SUBMISSION 1

The Institute of Chartered Accountants in Australia

9 December 2011

Mr Stephen Boyd
Committee Secretary
Standing Committee on Economics
PO Box 6021
Parliament House
CANBERRA ACT 2600

By email: economics.reps@aph.gov.au

Submission to inquiry on Tax Laws Amendment (2011 Measures No. 9) Bill 2011

Dear Stephen

The Institute of Chartered Accountants in Australia (the Institute) welcomes the opportunity to provide a submission to the House Economics Committee (Committee) on its inquiry into the Tax Laws Amendment (2011 Measures No. 9) Bill 2011 (the No. 9 Bill).

Specifically, the Institute wishes to make comments on two aspects of the No. 9 Bill:

- Part 3 of Schedule 3 - the proposed hire purchase amendment allowing small businesses that account on a cash basis to access full input tax credits (ITCs) upfront when they enter into hire purchase arrangements; and

- Schedule 4 – the proposed amendments to ensure that a "wholesale supply" of premises under a development lease arrangement is disregarded in determining whether a sale or long-term lease of the premises is of new residential premises.

This formal submission to the Committee follows our earlier submissions to Treasury of:

- 19 August 2009 in relation to Treasury's Consultation Paper on the Review of the Financial Supply Provisions, and our submission of 8 September 2010 in response to Treasury's Discussion Paper: 'Implementation of the recommendations of Treasury's review of the financial supply provisions'; and

- 2 March 2011 in relation to Treasury's Consultation paper issued on 27 January following the adverse court decision in *Commissioner of Taxation v Gloxinia Investments (Trustee)* [2010] FCAFC 46, and our submission of 27 October 2011 in relation to the Exposure Draft (ED) legislation and Explanatory Memorandum (EM) on the 'GST Treatment of New Residential Premises' released on 23 September 2011.

We refer the Committee to the respective sections of those submissions dealing with the topics of hire purchase arrangements and the legislative approach to deal with the *Gloxinia* decision. Our views in this submission are consistent with the views expressed in those earlier submissions.

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Hire Purchase amendment – Part 3 of Schedule 3

This submission is focused on providing the Institute's key recommendations in relation to how the hire purchase amendment measure should be implemented. We believe that if the measure is passed as currently drafted in Schedule 3, it will be likely to lead to uncertainty and unintended consequences. In our view, the drafting is technically deficient in a number of respects, with the risk that the new provisions are left to the Commissioner to administer and the courts to construe, in a manner which may not be in line with the policy intent of the parliament and present possible risks to the revenue.

In addition, as only part of the proposed changes to GST and hire purchase agreements are included within the Bill, (the proposal to make all of the hire purchase a taxable supply is likely to be made by amending the *A New Tax System (Goods and Services Tax) Regulations 1999* (GST Regulations)), we consider that there may be some potential issues arising as a result of these changes. Consequently, we wish to take this opportunity to identify and resolve these issues in the context of the Bill itself.

Key comments and concerns

The Institute accepts that taxpayers who account on a cash basis who purchase goods under a hire purchase agreement should be entitled to claim ITCs for the acquisition upfront, instead of waiting until each instalment payment is made.

This is proposed to be achieved by the insertion of new Division 158 into the GST Act, an amendment to Division 156, and the making of associated amendments to the GST Regulations.

However, the Institute has a number of fundamental concerns with the way in which the hire purchase amendment has been designed and drafted, namely:

1. The amendments to Divisions 156 and 158 specify which parts of the GST attribution rules do not apply to a hire purchase agreement, but they do not contain any provision that specifies the policy intent that GST payable and ITCs claimable on hire purchase agreements are attributed "up front". The law, as proposed, will leave the actual attribution to the operation of the general provisions – the operation of which has caused uncertainty to date.

2. A high degree of uncertainty surrounds whether a hire purchase involves one, two or more supplies. Under the proposed new law, following the removal of item 8 from the GST Regulations: -

    a. If there will be one supply, this creates issues for the Luxury Car Tax (LCT) "price" as the vehicle price will be inflated by the credit component. Similarly, section 69 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) will limit ITCs on the entire amount payable under the hire purchase agreement to the "car limit".

    b. If it is intended that a hire purchase continues to involve two supplies, both being taxable, it is not apparent how the law will operate to identify two separate supplies once the credit component is no longer input taxed. The definition of hire purchase in section 995 of the *Income Tax Assessment Act 1997* which applies (through section 195-1) is "a contract for the hire of goods ... and an agreement for the purchase of goods by instalments ...". Given this is the definition, it appears that there is not a separate supply of "credit" as suggested in proposed section 156-23.

3. The amendment introduces an additional risk into the GST system such that if a customer (hiree) defaults on a hire purchase, the financier will be able to claim a credit under Division 19 and / or Division 21, but the Commissioner will be unlikely to recover the GST from the hiree.

4. There is no sound policy reason why Division 156 should not apply to hire purchase agreements. In fact, there are sound fiscal reasons why Division 156 should at least be available as an option.

5. The application of this amendment is in relation to hire purchase agreements entered into on or after 1 July 2012. When this expression has been used in the past, an agreement has been taken to be entered into when it is binding on the parties to it, not for example, when it is signed or the goods are delivered. Such an application date will be uncertain and difficult to operate in practice.

Recommendations

We recommend that amendments be made to the GST law, the GST Regulations, and the LCT legislation to clarify that:

- the supplies made under a hire purchase agreement are deemed to be two[1] 'taxable supplies'. That is, a taxable supply of goods and a taxable supply of finance (rather than a single taxable supply of goods inclusive of the finance component). We consider that the GST Act does not authorise the making of regulations about the meaning of "supplies". Accordingly, to specify the character of the special supplies that are deemed to be made under a hire purchase agreement, this requires an amendment to be made to the GST Act and not the Regulations.[2] Item 6 of GST Regulation 40-5.12 should also be amended to encompass both 'goods' and 'credit' under a hire purchase. This item currently only covers the supply of 'goods'. Such an amendment should also ensure that item 2 of GST regulation 40-5.09(3) would not apply.

- the GST payable and ITCs claimable on entering into the hire purchase agreement are attributed upfront by both parties to the tax period in which any payment is made or an invoice is issued under the contract; or alternatively, at the agreement of both parties, the two taxable supplies are treated as if they were both periodic or progressive supplies (such that Division 156 applies).

- the "price" of a car supplied under a hire purchase agreement for the purposes of Division 69 of the GST Act and the *A New Tax System (Luxury Car Tax) Act 1999* (LCT Act) remains as it currently is, i.e. that it is only the price paid for the car (excluding the finance component of the hire purchase).

- the new rules are applicable to the supply of goods and other things under a hire purchase agreement if the goods are delivered or made available on or after 1 July 2012.

***Gloxinia* amendment – Schedule 4**

The proposed amendment will insert subsection 40-75(2B) into the GST Act. Its purpose is to deal with circumstances substantially similar to those at issue in *Gloxinia* where premises are constructed by one party (a "developer") under an agreement where the premises will be supplied by a second entity (often the original land holder - a government entity) to the first entity following completion. The proposed subsection refers to the supply by the second entity as a "wholesale" supply.

The Explanatory Memorandum (EM) to the Bill contains an example of the type of transaction to which the proposed amendments are directed. In doing so, the EM takes the view that numerous supplies are made and consideration is provided between the developer and the government entity in relation to the construction. In particular:

- the developer makes a supply of development works to the government entity in consideration for the "wholesale sale"; and
- the "wholesale sale" is in consideration for the development works.

The proposed amendment relies on this characterisation of a "barter supply" to achieve the intended policy outcome.

[1] Without specification that there are two supplies, there is uncertainty about whether a number of payments made under typical agreements are for one, two or more supplies – for example, where establishment fees and "deposits" are involved.
[2] We note that the 1997 Act required a specific rule (in Division 240) to deem hire purchase to be a sale of goods and loan because the general law was not considered adequate.

Key comments and concerns

Our main concern in this case is the highly detailed and prescriptive form of drafting in circumstances where the 'mischief' is of a general nature and will exist in many cases not covered by the proposed amendments.

We observe that past amendments to the real property provisions of the GST Act have proved to be too narrowly phrased and in need of subsequent amendment.

Secondly, the approach to the characterisation of the "conditions" contained in the agreement between the developer and the government entity as a barter supply (where the action of the developer is both consideration for and a supply to the government entity) is not consistent with similar arrangements in infrastructure arrangements.

The ATO view, in general terms, was stated in paragraphs 40 and 41 of GSTR 2008/2 as follows:

> 40. The undertaking of the development works by the developer is neither a supply of development services from the developer to the government agency nor (non-monetary) consideration for any supply made to the developer.[24]
>
> 41. While the undertaking of the development works by the developer is an obligation that needs to be fulfilled for the developer to become entitled to the freehold or leasehold title to the land, it does not have a separate identity or an independent value to the government agency. It is merely a condition of the primary transaction between the parties, being the sale or long-term lease of land by the government agency to the developer.

We submit that there is nothing in the *Gloxinia* decision that should be regarded as bringing this characterisation into doubt.

The alternative view, as contained in the EM, is more complicated and less reflective of the "practical business tax" that is favoured by the courts.

Most concerning is that large amounts of GST and ITCs are generated by this new view – putting the revenue at considerable risk if the original characterisation is correct. The risk is even more problematic if the approach is carried over into other large infrastructure projects.

Recommendations

We recommend that the proposed definition of "wholesale sale" be broadened to reflect the policy intent that ensures that residential premises are "new" if they have not been occupied as residential premises.

The description of the "barter" transaction in the EM should be omitted pending clarification of the status of "conditions" in infrastructure contracts as supplies. Ideally, the law should be amended to clarify that the satisfaction of a condition of this nature is not, of itself, a supply or consideration.

If you would like to discuss any aspect of this submission or require further information, please contact me on 02 9290 5623.

Yours sincerely

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