
The Parliament of the Commonwealth of Australia

Advisory Report on the Tax Laws Amendment (2011 Measures No. 9) Bill 2011

House of Representatives
Standing Committee on Economics

February 2012
Canberra

© Commonwealth of Australia 2012

ISBN 978-0-642-79617-2 (Printed version)

ISBN 978-0-642-79618-9 (HTML version)

Cover image courtesy of *Thinkstock*.

This work is licensed under the Creative Commons Attribution-NonCommercial-NoDerivs 3.0 Australia License.



The details of this licence are available on the Creative Commons website:

<http://creativecommons.org/licenses/by-nc-nd/3.0/au/>.



Chair's foreword

The Tax Laws Amendment (2011 Measures No. 9) Bill 2011 is similar to other tax amendment bills in that it has a package of measures designed to fine tune or improve the tax law. During the inquiry, some of the measures received express endorsement in submissions. For example, the Australian Institute of Superannuation Trustees and the Association of Superannuation Funds of Australia supported the provisions on the electronic portability form. This will be a system whereby super fund members will be able to electronically request the consolidation of their super through the Australian Taxation Office (ATO). It will assist individuals who are reunited with their superannuation funds in consolidating the different amounts.

Some measures did not receive comment from stakeholders, but are beneficial to taxpayers and should be supported. For example, under current law, taxpayers can obtain a capital gains tax (CGT) roll-over for a capital gain or loss that arises from their interest in a company or trust because of the demerger of an entity from the group of which the company or trust is the head entity. However, this is not available where the head entity is a corporation sole or complying superannuation entity. Schedule 2(2) of the Bill makes this roll-over available for these types of bodies.

The Goods and Services Tax (GST) and hire purchase amendments remove a tax-induced distortion between chattel mortgage and hire purchase. Under current law, chattel mortgage is more attractive because the GST input tax credits are up front for small businesses that use cash accounting for GST, whereas they are only available on a payment basis under hire purchase. Small businesses now rarely use hire purchase for this reason, despite its other advantages over chattel mortgage.

The Bill also reduces compliance costs for small business by increasing the financial acquisitions threshold from \$50,000 to \$150,000. If a small business makes financial acquisitions below this amount, then it is outside the financial supply regime and can claim input tax credits for its financial supplies. Increasing this threshold takes more small businesses outside the financial supply regime and allows more businesses to claim input tax credits on their financial supplies.

The amendments for GST and new residential premises will reverse the effect of the court case *Gloxinia Investments*, which found that, where a particular combination of strata titles and leases were involved, newly constructed residential premises were not subject to GST. The Bill will re-affirm the policy intent that newly constructed homes should be subject to GST. They will also protect the revenue that funds Government services that assist the whole community.

The Bill comprises measures that are important refinements to the tax system.

The Institute of Chartered Accountants in Australia (ICAA) was the only stakeholder to raise concerns about the Bill. These applied to the provisions to enable businesses acquiring assets through hire purchase to obtain their GST input tax credits up front and the provisions to reverse the effect of the recent court decision of *Gloxinia Investments*. The ICAA's concerns related to whether the provisions would implement the policy intent, rather than the policy itself.

Despite the ICAA's comments, there are several reasons why the provisions in the Bill are the best available solution. For example, in relation to hire purchase, the ATO believes it has sufficient legislative basis for its interpretation and there have been no court actions disputing them. Further, in consultations in the review of GST and financial supply, stakeholders rejected the more fundamental reforms of the GST implied by ICAA's submission. Finally, the equipment finance industry itself is 'delighted' with the proposal.

In relation to GST for new residential premises, the ICAA has again suggested a wider reform than that supported in consultations. Treasury has noted that there is a risk of further court action in this area if the Bill proceeds, but this is part of bedding down what is still a relatively new tax.

After scrutinising Treasury and the ICAA, and noting the many positive measures in the Bill, the committee is of the view that it should proceed unamended.

I would like to thank the organisations that assisted the committee during the inquiry through submissions or participating in the hearing in Canberra. I also thank my colleagues on the committee for their contribution to the report.

Julie Owens MP
Chair



Contents

Chair's foreword	iii
Membership of the Committee	vii
Terms of reference	viii
List of abbreviations	ix
Recommendation	x


THE REPORT

1 Introduction	1
Referral of the Bill	1
Contents and structure of the Bill	2
Policy background	4
GST on financial supply	4
Gloxinia Investments case	6
Support for the passage of the Bill	8
Schedule 1 – electronic portability of superannuation	8
Schedule 3 – GST and financial supply	9
Committee objectives and scope	10
Conduct of the inquiry	10
2 Analysis of the Bill	11
Schedule 3(3) – the GST treatment of hire purchase	11

Background 11
Analysis..... 12
Conclusion 14
Schedule 4: GST on new residential premises..... 14
Background..... 14
Analysis..... 15
Conclusion 16
Overall conclusion 17

APPENDICES

Appendix A – Submissions19
Appendix B – Hearings and witnesses21
Appendix C – List of advisory reports23



Membership of the Committee

Chair	Ms Julie Owens MP
Deputy Chair	Ms Kelly O'Dwyer MP
Members	Mr Scott Buchholz MP Mr Stephen Jones MP Dr Andrew Leigh MP Mr Tony Smith MP Mr Craig Thomson MP

Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Mr David Monk
Research Officer	Dr Phillip Hilton
Administrative Officer	Ms Natasha Petrović



Terms of reference

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.

Under Standing Order 222(e), the House is taken to have adopted the Selection Committee's reports when they are presented.



List of abbreviations

AELA	Australian Equipment Lessors Association
AFC	Australian Finance Conference
AIST	Australian Institute of Superannuation Trustees
ASFA	Association of Superannuation Funds of Australia
ATO	Australian Taxation Office
CGT	Capital gains tax
Commissioner	Commissioner of Taxation
DGR	Deductible gift recipient
GST	Goods and services tax
GST Act	<i>A New Tax System (Goods and Services Tax) Act 1999</i>
ICAA	Institute of Chartered Accountants in Australia
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
RITC	Reduced input tax credit
TFN	Tax file number



Recommendation

2 Analysis of the Bill

Recommendation 1

That the House pass the Tax Laws Amendment (2011 Measures No. 9) Bill 2011 as proposed.

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.

Analysis of the Bill

- 2.1 The only stakeholder to raise concerns about the Bill was the Institute of Chartered Accountants in Australia (ICAA). The ICAA's submission covered the amendments of the GST treatment of hire purchase (Schedule 3(3)) and the reversal of the Full Federal Court decision in *Gloxinia Investments*. These issues are discussed below.

Schedule 3(3) – the GST treatment of hire purchase

Background

- 2.2 Division 156 of the *A New Tax System (Goods and Services Tax) Act 1999* covers supplies and acquisitions made on a progressive or periodic basis. This currently covers hire purchase arrangements. Section 156-25 provides that the Division does not apply if a taxpayer accounts on a cash basis.
- 2.3 The Bill seeks to insert section 156-23 into the Act, stating that Division 156 does not apply to hire purchase. It also seeks to insert Division 158 to specifically cover hire purchase, stating that taxpayers who account on a cash basis are treated as not accounting on a cash basis for the purposes of the Act and regulations for these agreements. The implication is that cash accounting taxpayers will be able to obtain input tax credits up front from the interaction of this new Division with other provisions in the tax law.
- 2.4 However, the ICAA expressed concern about the provisions because they implement the policy intent through other provisions in the tax law, rather than by explicit statement.¹ For example, the ATO has issued a ruling of its interpretation of the general attribution rules that a taxpayer who

1 Mr Michael Evans, ICAA, *Committee Hansard*, Canberra, 16 December 2011, pp. 4, 9.

accounts for GST on an accruals basis can claim input tax credits up front for hire purchase.² However, the Institute has stated that this interpretation is open to question:

... there seems to be a doubt, just on the basis of the law that we have, as to whether this is the supply of credit as well as the supply of goods, in which case there would be two supplies being made for different prices. In the institute's view, the operation of the general rule about when the GST on those two supplies is payable is open to question. It depends when the part of the consideration is paid for each of the parts of the supplies.³

- 2.5 The Institute also raised the question of how GST for hire purchase would interact with the luxury car tax, in particular whether the GST-inclusive price of the supply of credit would inadvertently increase the value of a car for the purposes of luxury car tax:

When we get to the luxury car tax and the credit limitation issue we have to work out for the purpose of luxury car tax, and for the limitation on input tax credits for luxury cars, what the price of the car is. It takes us back to the question of whether this is a supply or two supplies. Without something clear in the law to say that, it seems to me, as a matter of the legal form of a contract, the price of the car is the 60 monthly payments, including the interest component, which would mean the luxury car tax could be higher.⁴

- 2.6 As the Institute noted in the hearing, this depends on whether hire purchase is treated as one or two supplies, in the former case a supply of goods by way of hire, or in the latter case a supply of goods and a supply of credit. Although this relates to the regulations, rather than the Bill, it warrants discussion due to the coverage it received in the hearing and its relevance to the GST treatment of hire purchase generally.

Analysis

- 2.7 In response to the Institute's position that the interpretation of the GST law in relation to hire purchase is uncertain, Treasury responded that the ATO is satisfied with its approach. Treasury also stated that the sorts of

2 ATO, *Goods and Services Tax Ruling, Goods and services tax: attributing GST payable, input tax credits and adjustments and particular attribution rules made under section 29-25*, GSTR 2000/29, 11 July 2007, para. 211.

3 Mr Michael Evans, ICAA, *Committee Hansard*, Canberra, 16 December 2011, p. 3.

4 Mr Michael Evans, ICAA, *Committee Hansard*, Canberra, 16 December 2011, pp. 4-5.

changes that the Institute have been canvassing are wide ranging, yet the industry feedback in the Treasury's *Review of the GST financial supply provisions* favoured refinement over fundamental reform. Further, the bodies representing the hire purchase and equipment leasing industries fully support the provisions at an operational level:

... the sorts of changes that Mr Evans is seeking probably go to the fundamental core of our GST, and the government is probably not in a position to have a complete, wholesale revision of our existing GST law. I do not think it is simply a matter of a couple of words in the legislation to deal with that issue.

Secondly, my advice is: the commissioner is comfortable administering the law as it is. He believes he has the necessary backing, in the combination of the legislation and the regulations, to deal with his existing interpretation and, as I said, to date that has not been challenged in the courts. As I have said before, the other people at the operational level, who are issuing and dealing with taxpayers and providing hire purchase agreements, fully support the legislation as it currently stands.⁵

- 2.8 Treasury's comment that the amendments have industry support were corroborated by the industry itself. The Australian Finance Council and the Australian Equipment Lessors Association stated in their submission:

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 ...

This is a significant tax reform measure. It will address the adverse consequences of the current tax treatment of hire purchase, which has created a tax inefficiency which has driven taxpayers to other finance products. As such, this amendment enhances the integrity of Australia's GST regime.⁶

- 2.9 In relation to the question of whether there will be one or two supplies under hire purchase and whether the supply of credit would increase the value of a car for the luxury car tax, Treasury stated in evidence that this was a matter for the regulations, in particular that:

5 Mr Rob Dalla-Costa, Treasury, *Committee Hansard*, Canberra, 16 December 2011, p. 5.

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

... we will attempt to address some of the uncertainty that the ICAA are raising in the context of the regulations, where we can give more emphasis to the separate supply nature of the provisions.⁷

- 2.10 On 13 January 2012, the Government released exposure draft regulations amending the *A New Tax System (Goods and Services Tax) Amendment Regulations 2012*. Items 2 and 3 in the draft regulations provide that hire purchase arrangements will not be financial supplies, so both components of a hire purchase transaction will be fully taxable and administratively easier for operators.⁸ Making hire purchase transactions fully taxable for GST does not increase the tax burden for operators because the transactions are business to business and they receive input tax credits for the amounts involved. In relation to the luxury car tax, the Explanatory Memorandum to the draft regulations features an example of how the new provisions will operate. It states that the GST-inclusive price of the supply of the car is not included in calculations for the luxury car tax.⁹

Conclusion

- 2.11 The committee is confident that the Bill will deliver its policy intent in relation to hire purchase. The ATO has taken the view that its interpretation of the GST for hire purchase is supported by the legislation and there has been no court challenge to date on this point. Further, the recently released Explanatory Memorandum on the draft regulations make clear that there will be no inadvertent consequences with the luxury car tax. Schedule 3(3) can proceed as drafted.

Schedule 4: GST on new residential premises

Background

- 2.12 ICAA expressed its support for the overall intention of the amendments, which was to restore the general state of the law following the outcome of the *Gloxinia Investment* case. However, ICAA qualified this support by setting out several reservations. Firstly, ICAA was concerned by the Bill's

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

8 Mr Rob Dalla-Costa, Treasury, *Committee Hansard*, Canberra, 16 December 2011, p. 3.

9 A New Tax System (Goods and Services Tax) Amendment Regulations 2012, *Explanatory Memorandum*, p. [4].

very specific focus. In their submission, they referred to the fact that previous amendments to the GST have tended to be narrowly prescriptive and required subsequent amendment.¹⁰ In the ICAA's own words at the hearing:

Our view comes from an acceptance of the stated policy and the policy reiterated in *Gloxinia* that the sale of newly constructed premises should be subject to full GST when they go into consumption. We accept that it appears that the proposed response to the deficiency highlighted in *Gloxinia* only addresses the *Gloxinia* situation, yet it is still stated that the policy intention is that newly constructed residential premises will be subject to full tax. If the policy is that that will only apply in the circumstances of *Gloxinia*, then we could have no complaint with these amendments.¹¹

- 2.13 Secondly, the ICAA were concerned that the Explanatory Memorandum of the Bill had introduced other matters that would also have broader implications for the administration of the law. In particular the Explanatory Memorandum stated that the treatment of barter transactions between developers and Crown agencies granting long-term leases would be taxable and creditable (for example, in infrastructure projects). This had not been announced in the press release of 27 January 2011.¹² The ICAA advised the committee that the treatment of 'barter transaction within the Explanatory Memorandum is inconsistent with the way the commissioner had administered law until he withdrew the law in 2008 and was not a matter that was addressed in the press release of 27 January'.¹³

Analysis

- 2.14 In their testimony before the committee, the Treasury advised that schedule 4 of the Bill was solely intended to address the specific facts of *Gloxinia Investments*.¹⁴ They acknowledged that the circumstances in the *Gloxinia Investment* case were only one example where the GST may not be applicable. They also acknowledged that the amendments in the Bill might not necessarily address a range of other circumstances where GST should be applied in line with the policy intent. Treasury representatives explained their position as follows:

10 ICAA, *Submission 1*, p. 4.

11 Mr Michael Evans, ICAA, *Committee Hansard*, Canberra, 16 December 2011, p. 12.

12 Mr Michael Evans, ICAA, *Committee Hansard*, Canberra, 16 December 2011, p. 12.

13 Mr Michael Evans, ICAA, *Committee Hansard*, Canberra, 16 December 2011, p. 12.

14 Mr Phil Bignell, Treasury, *Committee Hansard*, Canberra, 16 December 2011, pp. 5, 12.

The purpose of the amendments is to restore the intended policy outcome concerning new residential premises that arises from the decision of the full Federal Court in *Gloxinia* ... We believe that they are fairly widely supported by stakeholders in the form that they have been contained ... Treasury considered a broader principled change in response to the *Gloxinia* decision. We put that out for public consultation in the Treasury discussion paper released earlier in the year. Most submissions did not support the broader approach that the institute has proposed ... Treasury did not feel satisfied that the wider approach would address the issue without having a wider change of policy and potential revenue implications.¹⁵

2.15 In relation to barter supply and projects sponsored by Crown agencies, Treasury explained that the treatment of barter transactions had been carefully considered, following liaison with the Property Council of Australia. The inclusion of barter transactions in the Explanatory Memorandum was intended to ensure the clarity regarding the implications of the amendment for such transactions.¹⁶

2.16 Treasury also acknowledged that there was a risk that the Bill might not prevent future litigation, but this needed to be understood within the correct context. The GST remains a new tax compared with older taxes such as the income tax. Therefore the law is less settled and litigation does occur. As Treasury advised the Committee at the hearing:

The GST is a relatively new law, having been in place for 11 years, compared with our income tax, which has been a much more settled system. In recent years we have had many cases coming before the courts to test that new law, so it is certainly possible that there will be additional matters that will arise in the future with new areas of the law. Those certainly cannot be ruled out.¹⁷

Conclusion

2.17 The committee expects that Schedule 4 will ensure that taxpayers in the same circumstances as in *Gloxinia Investments* will pay GST on new residential premises in line with the policy intent. The proposal in the Bill has been subject to thorough consultation. The alternative proposed by ICAA, namely more fundamental reform, was rejected by stakeholders

15 Mr Phil Bignell, Treasury, *Committee Hansard*, Canberra, 16 December 2011, p. 12.

16 Mr Phil Bignell, Treasury, *Committee Hansard*, Canberra, 16 December 2011, p. 12.

17 Mr Phil Bignell, Treasury, *Committee Hansard*, Canberra, 16 December 2011, p. 14.

and potentially had wider revenue implications. The Bill contains a practical solution and it has the committee's support.

Overall conclusion

- 2.18 The Bill has a number of components, some of which received express endorsement in submissions. The provisions on the electronic portability form create a system whereby super fund members will be able to electronically request the consolidation of their super through the ATO. This will assist individuals who are reunited with their superannuation funds in consolidating the different amounts.
- 2.19 Many of the provisions for CGT and business restructures are beneficial to taxpayers. For example, under current law, taxpayers can obtain a CGT roll-over for a capital gain or loss that arises from their interest in a company or trust because of the demerger of an entity from the group of which the company or trust is the head entity. However, this is not available where the head entity is a corporation sole or complying superannuation entity. Schedule 2(2) of the Bill makes this roll-over available for these types of bodies.
- 2.20 The GST and hire purchase amendments remove a tax-induced distortion between chattel mortgage and hire purchase. Under current law, chattel mortgage is more attractive because the GST input tax credits are up front for small businesses that use cash accounting for GST, whereas they are only available on a payment basis under hire purchase. Small businesses now rarely use hire purchase for this reason, despite its other advantages over chattel mortgage.
- 2.21 The Bill also reduces compliance costs for small business by increasing the financial acquisitions threshold from \$50,000 to \$150,000. If a small business makes financial acquisitions below this amount, then it is outside the financial supply regime and can claim input tax credits for its financial supplies. Increasing this threshold takes more small businesses outside the financial supply regime and allows more businesses to claim input tax credits on their financial supplies.
- 2.22 The amendments for GST and new residential premises will reverse the effect of the court case *Gloxinia Investments*, which found that, where a particular combination of strata titles and leases were involved, newly constructed residential premises were not subject to GST. The Bill will re-affirm the policy intent that newly constructed homes should be subject to

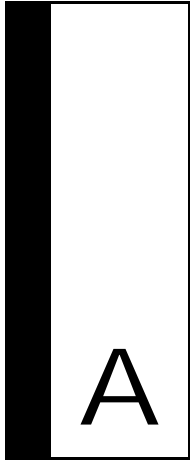
GST. They will also protect the revenue that funds Government services that assist the whole community. The Bill overall comprises measures that are important refinements to the tax system.

- 2.23 The ICAA was the only stakeholder to raise concerns about the Bill. These were the provisions to enable businesses acquiring assets through hire purchase to obtain their GST input tax credits up front and the provisions to reverse the effect of the recent court decision of *Gloxinia Investments*. The ICAA's concerns related to whether the provisions would implement the policy intent, rather than the policy itself.
- 2.24 Despite the ICAA's comments, there are several reasons why the provisions in the Bill are the best available solution. For example, in relation to hire purchase, the ATO believes it has sufficient legislative basis for its interpretation and there have been no court actions disputing them. Further, in consultations in the review of GST and financial supply, stakeholders rejected the more fundamental reforms of the GST implied by ICAA's submission. Finally, the equipment finance industry itself is 'delighted' with the proposal.
- 2.25 In relation to GST for new residential premises, the ICAA has again suggested a wider reform than that supported in consultations. Treasury has noted that there is a risk of further court action in this area if the Bill proceeds, but this is part of bedding down what is still a relatively new tax. After scrutinising Treasury and the ICAA, and noting the many positive measures in the Bill, the committee is of the view that it should proceed unamended.

Recommendation 1

- 2.26 **That the House pass the Tax Laws Amendment (2011 Measures No. 9) Bill 2011 as proposed.**

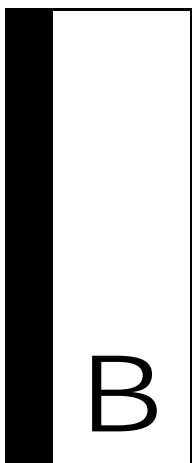
Julie Owens, MP
Chair
7 February 2012



Appendix A – Submissions

No.

1. Institute of Chartered Accountants in Australia
2. Australian Institute of Superannuation Trustees
3. Australian Finance Conference and the Australian Equipment Lessors Association
4. Association of Superannuation Funds of Australia



Appendix B – Hearings and witnesses

Friday, 16 December 2011, Canberra

Department of the Treasury

Mr Rob Dalla-Costa, Senior Adviser, Indirect Tax Division

Mr Phil Bignell, Senior Adviser, Indirect Tax Division

Institute of Chartered Accountants in Australia (ICAA)

Ms Donna Bagnall, Senior Tax Consultant

Mr Michael Evans, Chairman, Indirect Tax Committee



Appendix C – List of advisory reports

Below is a list of advisory reports tabled by the House of Representatives Standing Committee on Economics in the 43rd Parliament.

No.

1. Inquiry into the Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011; and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011
2. Inquiry into Indigenous economic development in Queensland and advisory report on the Wild Rivers (Environmental Management) Bill 2010
3. Advisory report on the Taxation of Alternative Fuels Bills 2011
4. Advisory report on the National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011
5. Advisory report on the Competition and Consumer (Price Signalling) Amendment Bill 2010 and the Competition and Consumer Amendment Bill (No. 1) 2011
6. Advisory report on the Food Standards Amendment (Truth in Labelling - Palm Oil) Bill 2011
7. Advisory report on the Corporations (Fees) Amendment Bill 2011
8. Advisory report on the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011

9. Advisory report on the Minerals Resource Rent Tax Bill 2011 and related bills
10. Advisory report on the Tax Laws Amendment (2011 No. 9 Measures) Bill 2011