

# *Changes to the GST financial supply provisions*

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# *Release of Exposure Draft legislation for changes to the GST financial services provisions*

***On 18 August 2011, the Assistant Treasurer released Exposure Draft legislation for 3 of the 7 proposed changes to the financial supply provisions of the Goods and Services Tax (GST) law announced by the Government in the 2010-11 Budget. The changes relate to hire purchase agreements, the borrowing concession and ADI deposit accounts and the financial acquisitions threshold.***

## ***Hire purchase agreements***

A new Division 158 of the GST Act will be introduced in relation to acquisitions made under hire purchase agreements entered into on or after 1 July 2012. Under the new law, a taxpayer who accounts for GST on a cash basis will be treated as if the taxpayer accounted for GST on a non-cash (accrual) basis in relation to acquisitions made under a hire purchase agreement.

The practical effect of the change is to allow taxpayers on a cash accounting basis to claim the full amount of any available input tax credits at the time the first payment under the hire purchase is invoiced or paid. Currently, these taxpayers can only claim input tax credits progressively in relation to each payment under the hire purchase. This has generally resulted in a negative cash flow impact for

affected customers under hire purchase agreements that require the GST amount to be paid to the hirer up front (to enable the hirer to meet its obligation to account for the full GST amount on the first payment). Historically, this caused a bias away from hire purchase for small to medium businesses in favour of other asset finance products, in particular chattel mortgages.

Asset financiers will need to consider the impact of the changes on finance product decisions by small to medium businesses. The change in the law should remove the existing GST related bias away from hire purchase agreements. Asset financiers may give consideration to the finance commitments and payment terms under hire purchase agreements. Indeed, it is possible that a preference for hire purchase may arise where it provides cash flow benefits for customers and better security for financiers in relation to GST amounts.

## ***Input tax credits for borrowing expenses – restrictions for ADI deposit accounts***

The Exposure Draft provides details of the changes announced last year to restrict the 'borrowing concession' to exclude bank deposit accounts. This involves an amendment to section 11-15(5)(a) of the GST Act to specifically restrict concessional

treatment to borrowings acquired 'other than through a deposit account you make available'. The change will affect acquisitions made from 1 July 2012.

The borrowing concession deals with situations where taxpayers borrow funds to use in their taxable activities. Because the process of borrowing funds is deemed to be a financial supply (a so-called 'acquisition-supply'), there would normally be a denial of input tax credits on acquisitions related to the borrowing. This has always been considered unfair, especially in the case of non-financial businesses acquiring funds for use in their underlying businesses.

The borrowings concession therefore allows input tax credits to be claimed where they relate to a borrowing which can be traced through to creditable activities (i.e. taxable or GST-free). This currently applies to all taxpayers, including banks and other approved deposit-taking institutions (ADIs). Since crediting money in deposit accounts is recognised in banking law as being a borrowing of the ADI, to the extent to which those funds are subsequently used by the ADI in carrying out (for example) taxable leasing businesses, then the borrowing concession applies. This has meant that ADIs are able to claim additional input tax credits on part of the costs they incur in operating deposit accounts (including, for example, the cost of their branch networks). The Commissioner of Taxation has taken the view recently that this treatment is

against the policy behind the borrowings rule, although the rationale for differentiating in this way against ADIs has never been clearly articulated.

The changes will restrict the application of section 11-15(5) to ADIs from July 2012, although given that they raise funds through a number of types of borrowings not strictly related to 'deposit accounts', there will still be scope for them to apply the concession. As is typically the case, the change will involve an increased administrative burden for ADIs in measuring which 'borrowings' still apply.

### ***Increase in the Financial Acquisitions Threshold***

The financial acquisitions threshold for determining whether input tax credits must be blocked in relation to financial supplies will be increased from \$50,000 to \$150,000 with effect from 1 July 2012.

The effect of this change is to increase the amount of acquisitions that relate to making financial supplies that can be made before input tax credits must be denied from \$550k to \$1.65m (inclusive of GST). The financial acquisitions threshold remains a 'two limb' test that must be considered monthly looking at both the previous 11 months and the next 11 months.

While this change will not impact financial service providers whose core business involves the making of financial supplies or taxpayers who undertake larger share transactions, it may provide relief for those who make minimal or irregular financial supplies.

### ***Consultation and further amendments***

A consultation process has been initiated with the deadline for submissions closing on Friday, 16 September 2011.

Exposure Draft legislation for the remaining Budget reforms to the GST financial supply provisions will be released at a later date. Those reforms are:

- Making hire purchase agreements fully taxable.
- Expanding the range of certain expenses qualifying for a reduced input tax credit.
- Reducing opportunities for businesses to take advantage of reduced input tax credit concessions by bundling services.
- Clarifying the language and relationship between the concepts of guarantees and indemnities.

### ***Contacts***

To have a deeper discussion about what the above means for your business, please contact your usual PwC contact or:

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