

Consultation Paper on the Review of the Financial Supply Provisions

ASFA Submission

August 2009

Association of Superannuation Funds of Australia

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Please Note:

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17 August 2009

Christine Barron
General Manager
Indirect Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

Dear Ms Barron

Re: CONSULTATION PAPER ON THE REVIEW OF THE FINANCIAL SUPPLY PROVISIONS

The Association of Superannuation Funds of Australia (ASFA) is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members include corporate, public sector, industry and retail superannuation funds plus service providers who provide professional services to SMSFs, account for more than 5.7 million member accounts and over 80% of superannuation savings.

ASFA would like to submit the following comments in response to the Treasury consultation paper on the review of the Goods and Services Act's financial supply provisions.

ASFA notes that the review is in response to a Board of Taxation recommendation that:

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

ASFA strongly recommends that the current legislative regime for the treatment of financial supplies be significantly retained. ASFA does not support any replacement of the present regime with a 'principles based approach' which we believe would involve significant compliance costs and cause disruption in the marketplace.

Further, ASFA does not support any reduction in the 75% rate applicable to reduced input tax credits in the present rules. Of necessity, any such reduction would be required to be met from members' accounts within superannuation funds, and thus would be reflected in either higher fees to members or reduced investment returns.

In the event the review concludes that changes are required, or justified, ASFA requests that the proposed changes be the subject of further discussions with industry so that the impact of the changes can be fully explored prior to finalisation of legislation.

The remainder of this submission is structured to follow the order of the questions posed in the discussion paper.

Responses to the questions posed

Option 1: Replace existing legislative framework with a principle or set of principles

ASFA does not support the replacement of the existing legislative framework with either a principle or a set of principles.

Although having some concerns with the complexity of the financial supply provisions, and noting shortcomings in the legislation that leads to uncertainty of application, ASFA does not consider that these issues would be adequately overcome by the introduction of principles based legislation.

Having lived with the provisions for 9 years, the initial complexities and confusions have been progressively worked through. At considerable expense, organisations have educated their staff on the operations of the provisions and have implemented appropriate IT systems and an appropriate risk management framework. The replacement of the existing law with a set of principles would likely involve significant cost, especially with respect to the re-implementation of what is largely a settled area of tax law.

In ASFA's view, any problems with the law are not sufficient to require a major change to the provisions or to the structure of the provisions. Additionally, the superannuation industry would not welcome the additional costs which would necessarily accompany such a change.

However, ASFA considers that interpretation and understanding of the financial supplies provisions by the ATO and the courts would be greatly enhanced by the inclusion of statements of principle within the regulations. The inclusion of statements of principle would also provide an opportunity to review whether the wording in the regulations reflects the principles and delivers an appropriate outcome.

Whilst ASFA considers that the present list of reduced credit acquisitions in Regulation 70 to be comprehensive, ASFA would support:

- Periodic review of this list, to ensure that the list remains current, and responds to new and emerging types of acquisitions, within the context of the overall guiding principle behind reduced credit acquisitions as a mechanism to remove the bias to in-source functions; and
- Legislative amendment to remove ambiguities or inconsistencies in the wording of certain items on the list, where the issuance of public rulings by the Australian Taxation Office (ATO) is unable to address such issues or is an inappropriate mechanism through which to do so.

During the development of the financial supplies regulations discussions were held between government and industry as to what items should be accorded reduced credit acquisition status thus giving rise to a reduced input tax credit. At that time a basic principle was enunciated that the status should be given to functions which would normally be done in-house, but which were contracted out to an external provider for various commercial reasons.

The underlying principle being one of commercial neutrality between in-sourcing and outsourcing of activities and this in turn gave rise to the RITC rate being set at 75%. The rate of 75% was intended to remove any outsourcing bias on the basis that approximately 25% of the costs incurred by the supplier would be subject to GST with the remaining 75% representing salary, wages and other costs not subject to GST. However, this process was not without its flaws. In a range of areas there appears to be a disconnection between what business/industry thought was covered by the items in the table and what the ATO has subsequently advised is covered.

In the absence of clearly enunciated underlying principles the ATO's interpretations of the reduced credit acquisition items in the table in regulation 70-5.02 have, of necessity, been based on the wording of the table items. But one example of this disconnection is the ATO's distinction between the coverage of Items 24(b) and 26(c):

Item 24 deals with administrative functions in relation to investment funds, including those functions for superannuation schemes.

24(b) is 'processing of applications contributions and benefits'.

Item 26 deals with life insurance administration services provided for a life insurer. 26(c) is 'processing and assessing claims'.

ASFA sought the ATO's view on whether, when outsourcing the processing of a temporary and permanent disablement (TPD) claim by a member of a superannuation fund under a group life policy, an RITC could be claimed with respect to the process of assessing the member's claim (i.e. the activity of receiving reports, the reviewing of those reports and the making of a recommendation to the fund trustee based on those reports).

In response, the ATO drew the following distinction between Items 24(b) and 26(c) by reference to the absence of the word 'assessing' in 24(b):

Therefore, in the absence of an assessing component under paragraph (b) of item 24 in the table in the subregulation 70-5.02(2) suggests that the assessment component of a benefit under the superannuation fund is to be excluded as part of a reduced credit acquisition under that item.

Thus, although a medical assessment may be a step/component in the processing of a claim, in itself it is not processing but merely an assessment of the client's medical status, which is not covered under paragraph (b) of item 24 in the table in subregulation 70-5.02(2) of the GST Regulations and is therefore not a reduced credit acquisition when acquired by the superannuation fund. The item does not extend to cover a service of assessing of claims.

Essentially the ATO concluded that 24(b) did not extend RITC availability to the outsourcing of the decision making process as the absence of the word 'assessing' meant that the term 'processing' in both 24(b) and 26(c) was restricted to the receipt of the application and the making of the payment or advice of denial of the claim.

Despite the ATO's current interpretive position, when submitting this item to government, the superannuation industry's view has always been that the term 'processing' covers a wide range of activities. For example, a superannuation fund's 'processing' of a TPD claim includes gathering information such as reports assessing the extent of the member's incapacity, reviewing the paperwork and forming a view and paying the benefit or advising the member the claim has been denied. With the exception of having an independent person prepare the injury assessment report, all activities can be done 'in-house' by a superannuation fund.

Similarly, because of the legislative restrictions on making contributions and paying benefits 'processing' as the term is used within the superannuation industry automatically and necessarily encompasses a broad range of activity including assessing a person's eligibility to make a contribution or withdraw a benefit or receive a benefit.

Ultimately, the industry view was and remains that the term processing covers the full range of activity capable of being conducted in-house by the superannuation fund and that those activities should be eligible for an RITC when outsourced.

Given present industry practice, superannuation funds within life insurance company structures benefit from the reference in item 26(c) to “processing and assessing claims”, whereas superannuation funds outside life insurance company structures or funds that may deal with such issues through their administrative functions (for example, by self-insuring) are required to look to item 24(b) which only references “processing of applications, contributions and benefits”.

As the broad principle underlying the reduced credit acquisition framework is to remove the bias to in-source, it would seem appropriate that the second group of funds should also obtain RITCs where they contract with a claims assessment agency to obtain such services. However, in the absence of a statement of the principle, this result may only be achievable if the words in item 24(b) are amended to include, for example, “and the assessment of claims or entitlements to benefits”.

Similarly Item 24(h) ‘compliance with industry regulatory requirements, excluding taxation and auditing services’ would benefit from a statement of principle that would provide flexibility in the face of changing regularity requirements and thus assist in the interpretation of new requirements imposed such as those under the AML/CTF act.

Option 2: Amend existing law

ASFA considers that there are some areas where amendment of the existing law may assist in understanding and interpretation and thus result in lower compliance costs.

In particular, throughout the table of reduced credit acquisitions the various items are either drafted in a definitive way (e.g. the following four functions...) or by way of example (e.g. administrative functions such as...). In some items specific items are ‘excluded’. This lack of consistency of structure leads to interpretational issues and thus increases compliance costs.

One area where greater clarification could assist is item 23 (c):

23. The following investment portfolio management functions, including those functions for a superannuation fund:
 - (c) acting as a trustee of a trust or superannuation fund.

There appears to be divergent views within the superannuation industry as to the scope of operation of this provision where the trustee provides a bundled service. That is, what is the situation where a trustee meets all of the expenses of management of a superannuation fund and then seeks reimbursement from the trust for expenses incurred in undertaking its role of ‘acting as a trustee of a superannuation fund’. Whilst much will depend on the terms of the trust deed, providing some basic principals upon which to base analysis would be helpful. For example, is there a requirement, obligation, or merely an expectation that the trustee should itemise its bill or is itemisation not required?

ASFA considers that the Treasury should articulate a clear statement of principle on this issue, for example, that “acting as a trustee of a trust or superannuation fund” encompasses all of the activities that the trustee engages in as the legal representative of the trust or fund.

In the absence of statements of principle or other clarification many items are open to numerous equally valid interpretations. The differing tax outcomes that result from the various interpretations would appear to be at odds with the underlying principle of neutrality, i.e. that business arrangements should not be driven by tax outcomes.

Option 3: Extent of eligible reduced credit acquisitions (RCAs) and rate of reduced input tax credit (RITC)

ASFA supports both the maintenance of the reduced input tax credit (RITC) regime and the present 75% RITC rate.

Critically, ASFA notes that any reduction in the 75% RITC rate would result in higher costs for superannuation funds. These higher costs would be required to be met from members' accounts within funds, and thus would be reflected in either higher fees to members or reduced investment returns.

In addition, superannuation is an industry where there is a wide divergence of arrangements. While many fund trustees outsource their administration and investment management, others engage their own staff to provide the services within the trustee corporate entity, and yet others have the trustee engage the staff directly in its capacity as trustee of the superannuation fund. Equally some funds outsource only some services while in sourcing others

This wide divergence of arrangements has been in existence for many years and predates the introduction of the GST legislation. Due to the wide divergence in arrangements ASFA considers it essential that the GST legislation supports providers of financial supplies who choose to outsource services.

ASFA also strongly opposes the use of differing rates for different types of acquisitions or industry sectors, unless this is justified by clear and specific circumstances. ASFA considers that the use of multiple rates would add significant complexity, and substantial administrative and compliance costs, especially as a result of the convergence of many parts of the financial services industry as a whole.

ASFA considers that the RITC regime achieves this and importantly, achieves it in a manner that does not distort commercial decisions. That is, the GST cost is not a key driver when determining whether to in-source or outsource a service.

Two types of services typically outsourced by a superannuation fund are administration and fund management services. ASFA has received independent advice from PricewaterhouseCoopers (PwC) that demonstrates that, for a superannuation fund administrator, the rate of 75% is an appropriate RITC rate. At ASFA's request PwC has carried out similar analysis for a sample Fund Manager, Again the analysis proves that the rate of 75% is appropriate.

Given the confidential nature of the information required to carry out this analysis, PwC will provide the numerical calculations on a confidential basis direct to Treasury and cross reference this submission.

It is important to note that any reduction in the rate will result in an increase in overall fund costs. The cost increase will be directly passed on to fund members.

ASFA's preference is for the retention of a single hybrid rate of 75% and ASFA is generally opposed to the introduction of multi rates. The introduction of multi rates has the potential to cause enormous complexities for Superannuation Funds and their suppliers (eg administrators and custodians), the majority of the IT systems currently available would not be able to cope with multi rates and the likelihood of coding errors and other compliance issues would increase. Given the risk profile of the Superannuation industry this increased risk of non compliance would not be palatable to the Trustees.

However, should the view prevail that, on the balance of available information, the single RITC rate should be lowered, ASFA would argue strongly in favour of a regime of sector based RITC rates with a 75% RITC rate applicable to eligible acquisitions by superannuation funds.

In summary, ASFA is of the view that Superannuation Funds and their suppliers have borne an enormous cost when implementing GST and as such are opposed to significant changes to the legislation that would necessitate further change. ASFA would welcome some minor amendments to clarify exactly what acquisitions are reduced credit acquisitions as this would assist the Superannuation industry with gaining optimal levels of GST compliance. Any reduction to the current reduced input tax credit rate of 75% would be strongly opposed based on the fact that the numerical calculations conducted indicate that 75% achieves policy intent and removes any in-sourcing / outsourcing bias.

Should you wish any further information on this matter please contact Robert Hodge, Principal Policy Adviser (rhodge@superannuation.asn.au) (02) 8079 0806.

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