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GSTFS

Australian GST Developments in Financial Services

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Changes to the GST financial services provisions

As part of the Federal Government's Budget announcement, a number of changes to the GST financial services provisions were announced. These measures mark the first substantive amendments to these provisions since the introduction of GST and they flow from Treasury's review of the financial supply provisions in 2009. The review was one of the recommendations from the Board of Taxation Report. The changes announced include:

Increasing the Financial Acquisitions Threshold to $150,000 of input tax credits

Noticeably, while other thresholds in the GST Act have increased, the FAT threshold has remained the same. The increase currently proposed means that many taxable and GST-free businesses, which were previously denied input tax credits on their acquisitions, may no longer suffer denial. More importantly, however, the increase signifies the Government's commitment to the existing FAT provisions and methodology, which many taxpayers have found confusing and onerous. It does not address one of the Board of Taxation's (and Treasury's) primary objectives to reduce complexity and administration costs for taxpayers. This is because the existing legislation still requires taxpayers to monitor the FAT on a monthly basis – although it is a custom more honoured in the breach than the observance[1].

1. Hamlet, Act 1, Scene 5

Hire purchase arrangements will be wholly taxable

The GST treatment of hire purchase arrangements has been a long running problem for the Government and taxpayers. While many overseas jurisdictions have specific legislation governing the treatment of hire purchase arrangements, the Australian GST legislation currently treats hire purchase arrangements according to its components (ie the credit and principal components) resulting in a mixed supply for GST purposes, and does not provide any specific attribution rules. Furthermore, the long-running dispute over the extent to which hire purchasers are entitled to input tax credits on their acquisitions has continued to frustrate industry and the Government.

The Government has announced that, with effect from 1 July 2012, all hire purchase arrangements will

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be treated as fully taxable, resulting in full input tax credits for acquisitions related to entering into hire purchase arrangements. This move significantly reduces complexity for hire purchasers, who have traditionally been faced with the difficult task of discerning the relevant elements of the agreement and calculating complex decreasing adjustments when agreements are terminated. As part of the changes, the government has also announced that hire purchase transactions are to be accounted for on an accruals basis, even where the taxpayer might otherwise account on a cash-basis, thereby allowing a full input tax credit entitlement (where appropriate) at the commencement of the arrangement for all taxpayers.

These changes are designed to correct the distortion between hire purchase arrangements and other financing options which have arisen as a result of the current GST treatment.

A question ha been raised as to whether this policy changed in attribution could be better implemented by changing the hirer's liability to account for GST

Section 11-15(5) – the borrowings rule

From 1 July 2012, ADI accounts will be excluded from the 'borrowings' exception in subsection 11-15(5) of the GST Act. Currently the borrowings rule allows input tax credits to be claimed by ADIs where accounts are made available and deposits (included as borrowings) are used to fund other taxable activities undertaken by the ADI. In 2009, the ATO released a draft ruling which proposed a curious apportionment formula designed to determine the extent of creditable purpose under subsection 11-15(5). Many taxpayers found the formula unhelpful and it is likely to be withdrawn in the near future. The Government argues that excluding ADIs from the operation of subsection 11-15(5) reflects the correct policy intent of the law, and the changes will not impact ADIs borrowing by way of issuing bonds or debentures to fund taxable or GST-free activities.

In the meantime, ADIs should review their existing apportionment methodologies to ensure that the necessary systems and recovery rate changes are implemented such that input tax credits will no longer be recovered on acquisitions directly related to account deposits used to make other taxable or GST-free supplies (unless of course those deposits are received from non-residents). ADIs which have not taken advantage of the borrowings rule in relation to deposits to date should urgently review their treatment, including potential refunds.

Guarantees and indemnities – clarification at last

While taxpayers and the Commissioner have often read the meaning of Item 7 of GST sub-regulation 40-5.09(3) so as to treat guarantees as distinct from indemnities and warranties, the Government will now correct the wording of the definition to reflect that these products are clearly separate and distinct. In GSTR 2006/1, the Commissioner outlines in detail the differences between guarantees, indemnities and warranties and how the GST legislation applies to these products. The amendments to item 7 are expected to reflect this distinction.

Reduced Input Tax Credits – the good, the bad and the ugly

Perhaps the most important part of the Government's budget announcement relates to RITCs. The **good news** is that the rate will stay at 75 per cent – for now that is. In other good news, RITC availability will be extended to lenders mortgage re-insurance, and for acquisitions related to providing life insurance by non-life insurers. RITCs will also be made available for transaction fraud monitoring services often carried out by network operators and charged to card issuers. These changes seek to address anomalies which have arisen over time as the RITC provisions have remained static since their introduction in 1999.

The **bad news** is that the RITC provisions for trustee services will be amended to disallow bundling different acquisitions into a single supply of trustee services which would not otherwise give rise to an RITC. A long-time bug-bear of the Commissioner, Treasury has proposed three different options to correct this 'distortion.'

1. Made and provided

   Treasury is considering introducing the concept of 'made and provided' to the provisions. Under this proposal, the consideration for a supply of trustee services should be reduced by the consideration for acquisitions the trustee has made that have subsequently been provided to the trust, except where a separate payment has been made by the trust to the trustee for the acquisition. A carve-out would apply to allow the trust an RITC where the trust would otherwise be entitled to an RITC had the acquisitions been provided directly to it.

   Treasury considers that the 'made and provided' concept is already well known and documented in the GST world and addresses the Commissioner's long-running concern that many services (such as fund auditing and advertising) can only be acquired by a trust.

The concept is considered in excruciating detail in public rulings such as GSTR 2005/6, which financial institutions will presumably be expected to digest and apply to trustee services.

2. Substance and character

Under this proposal, RITCs would only be available to the trust for trustee services to the extent that the acquisition is not an on-supply by the trustee of services the trustee has acquired without any alteration to the substance or character of the acquisitions. Essentially, this test would operate in the same manner as the unabsorbed contribution rules outlined in GST Regulation 70-5.02C. Once again, the proposal includes a carve-out to allow the trust an RITC where the trust would otherwise be entitled to an RITC for acquisitions provided to it.

As with the case of unabsorbed contributions, and unlike the first option, no meaningful ATO guidance currently exists on the application of the unabsorbed contribution rules and also brings to question what 'services' provided by a trustee will continue to allow RITC entitlement. Arguably, in many cases the trustee does little (if anything) to alter the nature of acquisitions before passing these on to the trust, and this proposal may unfairly increase the irrecoverable GST costs to funds and trusts.

3. Define trustee services

Under this proposal, RITCs would only be available to trusts for trustee services to the extent the services do not relate to advertising, auditing, taxation or valuation services. This would be done by defining trustee services to exclude these services. This option is perhaps the most straightforward approach for taxpayers to implement, and only includes those services specifically identified.

While the proposed changes would be relatively simple to implement into the existing legislation, often requiring only minor wording changes to the GST law or regulations, they raise more practical and implementation difficulties for taxpayers. In the case of the trustee services, apportionment will of course become an issue for fund managers to consider.

The **ugly news** is that these changes will not apply until 1 July 2012 (subject to agreement by the States and Territories). Treasury is accepting submissions on the above proposed changes until 30 August 2010.

Third party rebates – new law, but more questions

As part of the Board of Taxation Review, the Government has passed legislation to allow decreasing adjustments for payments made to third parties. The original version of this legislation, included in an Exposure Draft (ED) last year, was mainly aimed at manufacturers of goods (for example, '$100 cash-back' type offers). However, the final changes apply to 'things' supplied, therefore potentially including services (and therefore financial services).

The background to the changes is well known, and reflects the fact that the existing GST adjustment provisions do not work well in third party payment situations. New Division 134 of the GST Act concerning adjustments for third party rebates applies to payments made on or after 1 July 2010.

To illustrate the intent of the legislation, take a simple example in Figure 1 (using the terminology of the legislation):

Figure 1: Third Party Payments – Typical Situation

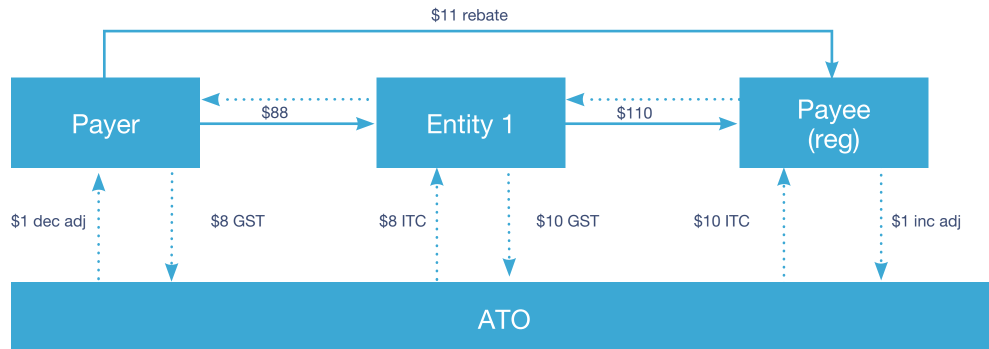
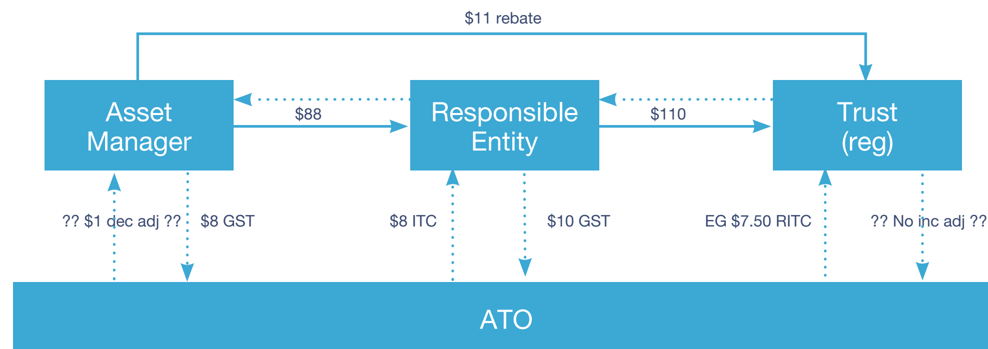


Figure 2: Third Party Payments – Fund Manager Situation



When a 'payer' sells something (or potentially provides taxable services) to an Entity, which then on-supplies those services to a third party (called a 'Payee'), new Division 134 may have effect.

The intention is that the Payer will receive a decreasing adjustment (effectively for 1/11 of the payment), when the payer provides a rebate to a third party. This rebate can be in the form of a monetary payment, or the forgiveness of a debt. It does not seem to include a payment 'in kind' or a barter exchange.

If the Payee is registered, then the effect of Division 134 is that it will have a corresponding increasing adjustment (depending on the level of ITCs it originally claimed, which could be less than 100 per cent).

There is also a need for the Payer to issue a 'Third party adjustment note'. This will need to be in the prescribed form (which is now available on the ATO website), and this may be a significant practical difficulty in some circumstances.

Where the Payee is unregistered, and therefore can claim back no ITCs, there is no increasing adjustment for the Payee, and no requirement to issue an adjustment note.

Fund Manager Situation

Although Division 134 would not usually apply to the Funds Management industry, there may be instances when it does. Charges and rebates take many forms within the industry, but as an example, an asset or investment manager may make a taxable supply of services to a trustee, who then passes this on to a trust (refer to Figure 2). A rebate is then paid to the trust. Variations of this could include financial advisory fees charged to a trust (or an investor), some part of which is then rebated.

In theory, this represents a similar situation to the basic scenarios discussed above – with the result of a decreasing adjustment to the asset manager, and (if registered) an increasing adjustment to the Payee.

But an issue has already been raised as to whether either of these adjustment events actually occurs. This is because there are doubts as to whether the supply which is subsequently made to the Payee (the Trust) is the same as that which was made to the RE. If the RE (for example) bundles up that service/supply with other acquisitions, and passes it onto the trust (perhaps in the form of a trustee fee), is that the same service? The legislation seems to require it to be substantially identical, although this is not clear. This same issue is likely to cause further complications for the industry when the fund considers its RITC entitlement under the proposed RITC changes as discussed above.

All this brings into question the long-standing ATO ruling to IFSA on management fee rebates. In most cases, those rebates were taken to be payments 'outside the scope of GST'. If the new rules apply, then they may (or may not) become adjustment events. This is clearly an area that requires further clarification.

New ruling regime – what it means for you

All financial services providers will be aware that, from 1 July 2010, the Taxation Administration Act was amended to adopt the existing income tax ruling system for GST, luxury car tax and wine equalisation tax. This new ruling system has a number of important implications for all taxpayers, which are perhaps most significant to the financial services industry. These implications highlight a fundamental change in what ATO guidance taxpayers can and cannot rely upon, and will impact the way in which taxpayers interact with the Commissioner. Important implications of the new regime include:

What's in, what's out

Under the previous indirect taxes ruling regime, 'indirect tax ruling' was broadly defined to include private and public rulings (such as GSTRs and GSTDs), but also encompassed a number of other documents published by the Commissioner (including information booklets, guides, fact sheets, ATO media releases, industry issues registers, rulings to industry associations and decision impact statements). Now, only a published document that states that it is a public ruling, and where the Commissioner has published notice of the ruling in the Gazette, is a public ruling. A private ruling, similarly, must state that it is a private ruling, and must clearly identify the entity to whom it applies, as well as the provisions to which it relates.

Public rulings existing before the adoption of the income tax rulings regime, such as GSTRs, GSTDs and GSTBs, as well as private rulings in existence at 1 July 2010, were covered by special transition rules to the new regime.

This means that other 'rulings' (including ATO fact sheets, and letters issued to various financial services industry associations under the previous indirect taxes ruling regime) may no longer be relied upon and are no longer binding on the Commissioner, which leaves taxpayers without protection. This change will be particularly relevant where financial service providers have continued to rely on 'advice' issued around the commencement of GST in setting up systems and processes, and have not reviewed these treatments or sought private binding rulings to confirm and protect their GST positions. We note, however, that the Commissioner has committed to transition a number of these publications considered as 'precedential' to the current rulings regime, although it is not certain at this stage which documents the Commissioner considers 'precedential'[2].

What's new

There are several areas in which modifications have been made to the general rulings regime so that these rules do not apply for indirect tax. Taxpayers may not apply for or receive oral rulings for indirect tax and, unlike many existing income tax rulings, where an indirect tax ruling does not specify an end time it will continue to apply until it is overridden by a later indirect tax ruling (public or private).

Taxpayers now have the right to object to private rulings issued by the Commissioner. For financial service providers who have not sought a private binding ruling on the application of the law to their arrangements for fear of receiving a negative ruling, this change comes as welcome news and is timely given that many previously relied upon documents are now no longer considered rulings under the new regime.

Furthermore, if a taxpayer applies for a private ruling and the Commissioner has not made, or has declined to make, a ruling within 60 days, the applicant can issue a written notice requiring the Commissioner to make the ruling. If the Commissioner does not make the ruling in 30 days, the taxpayer has objection rights. As many taxpayers have observed – especially in the financial services industry – applying for rulings under the previous system often resulted in many months (and in some cases years) of delay by the Commissioner, only to receive confusing and incomplete rulings. It is hoped that these changes will help provide certainty in a more timely manner for taxpayers.

The Commissioner may also issue Class Rulings which enable the Commissioner to provide binding advice about the application of a provision to a specific class of entities in respect of a particular scheme, and Product Rulings which enable the Commissioner to rule publicly on the availability of tax benefits from certain 'products' and thereby provide certainty to entities who participate or may be considering to participate in such a 'product'.

2. More information can be found at http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/00247341.htm&page=2&H2=&pc=001/003/103/002/022&mnu=44859&mfp=001/005&st=&cy=1

Moratorium

The Commissioner will allow a 12-month moratorium from any active compliance activities on issues covered by particular advice issued to industry associations that is not published on the ATO website. This moratorium is particularly relevant to financial supply providers who previously relied upon advice issued to industry associations and allows time for taxpayers to apply for private rulings.

It is important to note that the moratorium only extends to taxpayers that can demonstrate that they were already relying on that particular advice before 1 July 2010. It is not available to entities seeking to rely on that advice for the first time from 1 July 2010, and is not available where that advice is clearly covered by a subsequent public ruling.

Recent Australian developments

Indirect Tax Sharing Agreements – the essentials

With effect from 1 July 2010, the GST and Taxation Administration Acts have been amended to allow members of a GST group (and participants in a GST joint venture) to enter into indirect tax sharing agreements (ITSAs) with a representative member (or a joint venture operator) in relation to their indirect tax law liabilities. This includes the application of GST, Luxury Car Tax and Wine Equalisation Tax laws. The introduction of ITSAs marks a further move to bring the indirect tax regime more in line with income tax. Entering into an ITSA will limit the indirect tax liabilities of the members for tax periods in which they are a member of the GST group. Subject to certain conditions, a member with an ITSA can also leave a GST group during a tax period clear of any indirect tax liabilities in respect of the tax period in which it leaves the group.

In the financial services context, an ITSA may be relevant where different entities of the same GST group (or indeed same economic group) conduct different activities, perhaps independently of each other, and the representative member wishes to limit or protect the exposure of each member to the GST liabilities of other members. Similarly, an ITSA may also be relevant in the case of a merger or acquisition where a group representative wishes to protect the GST exposure of existing GST group members from an incoming or exiting group member.

The exposure to liabilities of each member will depend on the terms of the ITSA which prescribes each member's contribution amount. This amount need not be a specific amount – it may be determined as a fixed or variable percentage of the liability of the period, may be an amount based on 'notional' contributions for the period, or may be an amount based on some other formula. Furthermore, the amount may be nil. Most importantly, however, an ITSA must make a 'reasonable allocation' of the total amount of indirect tax payable for a tax period. An unreasonable allocation of part of the total amount to one member will invalidate the entire ITSA. In the case of dispute, what is and what is not a 'reasonable allocation' would ultimately be decided by the courts, however it is important to note that the law does not allow an ITSA to be upheld only in respect of some members and not others. This means that careful consideration of what is and is not a reasonable allocation between members is critical.

Interestingly, while an ITSA must be in the approved form, the Commissioner has noted that a group may use an ITSA for other purposes relevant to the group's internal arrangements, such as financing ongoing tax liabilities or allocation of refunds received. This illustrates the relevance to internal management accounting and costing systems in the context of GST for financial suppliers.

Other considerations relevant to the new ITSA law include:

- GST group members not party to an ITSA will continue to be jointly and severally liable for the full indirect tax liability incurred on behalf of the group representative member.
- While a separate ITSA is required for each tax period, practically the Commissioner will accept an agreement which covers multiple tax periods as a separate ITSA for each period. Therefore, even if one ITSA is found to be invalid because of an unreasonable allocation of indirect tax law debts in one period, it may

mean that other ITSAs covered by the agreement could be valid.

- A payment made by a member to the representative does not extinguish the liability of the member to the Commissioner. That is, the member could still be required to make a payment to the Commissioner of their contribution amount or of the full amount of the group's indirect tax law debt if the ITSA is found to apply. An exception to this rule is where a member makes a clear exit payment to the representative.
- Careful consideration needs to be given when amending an ITSA, so as not to invalidate an 'old' ITSA covering pre-existing liabilities, and to be sure that an updated ITSA will apply for the desired tax period, noting that the ITSA must be concluded prior to the due date of the BAS for the desired tax period.
- The GST law has been amended confirming that supplies between ITSA members will not be taxable supplies where the member is released from an obligation to pay a liability amount to the representative member, or where a member pays an amount to the representative member pursuant to the ITSA when leaving the group.

New International Dealings Schedule for financial services

The IDS-FS is the ATO's proposed new tax return schedule for large (> $250m turnover) financial services taxpayers. It would replace the Schedule 25A and Thin Capitalisation Schedule, and provides considerable additional information in relation to financial arrangements. This schedule will be optional for taxpayers in the 2010 income year and compulsory for the 2011 income year. The IDS-FS includes additional questions that will provide an additional insight into cross-border related party transactions. This information will be of potential interest to both financial services businesses and the ATO alike when considering apportionment, reverse charge, RITCs and associated party transactions.

ATO compliance plan for the financial services industry

The ATO's compliance activities in 2009-10 gave rise to over 1,210 compliance audits focusing on integrity of business systems, financial supplies and property transactions. The ATO will continue to focus on these and other specific GST issues in the financial services industry during 2010-11.

Of particular focus will be the potential for over-claiming of GST credits through a failure to appropriately identify and link acquisitions (solely or partly) to the making of financial supplies, or through an application of inappropriate apportionment methods. The ATO notes that the tendency for over-claiming GST credits is most common in large businesses that engage or operate in:

- capital raising activities (for example, initial public offerings, mergers and acquisitions, rights issues and share buy backs)
- managed funds or superannuation funds
- hire purchase transactions
- credit card issuing activities, and
- securitisation arrangements.

With regards to small and medium businesses making financial supplies,

the ATO is concerned about merger and acquisition transactions adopting non-commercial arrangements, as they are likely to result in a claim for additional GST credits which would not otherwise be claimed. Issues in relation to such arrangements have recently been on the ATO's radar as noted in a taxpayer alert outlining these concerns (TA 2010/1).

The compliance program also continues to emphasise the ATO's focus on systems and controls. In October 2008, the ATO published *GST and integrity of business systems*, which includes some useful insights including a case study on a financial services company. The ATO has identified that the main risks for GST accounting occur where the business is going through significant change, including changes to key personnel responsible for the BAS, systems changes and merger/acquisition activity. The document is a must-read for those businesses preparing for future GST risk reviews and/or audits. A copy of the document can be found by clicking here < http://www.ato.gov.au/businesses/content.asp?doc=/content/00215488.htm >

Following this publication, the ATO stressed in its compliance program that it will continue to examine internal controls and systems. We expect significant audit activity to be conducted in relation to specific systems and processes. Many taxpayers have already reported seeing elements by way of targeted GST risk reviews by the ATO associated with integrity of business systems.

Insurance update

In recent months there have been a few important developments for the general insurance industry as follows:

- ATO staff changes – the ATO GST Insurance Compliance team has lost some experienced team members to the ATO's increased compliance activity in the cash economy. We understand the ATO is recruiting for new team members into the Insurance team.
- The ATO's compliance activity in the general insurance industry has increased with a campaign concerning issues specific to the Compulsory Third Party (CTP) Insurance market. This largely impacted CTP insurers in NSW and Queensland and has resulted in varying outcomes for impacted taxpayers. In most cases, prospective changes to systems and/or processes are being contemplated by affected insurers.
- Legislative interpretation developments – the case concerning the Victorian Department of Transport[3] has provided some interesting insights into an issue that has been at the centre of many insurance claims scenarios since 2000. Please refer to the article below.

Cases & rulings update

Recent rulings

The ATO has released draft GST ruling GSTR 2010/D1: interest-free loans received by the developer of a retirement village. The ruling clarifies the Commissioner's view that the entire sale price of a retirement village (including assumed resident liabilities) will be subject to GST where it is sold as new residential premises.

Travelex

The High Court granted the taxpayer in Travelex special leave to appeal on 12 March 2010. This appeal was heard in Canberra on 21 May, with judgment reserved, and no indication of when that judgment may be handed down.

3. Commissioner of Taxation v Secretary to the Department of Transport (Victoria) [2010] FCAFC 84

The Commissioner was represented at the hearing by Stephen Gageler SC, the Commonwealth Solicitor-General, reflecting the importance being placed on the case, which will be the first High Court decision to consider the GST-free rules in Division 38-190, as well as the complex interaction of these rules with the financial supply regulations.

American Express International Inc v Commissioner of Taxation – Full Federal Court

Following the decision last year, the Full Federal Court heard an appeal by the taxpayer in November 2009. This case considered whether payments made by credit card and charge card holders following default on their accounts are consideration for a financial supply and also raised some interesting comments regarding the application of the penalties provisions. A decision has been reserved until further notice.

AAT considers anti-avoidance and the single entity concept

The Administrative Appeals Tribunal (AAT) recently released a decision[4] which considered in detail the GST anti-avoidance provisions. The AAT rejected the Commissioner's assertion that a GST group should be treated as a single entity, and that intra-GST group transactions should be ignored.

In relation to the GST anti-avoidance provisions, the AAT considered the relevant factors used in determining whether obtaining a GST benefit was the 'dominant purpose' or 'principal effect' of entering into a 'scheme'. In this case, the AAT held that a GST benefit may be obtained if an arrangement did not ultimately satisfy the commercial justifications for entry into that arrangement, and confirmed that GST benefits obtained by elections made under the GST Act would not be excluded from the anti-avoidance provisions if the arrangement was structured to take advantage of those elections.

In seeking to deny a GST benefit obtained by the taxpayer arising from an intra-GST group asset transfer, the Commissioner asserted that intra-GST group transactions should be ignored and that a GST group should be treated as a single entity. The AAT referred to the GST Act's "piecemeal approach to intra-GST group matters" in considering the Commissioner's arguments and decided that, with the exception of specific amendments, the GST Act did not construe a single entity in that manner. Accordingly, the AAT found that transactions between intra-GST group members should generally be separately considered.

Given the increased scrutiny on transactions and structuring arrangements by the Commissioner, consideration should be given to the relevance of any structuring or transactions and the timing of creating GST groups or adding group members which may otherwise fall within the ambit of the GST anti-avoidance provisions. Further, the AAT's comments regarding intra-GST group supplies may also have broader implications in respect of principles supporting GST apportionment methodologies and group recovery rates.

Full Federal Court decision in favour of the Department of Transport (Victoria)

On appeal from the Federal Court, the Full Federal Court of Australia recently handed down its decision in the multi-party case *Commissioner of Taxation v Secretary to the Department of Transport (Victoria) [2010] FCAFC 84*. This decision will be of interest to financial services businesses as it considers the input tax credit position in multi-party arrangements and in the B2B insurance sector where the ATO's policy is set out in GSTR 2006/10.

The case concerned subsidies paid by the Department of Transport (DoT) to taxi operators which provided services to Multi Purpose Taxi Program (MPTP) members, namely certain Victorian residents with disabilities.

The Commissioner rejected the DoT's claim for input tax credits in respect of the subsidies paid by the DoT to taxi operators under the MPTP program, on the basis the there was no supply made to the DoT. Following the DoT's objection, the Federal Court found in favour of the DoT, holding that there was a supply (namely the supply of the carriage of a relevant MPTP member) which was made both to the MPTP member and also to the DoT. Therefore, the Court held the Commissioner was incorrect in rejecting the DoT's input tax credit claim.

Grounds of appeal

The Commissioner did not contest that taxi operators make supplies to the DoT, eg taxi cab operators performing obligations under their taxi cab licences in return for the DoT granting the taxi licence. However, in the case of the subsidies paid to the taxi operators under the MPTP program, the Commissioner argued that there was no supply to the DoT.

4. The Taxpayer and Commissioner of Taxation [2010] AATA 497

The Commissioner argued, as he did before the primary judge, that there is only one supply of services: the supply of carriage of the passenger – a supply made to the MPTP member and not the DoT.

Full Federal Court decision for the taxpayer

A majority of the Full Federal Court upheld the primary judge's decision that there is, in fact, a supply made to the DoT for which the DoT is entitled to claim an input tax credit. The majority of the Full Federal Court rejected the Commissioner's arguments on the basis that:

1. The supply of transport services, ie the carriage of a MPTP member, is made both to the MPTP member **and** to the DoT, and the DoT is liable to make payment under the MPTP program.
2. The payment is **not** connected with an earlier acquisition made by the DoT when granting taxi cab licences. Instead, the payment **is** consideration for the supply of transport services which are acquired by the DoT in fulfilling its obligations under the Transport Act.

In forming the decision, the majority of the Court made the point that section 9-5 of the GST Act, which deals with taxable supplies, should be interpreted from the supplier's perspective.

The dissenting judge commented that whether a party assumes liability for a payment does not necessarily mean the party has to receive something in return. Particularly in circumstances where government entities make payments giving effect to social welfare policies, it would not be unnatural to conclude that there is nothing received in return. The dissenting judge thus concluded that payment of the subsidy was more analogous to a third party payment.

Implications

This case has provided some interesting insights into an issue that has been at the centre of many insurance claims scenarios since 2000. That is, who is the recipient of a supply of goods and services that are supplied by a third party to the insurer/insured party as part of an insurance claims settlement?

Given the ATO has issued a ruling on this matter (GST Ruling GSTR 2006/10), it will be interesting to note the nature and extent of the ATO comments in any Decision Impact Statement regarding the case. The ATO may consider that the outcome of the case will impact their previously stated position in GSTR 2006/10. In our view, subject to whether special leave is sought for an appeal to the High Court, the case has some important impacts for the general insurance and health insurance industry, such as the need to reconsider the appropriateness of wording in claims procurement contracts. A timely review of operational procedures in relation to claims fulfilment should also be considered, along with the need to consider whether the potential implications create opportunity or risk for individual insurers. This will depend on the nature of the insurance product and the GST registration status of insured customers.

International financial services VAT developments

There have been a number of rate changes and proposed rate changes since the last edition of GSTFS as governments around the world look to reduce budget deficits.

New Zealand

Closest to home, the GST rate will increase as part of a wider reform of New Zealand's tax system. The new GST rate with effect from 1 October 2010 will be 15 per cent, up from 12.5 per cent.

Australian financial services businesses with operations in New Zealand and with oversight for New Zealand GST accounting will need to consider the specific challenges and opportunities below. Please speak to your usual PwC GST contact who can put you in touch with a GST specialist in our global network firm PwC New Zealand.

Industry specific challenges and opportunities

Financial services providers

Financial services providers, or others who are unable to fully recover GST on costs, may suffer an increase in their cost base if vendors raise prices to pass on the higher rate. This could affect product pricing and fees. There may be an economic benefit where, for commercial reasons, significant costs are paid prior to any rate increase taking effect. Opportunities may arise for financial institutions from any increase in consumer activity (eg higher demand for borrowing via credit cards, hire purchase financing and similar).

Insurers

An increased GST rate should be neutral in the context of settlements where both the insurer and the insured are GST registered (ie the insurer claims a GST deduction and the insured accounts for GST). However, there could be GST mismatches for insurers when a payout under a policy occurs prior to a rate increase but a subrogation payment is not received until after the increase. Insurers will need to review the pricing of policies to determine whether a rate increase can and should be passed on, including any 'mixed' policies where the insured pays a lump sum premium covering both taxable and exempt components.

ECJ cases

Input VAT recovery possible on sale of shares in a subsidiary: AB SKF (C-29/08)

In its decision, the ECJ has ruled that:

- Share disposals are transactions within the scope of VAT and constitute an economic activity.
- Share disposals are covered by the VAT exemption (Art.135(1)(f) of the VAT Directive).
- There is no right to deduct the input VAT related to share disposals unless the input VAT incurred is a cost component of the underlying economic activity, in which case the recovery will be according to the VAT recovery position the head company.
- The transactions could qualify as a Transfer of a Going Concern (TOGC) and, if so, they do not constitute supplies for VAT purposes and any input VAT will be recoverable according to the pro-rata percentage. The ECJ also ruled that the VAT treatment as stated above is not affected where the disposal takes place in stages. The ECJ concluded that the disposal of the shares is an exempt supply and associated input VAT is irrecoverable unless the input VAT is a cost component of the underlying economic activity or it can qualify as a TOGC.

Actions

Any business involved in such offshore transactions should call their VAT adviser to discuss the implications of this case to the circumstances, in particular:

- the possibility of treating the costs associated with the transaction/s as a cost component of the economic activities of the seller so that the VAT may be recoverable (in accordance with the VAT position of the business)
- the potential application of the TOGC provisions so that the transaction may be treated as outside the scope of VAT with VAT recovery at the pro-rata percentage rate of the vendor
- the impact share sales will have on the pro-rata percentage of the vendor, and
- the possibility of applying this decision retrospectively, where applicable, to the extent that VAT recovery was previously denied.

Sale of reinsurance contracts not covered by VAT exemption: Swiss Re(C - 242/08)

This case concerned the transfer of reinsurance contracts from a German company to an affiliated Swiss company. The ECJ was asked to consider whether the transaction was subject to German VAT.

Decision

In its decision, the ECJ has ruled that:

- The sale of reinsurance contracts is not a VAT-exempt banking, insurance or reinsurance transaction.
- The sale of reinsurance contracts is not a VAT-exempt supply of assumption of obligations together with a transaction concerning debts.
- The ECJ also ruled that the transaction is a supply of services and not a supply of goods and that the VAT treatment in this case is not affected by the fact that some of the contracts had a negative value.
- The ECJ concluded, therefore, that since no exemption can apply, the sale of the contracts is a taxable supply. The place of supply of the taxable transaction is not specifically addressed by the ECJ but in the absence of evidence that the place of supply is shifted to the recipient, the basic rule is assumed whereby

the transaction is a taxable supply in Germany, on which German VAT is due.

Actions

Any business which has entered or intends to enter into a similar offshore transaction should call their VAT adviser to discuss:

- the potential application of the TOGC provisions so that the transaction may be treated as outside the scope of VAT, and
- the review of existing sale agreements in case VAT now becomes due on the sale.

Any business which has entered into a transaction involving the transfer of contracts (not necessarily insurance contracts) should also consider the above implications and actions.

Indonesia

The new VAT law which constitutes the third amendment to the 1983 VAT law came into force on 1 April 2010. The main change relevant to financial services covered in the new VAT law is that services such as traditional banking services (fund raising and placement), underwriting and financing services including shariah-based financing (leasing with option, factoring, credit card, and consumer financing) are specified as non-taxable services.

Luxembourg

Tax authorities issue interpretation of scope of VAT exemption for fund management services

In a circular dated 30 April 2010, the Luxembourg VAT Authorities specify their interpretation of the application of the VAT exemption for fund management services, particularly where individual activities are outsourced. The new Circular emphasises that, in the context of fund management services outsourced to third-party managers, outsourcing only one ‘isolated’ type of service remains outside the scope of the VAT exemption. The new Circular clarifies that the existence of a ‘whole combination of services’ implies that the outsourcing of one single type of service should be excluded from the scope of the exemption.

Luxembourg VAT Authorities have confirmed that positions taken in the past will not be challenged. The investment fund industry should stay alert to possible questions arising from the Luxembourg VAT authorities in respect of outsourced fund management services in the future. Reorganisations, outsourcing and changes in services flow should be carefully reviewed from a VAT perspective before implementation to ensure fiscal neutrality.

Switzerland

New Swiss VAT Law and Swiss VAT Ordinance entered into force on 1 January 2010

The new Swiss VAT Law, which entered into force as of 1 January 2010, offers several opportunities and reliefs. A number of these are set out below:

- A liability to tax arises when business activity begins and is no longer linked with options for start-ups.
- The provisions relating to the place of supply of services have been adapted to the EU VAT Package rules.
- Input tax recovery is to be reduced only on the basis of exempt turnover without credit and the receipt of subventions. Donations, dividends and other non-turnover revenue will no longer limit input tax recovery.
- Holding companies now receive extensive input tax recovery opportunities and input tax recovery for investments which can be claimed in the course of business activity.
- Excise duty will now be imposed on electricity, except where electricity is produced by renewable energy sources for own use.
- Special luxury tax will be imposed on cars, jewellery, precious stones and pearls, leather products, furs and fur products.

Financial institutions with a Swiss branch should be aware of new Swiss VAT Law

Under the new Swiss VAT Law, the place of business in Switzerland and all domestic permanent establishments together represent a single entity for tax purposes. This means that if the head office and the branch of the company are both located in Switzerland, the ‘single entity principle’ applies and the transactions between two parts of the company are considered as purely cost allocations that are irrelevant for VAT purposes. However, where either the head office or the branch of a company is located in Switzerland and the other abroad, the two parts of the company are treated as two different entities for Swiss VAT purposes (separate-entities principle). In that case, any activities carried out by the branch or the head office for the benefit of the other party qualify as supplies for Swiss VAT, as if the transactions were carried out between two independent parties.

This concept is clearly different from the EU's single-entity principle which applies in domestic and cross border situations. Accordingly, due to the system of the separate-entities principle, the establishment of a branch in Switzerland can lead to double non-taxation in international scenarios.

United Kingdom

UK Increases IPT & VAT Rates

Finance (No. 2) Bill 2010 was published on 1 July 2010. The indirect tax measures are limited to:

- increasing the standard rate of VAT to 20 per cent with effect from 4 January 2011
- 'anti-forestalling' legislation aimed at ensuring that the appropriate VAT rate applies to supplies spanning the change in the standard rate, and
- increasing the insurance premium tax (IPT) standard rate to six per cent and higher rate to 20 per cent from the same date.

Further information

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