1.31 The decision also has implications for situations where there is an alteration to property title arrangements for existing residential premises (other than new residential premises) held by way of freehold title. The subdivision of an existing block of flats into strata title units, or the excising of a vacant lot from land comprising existing residential premises,

19 See in particular the decision of Middleton J, paras 77, 88-91, in *Commissioner of Taxation v Gloxinia Investments (Trustee)* [2010] FAAFC 46 (24 May 2010).

20 Exposure Draft, GST Treatment of new residential premises, *explanatory material*, 2011, p. 3.

21 Exposure Draft, GST Treatment of new residential premises, *explanatory material*, 2011, p. 3.

may result in the premises becoming new residential premises and their subsequent supply being subject to GST, rather than input taxed.²²

Treasury consultations

- 1.32 The Government announced on 27 January 2011 that it would amend the GST law to ensure that it achieves the intended policy outcome for the GST treatment of residential premises and released a discussion paper outlining the proposed design of the measure. The Treasury undertook public consultation on the discussion paper up to 25 February 2011. Ten submissions were received.
- 1.33 The Government later announced some changes to the measure on 23 September 2011 when it released exposure draft legislation for comment. The Treasury undertook consultations on the exposure draft up to 21 October 2011. Seven submissions were received.

Support for the passage of the Bill

- 1.34 The committee received four submissions for the inquiry. They are listed in Appendix A. Three of the submissions supported individual parts of the Bill unreservedly. These are discussed below. The fourth submission, from the Institute of Chartered Accountants in Australia, focussed on Schedules 3(3) and 4. The Institute supported the policy intent of these parts of the Bill but expressed concerns about implementation.²³ These issues are discussed in Chapter 2.

Schedule 1 – electronic portability of superannuation

- 1.35 The Association of Superannuation Funds of Australia (ASFA) is a non-profit, non-political national organisation that seeks to advance the interests of members of superannuation funds. In relation to the electronic portability form, ASFA stated:

ASFA is a strong supporter of the scheme as it will provide a quick, efficient and low cost process with which fund members and RSA holders can consolidate these lost accounts. ASFA considers that consolidation of these lost and inactive accounts into an account that is receiving contributions is in the best interests of the fund member ...

22 Exposure Draft, GST Treatment of new residential premises, *explanatory material*, 2011, p. 3.

23 Mr Donna Bagnall, ICAA, *Committee Hansard*, Canberra, 16 December 2011, p. 1.

We believe that no unintended consequences will flow from the amendments as drafted.

We strongly support the passage of Schedule 1 of the bill.²⁴

1.36 The Australian Institute of Superannuation Trustees (AIST) is an independent, not-for-profit professional body that represents the trustee directors and staff of industry, corporate and public-sector superannuation funds. The Institute made a submission in which they focussed solely on the electronic portability form. The Institute supported:

- the ‘one touch’ approach by means of which members might alert the trustees of their lost accounts of a potential destination and that these trustees then may act without the need for additional requirements;
- a taxpayer’s right to decline to provide their Tax File Number (TFN), though they acknowledged that such an electronic tool may require a TFN to operate; and
- the idea of providing a manual solution where validation cannot be provided.²⁵

1.37 For these reasons, both ASFA and AIST supported the passage of Schedule 1 of the Bill.

Schedule 3 – GST and financial supply

1.38 The Australian Finance Conference (AFC) and the Australian Equipment Lessors Association (AELA) made a joint submission. The members of these organisations comprise the major providers of equipment finance in Australia, and include major and regional banks, international banks, independent financiers, manufacturer financiers, rental companies and fleet leasing companies. In their submission, the AFC and AELA focussed on Schedule 3, which they supported. The AFC and AELA state that:

The equipment finance industry was delighted when in the 2010-11 Budget the Government announced its intention to amend the financial supply provisions of the GST law, allowing full input tax credits upfront for businesses accounting on a cash basis when they enter into hire purchase arrangements.

The amendment will rectify a significant tax incongruity; the GST treatment of cash basis taxpayers under hire purchase arrangements has been distorting the equipment finance market, causing a major shift to chattel mortgage that would not otherwise

24 The Association of Superannuation Funds of Australia Limited, *Submission 4*, p. 2.

25 The Australian Institute of Superannuation Trustees, *Submission 2*, p. 1.

occur. GST cash basis taxpayers under hire purchase arrangements cannot presently claim input tax credits upfront, but can only claim them over the life of the agreement. Not surprisingly, these customers have opted for chattel mortgage, enabling them to claim the input tax credit immediately.²⁶

- 1.39 They also note that whilst chattel mortgage was largely unknown in Australia prior to the introduction of the GST, it now accounts for almost half of equipment hire finance. They report that in comparable countries (such as the UK, New Zealand and South Africa), 'a cash basis taxpayer is entitled to an input tax credit for the whole of the VAT/GST payable under the hire purchase agreement'.²⁷

Committee objectives and scope

- 1.40 The objective of the inquiry is to investigate the adequacy of the Bill in achieving its various policy objectives and, where possible, identify any unintended consequences.

Conduct of the inquiry

- 1.41 Details of the inquiry were placed on the committee's website. A media release announcing the inquiry and seeking submissions was issued on Monday, 28 November 2011.
- 1.42 Four submissions were received. These are listed at Appendix A.
- 1.43 A public hearing was held in Canberra on Friday, 16 December 2011. A list of the witnesses who appeared at the hearing is available at Appendix B. The submissions and transcript of evidence were placed on the committee's website at <http://www.aph.gov.au/house/committee/economics/index.htm>.

26 The Australian Finance Conference and the Australian Equipment Lessors Association, *Submission 3*, p. 2.

27 The Australian Finance Conference and the Australian Equipment Lessors Association, *Submission 3*, p. 2.