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General Manager
Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/madam

Discussion Paper
Implementation of the recommendations of Treasury's review of the GST financial supply provisions
June 2010

Attached please find a response from the Association of Superannuation Funds of Australia (ASFA) to the above discussion paper.

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 membership includes corporate, public sector, industry and retail superannuation funds, and accounts for more than 5.7 million member accounts and over 80% of superannuation savings.

ASFA, while appreciating the need to create certainty in the law, is concerned that the proposed changes to not address the fundamental issue – what is the definition of trustee services.

On the following pages we have addressed the specific issues that arise from the paper

Should you require further information please contact Robert Hodge, Principal Policy Adviser, on (02) 8079 0806.

David Graus

General Manager Policy and Industry Practice

TREASURY DISCUSSION PAPER

PROPOSAL – NO RITC FOR ACQUISITIONS BUNDLED WITH TRUSTEE SERVICES

Since the inception of GST in Australia, there has been uncertainty as to the degree that the costs incurred by a Trust in respect of trustee services qualify for a Reduced Input Tax Credit (RITC). ASFA therefore welcomes the move to clarify this matter.

ASFA considers that this proposal is not only of significant importance to trustees of superannuation funds but it is also to fund members, as ultimately they the costs that arise from any uncertainty in the application of the law.

Any amendments introduced should be clear in order for trustees to effectively and efficiently determine the correct treatment of costs incurred in their capacity as trustees of superannuation funds.

While a superannuation fund is not a separate legal person or entity at general law, it is treated as a separate entity for GST purposes. The trustee of a superannuation fund is also taken to be an entity for GST purposes. Accordingly, a trustee can conceptually make supplies and acquisitions in multiple capacities for GST purposes (e.g. in its personal capacity or on behalf of the fund).

Division 70 of the GST Regulations allows specific acquisitions relating to the making of financial supplies to give rise to an RITC. Pursuant to item 29 of regulation 70-5.02(2) an RITC (at a rate of 75%) is available on the supply of 'trustee and custodian services' to entities who make financial supplies.

Supplies in the nature of accounting and taxation are generally not eligible for an RITC however as per regulation 70-5.02(2) 'trustee services' are eligible for an RITC. There appears to be a degree of uncertainty as to whether all supplies that may comprise 'trustee services' in accordance with a trust deed (which may include accounting and taxation services) qualify as reduced credit acquisitions (RCAs) and thereby qualify as RITC's. This lack of clarity has resulted in disputes with the Australian Taxation Office as to whether RITC's have been validly claimed in respect of trustee services and, anecdotally, at issue is whether transactions being entered into are motivated by tax outcomes. Such behaviours have increased the amount of resources consumed by the superannuation industry in interacting with the ATO, and thereby increased costs being borne by members of superannuation funds.

However, some guidance as to the Policy may be obtained from the explanatory memorandum that accompanied the regulations introducing the RITC concept. On the topic of apportionment of trustee services it said:

> *Apportionment of trustee services*
> The GST Act treats a trust as an entity and recognises that a trustee can act in a number of different capacities. In particular, the same person often acts as trustee and also provides a range of portfolio management services. Without an amendment, business would need to apportion the value of certain fees according to the capacity in which the trustee is acting. An amendment will be made to deem the whole fee to be consideration for the provision of the management services. This approach has been sought by industry and will be welcomed as it significantly reduces compliance costs.

The explanatory statement also set out the benefits of the proposed Australian system of RITCs.

> **Benefits of the proposed system compared to overseas jurisdictions**
> The RITC approach – which is unique to the Australian GST – has a number of benefits over the general approach of broader input taxation taken in overseas jurisdictions. These include reduced bias to insource; lower compliance costs for smaller entities; greater legislative certainty; and a better competitive position for domestic service providers.

It would appear clear from the above that the policy intent is that where a trustee itself provides a range of services to the trust then there is no expectation that the fee charged to the trust should be apportioned depending on the capacity in which the service is delivered.

This position appears to be supported by the Commissioner of Taxation's statement at paragraph 666 of GSTR 2002/2 that "duties carried out by the trustee in compliance with the terms of the deed are defined as trustee services"[1]

[1] GSTR 2002/2 paragraph 666.

ASFA notes that a variety of structures are adopted in relation to the compensation of the trustee for fulfilling the trustee's obligations. A trust deed may provide for a fee for services and specific reimbursement of outgoings or, alternatively, a single fee that covers the reimbursement and remuneration for trustee services. The common feature of all compensation arrangements seems to be that the reimbursement or fee and any separate remuneration is to be met from the assets of the trust.

ASFA considers that, prior to drafting legislation, it is necessary that the concept of trustee services be clearly defined. For the law to operate effectively and for trustees to be able to administer a fund's entitlement to an RITC efficiently it is essential that a clear underlying principle be established. A starting point would be a clear statement as to whether a determinant of 'trustee services' is the method of remuneration or the content of the service delivered.

What constitutes 'trustee services'?

ASFA is of the view that where a single fee is established in advance of the provision of the service and the commercial risk lies with the trustee, then such a fee should be considered a 'trustee service' fee and subject to an RITC of 75% of the fee. However, where the trustee is merely indemnified by the trust for expenses incurred in relation to the operation of the trust then the 'trustee service' is the direct cost of administering the trust, but does not extend to the reimbursement of the trustee in relation to services the trustee has 'purchased' from parties external to the trustee office. Such expenses should only give rise to an RITC where that would have been the outcome had the trustee incurred the expense as 'trustee for the trust'. Such an approach is a modification to the concepts set out in Option 3. Option 3 involves defining trustee services widely and then, if necessary, excluding those components that for policy reasons should not be eligible for a RITC, as per the original legislative intent of the RITC regime. ASFA's preferred approach of defining trustee services on a 'commercial risk basis' (i.e. by an objective analysis of the commercial reality of the arrangement) would comply with the 'principles-based law design' concepts as set out at paragraph 1.4 of the Discussion paper.

The central concept is explained through the following examples:

Example One

A trustee provides a service of undertaking all of the administrative tasks in relation to a fund for a set fee of 1.1% of assets under management. For this fee, the trustee accepts responsibility for receiving and processing contributions and administering benefit payments, preparing and submitting taxation and regulatory returns, and all other matters associated with the administration of the trust in accordance with the relevant laws. Should, for any reason, the cost of administering the fund exceed the fee income, the trustee has no recourse to additional remuneration from the fund. That is, the trustee bears the commercial risk.

The fee of 1.1% of assets under management is for trustee services and the fund is entitled to claim a 75% RITC with respect to the entire fee.

Example Two

A trustee agrees to act as a trustee of a fund on a cost reimbursement basis. That is the trustee is reimbursed for the costs it incurs in administering the superannuation trust and for the costs of services directly related to the trust that it contracts for. The trustee establishes an office and hires staff to undertake the trustee tasks. The major activity of the trustee office is the arranging of trustee meetings and the engagement of external service providers to deliver specific services aimed at the business of the trust.

In this example the 'trustee service' is the fee the Trustee charges that covers the trustees cost of administering the trust. That is the office, staff and other costs that are directly related to the trustee's performance of its duty as trustee. Such costs may include the cost of external assistance provided to the trustee office staff (e.g. training costs for staff or the cost of legal advice to the trustee on the correct application of law to a specific set of facts related to the trust.)

Those costs for services related to the business of the trust and which are not performed by the trustee office and which are reimbursable from the corpus of the trust (e.g. the engagement of an external administrator, auditor fees, legal costs relating to the payment of a member benefit etc) are not 'trustee services'. They must be separately itemised on an invoice from the trustee and whether or not the GST component of the cost gives rise to an RITC would be determined under the standard rules.

Example Three

Under an agreement with the trust, a trustee agrees to provide a range of specific administrative tasks in relation to a fund for a set fee of 1.0% of assets under management, with other tasks that may from time to time be required to be performed charged on a cost recovery basis. Should, for any reason, the cost of administering the fund with respect to the specified administrative tasks exceed the fee income, the trustee has no recourse to additional remuneration from the fund. That is, the trustee bears the commercial risk with relation to those activities.

The fee of 1.0% of assets under management is for trustee services and the fund is entitled to claim a 75% RITC with respect to the entire fee. However, those costs which are separately reimbursable from the corpus of the trust are not 'trustee services'. They must be separately itemised on an invoice from the trustee and whether or not the GST component of the cost gives rise to an RITC would be determined under the standard rules.

The comments below address in more detail the specific focus questions asked in the Discussion Paper. Legislative references are to *A New Tax System (Goods and Services Tax) Act 1999*, unless otherwise noted.

Are there any cases where applying of the principles would create inappropriate outcomes?

ASFA does not consider that the issues surrounding bundling of 'trustee services' would be adequately overcome by the introduction of principle based tests that are proposed in Option 1 and Option 2. Such tests would suffer from the same challenge as existing regulations – a lack of clarity and difficulty in administration, leading to controversy and dispute.

Option 1

This concept is based on the determination of the party to whom the relevant services is provided in fact, in comparison to the party to whom the supply is made in a contractual sense. ASFA considers that that the application of the 'made and provided' test would result in ambiguity when applied to the trustee and fund relationship.

The origins of this test appear to be in the current law at section 38-190(3) and as set out in GSTR 2005/6. Furthermore, we note that the meaning of the word 'provided' is not defined in the GST Act.

As stated by the Commissioner in GSTR 2005/6 at paragraph 220, "*the judicial consideration of the term in other areas of law shows that the term 'provide' is capable of taking a wide range of meanings depending on the context in which it is used. For example, it has been found to cover in the context, preparation, making available and even acquisition.*"

It is unclear in what situations an acquisition would be considered to have been 'provided' to the fund as opposed to 'provided' to the trustee. Clarity on this issue is crucial. As a matter of law, a trust can only ever be provided with anything via its trustee.

The foundation of the difficulty lies in the treatment of a 'trust' as an artificial entity for GST purposes. This has often been described as an 'artificial fiction', as in contrast to the equity law position, a trust is not considered to be a 'legal person'.

For GST purposes, an 'entity' includes a trust and the entity that acts as the trust is in fact the Trustee (section 184-1(2)). Furthermore, section 184-1(3) provides that a legal person may act for GST purposes in a number of different capacities and in each of those capacities the person is taken to be a separate entity. Accordingly, in addition to its corporate capacity, a company may be a trustee of a trust.

ASFA considers that the fact that a trustee can act in multiple capacities for GST purposes, but a trust can only receive anything via it's trustee for the purposes of equity law would result in difficulty in applying the 'made and provided test'.

For example, in order to provide commercial benefit to the fund trustees may engage third parties to provide expert advice. The supply of this advice is arguably 'made' to the trust; however it can only be provided to and acted upon by the trustee (who for equity purposes is the trustee of the trust). In such instances, it would be difficult to identify the relevant entity to which the supply has been 'made' and 'provided'.

Furthermore, it is unclear what is intended to occur in respect of costs that the trustee might necessarily incur in carrying out its required functions and duties that also might involve the acquisition being 'provided' to the fund. Will this option require the trustee to separate the supply and apportion accordingly?

Option 2

The 'substance and character' approach seems to have its origins in the application of the rules around 'unabsorbed contributions' that are set out in Regulation 70-3.02C. As acknowledged in the Discussion Paper, this principle has not been fully developed. ASFA considers that the lack of established guidance would lead to increased compliance costs on behalf of the trustee understanding such a complex principle.

The 'substance and character' test also suffers from the same problems as the 'made and provided' test. In this regard, ascertaining whether the 'substance' of a supply has changed when supplied to the 'trust' is inherently difficult to apply to the trust/trustee relationship.

Furthermore, in many cases, trustees do not 'change the character' of an acquisition yet the acquisition is necessarily required to be made by the trustee in order to provide basic trustee services under the trust deed (for example, the acquisition of labor resources from third parties). In this regard, would this approach require the trustee to separately itemise an 'arranging fee'?

Question (vi) Could some trust arrangements be more or less disadvantaged under one of the options?

ASFA is concerned that the principles encompassed within Options 1 and 2 are conceptually flawed and will lead to substantially more scope for dispute as to which components of remuneration for trustee services qualify for RITCs. Thus potentially all superannuation funds would be disadvantaged in that compliance costs will increase.

ASFA is also concerned that smaller superannuation funds that do not have ready access to sophisticated resources would be significantly disadvantaged in applying the complex principles involved in Option 1 and Option 2 (for example, Self-managed superannuation funds (SMSF)).

Question (vii) If you favour of Option 3 are there other categories of acquisitions that should be excluded from the definition of trustee services?

As discussed above, ASFA is of the view that considerable care is needed as to which particular services are identified as excluded from trustee services. As specified in GSTR 2004/1, the reference to 'trustee services' in item 29 is capable of applying widely to services acquired from a trustee. We agree that trustee services should be afforded a broad definition and any 'carve outs' should be in line with the general policy rationale of RITC.

Whilst the concept behind the RITC mechanism is to remove the inherent preference to 'in-source' services in the financial services industry, ASFA considers that this cannot be applied to 'trustee services' as, by its very nature, such a service is unable to be in-sourced by a superannuation fund.

Rather, ASFA considers that, as detailed earlier, a principle should be established that looks at the commercial arrangement under which the trustee is recompensed for its costs of administering the trust. Where a single fee is established in advance of the provision of the service and the commercial risk lies with the trustee, then such a fee should be considered a 'trustee service' fee and subject to an RITC of 75% of the fee. However, where the trustee is indemnified by the trust for all expenses incurred in relation to the operation of the trust then such expenses should only give rise to an RITC where that would have been the outcome had the trust incurred the expense directly. As per example three above, the basic principle could be similarly applied to determine entitlement to an RITC where the trustee receives a basic fee for 'trustee services' but is able to separately seek reimbursement for expenses incurred but not covered by the general 'trustee services' fee.

Such an approach is a modification to the concepts set out in Option 3. Option 3 involves defining trustee services widely and then, if necessary, excluding those components that for policy reasons should not be eligible for a RITC, as per the original legislative intent of the RITC regime. ASFA's preferred approach would comply with the 'principles-based law design' concepts as set out at paragraph 1.4 of the Discussion paper.