

GST and Financiers - some thoughts and implications

Andrew Boxall

Allen Allen & Hemsley

Sydney

Banking Law Association Conference

June 1999

GST and Financiers: some thoughts and implications

1. Introduction

1.1 Purpose

The purpose of this paper is threefold:

- (a) To outline briefly the essential features and operation of the goods and services tax which appears increasingly likely to be introduced in Australia in July 2000.
- (b) To identify its general effect on financial institutions.
- (c) To comment on its application to a number of common financial transactions.

In this paper, the goods and services tax will be referred to as the *GST*, and the principal piece of legislation by which it is to be introduced, the *A New Tax System (Goods and Services Tax) Bill 1998*, will be referred to as the *GST Bill*.

2. Essential features of the GST

2.1 General Nature

The starting point in any consideration of GST is to appreciate that it is a tax which is very different from any other form of taxation with which we have previously been familiar in this country. It is not a tax on income, or revenues, or on documents or even, as its name might imply, on goods or services strictly speaking. Rather, it is a tax on incremental economic value added at each stage in the course of the productive process.

2.2 Value Added

This essential feature is recognised by the name under which similar taxes are known in other countries: in the United Kingdom it is known as *value added tax*, whilst in France it is called, with commendable bluntness, *tva* or *taxe sur la valeur ajoutée*, which translates directly as *tax on value added*. We have adopted the perhaps politically more palatable (although conceptually somewhat misleading) title of *goods and services tax*. The leading United Kingdom text on value added tax¹ provides the following general definition:

.... *A tax on the value which traders add to their purchases of raw materials, goods and services*²

which identifies the essential elements of GST as much as United Kingdom value added tax:: it is a tax on

- value added
- by traders
- which relates to goods and services.

2.3 Isolation of value added

The isolation and taxation of value added is implemented by:

- imposing GST on the value of supplies of goods, services and other things made by a trader (*output tax*)
- identifying GST already paid on inputs of goods, services and other things acquired by the trader for purposes of making those supplies (*input tax*)
- requiring the trader to account to the taxation authorities for the difference.

This process can be summarised as follows:

$$tVA = tO - tI$$

where:

t is the rate of GST

VA is the value added by a trader at a particular stage of the economic process

O is the value of outputs made by the trader at that stage in the economic process

I is the value of all inputs acquired by the trader in order to make those outputs.

¹ De Voil Indirect Tax Service, Butterworths, London, 1999

² *op cit*, p1103.

This is the system adopted by the GST Bill.

3. The GST Bill

3.1 The essential architecture of GST is found in Part 2-1, Division 7 of the GST Bill. This division establishes a number of basic propositions concerning the imposition and calculation of GST, which are elaborated on in the rest of the GST Bill.

3.2 These propositions are as follows:

- (a) Proposition 1: GST is payable on *taxable supplies* and *taxable importations*: c7-1(1).
- (b) Proposition 2: Input tax credits arise on *creditable acquisitions* and *creditable importations*: c7-1(2).
- (c) Proposition 3: Every *entity* which is *registered* (or is *required to be registered*) registered for GST purposes has tax periods applicable to it: c7-10.
- (d) Proposition 4: Amounts of GST for a tax period are set off against input tax credits for that tax period: c7-5.
- (e) Proposition 5: The net amount which results from setting off GST for a tax period against input tax credits for that tax period is, if positive, the amount payable by the entity to the Commonwealth by way of GST for that tax period, and, if negative, the amount refundable to the entity by the Commonwealth for that tax period: c7-15.

These five propositions represent the legislative implementation of the general principles of isolation and taxation of added value described above.

The main defined terms incorporated in these propositions, which are central concepts to understanding GST, are discussed below, other than those relating to imports. This paper will not deal with the application of GST to imports, or the concepts of *taxable importation* or *creditable importation*, other than to note that:

- (a) GST is generally payable in relation to imports of goods only; but
- (b) In some cases, an Australian who acquires services or other intangibles offshore may be required to account for GST on the value of the services or intangibles.

3.3 Taxable supplies

A *taxable supply* [c9-5] is a *supply* [c9-10] which is made for *consideration* [c9-15] in the course of an *enterprise* [c9-20] *carried on* [c195-1] by a person who is *registered* or *required to be registered* for GST purposes [Division 23] where the supply:

- is connected with Australia [c9-25], and

- is not GST *free* [Division 38] or *input taxed* [Division 40].

3.4 Creditable Acquisitions

A *creditable acquisition* [c11-5] is the corollary of a *taxable supply*. It is an *acquisition* [c11-10] for *consideration* [c9-15] by a person who is *registered or required to be registered* for GST purposes [Division 23] where the supply:

- *is a taxable supply [c9-5] to the acquirer, and*
- *is acquired for a purpose which is, in whole or in part, a creditable purpose [c11-15].*

A thing is acquired for a *creditable purpose* [c11-15] to the extent that it is acquired in *carrying on* [c195-1] the acquirer's *enterprise* [c9-20], and is not acquired for the purpose of making *input taxed* [Division 40] supplies or that the acquisition is not of a *private or domestic nature*.

3.5 Some comments on definitions

The definitions are complex, and often encompass concepts and circumstances which go far beyond the traditional legal meaning of the relevant term:

- (a) Consideration includes not payments, acts and forbearances made in connection with or as an inducement for the supply of anything, which covers the traditional contractual concept of consideration, but also:
 - (i) payments, acts and forbearances made in response to a supply, which clearly extends the concept to past consideration; and
 - (ii) payments, acts and forbearances which are voluntary (and thus outside the contractual concept of consideration).
- (b) An enterprise is not merely a business [c195-1, which includes any profession or trade] or an adventure or concern in the nature of trade, but extends to include the ongoing provision of rights under leases, licences and other arrangements for the provision of property, but also the activities of Commonwealth, state or territory governments or bodies corporate. It does not, however, extend to the provision of services by employees or individual acts of charity.
- (c) Supplies are made or acquired in the course of carrying on an enterprise even if they are made for the purpose of commencing or terminating an enterprise. So, it follows, the liquidator of a company is considered as carrying on the company's enterprise even as he disposes of the company's assets in the course of liquidating the company.
- (d) A supply is connected with Australia if, for example:

- in the case of supplies of goods, the goods are delivered, made available, assembled or imported in or into Australia by the supplier;
 - in the case of supplies of real property, the real property is located in Australia; and
 - in other cases, such as supplies of services or other intangibles, the thing supplied is done in Australia or through an enterprise carried on in Australia by the supplier.
- (e) A supply is GST-free if it is designated accordingly in Division 38 of the GST Bill. Examples are supplies of certain health and education services, exports from Australia of goods and certain supplies of intangibles: for example, supplies of services to persons outside Australia for use outside Australia. If a supply is GST free, no output tax is chargeable in respect of it, but input tax credits may be claimed for GST charged on creditable acquisitions of things acquired for the purpose of making the supply. The net result is that input GST incurred by a person making GST free supplies is in effect repaid to the person by the Commonwealth.
- (f) A supply is input taxed if it is designated accordingly in Division 40 of the GST Bill. Examples are sales or leases residential accommodation, and financial supplies. The concept of financial supply will be explored in more detail below. If a supply is input taxed, no output tax is chargeable in respect of it, and, unlike the position in relation to GST free supplies, no input tax credits may be claimed for GST charged on acquisitions of things acquired for the purpose of making the supply. The net result is that input GST incurred by a person making input taxed supplies is in effect a business expense of the person.
- (g) The principles developed in relation to [ITAA 1936/1997] are likely to apply in determining whether a particular acquisition is of a private or domestic nature.

3.6 Supply

- (a) Central to the operation of the GST is the concept of *supply*, and its reciprocal concept of *acquisition*:
- (b) A *supply* is [c9-10(1)] ... *any form of supply whatsoever*. This includes [c9-10(2)] not only supplies of goods or services, as the name of the GST might suggest, but also the provision of advice or information, the grant or assignment of real property, and financial supplies [see 5 below]. Interestingly, it also includes ... *a creation, grant, transfer, assignment or surrender of any right ...*, the ... *entry into, or release from an obligation ...* and any combination of circumstances falling within any two or more of the various enumerated categories of supply.
- (c) Hence, even the simplest of transactions – say, the purchase and sale of goods – entails no less than three supplies and a corresponding number of acquisitions:

- (i) the supply by the purchaser to the vendor of a bundle of rights, namely the rights of the vendor against the purchaser under the contract formed between them for the purchase and sale of the goods;
 - (ii) the supply by the vendor to the purchaser of a bundle of rights, namely the rights of the purchaser against the vendor under the contract formed between them for the purchase and sale of the goods; and
 - (iii) the supply of the goods on completion of the contract.
 - (iv) Payment of the purchase price by the purchaser is not a supply, since c9-10(2) provides that a supply of money (which includes payment of the purchase price) is not a supply, unless the money is supplied ... *as consideration for a supply that is a supply of money*: payment of interest on a loan is therefore a supply, but payment of the purchase price for goods is not.
- (d) Without more, the result of all this would be to require the transaction to be analysed for GST purposes in the same way as, following the High Court's decision in *Orica Ltd v FCT*³. In that case, the High Court took the view that a single commercial transaction which was implemented by means of a series of contracts should not be analysed for capital gains tax purposes as a single transaction, the capital gains tax consequences should be determined on a consolidated basis. Rather, in the majority's view, the wider commercial transaction should be dissected into a series of acquisitions and disposals of contractual rights, each of which must be treated for capital gains tax purposes as a separate disposal of property and taxed accordingly. The consequences of adopting such an approach for GST purposes would be horrific, by requiring even the simplest of transactions to be broken down into (and taxed as) a series of acquisitions and supplies.
- (e) Clause 9-10(3) of the GST Bill appears to be an attempt to avoid this result. The clause applies where there is granted ... *a right or option to acquire a thing*..., and its effectiveness in achieving its apparent objective depends on the word *acquire* in c9-10(3) having the meaning which corresponds to that given to *acquisition* in c11-10. This approach is supported by normal principles of statutory interpretation⁴. Accordingly, the concept of a right to acquire a thing should be read as extending not merely to acquisition in its ordinary meaning, but to acquisition in the sense used in the GST Bill, as the reciprocal concept to that of supply. The result is that the provisions of c9-10(3) extend not merely to transactions, such as the purchase and sale of goods or real property, which fall within the ordinary

³ (1998) 98 ATC 4494

⁴ See, for example, *Registrar of Titles v Franzon & Finance Corporation of Australia* (1975) 132 CLR 611, at 618 per Mason J.

concept of acquisition, but also to transactions which entail the wider statutory concept of acquisition, such as entry into or release from obligations.

- (f) The effect of clause 9-10(3) is thus to require a single economic transaction comprising a number of supplies, some of which are supplies of contractual rights to acquire or supply the commercial subject matter of the transaction, to be dissected for GST purposes into multiple transactions only if a separate consideration can be identified for the various elements of the transaction. This would be the case if the transaction entailed the grant of an option to acquire the goods followed by a separate exercise of the option.

4. The Financier's Dilemma

- 4.1 In the normal course of making taxable supplies, the effect of the system of taxation of incremental value established under the GST Bill is, if a supplier of goods, services or things chooses to do so, to pass on to the ultimate consumer of those goods, services or things the full amount of GST payable. Attachment 1 illustrates with a simple example⁵.
- 4.2 Where a supplier of goods, services or things makes input taxed supplies, however, the effect of the GST Bill is to treat the supplier for GST purposes as the ultimate consumer of supplies of goods, services and things acquired by it for purposes of its business of making input taxed supplies. It can claim no GST input credits in respect of GST charged to it on acquisitions made by it for purposes of its business, since it does not charge GST on supplies made by it. Attachment 2 provides an example. Any increased cost for it resulting from the imposition of GST can be passed on by it only as an increase in the price of the goods, services or things which it supplies.
- 4.3 As indicated in 3.5(f), financial supplies are input taxed. The precise extent of financial supplies is discussed in 5 below, but the broad consequence is that a financial institution will incur GST on taxable supplies acquired by it for purposes of its financial business, such as rental premises, computer equipment and consumables, and professional advice, but it will only be able:
- (a) to obtain input tax credits in respect of that GST to the extent that its business includes the making of taxable supplies to customers; and
 - (b) to pass the GST paid by it on to its customers as an increase in the price charged by it to customers for financial supplies, not as GST on taxable supplies made to (and creditable acquisitions made by) the customers.
- 4.4 Of particular concern here are disbursements and out-of-pocket expenses incurred by the financial institution, such as external lawyers' or valuers' fees.

⁵ This example is taken from the Commonwealth Government's 1998 publication entitled [A New Tax System].

In the example in Annexure 2, the fees of \$1000 plus \$100 GST charged by XYZ Solicitors to the bank will be passed on to the bank's customer for payment, not as a total of \$1100, of which \$100 is creditable input GST, but rather as a total of \$1100, none of which carries any GST credit. The obvious consequence will be:

- (a) to make more attractive the provision of legal and other services by banks' in-house professionals; and
- (b) to encourage attempts to develop retainer arrangements which allow banks' advisers to provide advice exclusively to the bank, whilst being retained by and billing directly the banks' customer.

4.5 A further consequence will be to penalise financial institutions which outsource functions, because they will be charged irrecoverable GST by the providers of outsourced functions, whilst rewarding institutions which do not outsource. The agreement between the Commonwealth Government and the Australian Democrats in relation to the New Tax System legislation contemplates some liberalisation of this position, by treating some outsourced functions as GST-free supplies⁶. The detail of this proposal, and in particular the list of services in respect of which partial input credits are contemplated, was unavailable at the time of writing.

Any increase in the pricing of financial services which is designed to compensate the providers of financial services for the cost of being unable to obtain credits in relation to input tax paid on acquisitions by them of goods and services will be subject to review by the Australian Competition and Consumer Commission (ACCC) under the proposed new Part VB of the Trade Practices Act 1974, which is comprised in the *A New Tax System (Trade Practices Amendment) Bill 1998*. Part VB, to be entitled *Price exploitation in relation to A New Tax System*, restricts price exploitation in relation to *regulated supplies*, which are defined, relevantly, as taxable supplies or supplies which would be taxable supplies if they were not input taxed. Financial supplies clearly fall within the scope of regulated supplies. Whether a particular price increase amounts to price exploitation will be determined in by reference to two questions:

- (a) The threshold question, which is whether the price for the supply is unreasonably high, having regard alone to the effects of the New Tax System; and
- (b) If the answer to threshold question is yes, are there other circumstances – supply and demand conditions, for example – which to which the price increase is attributable?

⁶ The Prime Minister's letter of 28 May 1999 to Senator Meg Lees has attached to it a summary of various changes. One of the changes summarised in the letter is the following:

A partial input tax credit will be provided for the purchase of a specified list of services used to make financial supplies. The partial credit rate will be set to ensure that there is no bias between insourcing and outsourcing a listed service. This measure will particularly benefit smaller organisations in the financial sector like credit unions, which operate with a large range of outsourced activities.

The ACCC is to formulate guidelines for its implementation of Part VB.

5. What are financial supplies?

5.1 It is clearly of fundamental importance to identify what are financial supplies. This part of the paper will address this issue. Clause 40-5(2) of the Bill lists 13 Items of supply which are to be treated as financial supplies. This paper comments on items 1 to 8 (inclusive). A subsequent paper comments on items 9 to 13.

5.2 Item 1

The creation, issue, transfer, assignment or receipt of, or any other dealing with, money including:

- (a) lending or borrowing money; and
- (b) creating or transferring a debt or an interest in a debt; and
- (c) making any advance or granting any credit.

Several comments can be made:

- (a) The word money is defined in Clause 195-1. Not only does it include, as one might expect, both Australian and foreign currency and currency notes and coins, but it also includes:
 - (i) promissory notes and bills of exchange; and
 - (ii) *...whatever is supplied as payment by way of ... credit card or debit card; ... crediting or debiting an account; or creation or transfer of a debt.*
- (b) By including account entries in the extended definition of money, the GST Bill seeks to avoid in relation to GST the conceptual difficulties which have sometimes accompanied attempts to apply remedies and concepts developed in relation to dealings with specie to the more complex and sophisticated environment of dealings with account balances⁷.
- (c) Transactions such as bill acceptance and discount facilities and receivables factoring are clearly financial supplies which fall within this category, as are to loan and similar facilities.
- (d) The reference to *..granting any credit ..* raises an issue. Do suppliers of goods and services who allow their customers to defer payment grant credit? Is there a difference between, on the one hand, a supplier whose normal trading terms require payment within, say, 30 days of delivery and, on the other, a supplier who allows instalment payment

⁷ The oxymoronic notion of a "pledge over deposit" is an example.

in consideration of interest? A European Court of Justice decision⁸ suggests that the granting of credit includes the deferral of payment of instalments of purchase price, in circumstances where the supplier charges interest.

- (e) The question is an important one, since the extent to which a trader which is not a financial institution can obtain input credits depends, in turn, on the extent to which its business activities include, in addition to its normal non-financial business, the making of financial supplies: clause 11-30(2). In summary, a trader's ability to recover in full input GST will be reduced if its annual turnover of financial supplies exceeds the lesser of \$50,000 and 5% of total turnover. If it is the provision of credit to allow under normal trading terms customers to settle within a fixed period after delivery, then virtually all traders will necessarily be making financial supplies, and thus potentially subject to limitation on the full recovery of input GST.

5.3 Item 2

The creation, keeping or closing of a savings account, cheque account or deposit account.

This item appears self explanatory.

5.4 Item 3

The creation, issue, transfer, assignment or receipt of, or any other dealing with, a security for a debt (including a guarantee or indemnity), but not if the security is a lease, licence or other similar arrangement in respect of real property.

This is perhaps the most troublesome of the items:

- (a) The word *security* has several quite distinct meanings⁹.
- (b) In some circumstances, it means an interest in property conferred on a creditor, entitling the creditor to satisfy the indebtedness out of that property. The addition of the words ... *(including a guarantee or indemnity)* ..., which are clearly intended to expand the meaning of *security*, suggest that c40-5 proceeds on the basis that this is one at least of the meanings of the word for GST purposes, and seeks to expand the types of transactions covered by security to include, not only security in the form of interests in property, but also contractual undertakings on the part of sureties, not entailing the creation of interests in property, which are collateral to and supportive of an obligor's financial obligation.
- (c) In others, it has a wider meaning, as the instrument from which an obligation to pay moneys originates, rather than one which is supportive of a payment obligation. Consider, for example, the

⁸ Case C-281/91: *Muys'en De Winter's Bouw-en Aannemingsbedrijf BV v Staatssecretaris van Financien* [1997] STC 665, ECJ

⁹ See, for example, Everett & McCracken, *Financial Institutions Law*, LBC Sydney, 4th edition, paragraph 902.

comments of Lee J in *Broad v Commissioner of Stamp Duties*¹⁰, where His Honour observed that:

- (d) *In a proper context an instrument, may constitute a security even though it is not collateral or ancillary to any other document but itself creates the obligation.*
- (e) In a variant on the second meaning, the expression *security* or *debt security* is also used, especially in the context of the stock or capital markets, to refer to instruments which are available to be dealt with on the relevant market.
- (f) All three usages appear to be contemplated by Item 3. The generally similar provisions of the UK legislation have been held to cover certificates of deposit¹¹ and non-negotiable bonds¹²
- (g) Item 3, however, may go further. The addition at its end of the words ... *but not if the security is a lease, licence or other similar arrangement in respect of real property* raises difficult questions:
 - (i) Do those words qualify the word *security* when used in the first, narrower meaning described in (b) above? If so, the result is the somewhat arbitrary and eccentric exclusion from the category of input taxed financial supplies of mortgages over leasehold interests which are effected by the method of taking a sub-lease by way of mortgage?
 - (ii) Do they, on the other hand, qualify the second and wider meaning of *security*, by suggesting that a lease of real property is an example of a security within the meaning of Item 3 but is expressly excluded?
- (h) The latter certainly appears the better construction, but if correct it raises the spectre of Item 3 having a meaning akin to the expression ... *instruments of security of any other kind* ... in Item 13 of the Second Schedule to the Western Australian Stamps Act. The Western Australian legislation imposes duty on that broad category of instruments, and was the subject of judicial consideration in *National Mutual Life Nominees Limited v Commissioner of State Taxation*¹³. In that case, the WA Supreme Court held that the expression ... *instruments of security of any other kind* ... extended to include not merely securities in the narrower or wider meanings discussed above, the common element of which is that they both relate to loans or other methods of providing credit, but also an agreement to hire a business.

¹⁰ [1980] 2 NSWLR 40.

¹¹ *Guy Butler (International) Limited v Commissioners of Customs & Excise* [1976] STC 254

¹² *Dyrham Park Country Club v Commissioners of Customs & Excise* [1978] VATTR 224.

¹³ (1991) 91 ATC 4309.

- (i) If this interpretation of Item 3 is correct, then the commercial community faces considerable difficulty in determining the GST implications of a wide range of seemingly simple commercial transactions: Is an agreement for the sale of property with the purchase consideration payable in instalments a *security*? Is an equipment lease? At first sight, one might be inclined to think that the problem is not a major one: if GST is chargeable, then it is charged and claimed back in the process of offsetting input and output tax; if GST is not chargeable, then it is not and both the supplier and the consumer are none the worse off. But this conclusion ignores the effect of c11-30(2)¹⁴, the effect of which is to link the availability to an enterprise of input tax credits to the proportion of financial supplies comprised in its business. If every agreement entered into by a business under which it agrees to make periodic payments is characterised as a debt security for purposes of Item 3, then the availability to many non-financial businesses of input tax credits will be reduced even though they stick to their core, non-financial businesses.

5.5 Item 4

The allotment, issue, transfer, assignment or receipt of, or any other dealing with, a security within the meaning of subsection 92(1) of the Corporations Law (other than paragraph (ca) of that subsection)

- (a) Section 92(1) defines *securities* as meaning, relevantly:
- (a) *debentures, stocks or bonds issued or proposed to be issued by a government; or*
 - (b) *shares in, or debentures of, a body; or*
 - (c) *interests in a managed investment scheme; or*
 - (ca) *in Parts 7.3 to 7.6 (inclusive)-interests that would be interests in a managed investment scheme but for paragraph (b) of the definition of managed investment scheme in section 9; or*
 - (d) *units of such shares; or*
 - (e) *an option contract within the meaning of Chapter 7*
- (b) There is obviously some overlap between Items 3 and 4 in relation to debentures and similar debt securities (if the analysis proposed in relation to Item 3 is correct), and with Items 5 and 7, as to which see below. The fluidity of the various categories in c40-5 is, one might suggest, such that no particular significance should be attached to the overlap in interpreting the various Items. Many common transactions or supplies will fall necessarily within several Items: consider, for example, a promissory note, which falls within Item 1 (in view of paragraph (b) of the definition of *money*), Item 3, as a security for a debt, and Item 4, as *marketable security* within the meaning of the

¹⁴ See 4.3 and 5.1(c) above.

Corporations Law (provided it has a face value of less than \$50,000 and thus falls within the definition of *debenture* in s9 of the Corporations Law).

- (c) A contrast should be drawn between sales of company shares and transfers of businesses as going concerns. If the vendor of a business chooses to dispose of the business by selling the entire share capital which he holds in the company which carries on the business, then the share sale will be a financial supply by reason of Item 13, and will be input taxed: that is to say, no GST need be charged on the sale, but no input tax credits can be claimed by the vendor in respect of supplies – for example, lawyers' or valuers' services – acquired by him in effecting the sale. If, however, the vendor disposes of the business as a going concern, that is to say by selling ... *all of the things that are necessary for the continued operation of ...* the business, then the sale will be GST free. No GST will be chargeable on the sale but, unlike the sale of shares, input tax credits are claimable in respect of the supplies acquired for purposes of the sale. This anomaly is obviously relevant to financiers in relation to the sale of a business when enforcing security¹⁵.

5.6 Item 5

The creation, issue, transfer, assignment or receipt of, or any other dealing with:

- (a) *a unit trust; or*
 (b) *an interest in a unit trust.*

The management of a unit trust.

- (a) The expression *unit trust* has the same meaning as in s202A of the Income Tax Assessment Act 1936, that is to say:

"unit trust" means a trust to which a unit trust scheme relates, and includes:

- (a) *a cash management trust;*
 (b) *a property trust;*
 (c) *an arrangement declared by the Minister, by notice*

published in the Gazette, to be a unit trust for the purposes of this definition; but does not include any arrangement declared by the Minister, by notice published in the Gazette, not to be a unit trust for the purposes of this definition;

"unit trust scheme" means an arrangement made for the purpose, or having the effect, of providing for a person who has funds available for investment, facilities for participation by the

¹⁵ The application of GST to security enforcement is an interesting topic, but beyond the scope of this paper. Those interested should refer to Division 105 of the GST Bill, and the provisions of the *A New Tax System (Goods and Services Tax Administration) Bill 1998* concerning the liability for GST of controllers of insolvents' property.

person, as a beneficiary under a trust, in any profit or income arising from the acquisition, holding, management or disposal of property under the trust.

It appears to cover not merely unit trusts of the traditional kind, but also securitisation trusts.

- (a) The first point to note here is that not merely are dealings with interests in unit trusts financial supplies, and thus input taxed, but so too are the performance of management functions in relation to unit trusts. So, trust managers and responsible entities are likely to find that they are input taxed in relation to their trust management businesses.

5.7 Item 6

The provision, transfer or assignment of a futures contract through a futures exchange.

- (a) On the face of matters, the effect of this Item is clear: dealings with exchange traded options are financial supplies, and accordingly input taxed.
- (b) It raises the question, however, as to the GST treatment of other forms of derivative transactions – in particular, over the counter derivatives.
- (c) On the one hand, any form of cash settled derivative entails mutual payment obligations, and so one might conclude any such arrangement falls within either both of Items 1 and 3. On the other, a derivative under which the subject matter of the contract – assuming that the subject matter is not itself something amounting to a financial supply, such as debt instruments – is deliverable on settlement should carry the same characteristics for GST purposes as the underlying subject matter of the arrangement. If the derivative relates to financial instruments, it will be a financial supply, whether cash settled or settled by delivery of the underlying commodity. If, however, the derivative concerns physical commodities, then one might expect its GST treatment to depend on the applicable settlement mechanism. On this basis, contracts for differences will always be financial supplies, whether the underlying hedge relates to alpaca fleece or the share price index.
- (d) This is not the position which applies in New Zealand, however. In a public ruling issued ¹⁶in 1997, the New Zealand Inland Revenue ruled that an electricity hedge contract, under which:
 - (i) neither party had any obligation to deliver electricity to the other; and

¹⁶ Product Ruling – BR Prd 97/3

- (ii) the parties' sole obligations were to make cash payments to one another, determined by reference to movements in certain electricity prices,

was not a financial supply, and was thus a taxable supply. The Inland Revenue appeared to view as determinant the nature of the commodity by reference to which the payment obligations were determined, rather than the nature of the payment obligations themselves. The New Zealand Government has recently announced¹⁷ a proposal to amend the GST legislation in order to establish a GST regime in relation to hedges and other derivatives along the lines described in (c) above.

5.8 Item 7

The creation, issue, transfer, assignment or receipt of, or any other dealing with, an option or warrant relating to a future supply covered by item 3, 4 or 5.

The comments made in relation to Items 3, 4, 5 and 6 apply here.

5.9 Item 8

An underwriting of a supply covered by any of items 1 to 7 (other than items 2 and 3).

Again, this item requires little comment. One interesting issue, however, concerns the exception for underwritings of supplies of debt securities: Item 3 supplies. There may be some scope here to argue that for a group of banks to underwrite a debt financing will be a taxable supply (and thus both subject to GST and attractive of input tax credits); thus, the use of underwriting commitments may offer greater scope for financiers to pass on to borrowers, in a GST effective (ie creditable) way, the GST incurred by them in arranging financings.

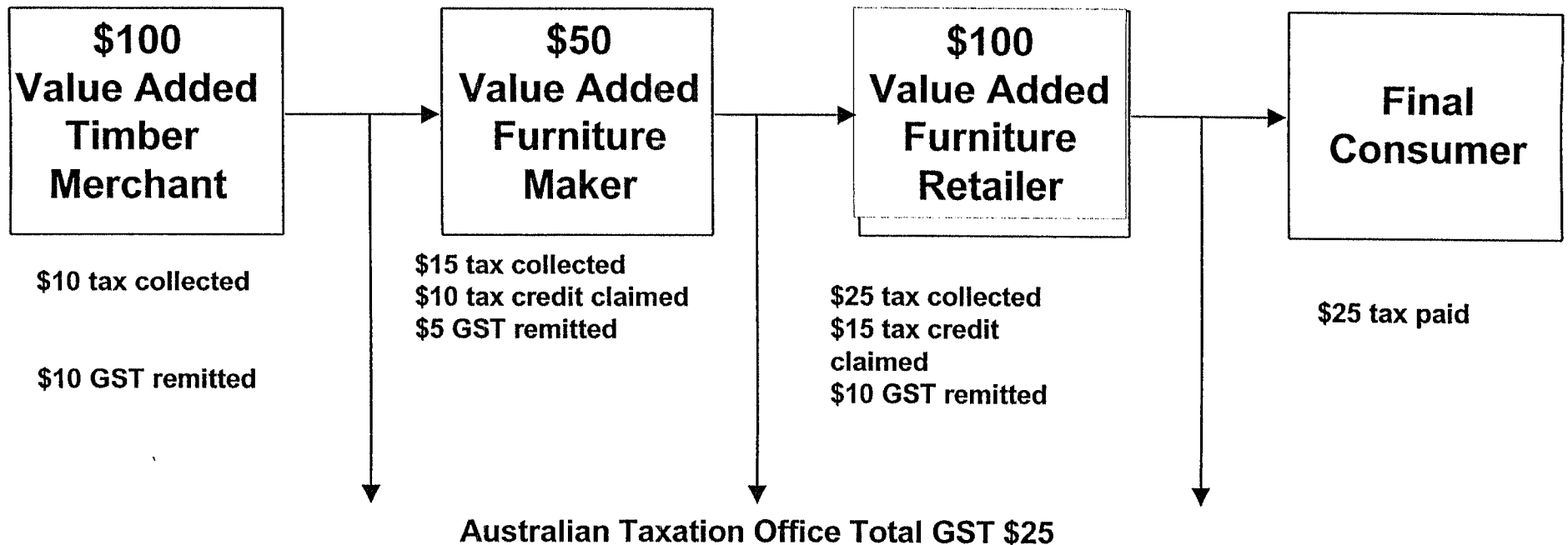
¹⁷ Inland Revenue Department Discussion Paper, March, 1999, Paragraphs 11.20 to 11.24.

HOW WILL THE GST AFFECT A BUSINESS\$?

Selling price \$110
(\$100 value + \$10 tax)

Selling price \$165
(\$150 value + \$15 tax)

Selling Price \$275
(\$250 value + \$25 tax)



HOW GST AFFECTS INPUT TAXED BUSINESS

Selling Price \$110
(\$100 value + \$10 GST)

\$100
Value Added
Telstra

\$100
Value Added
Computer Co

Selling Price \$1100
(\$1000 value + \$100 GST)

\$1000
Value Added
XYZ Solicitors

Selling Price \$1200
(\$1100 cost to bank)

Bank

Customer

\$10 GST collected
\$10 GST remitted

\$10 GST collected
\$10 GST remitted

\$100 GST collected
\$20 GST claimed
\$80 GST remitted

\$100 GST Paid

\$1200 Paid
\$0 GST Paid
\$0 GST credits

Australian Taxation Office
Total GST \$100

Selling Price \$110
(\$100 value & \$10 GST)

Allen Allen & Hemsley

LAWYERS

ALLENS
ARTHUR ROBINSON
GROUP