GST AND FINANCIAL SUPPLIES

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This article provides an outline of the treatment of financial supplies under the GST legislation. It examines the threshold requirements to be satisfied for something to be a financial supply and provides commentary on each of the eleven financial supply items listed in the GST Regulations. There is also a discussion of the reduced input tax credit system which is a unique feature of the Australian GST model.

1. INTRODUCTION

1.1 Input Taxation of Financial Supplies

A financial supply, and a supply of a right to receive a financial supply, are input taxed.[1] This means that a maker of financial supplies does not have to pay GST on the consideration it receives for the supply but will not as a general rule be able to claim input tax credits for GST charged on its business inputs to the extent that the acquisition of the inputs relates to the making of financial supplies. Consequently, banks, non-bank financial institutions and any other provider of financial supplies will generally have to absorb the GST costs passed on to them by their suppliers ("input GST") because they will not be able to pass these GST costs on to their customers in the same way that a maker of taxable supplies may do so.

Input taxation of financial supplies is consistent with the way in which GST and similar value added taxes ("VATs") are levied in comparable overseas jurisdictions.[2] It is said that the reason financial supplies are subject to GST on an input taxation basis is that it is often difficult to identify and measure the value added to many financial supplies on a transaction-by-transaction basis so as to subject such supplies to GST in the ordinary way. The maker of financial supplies is therefore effectively treated as an end consumer to whom the GST burden is ultimately passed.

This paper outlines in general terms the rules applying to financial supplies under the Australian GST legislation and considers the treatment of specific industries and transactions.

1.2 Consequences of Input Taxation

Because makers of financial supplies are effectively treated as the end consumer, the input taxation of financial supplies will mean that financial institutions may bear up to an additional 10% on top of the business costs they would otherwise incur. Input GST costs will be added to the costs of inputs such as purchases of real property, leases, the acquisition of information technology services and the acquisition of office supplies and equipment. However, there should be no input GST costs included in the cost of wages as the supply of services by an employee will generally not be subject to GST.[3]

Most taxpayers will be concerned with accounting for GST. That is, they will pay GST on the taxable supplies they make and will recover as input tax credits, amounts collected from them on

[*] This article is based on material written by Peter McMahon (Blake Dawson Waldron) and Amrit MacIntyre (Baker & McKenzie) for *TheGST Guide* published by CCH Australia Limited.
[1] *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ("GSTA"), ss 9-30(2) and 40-5(1).
[2] For example, the United Kingdom, Canada and New Zealand.
[3] GSTA, ss 9-5(b) and 9-20(2)(a).

account of GST by their own suppliers. Makers of financial supplies, however, will be concerned not with accounting for GST but with how they can recover input GST costs. There are two ways in which input GST costs can be recovered.

First of all, the taxpayer may increase the costs it charges its customers. For example, a bank may increase the margins or fees it charges to its customers to cover input GST costs. During the transitional period however a bank will need to ensure that there is no "over recovery" of input GST costs from its customers as this could result in a contravention of Part VB of the *Trade Practices Act 1974* (Cth).

Secondly, makers of financial supplies will seek to minimise the input GST they have to absorb. Minimisation will firstly depend on the ability to characterise a supply as a taxable or GST-free supply rather than as a financial supply. To the extent that supplies can be re-characterised as taxable or GST-free supplies, input GST relating to those supplies will be recoverable. For example, if financial advice were characterised as an incidental financial supply, input GST costs of an acquisition related to giving that advice are likely to be unrecoverable as input tax credits. However, if the financial advice were not an incidental financial supply, those input GST costs are likely to be recoverable. Characterisation therefore assumes some importance to makers of financial supplies. Minimisation will also depend on the ability to *apportion* input GST costs between financial supplies and taxable supplies. Where the acquisition of an input relates to making taxable supplies and supplies that are input taxed, the taxpayer will normally apportion input GST between the two kinds of supplies so that the maximum amount recoverable can be apportioned to taxable supplies and recovered as an input tax credit. For example, a stockbroker would ordinarily apportion input GST costs included in the cost of hardware which it uses for both brokerage trading and proprietary trading so as to recover a proportion of these costs to the extent that they are attributable to brokerage trading.[4]

1.3 Reduced Input Tax Credit Scheme and Other Relief

A unique feature of the Australian GST system is the reduced input tax credit ("RITC") scheme. Effectively, this is a scheme that permits financial supply providers to claim a proportion (currently 75%) of input tax credits for certain input GST costs which relate to making financial supplies. These input costs are for a range of supplies that are ancillary to other financial supplies which are input taxed in comparable overseas jurisdictions. The recipient, however, will not be entitled to a full input tax credit but will recover 75% of the input GST costs passed on to it by the supplier.[5]

The Australian GST legislation also allows relief from the denial of input tax credits for:

- financial supply providers who do not exceed certain financial acquisition thresholds;[6]
- acquisitions relating to making financial supplies consisting of borrowings where the borrowings relate to making non-input taxed supplies.[7]

1.4 Specific Difficulties

Specific difficulties that arise in the taxation of financial supplies include the following:

- *Acquisitions* - the GST Regulations dealing with financial supplies purport to treat the acquisition of a financial supply as the making of that supply. The input taxation of both sides of financial transactions is unique to the Australian GST system.[8]

[4] See the discussion at Part 8.2.10(a). Also, see the discussion on "Apportionment" at Part 10.
[5] The RITC scheme is discussed at Part 11.
[6] See the discussion at Part 12.
[7] See the discussion at Part 8.2.
[8] See the discussion at Part 3.2.

- *Interest* – a financial supply requires the provision, acquisition or disposal of an *interest*, which is anything that is recognised at law or in equity as property in any form. In other words, the subject of the financial supply must be something that is proprietary in nature. This limitation of the financial supply concept to relevant dealings in property could preclude the application of input taxation to a range of services including account keeping services, even though the intention of the legislation appears to be that these services should be input taxed.[9]
- *Nexus* - the nexus provisions which say when a financial supply will be connected with Australia contain some anomalies. The nexus provisions applying to mortgages appear to differ depending on whether the mortgaged property is tangible or intangible property.[10]
- *Security interests* - while dealings in mortgages, charges, guarantees and indemnities will generally be subject to input taxation as financial supplies, it appears that dealings in other security interests including rights of set-off and negative pledges will not be input taxed. This may allow financial institutions to recover input GST costs which are not recoverable in other comparable jurisdictions.[11]
- *Hire purchase and finance leases* - the credit charge component of a hire purchase agreement will generally be input taxed. Consequently, GST will only be payable by the lessor/vendor calculated on the principal component. However, finance leases will be chargeable with GST in respect of both the principal amount and the credit charge component of lease charges. This may create a significant disincentive to financing an asset acquisition by way of a finance lease because of the higher GST costs of a finance lease.[12]
- *Trusts* - dealings in the capital of a trust fund are generally input taxed as financial supplies. This may produce the result that a maker of financial supplies may avoid the full consequences of input taxation simply by purchasing an asset which is subject to a trust so that it remains subject to the trust rather than acquire full legal ownership.[13]

2. WHAT IS A "FINANCIAL SUPPLY"?

Section 40-5(2) states that "financial supply" has the meaning given by the GST Regulations. The GST Regulations are contained in the *A New Tax System (Goods and Services Tax) Regulations 1999* ("GSTR"). Regulation 40-5.08 states that for the purposes of s 40-5(2) of the GSTA, a supply is a financial supply if the supply is mentioned as a financial supply in r 40-5.09, or an incidental financial supply in r 40-50.10. The r 40-5.09 definition contains the threshold requirements for a financial supply which are set out below. Regulation 40-5.09(3) contains a list of 11 items the supply of which will be a financial supply.

Some things are specifically excluded from the concept of financial supply. There are 18 excluded items and these are set out in the table in r 40-5.12. They include professional services, including information and advice in relation to a financial supply.[14] This list overrides the list in r 40-5.09, so that if something is within the scope of items on both lists it will *not* be a financial supply. However, r 40-5.12 does not override r 40-5.10, so that if something is both an incidental financial supply and is contained within r 40-5.12, its characterisations as an incidental financial supply prevails.

[9] See the discussion at Part 8.
[10] See the discussion at Part 6.
[11] See the discussion at Part 8.2.3.
[12] See the discussion at Part 8.2.8.
[13] See the discussion at Part 8.2.10(b).
[14] GSTR, r 40-5.12 (item 3).

If a supply is provided by a "financial supply facilitator", rather than a "financial supply provider", it will not be a financial supply.

Schedules 7 and 8 to the GSTR contain lists of examples of financial supplies and non-financial supplies under most of the items in r 40-5.09 and r 40-5.12 respectively. The examples are not exhaustive and, to the extent of any inconsistency, the meaning of the item in the main body of the GSTR will prevail.

Division 84 of the GSTA (the "reverse charge" provisions) may in some circumstances apply to an "imported" financial supply so as to make that transaction a taxable supply by the recipient. This may occur where the transaction is not connected with Australia, or where the supplier is not registered or required to be registered.[15] Regulation 40-5.09(3) avoids this result by treating the transaction as a financial supply to the extent that it would, apart from the connection or registration requirements, be a financial supply.

2.1 Threshold Requirements

There are a number of threshold requirements to be satisfied for something to amount to a financial supply. These requirements, as set out in r 40-5.09(1), are as follows:

- the supply must be a *provision, acquisition* or *disposal*;
- the subject of the provision, acquisition or disposal must be an *interest* (which is anything recognised at law or in equity as property in any form);
- the interest must be an interest mentioned in rs 40-5.09(3) or (4);
- the provision, acquisition or disposal must be for *consideration*;
- it must be in the *course or furtherance of an enterprise*;
- it must be *connected with Australia*;
- the supplier must be *registered* or required to be registered; and
- the supplier must be a *financial supply provider* in relation to the supply of the interest. A supply by a *financial supply facilitator* is *not* a financial supply.

Each of these requirements are discussed in the following parts.

3. ACTIVITIES GIVING RISE TO A FINANCIAL SUPPLY

A financial supply must arise out of a particular form of activity. These activities are a provision, acquisition or disposal. The meaning of each of these terms is discussed below. They will cover a broad range of things. The wide application of the financial supply concept is consistent with the wide definition of "supply" in s 9-10 of the GSTA.

3.1 Provision

"Provision" is defined in r 40-5.03 in inclusive terms and so will include what is a "provision" in its ordinary meaning. "Provision" in its ordinary meaning is "the providing or supply of something".[16] This will broadly cover any supply in the general sense. Regulation 40-5.03 says that "provision" of an interest will also include an allotment, creation, grant and issue of the interest. It is difficult to see how the inclusion of these terms in the definition of "provision" will extend the meaning that provision has in the ordinary sense.

The term "provision" appears to be wide

[15] For example, an offshore issue of commercial paper to non-resident dealers.
[16] The Macquarie Dictionary (3rd ed).

enough to catch both the transfer of a pre-existing interest (eg the transfer of a share or unit) as well as the creation and vesting in a person of an interest that did not previously exist.[17]

3.2 Acquisition

The definition of "acquisition" is set out in r 40-5.05. "Acquisition" in relation to the provision or disposal of an interest, includes acceptance and receipt of the interest. The definition of "acquisition" is inclusive. Consequently, it will include what is an acquisition in its ordinary meaning. "Acquisition" in its ordinary meaning has a wide reach to extend to an acquisition which occurs either passively or by active steps.[18] This will include the acquisition of existing property as well as a vesting of newly created property.

At first glance, the inclusion of an "acquisition" within the definition of a financial supply seems curious to the extent that the acquisition of something is taken to be a supply by the acquirer (even though the acquirer is actually the recipient). However, the inclusion of "acquisition" within the concept of financial supply appears to be intended to ensure that activities of banks such as the receipt of money on deposit and activities of stockbrokers such as the purchase of marketable securities in their own right are treated as financial supplies even though no supply is made by the acquirer in the ordinary sense.

The *Value Added Tax Act 1994* (UK) is expressed to apply VAT exempt treatment[19] to the "issue, transfer or *receipt* of, or any dealing with, money [and] any security for money"[20] and the "issue, transfer or *receipt* of, or any dealing with, any security or secondary security".[21] However, in practice, the UK and European VAT legislation is administered so as *not* to treat a relevant receipt as VAT exempt.

The Australian approach produces the result that on the provision or the disposal of the relevant interest by one person where another person accepts or receives that interest, each activity is *separately* treated as a financial supply. Consequently, on a share transfer, both the transferee and transferor will be taken to have made a financial supply. In a securities lending transaction there are four potential financial supplies, two involved in the "lending" and two involved in the "return" of the securities. The result will be that each party will be input taxed in respect of the financial supply. In other words, input GST included in the costs of anything each party acquires relating to the financial supply will not be fully recoverable, including input GST costs included in the cost of professional advice and valuations. Because a purchase of shares or the borrowing of funds is to be treated as the making of a financial supply by the purchaser or the borrower, many non-financial supply businesses will have borrowings or share acquisitions (eg on a takeover) at a level where they may not be protected by the de minimis provisions contained in Div 189 of the GSTA. In the case of borrowings, however, relief from the consequences of input taxation will be provided by s 11-15(5) to the extent that the borrowings relate to non-input taxed supplies.

Although the clear policy intent of the legislation is that an "acquisition" of the relevant kind be taxed as a financial supply, questions arose as to whether the GSTR in their original form were capable of giving effect to that intention. This was because of the requirement that the supplier of a financial supply be a "financial supply provider" in relation to the supply of the interest. An entity is a "financial supply provider" of an interest if immediately before the supply of the interest, the interest was the property of the entity, or was created by the entity in making the supply.[22]

Regulation 40-5.06(2), inserted by *A New Tax*

[17] For example, the allotment and issue of a share or unit or the grant of a mortgage.
[18] See, for example, the *Shorter Oxford English Dictionary*.
[19] Which is equivalent to input taxation under the Australian GST.
[20] Schedule 9, Group 5 (item 1).
[21] Schedule 9, Group 5 (item 6).
[22] GSTR, r 40-5.06(1).

System (Goods and Services Tax) Amendment Regulations 2000 (No 2), now provides that the entity that acquires an interest from a financial supply provider is also the financial supply provider of the interest.

3.3 Disposal

The concept of "disposal" is defined in r 40-5.04. Disposal of an interest includes assignment, cancellation, redemption, transfer and surrender of the interest. This is a wide definition which will include a disposal in its ordinary meaning, namely "the putting of something in a suitable place or to get rid of".[23]

3.3. 1 Assignment and Transfer

An assignment is the "immediate transfer of an existing proprietary right, vested or contingent, from the assignor to the assignee".[24]

A "transfer" of an interest in its ordinary meaning occurs when ownership of the interest passes from one person to another as a result of an act of the transferor with that intention or by operation of law. Conveyances or assignments by way of sale or gift are a common example of transfers happening as the result of the intentional act of the transferor.[25] A transfer by virtue of a court order is an example of a transfer occurring by operation of law.

Neither a transfer nor assignment would generally include any vesting in a person of newly created property which did not exist before the vesting whether the rights are created out of pre-existing property (eg the grant of a mortgage) or newly created property which did not exist before the vesting (eg the allotment and issue of shares). This is because the concept of transfer as ordinarily understood requires the property being transferred to be pre-existing property.[26] Assignment" has a similar meaning (see above). However, though the creation of a new interest will not be a "transfer" or "assignment", it is likely to come within the meaning of "provision".[27]

An assignment or transfer of a relevant interest will involve a separate financial supply being made by the acquirer of the interest being assigned or transferred.

3.3.2 Cancellation and Redemption

A "cancellation" in its ordinary meaning is "the act of making void or annulling".[28] This will arguably include the cancellation of shares (subject to the matters discussed below).

A "redemption" in its ordinary meaning is "the act of buying back".[29] Consequently, the redemption of a trust unit may be taken to be a financial supply (subject to the matters discussed below).

In the case of both a share cancellation and redemption of a trust unit, a financial supply will potentially be made even though no person will have acquired any interest as a consequence of the cancellation or redemption. In other words, only one financial supply will have been made unlike in the case of an assignment or transfer.

The treatment of the redemption of a unit or the cancellation of a share as a "disposal" gives rise to some difficulties.

The act of redemption of a unit or cancellation of a share is usually carried out not by the unitholder or shareholder, as the case may be, but by the relevant trust or company on application of the unitholder or shareholder. It does not appear that the redemption of a unit by a trust or cancellation of a share by a company could amount to a "financial supply" by the trust or company. The supplier must be a "financial supply provider" in relation to the supply of the interest in question. The trust or company,

[23] *The Macquarie Dictionary* (3rd ed).
[24] *Norman v FC of T* (1963) 109 CLR 9, 26 (per Windeyer J).
[25] See *Coles Myer Ltd v Commissioner of State Revenue* (Vic) 97 ATC 4110; 98 ATC 4537.
[26] See, for example, *Commissioner of Taxes* (Qld) *v Camphin* (1937) 57 CLR 127.
[27] See the discussion above.
[28] *The Macquarie Dictionary* (3rd ed).
[29] Ibid.

however, will not be a "financial supply provider" in that immediately before the supply, the unit or share will not have been the property of the trust or company or created by the trust or company in making the supply. Nor will the trust or company be a financial supply provider by being an acquirer of the relevant interest under r 40-5.06(2). These difficulties should not arise if the reference to the "supplier" in r 40-5.09(1)(b) were taken to be a reference not to the relevant trust or company but to the unitholder or shareholder.

However, on a redemption or cancellation occurring in these circumstances the unitholder or shareholder could arguably be said to have made a "disposal" in a broad sense even though he or she could not be said to have made a redemption or cancellation. Identifying a specific act of the shareholder or unitholder that amounts to the "disposal" may be difficult as the only specific act usually occurring will be the making of an application.

3.3.3 Surrender

A "surrender" in its ordinary meaning means "to yield (something) to the possession or power of another".[30] This will catch the act of any person of yielding up a relevant interest in favour of another. A surrender can amount to a change in the ownership of property if it has the effect of accelerating or bringing into operation interests which would not otherwise have existed.[31] For example, the surrender by a beneficiary of a trust of its interest in the trust estate may result in the enlargement of the interests of the other beneficiaries. However, the concept of "surrender" appears to be intended to catch the act of the person surrendering and not the resulting enlargement of rights of another. The concept of "acquisition" may catch the enlargement of the interests of the other persons.[32]

4. CONSIDERATION

A relevant provision, acquisition or disposal must be for consideration in order to amount to a financial supply. The concept of "consideration" is defined widely in the GSTA. It will include what is understood to be consideration at general law but is wider.

The mere identification of something as "consideration" for a relevant transaction should satisfy the requirements of r 40-5.09. The consideration does not need to be valued as in the case of a taxable supply for the purposes of calculating GST payable.

Difficult questions arise in identifying consideration for redemptions of units and capital reductions in companies. In *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)*,[33] the High Court held that a shareholder's right to receive distributions of money or assets from a company on a capital reduction was to be viewed as being in return for consideration provided by the shareholder. That consideration was the nominal amount paid for the shares. Whether a distribution of money by a company to a shareholder on a share cancellation can be said to be in "consideration" (as that term is normally understood) of cancellation of the share, is less clear. However, consideration for GST purposes includes "any payment ... in connection with a supply of anything".[34]This may extend the general law meaning of consideration to catch a payment by a trust or company to a unitholder or shareholder in connection with a disposal of a unit or share on a redemption or cancellation.

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[30] Ibid.
[31] *Platts Trustees v IRC* (1953) 34 ATC 292.
[32] See the discussion at Part 3.2.
[33] (1948) 77 CLR 143.
[34] GSTA, s 9-15.

5. IN THE COURSE OF FURTHERANCE OF AN ENTERPRISE

A relevant provision, acquisition or disposal must be in the course or furtherance of an enterprise in order to amount to a financial supply.[35] The concept of what is an enterprise is set out in s 9-20 of the GSTA. An enterprise is an activity or series of activities done in various ways including in the form of a business or in the form of an adventure or concern in the nature of a trade.

Consequently, occasional share trading by a private individual will not be a "financial supply" in that the relevant trading will not be in the course or furtherance of an enterprise. The individual concerned will not be able to recover input GST costs relating to the share trading activity. However, the inability to characterise something as a financial supply because it is not in the course or furtherance of an enterprise, does not produce the result that relevant input GST costs of acquisitions related to making the supply in question are recoverable. This is because one of the requirements for obtaining an input tax credit on an acquisition generally is that the relevant acquisition is in carrying on the taxpayer's enterprise.[36] Consequently, failure to satisfy the requirement in r 40-5.09(1)(a)(ii) in respect of an outward supply may also produce the result that s 11-15 will not apply to allow an input tax credit for inward supplies relating to making the outward supply.

Difficult questions arise in determining whether an entity whose sole purpose is to hold investments (such as shares) will be "carrying on an enterprise". Characterising this function as an enterprise may produce the result that the entity can register and claim relief on its inputs.[37]

In *Polysar Investments BV v Inspector der Invoerrecten en Accijzen, Arnhem*,[38]the European Court of Justice considered the VAT status of a holding company with no commercial activity other than the holding of shares in its subsidiaries. The Court considered that a holding company whose only object was taking holdings in other companies without that holding company being involved directly or indirectly in the management of those companies[39] did not have the status of a taxable person for VAT. Polysar had argued that the mere investment of financial resources in itself constituted an "economic activity".[40] The Court did not however accept this argument. The Court considered that dividends payable to the shareholder were merely benefits to be derived from the mere holding of the property, observing that if a different view were taken, any holder of shares or securities would have to be regarded as a taxable person. The Court considered that the outcome could be different if the company in question were a company engaging in share transactions which went beyond the activities of a normal investor in connection with the management of its assets, for instance where the company regularly bought and sold shares as profit-making transactions. However, this was not the case for a holding company which formed a "link" in a group of companies and which had acquired shares in its subsidiaries with a view to retaining them. A similar approach was taken by the European Court of Justice in *Welcome Trust Limited v Commissioners of Customs & Excise*.[41] The Court in this case considered that if the exercise of the right of ownership is not in itself regarded as constituting an economic activity within the meaning of the Sixth Directive, the same must be true of activities concerning the sale of such holdings. This case concerned the investment activities of a company acting as sole trustee of a charitable trust.

[35] GSTR, r 40-5.09(1)(a)(ii).
[36] GSTA, s 11-15.
[37] Other than inputs that relate to the making of financial supplies such as share acquisitions and sales.
[38] (Case C-60-90) [1993] BVC 88 ("Polysar").
[39] Except for any rights which the holding company had in its capacity as a shareholder or partner.
[40] This is the concept employed in the Sixth VAT Directive of the European Union ("Sixth Directive") equivalent to the concept of "enterprise" used in the GSTA.
[41] [1996] 2/CMLR 909.

The concept of "economic activity" applying under the Sixth Directive is different to the concept of "enterprise" employed in the GSTA. However, it is submitted that there is no reason why the basic approach outlined in these cases should not also apply in Australia, namely that a holding company whose only object was taking holdings in other companies should not be regarded as carrying on an enterprise by reason only of those holdings. The enterprise must be an activity or series of activities done in the ways described in s 9-20. An "activity" in its ordinary meaning means the state of action; "doing".[42] A passive holding is arguably not an "activity" which is "done".[43]

6. CONNECTION WITH AUSTRALIA

The provision, acquisition or disposal in question must be connected with Australia in order to amount to a financial supply. Section 9-25 of the GSTA sets out when something is connected with Australia for the purposes of r 40-5.09. The words "connected with Australia" in r 40-5.09(1)(a)(iii) refer to the *activity* giving rise to a financial supply. The connecting factors set out in s 9-25, however, are determined having regard to the subject of the supply rather than the activity giving rise to the supply. It would seem to follow that this what is intended by r 40-5.09 even though the language employed in the GSTR is not clear. *Taxation Ruling* GSTR 2000/31, which concerns "supplies connected with Australia", does not address financial supplies.

Section 9-25 states that a supply of real property is connected with Australia if the real property is in Australia or the land to which it relates is in Australia. "Real property" is defined widely to include, among other things, land and interests in land. This will include a mortgage of land.

A supply of goods is connected with Australia if the goods are delivered, or made available in Australia to the recipient or are removed from Australia (among other tests). If the relevant interest is not real property or goods, a connection will exist with Australia if either the thing is *done* in Australia or the supplier makes the supply through an enterprise that the supplier carries on in Australia.[44] An enterprise is *carried on in Australia* if it is carried on through a permanent establishment.[45]

The nexus rules will apply in different ways to a mortgage of tangible property and intangible property that is not real property.

As a general rule, land or an interest in land is situate in the jurisdiction if that is the place where the land lies.[46] Goods similarly exist at law, as a general rule, where the goods physically are. Consequently, the granting of a mortgage of land situated in Australia will potentially be treated as a financial supply for Australian GST purposes regardless of where the parties are situated, the transaction is effected or the mortgage documents are executed and kept. In the case of a mortgage of goods, the existence of goods in Australia may once again satisfy the nexus requirement.

However, in the case of a mortgage over intangible property (eg a copyright or debt), a relevant connection will exist if the grantor of the mortgage makes the supply through an enterprises that it carries on in Australia or if the thing is done in Australia regardless of where the mortgaged property is actually located.

It is difficult to see why the treatment of mortgages should differ depending on whether the mortgaged property is generally tangible property or intangible property.

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[42] *The Macquarie Dictionary* (3rd ed).
[43] See example 9 in *Taxation Ruling* MT 2000/1.
[44] GSTA, s 9-25(5).
[45] As defined in GSTA, s 9-25(6).
[46] *Haque v Haque* (No 2) (1965) 114 CLR 98, 136 (per Windeyer J).

6.1 Cross-Border Financial Transactions

"Cross-border" financial services (eg services relating to an offshore debenture issue) may give rise to the following GST treatment:

- if the transaction has no connection with Australia in the requisite sense it will be outside the scope of GST;[47]
- a taxable financial service,[48] may attract a GST liability for the recipient under the reverse charge provisions in Div 84;
- an offshore financial service provided by an unregistered financier that would be an input taxed financial supply if it otherwise satisfied the criteria under r 40-5.09(1) will not be subject to the reverse charge provisions;[49]
- supplies made by the Australian party to such transactions may be GST-free under s 38-190 of the GSTA.

7. REGISTERED OR REQUIRED TO BE REGISTERED

The supplier must be registered or required to be registered. Registration is compulsory for a person carrying on an enterprise whose annual turnover meets the threshold of $50,000 in respect of supplies connected with Australia in the case of a business of the ordinary kind.[50] It does not matter whether the enterprise in question is carried on in Australia or not. Financial supplies are not taken into account in calculating the threshold[51] so that a business that only makes financial supplies whose value exceeds the threshold does not have to register.

8. INTERESTS

The subject of the relevant provision, acquisition or disposal must be an "interest" mentioned in rs 40-05.06(3) or (4) in order to amount to a financial supply. Regulation 40-05.02 defines "interest" as "anything that is recognized at law or in equity as property in any form".

8.1 What is property?

The concept of "property" under the general law is regarded as "the most comprehensive of all the terms which can be used in as much as it is indicative and descriptive of every possible interest which a party can have".[52] The main criteria for determining whether a right is proprietary have been summarized as follows:

- the holder of the interest has the power to recover the property which is the subject of the interest (or the income derived from it);
- the holder of the interest has the power to transfer the benefit of the interest to someone else;
- the holder has remedies against third parties purporting to have or exercise rights contrary to those of the holder; and
- to what extent can these interests be displaced by others?

However, all these criteria are not required to give rise to a proprietary interest.[53] Relevantly, the following things have been considered to be property:

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[47] Unless the "reverse charge" provisions in Div 84 apply.
[48] For example, an arranging service provided by an unregistered offshore financier in relation to an input taxed activity of the recipient in Australia.
[49] See GSTR, r 40-5.09(3).
[50] GSTA, s 23-15.
[51] GSTA, s 188.
[52] *Jones v Skinner* (1835) 5LJ CH(NSW) 87, 90 (per Lord Langdale MR), *Flanagan v National Trustees, Executors and Agency Co of Australasia Ltd* (1923) 32 CLR 468, 448.
[53] See Meagher, Gummow and Lehane, *Equity Doctrines and Remedies* (3rd ed), 104. See also *Commissioner of Stamp Duties* (NSW) v *Yeend* (1928) 43 CLR 235, 246-247; *R v Toohey*; *Ex-parte Meneling Station Pty Limited* (1982) 158 CLR 327, 342 and *National Provincial Bank Ltd v Ainsworth* (1965) AC 1175, 1247-1248.

- shares in a company and units in a unit trust scheme;
- contractual debts including the debt arising between banker and customer;[54]
- book debts;[55]
- a mortgage; and
- currency.

8.2 Effect of "Property" Requirement

The requirement that the subject of the financial supply be an interest in property appears to place some important limitations on what is a financial supply. Effectively, it appears to exclude a range of financial services that are subject to input taxation in comparable overseas jurisdictions. This is because the supply of the relevant services would not usually amount to the provision, acquisition or disposal of property. There will be many services provided by banks which will not strictly involve a dealing in existing "property" of the bank, or the creation of new "property" by the bank in making the relevant supply. However, the clear intention of the legislation is to tax as financial supplies the services listed in r 40-5.09(3) and (4). Each of these items are discussed in the following paragraphs.

8.2.1 Accounts (Item 1)

The provision, acquisition or disposal of an "interest" in or under an account made available by an Australian ADI (authorised deposit-taking institution) is potentially a financial supply. The account must be made available in the course of the banking business of the Australian ADI within the meaning of the *Banking Act 1959* or its State banking business.[56]

Part 1 of Sch 7, contains examples of supplies that are financial supplies within item 1. They include opening, keeping, operating, maintaining and closing of cheque, debit card, deposit and savings accounts for account holders. These appear to be supplies of services (as are most of the other things listed in Part 1 of Sch 7). While a dealing in an interest recorded in an account such as a debt could amount to a financial supply as a "provision, acquisition or disposal of an interest", it is difficult to see how a service such as the maintenance of bank accounts or electronic funds transfers could satisfy this description. Nevertheless, the examples in the schedule appear to indicate that the legislation intends to catch the provision of the relevant services as a financial supply.

A supply of a service by an Australian ADI to a non-account holder for a fee of $1000 or less will be treated as an input taxed supply.[57]

8.2.2 Debt, Credit Arrangement or Right to Credit, Including a Letter of Credit (Item 2)

Item 2 in r 40-5.09(3) potentially brings within the concept of a financial supply, the provision, acquisition or disposal of an interest in or under a debt, credit arrangement or right to credit, including a letter of credit.

Debts

The creation of a debt (or of a right to receive a debt) will potentially be an input taxed supply made by the debtor. The debtor will be the provider of the relevant interest to the creditor. Similarly, the creditor will also potentially be the maker of a financial supply. That supply will be the *acquisition* of an interest in or under the debt. It follows that on the creation of a debt, there will be two financial supplies, one by the debtor and another by the creditor. For example, on deposit of funds into a bank account, both banker and customer will have made a financial supply, the banker on "provision" of a debt to the customer and the customer on "acquisition" of the debt.

The transfer of a debt will also potentially be a

[54] *English Scottish and Australian Bank Ltd v IRC* [1932] AC 238.
[55] *Measure Brothers Ltd v IRC* (1900) 82 LT 689.
[56] GSTR, r 40-5.09(3) (item 1.)
[57] See GSTR, r 40-5.09(4). Note that GSTR, r 40-5.09(1) requires there to be an "interest mentioned" in subregulation (4), although subregulation (4) does not actually refer to an "interest".

financial supply. The transferor will be making a supply in that there will be a provision of an interest in or under the debt. The transferee will also be making a supply in that it will arguably acquire an interest in or under a debt.

The release of a debt is likely to result in a financial supply being made by the releasor. This arguably is a disposal of an interest in or under the debt. However, no financial supply appears to be made by the debtor in that it will not have acquired any interest in or under the debt. The release of a debt has been held not to amount to a conveyance of the debt because it does not transfer the debt from the creditor to the debtor but merely extinguishes it.[58]

The term "debt" is not defined in the GSTA and therefore its meaning is to be ascertained by reference to general law concepts. The ordinary meaning of the word is "a sum of money due from one person to another".[59] The authorities appear to require that for a receivable to be a "debt" it must be:

- an ascertainable amount;[60] and
- payable now, or in the future, based on a present obligation.[61]

The supply of a right to receive a future debt may be an input taxed supply by virtue of s 9-30(2).

Lending money

The lending of money by financial institutions will potentially be caught within item 2 as a financial supply. The lending of money by a financial institution appears to answer the description of the "acquisition ... of an interest" in or under a debt in that the loan will create a debt owing by the borrower to the financial institution. The Sch 7 examples for item 2 include the "borrowing and lending, including establishing, maintaining and discharging loans". A loan is also likely to amount to the provision of a "credit arrangement or right to credit" within item 2, or the provision or disposal of an interest in or under Australian currency or the currency of a foreign country under item 9.

A financial supply will also be made by the borrower in the "provision" or "acquisition" of the relevant interest. Consequently, input GST costs included in the costs of both the borrower and the lender (eg the cost of valuations and legal advice) may not be fully recoverable.

Concerns arose under the legislation as originally enacted as to whether a borrower whose principal business is making taxable supplies could recover by way of input tax credit, input GST costs of borrowing money for use in that business (eg GST included in the cost of transaction documentation and legal advice). An input tax credit will not be available in respect of an acquisition that *"relates to making supplies that would be input taxed"*.[62] The acquisition of the transaction documentation and legal advice arguably answer this description in that they relate to making a financial supply (ie the borrowing).

In *Edgemond Group Ltd*,[63] the question arose was whether lawyers' and accountants' services for a management buy-out were attributable to taxable supplies. It was accepted that it was not the taxpayer group's purpose to deal in shares and that the issue of shares and the raising of finance in the management buy-out were purely incidental to the trading objectives of the companies in the group. It was held that input tax on lawyers' and accountants' fees involved inward supplies that

[58] *McCaughey v Commissioner of Stamp Duties* (1914) CLR 475 and *Tokenhouse Enterprises Pty Ltd & Anor v Commissioner of Stamp Duties* (Qld) 85 ATC 4682.
[59] See *Osborn Law Dictionary* (5th ed).
[60] See *Ogden's Ltd v Weinberg* (1906) 95 LT 567.
[61] Sums of money payable on the occurrence of future contingencies are not debts in the strict sense – see *Webb v Stention* (1883) 11 QBD 518; *Bakewell v Deputy Commissioner of Taxation* (1937) 58 CLR 743.
[62] GSTA, s 11-15(2)(a).
[63] [1995] BVC 627 ("*Edgemond*").

were used for the purposes which included the making of taxable supplies. The Tribunal held that to:

> … hold otherwise and to disallow input tax on supplies on the grounds that the immediate use of the supplies was in some preparatory economic activity only although that preparatory activity was a necessary activity undertaken for the purpose of enabling the taxable person to make taxable supplies would appear to be inconsistent with the judgment of the European Court in *Rompelman & Anor v Minister Van Financien* (1985) [2 BVC 200] in which para 19 says:
>
> > From the characteristics cited above, it may be concluded that the purpose of the system of deductions is to relieve the undertaking totally of VAT charges due or paid in the context of all its economic activities. The common system of VAT thus ensures perfect neutrality in respect of fiscal charges for all economic activities whatever their objects or results provided that the activities are themselves subject to VAT.

The same outcome would not necessarily result under the Australian GST legislation because of the different concepts and language employed. Ordinary GST treatment relevantly applies under the Australian legislation to an input unless the acquisition of the input "relates to making supplies that would be input taxed".[64] In *Edgemond*, however, the question for determination was whether the relevant lawyers' and accountants' services were "attributable ... to taxable supplies". Therefore, in Australia, input GST costs relating to professional services for a takeover effected by an acquisition of shares will be denied input tax credits by reason of s 11-15(2)(a).[65] Similar treatment will apply to an acquisition of things by a taxable business if it funds the acquisition by a sale of receivables, such a sale being an input taxed supply under item 2 of s 40-5.09(3).

However, special rules apply to transactions that constitute "borrowings". If an entity exceeds the de minimis threshold[66] and incurs input GST costs relating to borrowings, it will under the general rules be denied input tax credits for those expenses (because they relate to the making of a financial supply). This result is overcome by s 11-15(5) which provides that a borrowing related acquisition is not treated as an input taxed supply to the extent that "the borrowing relates to you making supplies that are not input taxed". In the *Explanatory Memorandum* to the Indirect Tax Legislation Amendment Bill 2000, it is stated that this provision will ensure that if an entity borrows money "and uses it" in making taxable or GST-free supplies, it will be entitled to input tax credits for its borrowing related expenses.[67] “Borrowing" is defined in the Dictionary of the Act as having the meaning given by s 995-1 of the *Income Tax Assessment Act 1997* (Cth) ("ITAA97"). This provision defines "borrowing" to mean:

> any form of borrowing, whether secured or unsecured, and includes the raising of funds by the issue of a bond, debenture, discounted security or other document evidencing indebtedness.

In cases where the lender passes on to the borrower the cost of something the lender has acquired for the transaction (eg legal advice), the question arises whether the borrower will be entitled to an input tax credit for the input GST costs included in the costs passed on to it by the lender. It does not appear that such an entitlement arises. While a creditable acquisition may occur if the *borrower* acquires something solely or partly for a creditable purpose,[68] no creditable acquisition would arise where the acquirer is another person (ie the lender).

[64] GSTA, s 11-15(2)(a).
[65] Since the services "relate" to the making of an input taxed supply.
[66] See the discussion at Part 12.
[67] Paragraph 5.20.
[68] GSTA, s 11-5.

8.2.3 Charges or Mortgages over Real or Personal Property (Item 3)

The provision, acquisition or disposal of an interest in or under a charge or mortgage over real or personal property is potentially a financial supply.[69]

Item 3 will potentially treat as a financial supply a mortgage over both real and personal property. Consequently, the distinction between real and personal property will not be of great significance, other than to the extent that this is relevant to questions of nexus.[70]

The kinds of security interests listed in r 40-5.09(3) are limited to charges, mortgages, guarantees, indemnities and letters of credit. The *Value Added Tax Act 1994* (UK) by contrast is capable of applying VAT exempt treatment to "any dealing with ... any security for money".[71]

A range of other security interests are not included in the list in r 40-5.09(3). They include the following:

- *(Rights of set-off* - it is common for banks and other financial institutions to take security in the form of a right of set-off. This happens in the following way. The borrower deposits an amount of money with the lender. The lender obtains from the borrower a right to set-off against the amount owing by the borrower, the amount held in the deposit. This is not a mortgage or charge as generally understood and so will not come within item 3 of r 40-5.09(3). In *Broad* v *Commissioner of Stamp Duties (NSW)*,[72]the Supreme Court of New South Wales held that there can be no mortgage or charge in favour of oneself of one's own indebtedness to another. This decision was followed in *Estate Planning Associates (Australia) Pty Ltd* v *Commissioner of Stamp Duties (NSW)*.[73] While in the United Kingdom, a contrary position appears to have been established following the decision of the House of Lords in *Bank of Credit and Commerce International SA (No 8)*,[74] the position stated in *Broad's Case* was recently confirmed in *Wiley v Rothschild Australia Limited*.[75]
- *Negative pledges* - this is an arrangement where a borrower agrees not to mortgage, charge or otherwise encumber its property so that the lender will in the future be able to have recourse to the property free of encumbrances. It appears that for GST purposes the supply of a negative pledge will not be a financial supply.

However, the supply of rights such as rights of set-off and negative pledges, though not within the list set out in r 40-5.09(3) as financial supplies, may be taxed as financial supplies if they are incidental financial supplies under r 40-5.10. This may apply, for example, where a borrower grants security including mortgages and charges together with rights of set-off or negative pledges as collateral security.[76]However, where the sole security provided is a right of set-off or negative pledge, input taxation does not necessarily apply.

Other security interests not included in item 3 of r 40-5.09(3) are promissory notes, bonds and covenants although debt instruments may be "securities" within item 10 of r 40-5.09(3). A promissory note is within the definition of "money". A supply of money is generally not recognised as a supply of any kind for GST purposes.

8.2.4 Superannuation Funds (Item 4)

The provision, acquisition or disposal of an interest in or under the following superannuation

[69] GSTR, r 40-5.09(3) (item 3).
[70] See discussion at Part 6.
[71] Schedule 9, Group 5 (item 1).
[72] 80 ATC 4578 ("Broad's Case").
[73] 85 ATC 4514.
[74] (1997) 15 ACLC 5107.
[75] (1999) 17 ACLC 1643.
[76] Incidental financial supplies are discussed at Part 9.

schemes will be a financial supply:

- a regulated superannuation fund;
- an approved deposit fund;
- a pooled superannuation trust; or
- a public sector superannuation scheme that is within the meaning of the *Superannuation Industry (Supervision) Act 1993*; and
- an RSA (retirement savings account) that is within the meaning of the *Retirement Savings Accounts Act 1997.*

Therefore, input taxation should apply to the establishment and winding up of these types of superannuation schemes, as well as to contributions and benefit payments made under them. However, many of the services provided to super funds, such as actuarial advices, legal and custodial services, administration and investment management services will be taxable supplies so that GST relief on those inputs may be partially or wholly denied.

8.2.5 Annuities and Allocated Pensions (Item 5)

Neither the term "annuity" nor "allocated pension" is defined in the GSTR . Nor are these terms defined in the GSTA. Further, no examples are given in the GSTR of financial supplies which would fall within this item. This means that an examination of the ordinary meaning of the terms is required.

In general terms, an "annuity" is a regular, periodic payment which is made to a person for either a fixed number of years or for the life of that person. These annuity payments may be made in return for the outlay of an initial capital sum. Annuities are used in a variety of contexts, typically as investments or for the provision of benefits by life assurance or superannuation organisations. Presumably input taxation will apply to both the "purchase" of an annuity and the regular payments made in return.

An "allocated pension" is a pension which involves the operation of an "account" for each investor. Under an allocated pension the investor may have more control over the income stream derived and the assets from which they are derived. As with annuities, presumably both the creation of the pension and the pension payments made will be input taxed.

8.2.6 Life insurance (Item 6)

A relevant dealing in "[1]ife insurance business to which subsection 9(1) of the *Life Insurance Act 1995*, or a declaration under ss 12(2) or 12A of that Act, applies, or related reinsurance business" will be input taxed.[77]

Regulation 40-5.12 which sets out in a list the supplies that are *not* financial supplies for GST purposes, includes in item 10 "insurance and reinsurance business, except business mentioned in item 6 of the table in r 40-5.09".

It follows that most dealings in "life insurance business ... or related reinsurance business" will be input taxed and most other types of insurance business will be liable to GST.

Parameters of the expression "life insurance business"

To be a financial supply, the thing supplied must constitute an interest in or under "life insurance business ... or related reinsurance business". It is noted that item 6 of the table in r 40-5.09(3) replaces item 10 of s 40-5(2) of the GSTA (as originally enacted) which was more restrictive in its terms by limiting input taxation to "the provision, transfer or assignment of a life insurance policy or reinsurance relating to a life insurance policy". The GSTR extend the input taxation of life insurance from the issue and transfer of life insurance policies to most dealings in life insurance business.

[77] GSTR, r 40-5.09(3) (item 6).

What is "life insurance business"?

The definition of "life insurance business" in s 11 of the *Life Insurance Act* 1995 is wider than merely the issuing and undertaking of liabilities under life policies. It extends to the issuing and undertaking of liabilities under sinking fund policies. It also extends to business which relates to the previously mentioned business, including the investment, administration and management of the assets of a statutory fund.

In item 6 of the table in r 40-5.09 the term is limited to business to which ss 9(1), 12(2) or 12A of the *Life Insurance Act 1995* applies. This effectively links input taxation for GST purposes with all business permitted to be carried on by life companies under the *Life Insurance Act 1995.* Again, this may be contrasted with the replaced item 10 of s 40-5(3) of the GSTA which limited input taxation to dealings in "life insurance policies", a term expressly restricted to "policies of insurance on the life of an individual". The previous formulation required that the contract be one of "insurance". Regulation 40-5.09(3) item 6 which, in linking life insurance business to transactions permitted under the *Life Insurance Act 1995*, will comprehend arrangements which may not be "contracts of insurance" per se or which may not be policies of insurance on the life of an individual.

The GSTR contain examples of supplies that will constitute life insurance business within item 6 of r 40-5.09(3).[78] The examples, which are not to be taken as exhaustive, include:

- a contract of insurance that provides for the payment of money on the death of a person or on the happening of a contingency dependent upon the termination or continuance of human life;
- a contract of insurance for a term dependent upon the termination or continuance of human life that provides for the payment of an annuity;
- a continuous disability policy within the meaning of s 9A of the *Life Insurance Act 1995;*
- a contract (whether or not a contract of insurance) that constitutes an investment account contract, or an investment-linked contract, within the meaning of s 14 of the *Life Insurance Act 1995.*

8.2.7 Guarantees and Indemnities (Item 7)

Pursuant to item 7 of r 40-5.09(3) the provision, acquisition or disposal of an interest in or under a "guarantee, including an indemnity (except a warranty for goods or a contract of insurance or reinsurance)" will be an input taxed financial supply (assuming that the other requirements for a financial supply outlined above are satisfied).

Part 5, Sch 7 of the GSTR provides a non-exhaustive list of examples for item 7 in the table in r 40-5.09(3) as follows:

- an indemnity that is not a contract of insurance;
- a surety bond that is a guarantee; and
- a performance bond.

These examples are given subject to the description of the relevant item in the table in r 40-5.09(3) and, to the extent of any inconsistency, the description in the table prevails. Therefore, a performance bond will only fall within item 7 if it is a guarantee or an indemnity within item 7.

The words "guarantee" and "indemnity" are not defined in the GSTA or the GSTR and should therefore be construed according to their general law meanings. Stroud's Judicial Dictionary defines a "guarantee" as a "collateral engagement to answer for the debt, default or miscarriage of

[78] See GSTR, Pt 4, Sch 7.

another person". A guarantee can be defined as a promise to answer for a third party's obligation and is therefore a contractual obligation required to be performed only if the third party does not perform his or her obligations.

A guarantee can be distinguished from an "indemnity". *Halsbury's Laws of Australia* states that "the crucial element of the guarantee which distinguishes it from the indemnity, is the promise to answer for the debt or default of another ... a guarantor's liability is co-extensive with that of the principal debtor. By contrast, an indemnifier's obligation is independent and taken as principal".

The language of item 7 – "a guarantee, including an indemnity" - suggests that an indemnity will only be included in the item if in fact it is in the nature of a guarantee or is granted under or in connection with a guarantee. However, the better view is that a stand-alone indemnity will also be within item 7.

It would seem that item 7 will extend to any guarantee or indemnity (other than a warranty for goods or a contract of insurance or reinsurance) and is not limited to guarantees or indemnities given in relation to another financial supply. The item would extend to guarantees or indemnities provided in many commercial transactions or other arrangements. So, for example, an indemnity contained in a sale of land agreement, if given for separate consideration, should be treated as a financial supply separate from the supply of the land.[79]

The grant or creation of the guarantee or indemnity obligation will be the provision or acquisition of an interest in or under the guarantee or the indemnity.

The GST consequences of a demand being made under a guarantee or indemnity and payment made to the beneficiary of the guarantee or indemnity pursuant to that demand, are not so clear. There are two possible analyses, namely that:

(i) there is merely a payment of money by the guarantor to the beneficiary and therefore no supply for GST purposes; or

(ii) the payment of the guaranteed monies is the consideration for a disposal by the beneficiary of its interest in the guarantee or indemnity and therefore an input taxed supply under r 40-5.09.

The correct answer may well turn on the facts and circumstances of the particular transaction. Where for example in connection with a payment under a guarantee a formal release is given by the beneficiary in favour of the guarantor, that may more clearly point to the transaction being one which involves the disposal of the guarantee rights.

An indemnity which constitutes a "contract of insurance or reinsurance" will fall outside item 7 and be dealt with under Div 78 or under the general provisions of the GSTA.

The expression "contract of insurance" is not defined. The following points may be made in relation to the meaning of the expression under general law:

- A contract of insurance will have three essential elements, namely, consideration (premium), some benefit to the insured (usually but not necessarily the payment of the sum of money), the happening of some specified event.[80]
- A contract of insurance is to be distinguished from a guarantee.[81]

A warranty for goods will also fall outside item 7 and be dealt with under the general provisions of the GSTA.

[79] See the discussion on the ancillarity principle at Part 9 below.
[80] *See Prudential Insurance Co v Commissioners of Inland Revenue* (1904) 1WLR 99; *Medical Defence Union v Department of Trade* (1980) Ch 82.
[81] *Seaton v Heath* (1899) 1 QB 782.

8.2.8 Hire Purchase Agreements (Item 8)

The provision, acquisition or disposal of an interest in or under the credit component under a hire purchase agreement in relation to goods is potentially a financial supply. The following requirements need to be satisfied;

- the credit for the goods must be provided for a separate charge; and
- the charge must be disclosed to the recipient of the goods.

It follows that provided the threshold requirements set out at Part 2 above are satisfied, the credit charge component payable under a hire purchase agreement will be input taxed while the remaining payments (ie the principal amount) will be subject to GST in the ordinary way. The example for this item in Pt 6, Sch 7 of the GSTR is "the amount of interest, and associated fees and charges, in respect of the credit component under a hire purchase agreement."

"Hire purchase agreement" in the GSTA has the meaning given by s 995-1 of ITAA97. This provision defines a "hire purchase agreement" to mean a contract for the hire of goods where;

- the hirer has the right or obligation to buy the goods;
- the charge that is or may be for the hire, together with any other amount payable under the contract (including an amount to buy the goods or to exercise an option to do so) exceeds the price of the goods; and
- title in the goods does not pass to the hirer until the option to purchase is exercised.

Also included in the definition of "hire purchase agreement" is an agreement for the purchase of goods by instalments where the title in the goods does not pass until the final instalment is paid.

Finance leases, unlike hire purchase agreements, are likely to be subject generally to GST in the ordinary way. A finance lease as generally understood, is a lease of goods from a financier to a customer with no right, obligation or option for the customer to acquire the rights of the financier in the goods.

Because a hire purchase agreement will be subject to GST only on the principal amount but a finance lease will be subject to GST on both principal and credit components, this may be a significant disincentive for financing an asset acquisition by means of a finance lease. If the customer is the end user (eg a private consumer or a business that is input taxed), the customer will have to bear the full input GST cost passed on to it by the financier without any entitlement to recover the amount by way of an input tax credit.

8.2.9 Currency (Item 9)

The provision, acquisition or disposal of an interest in or under Australian currency, the currency of a foreign country, or an agreement to buy or sell currency of either kind is potentially a financial supply.[82] The examples for item 9 in Sch 7 to the GSTR include foreign currency in cash or drafts, and travellers cheques.

This item should extend to any deposit with a financial institution of Australian currency or foreign currency. Where the amount is deposited in an account, it will arguably be caught as a financial supply under item 2 to the extent that a debt is created. Where however no debt is created (for example, where money is provided to the financial institution for transfer to another financial institution), it is arguably item 9 that is intended to apply.

A contrary view is that item 9 is limited to

[82] GSTR, r 40-5.09(3) (item 9).

physical currency. However, the words "interest in or under" currency suggest that item 9 will extend beyond mere physical currency to include the crediting of an account which gives the right to acquire physical currency.

8.2.10 Securities (Item 10)

The provision, acquisition or disposal of an interest in or under certain securities, or the supply of a right to receive such securities, is potentially a financial supply. "Securities" is defined in the Dictionary of the GSTR to take the meaning of that term in s 92(1) of the Corporations Law. That definition defines securities to include generally shares in, and debentures of a corporation and a range of other interests.

Item 10 of r 40-5.09(3) adds to these things a number of other interests including an interest in or under the capital of a partnership or trust. This is likely to include the interests of a unitholder in a unit trust scheme of the ordinary kind. A "time-sharing scheme" is expressly excluded by item 10(b).

(a) Trading in Shares and Units

Transfers

The transfer of a share is potentially a financial supply (this is consistent with the treatment of share trading in comparable overseas jurisdictions). Both the transferee and the transferor will be makers of a financial supply on the transfer occurring. The transferor will have provided or disposed of an interest in or under the relevant share. The transferee will have acquired such an interest. It follows that both the transferor and the transferee may not be able to recover as an input tax credit, input GST included in the cost of anything acquired in relation to the share transfer (such as the cost of legal advice and valuations).

Allotments and Issues

The allotment and issue of shares is also potentially a financial supply. Both the company allotting and issuing the shares and the person to whom the shares are allotted and issued will have potentially made a financial supply. For example, on the float of a company, the allotment and issue of shares to subscribers will potentially involve a financial supply by both the company and the subscribers.

Share Cancellations

These are discussed at Part 3.3 above.

Stockbrokers

A stockbroker buying and selling shares in its own right will be input taxed in respect of those purchases and sales. That is, it will not be able to recover as an input tax credit, any input GST included in the cost of acquiring anything relating to the share transfers. This will include, for example, the cost of leasing premises, purchasing or hiring computer hardware and all other expenses relating to share trading.

Where the broker acts as agent for a principal, brokerage services provided to principals in the purchase or sale or shares and other securities will not be input taxed. GST will apply in the ordinary way. Item 11 of r 40-5.12 provides that the supply of "broking services" is not a financial supply, and therefore they will be taxable. This is in contrast to the position that applies in comparable overseas jurisdictions such as the United Kingdom where brokerage is generally input taxed.[83] However, the RITC scheme will apply. In other words, the broker's customer may recover up to 75% of the input GST cost passed on to it. This is likely to mean a real increase in the cost of brokerage to both registered GST payers on the introduction of GST (an increase effectively of up to 2.5%) and to an end consumer (an increase effectively of up to 10%).

Stockbrokers for their part will need to apportion input GST costs between proprietary trading and brokerage trading. For example, if a particular facility such as a part of a leased building or computer hardware is used for both

[83] Schedule 9, Group 5 (item 7).

proprietary trading and brokerage trading, the stockbroker will need to apportion the input GST cost of acquiring those things between the two activities and will recover input GST costs to the extent that they relate to brokerage trading.

Dealing and Underwriting Services

The dealers and underwriters who arrange the placement of securities to investors for a fee will be providing non-financial supplies for GST purposes and, accordingly, will be taxed on their underwriting fees. The services provided by these parties are not listed in any of the items in the table for r 40-5.09(3). Regulation 40-5.12 includes item 9 - "facilities for: (a) trading securities or derivatives; and (b) clearance and settlement of those trades." A different result may arise where the services are purely margin based.

(b) Trust Capital

Acquisitions from Trusts

The inclusion of item 10(a)(iv) in r 40-5.09(3) appears to be intended to bring within the financial supplies net dealings in units in a unit trust scheme in the same way as dealings in shares. A beneficiary of a unit trust of the ordinary kind is said to have an equitable interest in the assets of the trust.[84] Consequently, a dealing in a unit of this kind should ordinarily amount to a dealing in "an interest in or under...the capital of a ... trust".

The treatment of the provision, acquisition or disposal of an interest in or under the capital of a trust as potentially a financial supply appears to have far reaching application going beyond relevant dealings in units. Taken in its literal tenor, on any transfer of property that is capital in a trust, no GST will be paid. The supply will be potentially input taxed as a financial supply.

The capital of a trust generally will include all property held by the trust for the beneficiaries of the trust. Does it therefore follow that if a financial institution such as a bank were to buy an asset (for example office premises) from a trust and it remains subject to the trust, it will pay no input GST whereas if it bought the asset outright, GST may apply and any input GST cost passed on to the financial institution will be unrecoverable? This seems an odd outcome.

Trustee Services

Trustee services are expressly identified as something that is not a financial supply.[85] Accordingly, a trustee will have to pay GST on the services it supplies if the requirements for a taxable supply set out in s 9-5 of the GSTA are satisfied.

Whether the recipient is entitled to an input tax credit or not will depend on the ordinary rules set out in s 11 of the GSTA. Input GST costs included in the cost of services of a trustee which the trustee provides to a trust holding commercial real property, for example, would generally be fully recoverable.[86]

The rules set out in s 11 would not allow recovery of input GST where a trustee provides services to makers of financial supplies. However, where the RITC scheme applies, the recipient will recover 75% of input GST costs passed on to it. The range of trustee services provided to makers of financial supplies covered by the RITC scheme is fairly wide. For example, item 29 of r 70-5.02(2) brings within the RITC scheme the provision of trustee and custodial services generally (with some limited exceptions). Services specifically identified as qualifying are a range of investment portfolio management functions including acting as trustee of a trust or

[84] *Kemptron Industries Pty Limited v Commissioner of Stamp Duties* 84 ATC 4380.

[85] GSTR, r 40-5.12 (item 15).

[86] Other than to the extent that the services relate to financial supplies made by the trust such as the issue of units in itself.

superannuation fund and acting as a single responsible entity.[87]

It appears, therefore, that the provision of services by a trustee to a trust which is a superannuation fund, managed investment scheme or securitisation vehicle would generally qualify for an RITC.

Whether a trustee is legally able to pass on GST to the trust or fund of which it is trustee will depend upon the terms of the constitution of the trust or fund and possible statutory restrictions.

8.2.11 Derivatives (Item 11)

The provision, acquisition or disposal of an interest in or under a "derivative" by a financial supply provider is potentially an input taxed financial supply.[88] A "derivative" is defined in the Dictionary of the GSTR to mean "an agreement or instrument the value of which depends on, or is derived from, the value of assets or liabilities, an index or a rate". This seems a wide concept capable of catching a range of on-market and off-market derivate transactions.

Part 9, Sch 7 of the GSTR provides a non-exhaustive list of examples of an interest in or under a derivative, including:

- forward contracts, futures contracts, swap contracts and options contracts the value of which depends on, or is derived from:
  - (a) the price of debt securities or debt securities index values or interest rates; or
  - (b) foreign exchange or currency values or currency index values; or
  - (c) share or stock prices or equity index values; or
  - (d) credit spreads or credit events, including:
    - (i) default; and
    - (ii) other forms of financial distress; and
    - (iii)credit index values; or
  - (e) macroeconomic indicators or variables; or
  - (f) climatic events or indexes;
- commodity derivatives that involve no option, right or obligation to delivery of the commodity, such as electricity derivatives;
- reciprocal repurchase agreements (REPOs);
- options over input taxed supply of precious metals;
- securities lending agreements.

Many of these arrangements, including forward contracts, swap contracts and commodity derivatives, are documented under an ISDA or other approved master agreements. Set out below is an examination of Australian GST laws as they apply to transactions contemplated by the ISDA Master Agreement (1992).

ISDA Master Agreements

The entry into and settlement of an ISDA Master Agreement or any specific transaction in the form of a confirmation under an ISDA Master Agreement relating to Australian or foreign currencies, debts, debt securities, equity securities, and precious metals will be *input taxed.* This means that GST will not be payable on consideration received including any premiums paid on entry into the agreement. However, the parties will not be able to claim an input tax credit for any input GST costs they incur relating to the agreement. This will apply to GST costs included in overheads which are allocated to financial supplies and costs which relate solely to making financial supplies.

[87] Item 23.

[88] GSTR, r 40-5.09(3) (item 11).

Clause 2(a) of the ISDA Master Agreement provides for each party to make certain payments and deliveries specified in each confirmation, subject to the other provisions of the agreement.

Clause 2(c) provides for netting. The way this works is that if on any date amounts would otherwise be payable in the same currency and in respect of the same transaction, by each party to the other, the payment obligation will be automatically satisfied and discharged. If the aggregate amount that would otherwise have been payable by one party exceeds the aggregate amount that would otherwise have been payable by the other party, the obligations to pay will be replaced by an obligation upon the party by whom the larger aggregate amount would have been payable. It must pay the excess of the larger aggregate amount over the smaller aggregate amount.

Assuming that the relevant agreement (including the terms of the confirmation) provides *only* for the payment of money on the relevant conditions being satisfied, and there is no option, right or obligation to delivery of something the delivery of which would be a taxable supply (eg electricity or wool),[89] the agreement is likely to amount to a "derivative". This further assumes that the payments to be made under the agreement (and therefore the value of the agreement) depend on or are derived from an index or rate.

Entry into Agreement

Consequently, the entry into an ISDA Master Agreement as modified by the addenda used and confirmation is likely to amount to a provision, acquisition or disposal of an interest in or under a "derivative" within item 11 of r 40-5.09 (3). Input taxation will therefore apply.

Settlement of Agreement

The question arises as to how the automatic satisfaction and discharge of obligations under cl 2(c) of the ISDA Master Agreement will be treated for GST purposes.[90] Prima facie, a satisfaction and discharge is a supply and potentially a taxable supply subject to GST at the rate of 10% on the consideration for the satisfaction and discharge. However, GST should not apply in this way.

Application of the ancillarity principle discussed at Part 9 below should provide the result that the satisfaction and discharge of payment obligations should not be treated as a separate taxable supply. To do otherwise, would defeat the object of the legislation which is to treat a relevant dealing in a derivative as subject to input taxation, whereas application of the ancillarity principle would give effect to that intention.

Item 7 of the examples in Pt 9, Sch 7 suggests that the Commissioner will regard as an input taxed derivative transaction the "cash settlement of a derivative over the counter or on the exchange rather than the physical delivery of the underlying taxable assets".

Payment of Money

The payment of money provided for in cl 2(a) and 2(c) of the Master Agreement should not be treated as a taxable supply. This would be either a simple supply of money (and therefore a supply not recognised for GST purposes) or a financial supply.[91] In either case, no GST applies to the payment of the money. The wide definition of "consideration" in s 9-15 arguably produces the result that each payment stream would be consideration for the other so that a financial

[89] GSTR, r 40-5.12 (item 7).
[90] That is, whether as a supply of money provided as consideration for another supply of money – see s 9-10(4) - or otherwise.
[91] As a supply of currency – see GSTR, r 40-5.09(3) (item 9).

supply occurs.

Consequences of Input Taxation

The consequences of input taxation are as follows. The supplier (ie both parties to the ISDA Master Agreement) will not be entitled to recover as input tax credits GST costs included in the costs of their business operations to the extent that the inward supplies for which these costs are incurred relate to the entry into ISDA Master Agreements and performance of them. For example, this will apply to overheads, legal costs and other costs incurred in connection with or allocated to ISDA Master Agreements.

Other Commodity Supplies

Regulation 40-5.12 provides a specific list of certain supplies that are not financial supplies. To the extent a supply under the ISDA Master Agreement comes within an item in r 40-5.12, the supply will not be a financial supply, unless it is an incidental financial supply.

Amongst other things, items which are not financial supplies include "an option, right or obligation to make or receive a taxable supply" with some exceptions.

A wool or electricity derivative, for example, which comes with an option or right to delivery of wool or electricity may be treated as a taxable supply. However, in the absence of such an option or right, r 40-5.12 should not apply.

Connection with Australia

A supply will be connected with Australia if either a "thing is done in Australia" or the supplier makes the supply through an enterprise that the supplier carries on in Australia. The thing would be done in Australia if the ISDA Master Agreement is entered into in Australia or payments are made in Australia. If supplies made under an ISDA Master Agreement are not connected with Australia, the supplier will be outside the scope of GST. That is, input taxation will *not* apply so that input GST costs relating to the supplies may be recoverable. Even if there is a connection with Australia, GST-free treatment may apply if the transaction involves a supply for consumption outside Australia under s 38-190 of the GSTA. If an entity enters into relevant agreements with counterparties outside Australia, the GST exemption under s 38-190 may apply and, if so, relief from GST on inputs should be available.

GST Gross-Up Clauses

Assuming the supply of the derivative will be input taxed, no GST will be payable by the supplier. To this extent, no GST "grossing up" clause should be required in the transaction documents.

Where the derivative does involve an option, obligation or right to delivery of a commodity (other than precious metal), a GST grossing-up clause should be included to enable the supplier to recover GST amounts which are payable.

Clause 2(d) of the ISDA Master Agreement (dealing with the gross-up of payments for certain taxes) is unlikely to apply to GST as the clause is limited to tax (as defined) which is "required by any applicable law" to be deducted or withheld from payments under the Agreement. GST is not a tax which is required to be deducted or withheld, but is a tax imposed on the party making a taxable supply to remit the amount of tax to the taxing authority.

Therefore, taxpayers might consider the insertion of a standard GST recovery clause into any confirmations to cover all contingencies, including changes to the GST legislation or its future administration which may give rise to a need to "gross up" for GST. This clause may be expressed to apply only to a limited class of derivative transactions.

Reduced Input Tax Credits

Items 21 and 22 of r 70-5.02(2) allow RITCs for certain acquisitions relating to derivatives. Item 21 includes arrangement by a financial supply facilitator of the supply of a derivative. Item 22 includes transaction processing account maintenance and report generation services provided to suppliers of derivatives.

Other Issues

- If a party enters into derivative transactions as agent for a non-resident of Australia, different GST consequences may apply. The agency services will be a taxable supply if the general requirements in s 9-5 are satisfied.
- If a derivative transaction involves an export from Australia, then different GST consequences may apply (ie the relevant supply will be GST-free and therefore entitlements to input tax credits will not be affected).

9. INCIDENTAL SUPPLIES

If something is supplied by an entity to a recipient directly in connection with a financial supply to the recipient by the entity, the thing may be an incidental financial supply if it meets the tests in r 40-5.10. The thing will be a financial supply[92] and therefore input taxed regardless of the characterisation it would have had if it were not an incidental financial supply.

The intention is that r 40-5.12 (which specifies supplies which are not financial supplies) should operate subject to r 40-5.10. Consequently, something that is identified in r 40-5.12 as not being a financial supply will nevertheless be treated as one if it is an incidental financial supply.

A number of requirements must be met if a thing is to be an incidental financial supply, namely:

- the relevant supply must be made "directly in connection with" a financial supply;
- the relevant supply must be made by the same supplier of the financial supply to the same recipient;
- the relevant supply must be "incidental to the financial supply";
- the relevant supply and the financial supply must be supplied, at or about the same time, but not for separate consideration; and
- it must be the usual practice of the supplier to supply "the thing, or similar things, and the financial supply together in the ordinary course of the entity's enterprise".

These requirements will significantly limit the kinds of things that will be treated as incidental financial supplies For example, if a bank makes a loan to a customer and, together with the loan, provides for no separate consideration some "incidental" financial advice, this is arguably an incidental financial supply. However, if the bank were, to give investment advice to the customer at a later date, or for a separate fee this will not amount to an incidental financial supply.

Further, the parties between whom the main supply is made must also be the same as the parties between whom the incidental financial supply is made. In other words, a supply that is related to a financial supply that is made to the recipient by a person other than the maker of the financial supply will not qualify as an incidental financial supply under r 40-5.10. Consequently, if in connection with a particular loan, the customer receives financial advice not from the lender but from some other entity which is related to the lender, the financial advice will not be an incidental financial supply for the purposes of r 40-5.10 and will be taxable.

[92] GSTR, r 40-5.08.

A general principle applying in comparable overseas jurisdictions is that a supply that is ancillary or incidental to another supply should be characterised in the same way as the main supply even though, taken by itself, the ancillary and incidental supply may have a different characterisation.[93] While the rule in r 40-5.10 is capable of treating something that is not otherwise a financial supply as an incidental financial supply, the general law rule may produce the result that something which is a financial supply if taken by itself will not be treated as a financial supply if it is ancillary or incidental to a taxable supply.

The circumstances in which this may apply could include:

- deferred terms of payment allowed by a vendor to a purchaser. Taken by itself, the deferred terms may amount to the creation of a debt or a credit and therefore a financial supply. Taken in context however, the relevant debt may be treated as being ancillary or incidental to the supply made under the sale agreement between the vendor and purchaser.
- a provision in a building contract which grants to the builder a charge over the land on which the building works are to be constructed as security for payment of the contract sum. The charge taken by itself may be a financial supply but taken in context may be treated as ancillary and incidental to the supply made under the building contract.

At law, many commercial transactions will involve multiple "supplies". For example, each promise in a contract such as an asset sale agreement, at law, takes effect as a separate obligation in favour of the promisee. It would therefore give rise to a distinct "supply" by the promisor to the promisee. These obligations include the promises to pay money, representations and warranties by the seller, indemnities and of course, a promise to transfer the assets. Many of these things would, if taken by themselves, ordinarily amount to *taxable supplies.* To administer the GST legislation on this basis would make compliance by the taxpayer and collection of GST by the Revenue an impossibility. For example, if each and every term in a sale agreement that does not amount to a financial supply, were treated as a separate taxable supply, how will a separate value be given to each such supply? It is to avoid this result that the "ancillarity" principle has developed in the UK and Europe.

Whether the ancillarity principle generally applies is said to depend on whether the supply that is said to be ancillary contributes to the proper performance of the principal supply and whether it makes up a marginal proportion of the package price compared to the price for the principal supply.[94] The UK Courts have also held that the following things may indicate ancillarity:

- Whether or not the alleged separate supply can realistically be omitted from the overall supply so that if something is necessary for a supply, it will almost certainly be an integral part of it.[95]
- Where a single indivisible price is paid for a package of services under one contract, that may be an important indication that it is for a "composite supply" forming a single supply for tax purposes.[96]

It is not apparent at the present time whether the principle of ancillarity developed by the Courts of the UK and Europe forms part of Australian law. The extent to which such a principle will apply in Australia will depend on the approach taken by the Australian Courts. This approach is likely to be different to that taken in the UK, because of specific provisions in the

93 See, for example, *British Airways Plc v Customs and Excise Commissioners* [1990] STC 643 and *Commissioners of Customs and Excise v British Telecommunication Plc* (Unreported, 1 July 1999) House of Lords.
94 *Madgett & Baldwin* [1998] STC 1189.
95 *British Airways Plc v Customs and Excise Commissioners* [1990] STC 643.
96 *Virgin Atlantic Airways Ltd v Customs and Excise Commissioners* [1995] STC 341.

Australian GST legislation discussed below.

Any application of the ancillarity principle appears to be modified to some extent by s 9-80 of the GSTA. Section 9-80 says that if a supply (called the "actual supply") is partly a taxable supply and partly a supply that is GST-free or input taxed, apportionment of the *value* of the composite supply made is required for the purposes of accounting for GST. To do this, the taxpayer needs to calculate the proportion of the value of the composite supply that the taxable supply represents. The example given in the *Explanatory Memorandum* to *Act No 55 of 1999* as to how these principles apply is a supply of an education course (GST-free supply) including meals (taxable supply) for one price.

Where no value can be attributed to consideration for a specific supply forming part of a composite supply (as in the case of an agreement of the kind described above), it would not be possible to apportion under s 9-80. Where apportionment is not possible, one outcome is that the taxable supply forming part of the composite supply cannot be taxed and it may be difficult to apportion inputs relating to the composite supply as a whole as between the taxable supply component and the input taxed supply component. On this approach, the GST legislation will not be capable of any operation with respect to a composite supply, the value of which cannot be apportioned under s 9-80. Alternatively, the ancillarity principle will apply so as to allow the composite supply to be characterised one way or the other for GST purposes and inputs dealt with accordingly. Arguably, a Court will take the approach that gives effect to the legislation rather than the approach that renders the legislation incapable of operation. In other words, it appears that there is scope for the ancillarity principle to apply in circumstances where the value of supplies making up a composite supply cannot be apportioned under s 9-80. Therefore, s 9-80 may not oust the application of the ancillarity principle but could limit the circumstances in which it may otherwise apply. An asset sale agreement of the kind described above, for example, may be a circumstance in which the ancillarity principle may apply.

10. APPORTIONMENT

The financial supply regime under the Australian GST will give rise to complex apportionment issues.

Difficult apportionment questions arise where a supply is partly a taxable supply and partly a supply that is GST-free or input taxed. In these circumstances, the value of the part of the supply that is a "taxable supply" is the proportion of the value of the supply that the taxable supply represents.

The legislation itself does not provide any guidelines as to how the proportion of the value of a supply that is attributable to a taxable supply is to be calculated. Accordingly, where a contract deals with taxable supplies and other supplies, it will be prudent to allocate separate considerations for each kind of supply.

Apportionment problems also affect the availability of input tax credits in cases where an acquisition or importation is only partly for a creditable purpose.

Under Divs 11 and 15, suppliers will only be entitled to full input tax credits on acquisitions or importations to the extent to which they are not used to make input taxed supplies, or the acquisition is not of a private or domestic nature. As most financial service providers will make a mixture of input taxed supplies GST-free and taxable supplies, they will be required to apportion input tax credits (or reduced input tax credits) between these supplies.

Taxation Ruling GSTR 2000/22 sets out the Commissioner's views on apportionment and determining the extent of creditable purpose for financial supply providers. The ruling sets out

what the Commissioner considers to be acceptable apportionment methodologies for calculating input tax credits by financial supply providers. It also provides an explanation of the way in which the RITC provisions in Division 70 interact with the apportionment methodologies.

The approach favoured by the ATO as set out in the ruling involves the following:

- The apportionment method chosen should reflect as closely as possible the taxpayer's use of an acquisition or importation in carrying on its enterprise.
- It must be appropriate and reasonable, accurately reflect the planned use of the acquisition, and be well documented and justifiable.
- The methods for apportionment acceptable to the ATO are:
  - Direct attribution method;[97]
  - Direct attribution plus the use of a general formula (or an appropriate alternative formula) for unallocated costs;[98] or
  - General formula method (or an appropriate alternative formula) where direct attribution has been used as far as possible.
- Special allocation approaches imposed by statute and certain input based methods may be acceptable.

11. REDUCED CREDIT ACQUISITIONS

One of the unique features of the Australian GST is the RITC scheme.[99] Essentially, this is a scheme which allows providers of financial supplies to recover a proportion of input GST costs they incur. That proportion is 75% where the scheme applies. This rate has been set so as to give a financial supply provider a credit estimated to be equal to the GST on the value added by the outsourced supplier.

Division 70 allows the making of GSTR which may provide that acquisitions of a specified kind (called "reduced credit acquisitions") that relate to making financial supplies can give rise to an entitlement to a reduced input tax credit.[100] The GSTR set out a range of acquisitions to which the scheme applies that represent functions that financial institutions have outsourced in recent years, including transaction processing, arranging and managing loans and debt collection services. In the absence of an RITC entitlement, the acquisition of these supplies would largely have been input taxed so that no input tax credit would have been available for the financial institution in respect of input GST collected from it on the acquisition. The object of the RITC scheme is to remove the bias in favour of insourcing by reducing the input GST costs of outsourcing. It is claimed that the giving of RITCs is a more effective response to the self-supply bias, than extending input taxation "upstream" to another layer of supplier, thereby increasing compliance costs.

For example, consider a situation where a bank, which makes only financial supplies, is choosing whether to insource or outsource its mortgage valuation service. If it *insources* the service no GST would be payable. However, if it *outsources* the valuation service, then:

- the supply of the valuation services *to* the bank will be a taxable supply;
- GST will be included in the price of the services; and

[97] Ie the matching of specific costs with specific outputs, as well as the allocation of mixed purpose costs to specific outputs in accordance with an internal cost allocation system.

[98] The general formula calculates the extent, expressed as a percentage, to which an acquisition or importation is for a creditable purpose; it then applies the resulting percentage to the input tax credits not previously accounted for under the direct attribution method

[99] Contained in GSTA, Div 70 and GSTR, Pt 4-2.

[100] GSTA, s 70-5(1).

- because the bank is making input taxed supplies, it would not be entitled to any input tax credits on the acquisition of the valuation services.

The effect of this will be that it may be cheaper for the bank to insource the service.

Not all inputs will give rise to an RITC. For example, the RITC scheme will not apply to a hire purchase of goods to a financial supply provider.[101] Nor will RITCs be available for services which cannot be easily insourced (eg stock exchange services).

Those inputs which give rise to an RITC when acquired by a financial supply provider are itemised in r 70-5.02(2).[102] As previously noted, makers of financial supplies under most GST and VAT regimes need to apportion input GST costs between financial supplies and taxable supplies so as to recover input GST to the extent that it relates to taxable supplies. Under the Australian GST, apportionment includes the additional task of apportioning input GST costs to acquisitions that give rise to an RITC so as to recover 75% of that input GST. There may be cases where a particular input GST cost may need to be apportioned into three components. Take the example of an acquisition of the service of electronically processing information provided to a bank by an information technology company. To the extent that the processing services relate to finance leasing, a full input tax credit will be available. To the extent that the processing services are used to process information concerning savings accounts generally, an RITC will be available. To the extent that the processing services are used to process the bank's payroll, no input tax credit may be available.

It will be important for banks and other financial institutions to maximise their recovery of RITCs. This will of course depend on the extent to which the RITC scheme applies to functions they have outsourced. In some cases, there may be difficulties in identifying the precise extent to which the scheme applies. Some of these difficulties are discussed below.

11.1 Transaction Processing

A range of services concerning the processing of banking transactions qualify for the RITC scheme. The RITC scheme will potentially apply to an acquisition of processing services in relation to account information for account providers including processing and manipulation of information relating to accounts.

Processing in its ordinary sense means "to manipulate (data) in order to abstract the required information".[103]

The activities involved in "processing" cover a wide range of things. For example, they are likely to include the task of data entry. They are also likely to go beyond this to cover the electronic processing of information following the point of data entry. These are functions which a number of the large Australian banks and other financial institutions have outsourced in recent years, particularly the operation of ATM systems.

Typically, the electronic processing of information will involve a range of software maintenance and support functions provided on a continuous basis to ensure that the system operates properly. The extent to which the RITC will apply to such maintenance and support functions however is not clear. Something that is used in making an RITC acquisition is not for that reason an RITC acquisition.[104] This would appear to preclude the application of the RITC scheme to maintenance and support functions used in the delivery of processing services. However, arguably, to the extent that the maintenance and

[101] Although fees charged to that person for "arranging" the hire purchase will be RITC eligible.

[102] In its *Consultation Document on Financial Supplies*, issued 17 August 1999, the Government stated that it was "expected that the Government will conduct regular reviews of both the list of services qualifying for a reduced input tax credit and applicable rate(s)".

[103] *The Macquarie Dictionary* (3rd ed).

[104] GSTR, r 70-5.02(3).

support functions can be said to be integral and essential to the normal processing tasks involved, the RITC scheme should nevertheless apply.

Where the supplier of the processing services also supplies the information technology to carry out the processing tasks (the hardware and software) for a single charge, apportionment applies under Div 70 of the GSTA. To the extent that charge is apportioned to the supply of the information technology, no RITC will be available.

11.2 Debt collection

Debt collection services are expressly stated as something that does not involve a financial supply.[105] Acquisition of a debt collection service which is debt recovery will potentially qualify for an RITC.

The debt collection services that may qualify for the RITC include litigation. Does it therefore follow that the RITC scheme may apply to allow recovery of 75% of input GST costs included in the cost of litigation whenever a debt is claimed but not where unspecified damages are sought? Does the availability of the RITC scheme depend on the plaintiff successfully establishing that a debt exists? In other words, if the Court were ultimately to find that no debt is owing, are input GST costs included in the cost of the litigation unrecoverable under the RITC scheme?

11.3 Loan Origination

A range of activities by originators of loans will also be subject to the RITC.

Item 11 of r 70- 5.02(2) provides that the RITC scheme will apply to the supply by a *financial supply facilitator* of certain loan services. They are:

- loan agency services;
- provision of a loan facility;
- mortgage broking;
- arranging syndicated loans; and
- introducing and broking.

In other words, these services will be treated as taxable supplies made by the financial supply facilitator giving rise to an entitlement to an RITC for the recipient financial institution. A "financial supply facilitator" in relation to a *supply of an interest*, is an entity *facilitating the supply* of the interest for a financial supply provider.[106] The GSTR thus make a distinction between the act of supplying an interest by one person and the act of facilitating that supply by another.

Difficulties arise where an agent receives the loan funds from the lender, holds them in its own account and then provides them to the borrower. The question arises as to whether a transfer of funds to the agent's account by the lender and the on-transfer of the funds to the borrower merely amounts to *facilitation* of the relevant supply or the actual *making* of a separate financial supply by the agent.

If the agent were treated as itself the maker of a financial supply, the agent may be input taxed in relation to the receipt and transfer of the funds. It appears that the intention, however, is to treat such a supply simply as facilitation rather than as a financial supply itself, although on a strict construction of the legislation, the outcome may be different. Division 153 of the GSTA refers to supplies being made by a person *through* an agent. This seems to indicate that even though there may in a strict sense be two supplies, for GST purposes this will be treated as a single supply.

New provisions under which agents may be treated as principal suppliers were introduced by *Indirect Tax Legislation Amendment Act 2000.*[107]

[105] GSTR, r 40-5.12 (item 13).
[106] GSTR, r 40-5.07.
[107] Sub-division 153B.

12. DE MINIMIS PROVISION

The GSTA contains de minimis provisions.[108] The object of these provisions is to allow taxpayers who make financial supplies below a certain threshold to recover all of their input GST costs despite the making of financial supplies. To allow recovery of input GST costs on an acquisition under the de minimis rules, the following requirements need to be satisfied:

- the only reason the acquisition would (apart from the de minimis provisions) be treated as relating to making supplies that would be input taxed is because it relates to making financial supplies.
- the taxpayer entity does not "exceed the financial acquisitions threshold".

The "financial acquisitions threshold" is based on an entity's level of input tax credits. Under the de minimis test, a registered entity can obtain input tax credits for acquisitions that relate to making financial supplies if the total amount of credits which would otherwise be denied do not exceed either or both of the following levels:

- $50,000 or such other amount specified by the GSTR;
- 10% of the total input tax credits of the entity.

If either or both of these levels are met, an entity will have exceeded the financial acquisitions threshold. In that event, it is denied input tax credits to the extent its acquisitions are not acquired for a creditable purpose.

The test requires the taxpayer to consider its position in a given month taking account of both past acquisitions[109] and future acquisitions.[110] "Financial acquisitions" are acquisitions relating to the making of financial supplies, other than financial supplies consisting of borrowings. Therefore the de minimis test is to be determined without regard to acquisitions relating to borrowings.[111]

For a GST group the de minimis threshold is a combined threshold, based on financial acquisitions made by all members of the group. Accordingly, if one member of the group makes financial acquisitions exceeding the threshold, then the GST group as a whole will exceed the threshold.

13. GOING CONCERN EXEMPTION

The availability of an exemption for the supply of going concerns may, in some cases, apply to what would otherwise be a financial supply. It will be important to determine whether the exemption applies because, if it does, input GST costs included in the cost of an input that relates to the supply of the going concern will be recoverable. The issue arises particularly in connection with the acquisition of a loan book. While the acquisition of loans and mortgages securing the loans by themselves may amount to financial supplies and will therefore be input taxed, if the transaction amounts to the supply of a going concern, GST-free treatment may apply.

Where the acquisition of the loan book is accompanied with the acquisition of other assets such as goodwill, employees, the premises from which the business is carried on and the business name, it is likely that a going concern may have been acquired.

Under s 38-325, the supply of a going concern is GST-free if a number of requirements are satisfied. These requirements are as follows:

- the supply is for consideration;
- the recipient is registered or required to be

[108] GSTA, ss 11-15(4)(b), 15-10(4)(b) and Div 189.
[109] By reference to "financial acquisitions" made or likely to be made currently and during the previous 11 months – GSTA, s 189-5(1).
[110] By reference to "financial acquisitions" made or likely to be made currently and during the succeeding 11 months – GSTA, s 189-10(1).
[111] GSTA, s 189-15.

registered;

- the supplier and the recipient have agreed in writing that the supply is of a going concern;
- the supplier supplies to the recipient all of the things that are necessary for the continuing operation of an enterprise;
- the supplier carries on, or will carry on, the enterprise until the day of the supply.

In *Baltic Leasing Ltd*,[112] the transfer of all or part of a leasing company's portfolio was held to be within the going concern rules applying under the *Value Added Tax Act 1994* (UK).

The application of the going concern exemption in these circumstances may however have adverse consequences for the acquirer. The acquirer has an increasing adjustment to make if it is the recipient of the supply of a going concern and it intends that some but not all of the supplies made through the enterprise to which the supply relates will be supplies that are neither taxable supplies nor GST-free supplies (eg input taxed supplies).

14. CONCLUSION

This article provides a general outline of the legislative scheme for the imposition of GST on financial services. The Australian GST model is complex in its structure and highly technical in its reliance upon concepts such as the "provision, acquisition or disposal" of "interests". The Australian model introduces a number of unique concepts not found in the legislation of comparable jurisdictions, particularly the dichotomy between financial supply "providers" and "facilitators" and the reduced input tax credit system. It is anticipated that the provisions will give rise to significant difficulties of implementation and application, and will likely require further refinement by amending legislation.

[112] (1986) VATTR 98.

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