BLAKE DAWSON WALDRON

L A W Y E R S

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INDIRECT TAX ROUND-UP

by

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1. INTRODUCTION

This paper sets out the changing landscape and current state of play in relation to:

(a) State and Territory taxes, in particular:

(i) Recent State Budget announcements and the timetable for abolition of State/Territory taxes

(ii) Mortgage duty issues and opportunities;

(iii) Rental / hire of goods duty issues, particularly in the context of sale and leaseback arrangements;

(iv) Queensland credit business duty situation;

(v) Credit card duty in Queensland and Tasmania;

(vi) debits tax and other miscellaneous financial transaction taxes; and

(vii) transfer duty, particularly in the context of sale and leaseback arrangements and securitisations.

(b) GST

(i) Syndicated loans

(A) Establishment of syndicate

(B) Recharging of costs

(C) Agents

(ii) Securitisation

(iii) Input tax credits for legal fees

(A) Legal services and reduced credit acquisitions

(B) Wrapping of legal fees

(C) Procurement of legal services

(iv) Apportionment

(A) Apportionment in relation to hire purchase arrangements

2. THE CHANGING LANDSCAPE AND CURRENT STATE OF PLAY IN STATE AND TERRITORY TAXES

The introduction of the Goods and Services Tax (**GST**) on 1 July 2000, itself a significant change, has resulted in a number of flow-on consequences for the tax landscape at the State and Territory level. A significant driver, but by no means the only driver, for changes to the State and Territory tax landscape has been the Intergovernmental Agreement of Commonwealth-State Financial Relations (**Intergovernmental Agreement**) which was made between each of the Australian States and Territories and the Commonwealth on 1 July 1999. The impact of the Intergovernmental Agreement is discussed in greater detail below.

A number of other important developments in State and Territory taxation have occurred, such as the removal of the "debenture trust concession" in Victoria and New South Wales, the abolition of mortgage duty in Victoria and the response of other States to that abolition, the impact of the re-drafted land-rich provisions in Victoria, the introduction of "vendor" duty and "vendor land-rich" duty in New South Wales.

One development in particular, which has the potential to be of significant importance, is the general anti-avoidance provision contained in Chapter 11 of the Queensland *Duties Act* 2001 which commenced on 1 March 2002. Chapter 11 is intended to "deter artificial, blatant or contrived schemes to reduce liability to duty" and is drafted in very broad terms. The Chapter 11 anti-avoidance provision is the first of its kind in the stamp duty arena and has the potential to apply very broadly in Queensland.

What follows is a discussion of the current state of play in State and Territory taxes which are of particular relevance to the banking and finance sector. The discussion includes a consideration of various issues/traps which can arise, as well as the timetable for abolition of various State and Territory taxes and recent State budget announcements.

2.1 Summary of recent budget announcements

(a) **Victoria**: announced that bank accounts debits tax will be abolished from 1 July 2005 and rental business duty will be abolished from 1 January 2007.

(b) **Australian Capital Territory**: announced that debits tax will be abolished after 30 June 2005.

(c) **New South Wales**: From 1 August 2005, a restriction will apply to the mortgage duty exemption for refinancing a mortgage up to the previous amount secured with a different lender. The exemption will only be available for secured amounts up to $1 million.

(d) **Queensland**: Mortgage duty will be cut by 50% (to 0.2%) from 1 January 2008 and abolished from 1 January 2009. Credit business duty will be abolished from 1 January 2006.

(e) **Tasmania**: Mortgage duty will be cut by 50% (to 0.2%) from 1 July 2006 and abolished from 1 July 2007.

(f) **South Australia**: Mortgage duty on certain loan refinancings, residential loans for owner occupation and mortgage discharges will be abolished from 1 July 2005. There will be phased reductions in stamp duty rates from 1 July 2007, and full abolition by 1 July 2009. Rental duty will be phased out between 1 July 2007 and 1 July 2009. Current rates are 0.75 per cent for equipment finance arrangements and 1.8 per cent for all other forms of rental.

(g) **Western Australia**: A new exemption will be applicable from 1 January 2006 for loan refinancings undertaken by homeowners and small businesses. The Western Australian Treasurer recently announced that the Government would, in consultation with the Western Australian community, undertake a State Tax Review to shape tax reform in Western Australia over the next 5 years. Stage one of the review is expected to be completed by March 2006.

2.2 The timetable for abolition of State taxes

Under the Intergovenmental Agreement, the Ministerial Council was to review, by 2005, the need for retention of stamp duty on non-residential conveyances, leases, mortgages, debentures, bonds and other loan securities, credit arrangements, instalment purchase arrangements and rental agreements, and duty on cheques, bills of exchange, promissory notes and unquoted marketable securities.

As part of the Agreement and following the review of State and Territory taxes earlier this year, the following timetable currently represents the agreed basis for reform of Commonwealth-State Financial Relations.

State/Territory Taxes Abolition Timetable

	VIC	QLD	SA	TAS	ACT	NT	NSW	WA
2005-06	Debits Tax – 1 July 2005	Debits Tax – 1 July 2005 Lease Duty – 1 Jan 2006 Credit Business Duty – 1 Jan 2006	Debits Tax – 1 July 2005 (Part) Mortgage Duty – 1 July 2005	Debits Duty – 1 July 2005	Debits Tax – 1 July 2005	Electronic Debit Transaction Duty and Debits Tax (included in IGA Cheque Duty Totals) – 1 July 2005		Debits Tax – 1 July 2005
2006-07	Rental Business Duty – 1 Jan 2007	Hire Duty – 1 Jan 2007 Marketable Securities Duty – 1 Jan 2007	Other minor duties[1] - 1 July 2006	50% of Mortgage Duty – 1 July 2006	Non-Realty Conveyances – 1 July 2006	Marketable Securities Duty – 1 July 2006 Lease/Franchise Duty – 1 July 2006		
2007-08		50% of Mortgage Duty – 1 Jan 2008	33% of Rental Duty – 1 July 2007 (Part) Mortgage Duty – 1 July 2007	100% of Mortgage Duty – 1 July 2007	Rental Duty – 1 July 2007	Rental Duty – 1 July 2007		
2008-09		100% of Mortgage Duty – 1 Jan 2009	67% of Rental Duty (Part) Mortgage Duty	Non-Realty Conveyances – 1 July 2008				
2009-10		50% of Non-Realty Conveyances – 1 Jan 2010	100% of Rental Duty and 100% of Mortgage Duty – 1 July 2009 50% of Non-Realty Conveyances & Marketable Securities Duty – 1 July 2009		Lease Duty	Non-Realty Conveyances – I July 2009		
2010-11		100% of Non-Realty Conveyances – 1 Jan 2011	100% of Non-Realty Conveyances – 1 July 2010 100% of Marketable Securities Duty – 1 July 2010		Marketable Securities Duty			

This table is current as at 12 July 2005 (subject to the outcomes of the Western Australian State Tax Review referred to above).

[1] Minor Duties includes all stamp duties specified for review in the IGA but not explicitly identified in the table.

2.3 Mortgage duty – where are we now?

Mortgage duty does not apply in Victoria, the ACT or the NT. Mortgage duty was abolished in Victoria from 1 July 2004. Accordingly, no duty is payable in Victoria in respect of mortgages executed on or after 1 July 2004 or advances made on existing mortgages from 1 July 2004. The impact that the abolition of Victorian mortgage duty can have in the other States in the context of multi-State security is discussed below. Mortgage duty continues to apply in New South Wales, Tasmania, South Australia, Queensland and Western Australia. The following table summarises the current state of play in these States.

Table 1. Current state of play in mortgage duty

	What is liable for duty?	What is dutiable?	Rate	When does a liability for duty arise?
NSW	"mortgage" as defined	"Advances"	0.4%	Rewrite model 1
Tasmania	"mortgage" as defined	"Advances"	0.35%	Rewrite model 1
Qld	"mortgage" as defined	"Advances"	0.4%	Rewrite model 2
WA	"mortgage" as defined	"Advances"	0.4%	Rewrite model 2
SA	"mortgage, bond, debenture, covenant or warrant of attorney"	Liabilities	0.45%	• Execution • Affecting property • Matter or thing done or to be done

(a) What instruments are liable for duty?

By way of general comment, it is noted that mortgage duty is still an instrument based impost, rather than being a transaction based impost (as many other duties, such as transfer duty, have become). Accordingly, a liability for duty will arise only in respect of the instruments specified if there is a relevant nexus with a taxing jurisdiction at a "liability date".

In NSW, Tasmania, Queensland and Western Australia duty is charged on a "mortgage" as defined. Broadly speaking, the following instruments will be mortgages:

(i) a mortgage or charge over property which is located in a taxing jurisdiction at a liability date (discussed below);

(ii) a security by way of transfer of property to a trustee, to be sold or otherwise converted into money, redeemable before the sale or conversion, other than

if the transfer is made for the benefit of creditors who accept the transfer in full satisfaction of debts owed to them;

(iii) a security by way of transfer or agreement for transfer of property that is apparently absolute but is intended only as a security (in Queensland, Tasmania and Western Australia);

(iv) an instrument that becomes a mortgage on the deposit of relevant documents, such as documents of title.

In South Australia, duty is charged on a "mortgage, bond, debenture, covenant or warrant of attorney". A mortgage is defined very broadly and means:

(i) an instrument creating, acknowledging, evidencing or recording a legal or equitable interest in, or charge over, real or personal property by way of security for a liability; or

(ii) an instrument creating, acknowledging, evidencing or recording a liability in respect of which an instrument of title is or is to be pledged or deposited by way of security.

(b) **Amount on which duty is payable**

In NSW, Tasmania, Queensland and Western Australia duty is charged on secured "advances" (as that term is defined). Broadly speaking, advances are defined to include loans, bill facilities and certain contingent liabilities. By way of example, advances would not include the performance of non-monetary obligations and, in NSW, Tasmania, Western Australia and Queensland would also not include original payment obligations. For example, a mortgage or charge securing the obligation of a purchaser to pay the purchase price under an agreement for sale would not be dutiable in NSW, Tasmania, Queensland or Western Australia.

In South Australia, however, duty is payable in respect of "liabilities" which is considerably broader than "advances". A "liability", for South Australian mortgage duty purposes is defined as "a present, future or contingent monetary liability". Liabilities can, for example, include original payment obligations (not just re-payment obligations), such as obligations to make lease/rental payments.

(c) **When does a liability for duty arise?**

Under both Rewrite models identified in the table above, a liability for mortgage duty can, broadly speaking, arise in the following circumstances:

(i) upon execution if the mortgage affects property in the relevant jurisdiction at that time;

(ii) a mortgage becomes liable to additional duty on the making of an advance or further advance by which the amount secured by the mortgage exceeds

the amount secured by it at the time a liability to duty last arose in respect of it;

(iii) an instrument of security that does not affect property in the jurisdiction at the time it is executed, but that which subsequently affects land in the jurisdiction within 12 months after the date of execution;

(iv) on the deposit of documents of title.

In addition, under Rewrite Model 2 (applying in Queensland and Western Australia) a liability for mortgage duty can also arise in respect of an instrument of security that does not affect property in Queensland or Western Australia at execution but subsequently affects "specifically identified" property.

(d) **Impact of the abolition of Victorian mortgage duty in other States**

In general, a multi-state mortgage (being a mortgage which affects property located in a number of Australian States) can attract mortgage duty in each State in which property secured by the mortgage is located. In theory, the mortgage duty would be calculated by reference to the proportion of secured property located in each State. For example, the duty payable in South Australia on a multi-State mortgage is determined having regard to the value that the South Australian property bears to the value of all of the property secured by the mortgage.

However, a mis-match arises in Queensland and Western Australia because these States effectively "mop up" the benefit of the abolition of Victorian mortgage duty and the fact that there is no mortgage duty in the ACT or the Northern Territory. They achieve this by excluding from the proportionate calculation any secured property which is located outside Australia and in a non-taxing jurisdiction, being Victoria, the ACT and the NT. The Queensland provisions go further and allow the Commissioner to "re-assess" mortgage duty in circumstances where a refund of mortgage duty is available in Victoria.

In Tasmania, the proportionate calculation excludes property which is located outside of Australia, the ACT and the NT. Victorian property is included in the calculation notwithstanding the abolition of Victorian mortgage duty.

From 1 September 2004, New South Wales changed their rules and the proportionate calculation now includes all property affected by the mortgage or charge other than property located outside of Australia. Accordingly, Victorian property is included in the calculation, as is property located in the ACT and the NT.

Example

Advance: $1m

Secured property:

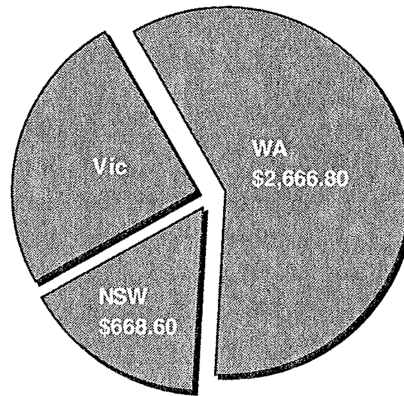
✓ Vic $500,000

✓ WA $400,000

✓ NSW $200,000

✓ USA $700,000

Total = $1,800,000



NSW proportion

= $200,000/($1.8m - $700,000)

= 18.18% x $1m

= $181.818

WA proportion

= $400,000/ ($1.8m – 500,000 – 700,000)

= 66% x $1m

= $666,666

Total duty = $3,335.40

(0.4% x $1m = $4,000)

NSW duty picks up overseas proportion

WA duty picks up overseas and Victorian proportion

(e) **Traps and tips in mortgage duty**

It can often be important when structuring security and financing arrangements to consider whether a package of securities will form a "mortgage package" within the meaning of the Duties legislation in New South Wales, Tasmania, Queensland and Western Australia. The South Australian *Stamp Duties Act* does not contain mortgage package provisions. However, as a matter of practice, it is understood that the South Australian Commissioner will calculate duty and stamp on that basis.

The impact of the mortgage package provisions in New South Wales, Tasmania, Queensland and Western Australia can be particularly important in circumstances where it is sought to "de-package" securities. For example, this can be an issue where an unlimited fixed and floating charge is given over all property and separate registrable mortgages are required over real property or a lease of real property which is located in a different jurisdiction. In this situation, the amount secured and ultimately recoverable under the separate registrable mortgage will very often be limited to the value of the real property the subject of the separate mortgage. If the separate registrable mortgage is not de-packaged from the fixed and floating charge, the risk is that a Commissioner may seek to ignore the limit contained in the separate registrable mortgage and calculate and charge duty by reference to the higher amount.

Based on the potential breadth of the mortgage package provisions and the current level of uncertainty about their potential application, de-packaging should be considered in the specific circumstances of a particular case.

Again, depending on the circumstances, there may be a number of potential opportunities to preserve the benefit of duty which has been paid on existing securities. For example, re-use and recycling of the old debenture trust structures. Given that mortgage duty has been abolished in Victoria, the benefit of re-using old debenture trust structures will only really be available in New South Wales.

Another potential opportunity may arise where a borrower is, for example, a special purpose vehicle (**SPV**) and does not hold property in a taxing jurisdiction at the time when relevant securities are issued. Depending upon the nature and location of property subsequently acquired or intended to be acquired by the SPV borrower, the result may be that no liability for duty subsequently arises. As indicated above, the duty result will very often depend on the specific circumstances of the particular case. As a general proposition, a liability for duty can subsequently arise if a mortgage or charge does not affect property at execution but affects land in New South Wales, Tasmania, Queensland and/or Western Australia acquired within 12 months of execution of the mortgage/charge. Careful consideration will also be needed where a mortgage or charge does not affect property at execution but it is intended that, subsequent to execution, the mortgage/charge will affect "specifically identified" non-land property which is located in Queensland and/or any property (including land) located in Western Australia.

As indicated above, mortgage duty in New South Wales, Tasmania, Western Australia and Queensland is charged in respect of "advances" which are, essentially, loans. Accordingly, no liability for duty would arise in these States where the obligations which are secured are not repayment obligations. For instance, where the obligation which is secured is a non-monetary performance obligation or an obligation to make an original payment (eg, the payment of a purchase price under a sale agreement), there would not be an advance and accordingly no liability for duty would arise in these States. This result would not apply, however, in South Australia because duty is there charged in respect of "liabilities", which is a broader concept than advances.

Rental / hire of goods duty

(f) **Current state of play**

The following table summarises the current state of play in rental/hire of goods duty in the various Australian States and Territories.

Jurisdiction	**Duty free threshold**	**Rate (% of total hire charges per return period)**
Australian Capital Territory – ordinary hire	$6,000 per month	1.5% (to a maximum of $10,000 duty for certain individual hires)
Australian Capital Territory – equipment financing arrangement	Nil	0.75% (to a maximum of $10,000 for certain individual hires)
New South Wales – ordinary hire	$14,000 per month	1.5%
New South Wales – equipment financial arrangement	Nil	0.75% (to a maximum of $10,000 for certain individual hires)
Northern Territory	Nil	1.8% (up to a maximum of $9,000 for certain individual hires)
Queensland	Nil	0.43%
South Australia – ordinary hire and equipment financing arrangements entered into before 1 October 2003	$6,000 per month (not applicable to old equipment financing arrangements)	1.8%
South Australia equipment financing arrangements entered into on or after 1 October 2003	Nil	0.75%
Tasmania	N/A	N/A
Victoria	$6,000 per month	0.75% (to a maximum of $10,000 for certain individual hire)
Western Australia (ordinary hires)	$50,000 per annum	1.5%
Western Australia (equipment financing arrangements)	$50,000 per annum (not available if the total amount of hiring charges exceeds $50,000 per annum)	0.75%

An "equipment financing agreement" includes a hire purchase agreement and other agreements for a term of not less than 9 months where the final payment is due not less than 8 months after the agreement is entered into.

An "ordinary hire" is a hiring arrangement other than an equipment financing agreement.

(g) **Current issues in rental/hire of goods duty**

As can be seen from the table set out above, rental business / hire of goods duty issues will continue to be relevant going forward (other than in Tasmania), with early abolitions (from 1 January 2007) in only Victoria and Queensland. For the ACT and the NT, the issues will continue to exist until 1 July 2007 and in South Australia, with a gradual phasing out of rental duty, until 1 July 2009. Based on the current landscape, hire of goods duty will continue in New South Wales and Western Australia (subject to the recommendations of the State Tax Review discussed above).

Rental business / hire of goods duty issues frequently arise in the context of sale and lease-back arrangements in connection goods, such as plant and equipment. Transfer duty issues (discussed below) also arise in this context. While there may be exemptions for certain kinds of goods, for example, ships and aircraft, duty issues frequently arise. In this context it is important to consider the nature and dutiability of all payments which potentially relate to a hire of goods.

Generally, duty is charged on "hiring charges", being payments made to the person who hires out the goods and includes amounts "that arise as an incident of" the hire of the goods. Amounts that arise as an incident of the hire of goods is potentially a very broad category. Accordingly, the concept of "hiring charges" is likely to encompass most payments made under or in connection with a lease or hire of goods arrangement unless specifically exempt.

By way of example, the Victorian provisions set out a number of charges which are specifically excluded from the definition of hiring charges. These include GST, insurance premiums payable by the hirer, refundable cash deposits or bonds (unless these are appropriated as hiring charges), payments for delivery, repositioning, erection, installation, maintenance or cleaning of the goods and payments for the sale of the goods, such as fuel, replacement parts or theft replacement. A specific exemption is provided in respect of a payment by a hirer if, as a consequence of the payment, title to the goods passes to the hirer.

From a practical point of view, to ensure that a termination payment does not attract hire of goods duty, it will be important to consider the drafting of the relevant document in terms of how the obligation to pay has arisen, as well as the procedures involved in processing the payment.

For instance, there are generally 3 options upon termination of a lease:

(a) the goods are returned to the lessor (usually for sale to a third party) and the lessee pays the difference between the sale price received by the lessor from the third party and the residual value provided for under the lease;

(b) the goods are retained by the lessee and the residual value of the leased goods is refinanced (ie, a new arrangement arises); or

(c) the goods are transferred to the lessee and the lessee pays the residual value provided for under the lease.

Typically, payments on termination of a lease might be structured in 1 of 2 ways, either:

(a) a payment is made by the hirer for the transfer of the goods and the obligations under the lease are subsequently waived; or

(b) payment is made by the hirer for the termination of the lease and the goods are subsequently transferred for no additional consideration.

To ensure that a termination payment is not dutiable, it will be necessary that the relevant goods are transferred to the hirer "in consequence" of the payment. There are good arguments (including constitutional arguments) that the expression "in consequence" should be given a broad interpretation such that the exemption should apply to payments made for the transfer of goods where there is a subsequent waiver of rights and obligations under a lease. However, a payment on the termination of a lease that relates to amounts which are previously owning would not be exempt because such an amount would not be regarded as being in consequence of a transfer.

Other exemptions not contained in the hire of goods provisions may also be applicable in particular circumstances. For example, the *Commonwealth Vehicles (Registration and Exemption from Taxation) Act* 1997 (Cth) provides an exemption from State and Territory taxation in respect of particular "exempt matters", which include the sale by the Commonwealth of certain vehicles (which are part of DASFLEET), the lease of vehicles to the Commonwealth for a period of at least 3 months and the registration of vehicles which are leased to the Commonwealth for a continuous period of at least 3 months.

With the re-write of the stamp duty legislation in Victoria, New South Wales, the ACT, Queensland and Western Australia the traditional "nexus" provisions for rental / hire of goods duty have been narrowed. Whereas the provisions previously could potentially apply where, for example, negotiations took place in these jurisdictions, the re-written hire of goods provisions generally only apply in the place where goods are to be solely or predominantly used. Particular rules apply to motor vehicles, such that a nexus will arise with the jurisdiction in which the motor vehicle is registered. However, in South Australia a nexus can also arise if good are to be delivered in South Australia where the goods are to be used outside Australia or if the goods are not going to be used solely in any one particular Australian

jurisdiction and it is not possible to determine which Australian jurisdiction will be the predominant place of use. In the Northern Territory a nexus, and hence a liability for duty, can still arise where the arrangement is entered into in the Northern Territory and/or the goods are delivered or agreed to be delivered in the Northern Territory but the goods are not used solely or principally in the Northern Territory.

This means that a double nexus can arise, such that the one arrangement still has a potential for duty in more than jurisdiction.

2.4 Queensland credit business duty

As indicated above, Queensland is scheduled to abolish credit business duty from 1 January 2006.

In brief terms, Queensland credit business duty (payable by the credit provider) applies to a "credit transaction", being a loan (secured or unsecured), a discount transaction or a credit arrangement, if:

(a) for a loan – the loan is to a Queensland resident or any negotiations for the loan take place in Queensland. However, the Queensland Commissioner has issued Practice Direction 71.1 which sets out that, as an administrative arrangement, "the only relevant nexus requirement is that the loan is to a Queensland resident"; or

(b) for a discount transaction – the transaction relates to book debts or other things in action that are situated or enforceable in Queensland; or

(c) for a credit arrangement – the credit arrangement relates to goods sold or services provided in Queensland.

For a financial institution that is a credit provider, only the following transactions will be dutiable:

(a) loans other than an overdraft on a current account;

(b) discount transactions for bills of exchange or promissory notes;

(c) loans, discount transactions or credit arrangements for which a credit card is produced.

A discount transaction is the purchasing, acquiring or factoring of book debts or other things in action, other than marketable securities, for a consideration less than the amount of the book debt or nominal or face value of the thing in action.

A credit arrangement is any arrangement for providing credit of more than $200 relating to the sale of goods or providing of services, if any amount in excess of the cash price may be charged for the goods or services under the arrangement.

The following table summarises the rates of Queensland credit business duty.

Credit amount	Short term rate	Other rate
Not more than $1,000,000	0.0025%	0.03%
More than $1,000,000	The lesser of: • $208.33; or • $25 + 0.00125% per dollar above $1,000,000	The lesser of: • $2500; or • $300 + 0.015% per dollar above $1,000,000

2.5 Credit card duty

Credit card duty was previously charged in Queensland on credit card transactions. Queensland credit card duty was abolished from 1 August 2004.

Credit card duty currently still applies in Tasmania, but is to be abolished from 1 July 2005.

Debits tax

The table[2] below provides a summary of the status of the abolition of debits tax in each Australian jurisdiction.

Jurisdiction	Debits tax abolition legislation implemented?	Date of abolition/ proposed abolition
New South Wales	Yes – *State Revenue Legislation Further Amendment Act 2001* received assent on 29 June 2001.	1 January 2002 – section 8 of the *Debits Tax Act 1990* (NSW) amended such that the Act only applies to debits made before the "proclaimed day" of 1 January 2002.
Victoria	No –*State Taxation Acts (General Amendment) Bill 2005* passed by Parliament on 17 June 2005, now awaiting assent.	1 July 2005 – new section 22 inserted such that there is no liability to pay debits tax on debits made on or after 1 July 2005.
Queensland	Yes – *Debits Tax Repeal Act 2005* received assent on 31 May 2005.	1 July 2005 – the *Debits Tax Act 1990* is repealed. Transitional provisions exist to save "pre-repeal debits".
Tasmania	No – *Revenue Measures Bill 2005* passed by Parliament on 16 June 2005, now awaiting assent. Debits tax is known as debits duty in Tasmania.	1 July 2005 – section 23 and schedule 1 repeal the *Debits Duties Act 2001* with effect from 1 July 2005. Transitional provisions exist so that unpaid debits duty relating to a transaction made before 1 July 2005 may be collected.
South Australia	Yes – *Statutes Amendment (Budget 2004) Act 2004* received assent on 1 July 2004.	1 July 2005 – section 5A included in the *Debits Tax Act 1994* (SA) such that the Act does not apply to debits made after 30 June 2005.
Western Australia	Yes – *Business Tax Review (Assessment) Act (No. 2) 2003* received assent on 5 December 2003.	1 July 2005 – section 5(4)(aa) of the *Debits Tax Assessment Act 2002* (WA) amended such that debits tax is not payable on debits made on or after 1 July 2005.
Australian Capital Territory	Yes – *Revenue Legislation Repeal Act 2005* was notified on 22 February 2005.	1 July 2005 – Part 6 of the *Debits Tax Act 1997* (ACT) has been replaced such that debits tax is not payable on taxable or eligible debits made on or after 1 July 2005.
Northern Territory	Yes – *Debits Tax Amendment Act 2004* received assent on 6 July 2004.	1 July 2005 – section 6 of the *Debits Tax Act* (NT) amended such that debits tax is only payable on taxable or eligible debits made before 1 July 2005.

2.6 Transfer duty

As indicated above, transfer duty issues can arise in the context of a sale and lease-back arrangement. In considering the potential for ad valorem transfer duty, it will be particularly important to have regard to the precise nature and location of the relevant

[2] The table is current as at 21 June 2005.

property involved. For example, certain items may be exempt from transfer duty in certain places, for example, the transfer of a ship or vessel is specifically exempt from duty in Western Australia but would not enjoy exemption in, for instance, South Australia. However, no duty would be payable in South Australia if the ship or vessel was not located within South Australian waters at the time of the transfer.

This issue will diminish over time as the scheduled abolition of duty on an agreement for transfer, or a transfer, of non-realty (ie, non-land) takes place. Based on the timetable set out above, these types of issues will remain live (other than in Victoria) for most jurisdictions for quite some time. The ACT is scheduled to abolish duty on non-realty conveyances from 1 July 2006. Following that, Tasmania is expected to make the abolition from 1 July 2008 and the Northern Territory from 1 July 2009. South Australia is scheduled to commence phasing out transfer duty on non-realty conveyances from 1 January 2009. Queensland is not expected to abolish duty on non-realty conveyances until 1 January 2010.

Transfer duty issues can also arise in the context of a securitisation. In a typical securitisation arrangement, an originator will assign receivables (owed to it by third party debtors) to an SPV. The assignment may also include any mortgages or charges provided by the third party debtors to secure repayment of the loans and may also include underlying property, for example, where equipment leases are involved. The SPV would typically issue securities, being debt instruments, such as loan notes, to an incoming investors. Stamp duty would not normally be payable in connection with the issue of loan notes or other debt instruments. Depending on the structure, security may be provided by the SPV to a trustee to hold for the benefit of the incoming investors/noteholders.

From a stamp duty point of view, ad valorem duty may be payable in respect of the assignment of receivables and/or other property to a relevant SPV depending on the nature and location of the property being transferred. By way of example, where the property being transferred comprises secured debts only, including the relevant mortgage/charge, and is not part of the transfer of a business involving goodwill, no duty would be payable in Victoria, New South Wales, Tasmania, the ACT, the Northern Territory or South Australia.

To the extent that the transfer also includes any underlying goods, such as equipment, duty would not be payable in Victoria, New South Wales, Tasmania, the ACT or the Northern Territory because the arrangement would not relate to any dutiable property. The transfer of any underlying property (whether or not together with the secured debt and mortgage/charge) by way of a written offer would not be dutiable in South Australia because these items would not fall within the South Australian clayton's contract provisions (which impose duty on transactions not effected by written instrument and which, generally speaking, apply in respect of a land or business transfer only).

For Western Australia, nominal duty would generally be payable in respect of a written instrument by which a transfer of the secured debt is effected for market value. Generally, an equitable assignment (eg, by means of a written offer) of a secured debt would not be dutiable in Western Australia. To the extent that any goods, such as equipment in Western

Australia, is also transferred, there is a potential liability for ad valorem duty. If goods located in Western Australia are transferred alone, no duty should be payable.

In Queensland, the assignment of secured debts would be potentially dutiable as a Queensland business asset or an existing right. Depending on the circumstances, an exemption from duty may be available if the arrangement comprises a debt factoring arrangement. Other possible exemptions from duty (the availability of which will depend on the particular circumstances) include the exemption for corporate debt securities and asset backed securities. To the extent that goods in Queensland are also transferred, these would potentially also be liable for duty. If goods located in Queensland are transferred alone, no duty should be payable.

Mortgage duty may be payable in connection with a mortgage or charge granted by the relevant SPV. On the basis that the relevant SPV does not hold any property in a taxing jurisdiction at the time the relevant mortgage or charge is granted, no mortgage duty should arise at the time of execution of the mortgage or charge. Depending on the circumstances, the nature and location of the relevant property and the drafting of transaction documents, in particular the security documents, the result may be that no mortgage duty subsequently arises. These issues would need to be considered in the circumstances of a particular arrangement.

3. GST

As is the case for all business transactions, the key questions financiers (and financees) need to ask with respect to GST are:

1) Is GST payable on any of the supplies being made; and

2) Are there any input tax credits available for that GST – and if so how much?

3) The input tax credits available in respect of acquisitions made that relate to making those supplies.

The main difference in the financial services sphere is the complexity of the answers to those questions. This is not due only to the complex nature of many financing structures, but also to the difficulty in drawing distinctions between the multiple capacities in which suppliers and recipients act, the characterisation of activities and the multiple purposes for which supplies are often made and acquired.

Five years down the track the industry has come to grips with many of the answers to the most common questions. The ATO's interpretation of items in Regulation 40-5.09(3) of the *A New Tax System (Goods and Services Tax) Regulations 1999* (**Regulations**) have been discussed at length in GST Ruling GSTR 2002/2. The rules for reduced input tax credits have also been dealt with in GST Ruling GSTR 2004/1. And for the acquisitions which are on the border, the question of apportionment has been addressed in GST Ruling GSTR 2000/22.

However, where the lines are drawn remains somewhat unclear. This paper explores some of the topical "border areas" between taxable and input taxed supplies and creditable, non-creditable and partly creditable acquisitions.

3.1 A Question of Capacity – Syndicated Loans

(a) Establishing a Syndicate

When working out whether GST will be payable with respect to a fee, it is necessary to consider to whom the fees been paid and with respect to what supply this fee is being paid. In transactions which involve multiple parties acting in multiple capacities, particularly transactions such as syndicated loan arrangements, this can be critical. Although there have been a number of rulings issued by the ATO to the ABA with respect to the GST treatment of syndicated loan arrangements, there remains considerable confusion in the industry as to which and to what extent fees attract the GST. There is also considerable confusion as to the extent, if any, that full input tax credits or reduced input tax credits can be claimed for related expenses.

In its rulings to the ABA of 10 January 2002 and 13 December 2000 the ATO broke syndicated loan arrangements into three principle types:

- Best endeavours syndications;
- Post-signing underwritten syndications;
- Pre-signing underwritten syndications.

In addition, the ATO accepted that any given syndication could involve elements of those three and added:

- Anticipated hybrid pre and post-signing underwritten syndications; and
- Unanticipated hybrid pre and post-signing underwritten syndications.

In addition to identifying the particular type of syndication in which a financier may be participating, the financier needs to understand the range of roles that it and the other parties are playing. These roles include the role of borrower, arranger, participant, agent and trustee. It is usual for the entity which acts as arranger to also act as a participant and frequently to also act as agent on an ongoing basis. It is the multiplicity of capacities which is most likely to cause confusion as to the GST treatment of a particular amount received by the arranger/participant/agent and the entitlement to credits for any expenses incurred by that entity and the borrower.

Example

A manufacturing company (**borrower**) approaches a financial institution (**lead bank**) in search of a $200m facility to fund expansion of its manufacturing operations. Lead bank considers the credit rating of the borrower and its general financial position and decides that it will be prepared to make credit available to the borrower under an ongoing facility to a maximum of $75m.

Scenario 1 – fees received in a best endeavours syndication

Lead Bank informs the borrower that it will provide the facility to the extent of $75m. Lead Bank also offers, in consideration of an arranging fee, to also use its best endeavours to find other participants interested in providing the remaining $125m. Any fees required by those other participants are to be paid directly by the borrower.

The borrower and lead bank agree that the borrower will pay fees up to the following limits:

(a) A **commitment fee** to Lead Bank for the $75m underwriting of $250,000;

(b) An **arranger fee** to Lead Bank for arrangement of the syndication of the facility and the commitment for the additional $125m by one or more other participants in the amount of $150,000; and

(c) **Participation fees** to other syndicate participants to a maximum of $350,000.

In this scenario, the commitment fee will be input taxed, the arranger fee will be taxable and the participation fee will be input taxed.

Scenario 2 – fees received in a pre-signing underwritten syndication.

The Borrow requires a commitment for the entire amount before it signs up to the facility. It mandates Lead Bank to arrange other participants in the transaction. It agrees that it will pay a commitment fee of $250,000 to Lead Bank for underwriting its $75m component of the facility, and that it will pay a further $500,000 to Lead Bank to arrange for the participation of other financiers.

Lead Bank approaches Bank B and C. Bank B agrees to participate in the amount of $70m and Bank C agrees to participate in the amount of $55m. Banks B and C, respectively, require a participation fee of $200,000 and $150,000 from Lead Bank for agreeing to sign up to the facility from its commencement.

The ATO considers that in this case, the commitment fee of $250,000 is input taxed. The arrangement fee of $500,000 is consideration for the taxable supply by the lead bank of arranging the participation of banks B and C for the benefit of the

borrower. The participation fees of $200,000 and $150,000 payable to Bank B and Bank C by Lead Bank are consideration for a taxable – an "incentive for the Participants to participate in a syndicated loan arrangement". So the "participation fee" is input taxed if paid by the borrower, but taxable if paid by the arranger.

Scenario 3 – post-signing syndication

In this case, Lead Bank has limited authorisation to commit to the facility for the full amount of $200m. However it must, in accordance with its own internal credit rules, sell down its interest in the facility within 6 months of settlement. The borrower is on notice of this fact and the agreement between the parties is that Lead Bank will proceed to provide the initial funding with the expectation that following entry into the facility arrangement between Lead Bank and Borrower, Lead Bank will seek to find other participants willing to be substituted for its position with respect to part of the facility.

Immediately following the signing of the facility agreement between lead bank and the borrower, the Lead Bank receives a fee from the borrower $750,000. Lead bank subsequently approaches Bank B and C and commences to negotiate for their participation by taking up part of Lead Banks commitment to the facility.
In consideration for Bank B and Bank C agreeing to commit to the facility in the amounts described for Scenario 1 and 2 above, Lead Bank agrees to pay Bank B and C a participation fee equal to $200,000 and $150,000 respectively.

The ATO considers that the fee of $750,000 paid by the Borrower to Lead Bank is an input taxed commitment fee. The fee paid by Lead Bank to each of Banks B and C is consideration for input taxed supply by Lead Bank of an interest in the existing debt arrangement to each of Banks B and C. Therefore, no GST is payable in respective of the participation fees.

The key message of these three scenarios is that changes to the form in which a syndicated loan is effected can have a significant impact on the GST treatment of the fees. If a borrower was not eligible to claim input tax credits for the GST included in the fees (e.g. if the borrowing was for investment in shares), the borrower would prefer the result in Scenario 3, where no GST became payable. This saves $3,750 in GST compared to Scenario 1 (where an RITC of 75% of the $15,000 GST could be claimed) and $12,500 in GST compared to Scenario 2 (allowing for an RITC of 75% of the $50,000 GST).

The borrower in this example intended to use the funds in the course of its business of making taxable supplies. Accordingly, it would be expected that the borrower would be entitled to full input tax credits for any GST charged on any fee. So on its face, this would mean that the borrower should be indifferent as to whether any of the fees attract GST or not. However, there is actually likely to be a bias in favour of Scenario 1 in this case, owing to the GST treatment of costs incurred by the Lead Bank, and the recovery of those costs from the Borrower, as discussed below.

(b) GST and the Recharging of Costs

Following on from the treatment of the fees is the treatment of the expenses incurred by Lead Bank (and the other participants) to derive those fees. It is common for the costs of setting up the facility to be recharged by the financiers to the borrower. The extent to which the recharge attracts GST or contains "built-in" GST, will depend on the nature of the expense and the supply by the financier to which the cost properly relates.

To the extent that costs are incurred as agent for the borrower, the role of the financier is ignored – they are acquisitions of the borrower and creditable on the basis of the borrower's GST profile. However, for the purpose of this discussion we consider those costs that the Lead Bank in the earlier example might incur in the course of effecting the participation of Banks B and C.

In each of the 3 scenarios, the Lead Bank makes an input taxed supply. To the extent any of the costs relate to that supply, the Lead Bank would not be entitled to full input tax credits. If the cost was a reduced credit acquisition, the Lead Bank would be eligible for reduced input tax credits (discussed further at 4 below). However, for current purposes it is assumed the costs in question are travel expenses of $11,000 arising from negotiations with Banks B and C, which are not a reduced credit acquisition.

In Scenarios 1 and 2, the costs would have been incurred by Lead Bank for the purpose of earning its arranging fee. As the arranging fee was taxable, Lead Bank would be entitled to claim an input tax credit of $1000 input tax in relation to the $11,000 expense. When Lead Bank recharged that expense to the Borrower, it would calculate its true cost by taking into account the $1,000 credit and therefore only on charge the $10,000. However, as the recharge is additional consideration for the taxable supply of the arranger services, the Lead Bank would be liable for GST on the recharge and would add an amount of $1,000 for GST. So the Borrower pays a total of $11,000, which includes $1,000 GST.

In Scenario 3, the costs would only relate to the Lead Bank's input taxed supplies of its underwriting of the credit facility and sell down of part of the facility to Banks B and C. So Lead Bank would not be eligible for any input tax credits and the real cost to be charged to the Borrower is $11,000. As the recharge is additional consideration for the input taxed supply of the underwriting of the facility, no GST need be charged by the Lead Bank. So again, the actual cost payable by Borrower is $11,000.

The significant difference between the costs for Scenarios 1 and 2 and Scenario 3 is that in Scenario 1 and 2 the $11,000 includes $1000 GST for which the Borrower can claim an input tax credit, whereas in Scenario 3 the $11,000 does not include any actual GST – although there is an underlying amount of GST which has become "built in". As the Borrower in the present case is entitled to claim full input tax credits for any GST it pays in relation to the facility, the result is that Scenario 3 is more expensive for the Borrower, as it cannot claim any input tax credits to offset the GST which is "built in". In the case of Scenarios 1 and 2, the Borrower can claim a full $1,000 input tax credit and therefore reduces its net cost of the recharge to $10,000.

(c) **Capacity as agent**

In the interest of simple administration of the syndicated loan facility, each of the banks appoint the Lead Bank as to act as agent with respect to the administration of the facility. The agent's role not only includes acting as agent for the banks with respect to communication with the borrower but also to undertake administrative tasks with respect to the facility such as calculation of repayments and interest and distribution of repayments amongst the banks.

In a ruling issued to the APLMA in January 2004, the ATO indicated that, subject to the appropriate documentation, the agency services for which a borrower is required to pay a fee can be provided both to the borrower and to the banks, such that the borrower will be the recipient of the supply of the services of the agent and therefore entitled to claim an input tax credit. However, it should be noted that the documentation must reflect an actual supply by the agent to the borrower in order for the agency fee to be treated as consideration for supply to the borrower, regardless whether or not it is actually paid by the borrower.

Following on from the earlier example, the ATO ruling of 10 January 2002 goes on to distinguish a post-signing syndication from the pre-signing syndication described for GST purposes. In particular, the ATO considers that all fees paid to the Lead Bank would be input taxed if there is no obligation on the part of the Lead Bank to arrange syndication prior to the signing of the facility documentation.

When the Lead Bank is appointed as agent it performs services in two capacities:

(i) In its own capacity (as principal) it performs administrative services and provides a service of acting as agent. These activities are taxable supplies from the agent to the borrower and/or the other participants; and

(ii) The Lead Bank performs services in its capacity as agent and makes acquisitions and supplies on behalf of the participants.

As the participants are primarily, making input tax supplies to the borrower, anything which the agent does in its capacity as agent for the participants will be treated as being an acquisition made by the participants. Therefore, it will be the participants GST status that will determine whether any input tax credits can be claimed and it will be the participants that are entitled to claim any such credits.

The fact that the documentation may reflect that the agent receive a fee from the borrower for services provided to the borrower (such as administration services) does not insure that full costs which the agent pays are paid by the agent in its own capacity in relation to the supply of a taxable service to the borrower. For example, many acquisitions are made by the agent in its capacity as agent for the participants in which case it is the participants who are entitled to claim input tax credits, if any. In turn, when any of those costs are recovered from the borrower the agent frequently makes such a recovery in its capacity as agent for all of the participants. This means that to the extent the costs relate to an input tax supply by the participants to the borrower, the recovery of those costs by the agent is consideration

for that input taxed supply. If the participants are not entitled to any input tax credits for the underlying cost then the amount recovered by the agent should be the total GST inclusive amount of that cost without any deduction for input tax credits and without any gross up for GST. If the participants were entitled to claim reduced input tax credits, the amount recovered from the borrower would be reduced by the amount of the reduced input tax credits.

Example 2 – recovery by agent of participants costs

Following the establishment of the facility established in Example 1 above, the borrower requests a change to the terms of the facility. The participants agree to the request to changes and instruct the agent to acquire services of a legal adviser to advise on the impact of those changes to the rights of the participants. The legal adviser charges a fee of $11,000 for the work and issues a bill to the agent for $10,000 plus $1,000 GST. Under the terms of the facility, this expense can be recovered from the borrower. However, the amount to be recovered must be calculated after taking into account:

(iii) the entitlement to input tax credits for the legal fees; and

(iv) any GST payable with respect to the recovery of these fees.

As the agent incurs the legal expenses in its capacity as agents for the participating banks, and the legal services are provided by the adviser for the benefit of the participants, it is the participant's entitlement to input tax credit which must be determined. Assuming that the legal advice did not include any RITC eligible aspects (for example, document preparation or debt recovery), the participants will acquire the legal services in the course of the supply of credit which is an input taxed financial supply. Accordingly, no input tax credits can be claimed for the GST included in the legal costs.

When the agent on-charges the $11,000 of legal costs it is seeking additional consideration for the input tax supply by the participants. Therefore, no additional GST amount needs to be recovered with respect to the $11,000. However the $1,000 worth of GST charged by the legal adviser has become "built in" to the costs recoverable. The tax invoice issued by the agent of behalf of the participants should show a charge of $11,000 including GST of $0.

This result cannot be circumvented merely by forwarding the legal advisers bill directly to the borrower for payment by the borrower. Although the borrower is entitled to input tax credits for costs associated with its "creditable borrowing", the borrower is not the recipient of the supply of the legal services. Therefore, the borrower is not eligible to claim any input tax credits in respect of those services.

A difficulty arises if the acquisition RITC eligible to the participants. For example, in the case of an acquisition of services in registering a charge or mortgage. Technically, each participating bank is required to include its share of the reduced input tax credit (and the revenue from the reimbursement) in its GST return. That means the agent must provide

copies of the tax invoice to all participants, and each participant must calculate its entitlement to a reduced input tax credit. The agent must then take those entitlements into account in working out the disbursement to be sought from the borrower.

Example 3

Assume that the legal services acquired by the agent in Example 2 were RITC eligible. As each of the participants are making an input taxed supply of credit to the borrower, each would be entitled to claim an RITC for its share of the legal fees. Accordingly, the total actual cost to be recovered from the borrower will be reduced by an RITC of $750. The agent will only be required to recover $10,250 from the borrower.

Lenders are on something of a tightrope with respect to this issue. Contractually, they can only generally recover their actual costs from the borrower, which means they need to identify any input tax credits, or reduced input tax credits, to correctly calculate the amount the agent is entitled to recover on their behalf. However, the lender must be satisfied of their entitlement to any input tax credits in order to comply with their GST obligations, and could find themselves out of pocket if they pass on to the borrower the benefit for a credit which they are not actually entitled to claim.

3.2 Securitisation

The key GST issue in the area of syndications is the treatment of fees charged in relation to securitisation arrangements, and the entitlement to credits for GST charged on the securitisation fees and for costs which are associated with the securitisation services.

Once again the question is whether acquisitions relate to the input tax supplies which form part of the syndication transaction or relate to taxable supplies, either pre –existing supplies or supplies which are undertaken in the course of the securitisation.

It is usual that an originator in a syndication transaction undertakes two principal transactions. The first is the assignment of the receivables to the securitisation vehicle which will be an input taxed supply of an interest in a debt. This is relatively uncontroversial. The second transaction in which the originator is usually involved is the provision of administrative services, in particular, debt collection and payment services. The originator is appointed in the capacity as "servicer" to manage the collection of the payment stream for the securitisation vehicle.

It could be suggested that in this case the controversy has been exacerbated rather than relieved by the finalisation of GST Ruling GSTR 2004/4 on the assignment of payment streams. The final ruling differed significantly from the draft with respect to the characterisation of servicer fees, and to the manner in which the ATO is believed to have previously administered GST relating to securitisations. The ATO does not consider that the provision of the servicer duties forms part of the underlying supply or contractual terms relating to the supply of the assignment of the payment stream. The servicer is considered, in that capacity, to be making a separate taxable supply of the service of collection and

remittance of payments, management of delinquent accounts and provision of reports. These services are acquired by the securitisation vehicle in relation to the input taxed acquisition of the payment stream. As a result, the securitisation vehicle will not be eligible for full input tax credits in relation to the servicer fee. Further, the ATO has indicated that it considers that the servicer fee is only a reduced credit acquisition to the extent it relates to the servicing of delinquent debts and not to the general collection and recovery of payments. As a result, the GST on the servicer fee becomes a real cost to the originator who is required to "reimburse" the securitisation vehicle for the amount of that fee and any net GST cost.

Frequently, the originator/servicer will have an interest in the securitisation vehicle. When the vehicle is a trust this may take the form of a right to residual income of the trust. Accordingly, it is often the case that the originator and the securitisation vehicle are treated as associates for the purpose of Division 72. This means that if an "arm's length" fee is not charged by the servicer, the servicer will be liable for GST on a deemed arm's length services fee. This is because the securitisation vehicle would not be entitled to a full input tax credit. The nature of the relationship between the originator and the securitisation vehicle means that a decision not to charge servicer fees will not avoid the issue.

It might be possible to get around the issue by grouping the originator (as servicer) with the securitisation vehicle, where for example distributions of income are not made to anyone other than the originator such that the grouping rules in Regulation 48 are satisfied. However, as a practical matter the credit rating of the securitisation vehicle frequently would be negatively affected by the joint and severable liability that arises as a result of GST grouping. The treatment of servicer fees remains a live issue and a large number of industry bodies continue to lobby the ATO to revise its views on this point.

3.3 Credits for Legal Fees

The following discussion focuses on the ability of participants in financial transactions to claim input tax credits or reduced input tax credits in respect of legal fees (because we are lawyers). However, many aspects of this discussion could apply equally to a range of acquisitions.

(a) Legal Services and Reduced Credit Acquisitions

One of the most contentious areas of the GST as it relates to financial transactions, and an area particularly close to our hearts, is the entitlement of financiers and borrowers to claim input tax credits or RITCs in relation to legal fees. The structure of a particular transaction and the manner in which legal services are delivered can have a significant impact on whether the GST charged by legal service providers becomes a real cost or is creditable.

Legal services are not generally eligible for RITCs. However, certain services which are frequently performed by lawyers can be included as a reduced credit acquisition under Regulation 70-5.02 of the Regulations. The most relevant reduced credit acquisitions are items 14 and 17 of the table in Regulation 70-5.02(2).

Regulation 14 relevantly provides:

"*The following loan application, management, and processing services:*

...

(*b*) *settlement and discharge of loans, including document preparation;*

(*c*) *registration of loan documents;*

...

(*f*) *property title searches;*

(*g*) *registration and certification of titles;*

(*h*) *mortgage variations, including name changes;*

(*i*) *adding and deleting to caveats to titles.*"

Item 17, titled "Debt collection services", provides:

"*The following debt collection services:*

(*a*) *debt recovery;*

(*b*) *litigation;*

(*c*) *lodgement of documents;*

...."

To the extent that legal services satisfy the above definitions, a financial supply provider may be eligible to claim a RITC for the cost of those services. The types of legal services that are reduced credit acquisitions under item 17 are relatively uncontroversial. For the most part, the application of item 14 is also straightforward. However, the intended application of Regulation 14(b) is the subject of greater debate – and is probably the item with the greatest potential to reduce the GST cost for lenders.

Item 14

The main reason for the debate as to the extent to which item 14 extends to legal services relates to the opening words: "*The following loan application, management, and processing services*". In particular, whether the words "document preparation" in item 14(b) can, in the context of those opening words, cover the provision of services by legal advisers in drafting loan documentation.

In a private ruling issued by the ATO to the ABA during the introduction of the GST, the ATO indicated that document preparation by legal advisers would be presumed to be a reduced credit acquisition.

However, in GSTR Ruling GSTR 2004/1, the discussion of the opening words of item 14 cast doubt on that interpretation. The ATO emphasises the need for the document preparation to be in the course of loan application, management and processing services. This is not unique to subsection (b): all of the items in item 14 have the same requirement. However, the discussion in GSTR 2004/1 with respect to item 14(b) emphasises the context in which the document preparation services are provided, particularly when compared to discussion of other items.

In relation to item 14(f), paragraph 401 of GSTR 2004/1 states:

"*An acquisition of the services of a solicitor or other service provider to conduct property title searches is a reduced credit acquisition under item 14(f) where the services are acquired in respect of property used as security for a loan.*"

Similarly, in referring to item 14(g), GSTR 2004/1states (at paragraph 403):

"*This service is normally acquired within a broader acquisition of loan processing services,* ***but where acquired in isolation it is still a reduced credit acquisition*** *under item 14(g).*" (emphasis added)

Paragraph 406, in the context of item 14(i), clearly states that services of adding and deleting caveats to titles provided by a legal practitioner in respect of titles of properties used as security for loans will be a reduced credit acquisition.

In a similar manner as for item 14(b), in the discussion in GSTR 2004/1 with respect to item 14(h), paragraph 404 specifically states that legal services for documenting variations to mortgages, including name changes, "*must be supplied in the context of loan management or processing services*" in order to be a reduced credit acquisition.

<u>Item 17</u>

GSTR 2004/1 provides, at paragraph 426-427, that in order for services to "*be a reduced credit acquisition mentioned in item 17, the service must do more than merely relate, or contribute, to the service mentioned...the service must be performed for the purpose of collecting a debt before it can be a reduced credit acquisition under item 17*".

The following examples of services provided by solicitors which could be reduced credit acquisitions are given:

a) calls to debtors;

b) preparation and mail-out of letters demanding payment;

c) preparation and filing of claims for a debt in a court;

d) serving of summonses;

e) litigation services in conducting legal proceedings (eg court appearances);

f) activities to enforce a judgement debt

g) lodgement of documents at court;

h) lodgement of documents at titles office to register writs on land where directed at the collection of a debt.

However, litigation that goes to establishing the existence of a debt is not considered to be directed at the collection of a debt and is therefore not a reduced credit acquisition (paragraph 438).

(b) **Wrapping of Legal Fees**

GSTR 2004/1 also provides some indications as to when certain legal services which are not alone reduced credit acquisitions can be "wrapped up" as part of a reduced credit acquisition, thus allowing a financial supply provider to effectively claim a RITC in relation to the cost of the legal services. In particular, the ruling highlights some circumstances when the acquisition of legal services which are required in the course of the transaction can effectively be supplied as part of a reduced credit acquisition.

This can be illustrated by the following example:

Assume a corporation (**Corporation**) requires the services of an arranger (**Arranger**) for the purpose of facilitating an issue of shares. The services of a law firm (**Law Firm**) are also required for preparation of documentation for the issue. The issue of the shares will be a financial supply by Corporation.

Example 4

Corporation separately acquires services of Arranger and Law Firm for $550 (including GST) each (total of $1100).

The services of the Arranger will be a reduced credit acquisition by Corporation. If the Arranger charges a fee of $550, including GST of $50, Corporation will be entitled to an RITC of $37.50 (75% x $50). Therefore, the net cost of the Arranger services to Corporation is $512.50 ($550-$37.50).

If Corporation acquires the document preparation services from Law Firm, the provision of those services will not be a reduced credit acquisition. Therefore, if the Law Firm charges $550, including $50 GST, the net cost to Corporation will be $550.

The total cost to Corporation will be $1062.50 ($512.50 + $550).

Example 5

Corporation acquires services of Arranger. Part of the required services of Arranger includes procuring the preparation of documents. The total fee for the Arranger services is $1100.

The services of the Arranger will be a taxable supply and a reduced credit acquisition. Ordinarily, Arranger would charge $500 for its services, oncharge the cost of any additional services, such as document preparation, then add GST. If Arranger acquires the services of Law Firm to prepare documents for $550, including $50 GST, Arranger will be entitled to a full input tax credit for the $50 GST. Therefore, the cost to Arranger will be $500.

When Arranger supplies its services to Corporation, including the document preparation which it outsourced to Law Firm, Arranger will charge Corporation $500 for its services, plus $500 being the cost of the document preparation. Arranger will then increase this by $100, being the GST for which Arranger will be liable on the supply of its services to Corporation. Therefore Arranger will charge Corporation a total of $1100, including $100 GST.

The services of Arranger will be a reduced credit acquisition by Corporation. Therefore Corporation will be entitled to an RITC of $75 (75% x $100). The net cost of the services of Arranger, including the preparation of documents, will be $1025 ($1100 - $75).

By using an Arranger to outsource the required legal services, the Corporation is able to effectively receive a 75% input reduced tax credit for the legal work completed by the Law Firm. This tax input credit is not available when the Corporation uses the Law Firm directly.

The following are some of the possible situations highlighted in GSTR 2004/1 where "wrapping up" acquisitions results in those acquisitions being reduced credit acquisitions are:

(a) Item 9: Arrangement by Financial Supply Facilitator (FSF) of provision, acquisition or disposal of an interest in a security:

(b) Item 11: Services provided by a Financial Supply Facilitator

- *Item 11(d) - arranging syndicated loans*

(c) Item 14: Loan application, management and processing services

Items 14(c), (f), (g) and (i) discussed above are reduced credit acquisitions when acquired in their own right or as part of a broader reduced credit acquisition. In addition, the following items may include "wrapped up" legal services:

- Item 14(b) - settlement and discharge of loans, including document preparation;
- Item 14(h) - Mortgage variations, including name changes.

(d) Item 17: Debt Collection Services

Items 17(a), (b) and (c) discussed in 1.2 are reduced credit acquisitions when acquired in their own right or as part of a broader reduced credit acquisition. In addition, item 17(d) - management by a financial supply facilitator of the recovery of sums due by borrowers - may include "wrapped up" legal services.

(e) Item 18: Arrangement by a financial supply facilitator of a hire purchase to which item 8 in the table in regulation 40-5.09 applies.

(c) **Procurement of Legal Services**

The necessity for legal services to form part of a reduced credit acquisition largely arises because the legal services are being supplied to a financial supply provider, as a result of which the supplies are not made for a creditable purpose.

However, a borrower who incurs expenses in connection with a borrowing will be entitled to full input tax credits for any costs provided that the borrowed funds are used for a creditable purpose – e.g. the borrowing funds the making of taxable or GST free supplies. Generally, the terms of an arrangement between a borrower and a lender require that the borrower bear the cost of the acquisition of legal services by the lender. Potentially, the terms could instead require that the borrower procure the supply of those services to the lender.

In the case of a borrower who intended to use the borrowed funds for a creditable purpose, the procurement of the legal services would be a fully creditable acquisition. From a legal perspective, it would be possible for the adviser to contract with the borrower to act for the lender, so that the client relationship was between the lender and the legal adviser.

A similar arrangement could also be constructed between the agent for a syndicate and the lenders. If the agents services included an obligation to ensure the necessary legal sign offs, the services of the legal advisers could be procured by the agent. As the procurement by the agent would occur in the course of the agent's taxable supply of agency services, the GST payable would be fully creditable. Such an arrangement could avoid GST on legal costs becoming "built in" as in example 2 above, as well as reducing administrative difficulties for agents or lenders who must otherwise invoice the recharge to the borrower.

The impediment for such procurement arrangements is the risk of the ATO seeking to apply the general anti-avoidance provisions in Division 165. A change from the current

arrangements with the result that there is less "leakage" of GST arising with respect to legal fees could raise suspicion in the absence of other strong reasons for doing so.

3.4 Apportionment

The issue of apportionment itself is not new. Since the introduction of GST, financial supply providers have had to determine the extent to which particular acquisition relates to input taxed versus taxable and GST-free supplies.

There are 3 big questions in this area, the first is the primary question as to the interpretation of section 11-15 and whether it is necessary to have a specific connection to an input taxed supply in order for a particular acquisition to be for a non-creditable purpose or whether an indirect connection is sufficient to require apportionment. The second question is, once it has been established that there is the necessary degree of connection between an acquisition and an input tax supplier, how is the degree of that connection compared to the degree of connection to creditable supplies to be determined. Third, really a sub set of the second question, is whether hire purchase transaction require special rules.

The ATO's views on the apportionment in relation to financial supplies are contained in GSTR 2000/22. The key messages in that ruling are:

- Direct attribution is to be undertaken wherever possible;
- Indirect attribution must be used where direct attribution is not possible;
- A taxpayer can adopt the most beneficial method but it must be fair and reasonable.

Clearly, where a business makes both input taxed financial supplies and taxable and GST-free supplies using the same staff on the same premises, there will be many costs which cannot be directly allocated to any particular supplies. For example, overhead costs such as rent and electricity will often require an indirect form of attribution. In many cases, the management accounting systems will already attempt to apportion those costs for the purpose of product or line costing. Generally, a pre-existing system which is objectively "fair and reasonable" will be an appropriate means of undertaking apportionment for GST purposes.

But for most financial organisations, there will be a number of "overhead" type costs which are not apportioned in the necessary way. This could be for a number of reasons. One of the main reasons is that an organisation may not "spread" certain overhead costs across its products. In particular, certain costs relating to the entire operating structure of an organisation are not divided among the business lines or products.

These costs are most "distant" from a particular supply. There is an argument as to whether some of these costs are "too remote" to be connected to a financial supply and thus do not require apportionment but are fully creditable i.e. give rise to fully input tax credits. The ATO, perhaps unsurprisingly, considers that supplies that do not "relate" closely to any supplies, must then relate to all supplies made by an organisation and should be apportioned on a business wide basis.

Another reason that GST may require a more detailed apportionment than the business costing generally is that a single "line" or "product" level contains both taxable and input taxed supplies, and there is no need to distinguish between these elements for any other purpose. Hire purchase transactions are a highly topical example of where GST requires a degree of apportionment that causes difficulties for the financial supply provider.

3.5 Apportionment in relation to hire purchase arrangements

The difficulty with hire purchase arrangements is that although for GST purposes there are 2 different tax treatments of the components of the consideration for a hire purchase, there is only one transaction taking place. Goods are supplied from the lessor to the lessee. The lessee is required to make payments over the term of the contract. For income tax purposes and, in respect of certain arrangements (perhaps most), for GST purposes the hire purchase transaction is treated as a sale of goods accompanied by a loan. However, there is one contractual arrangement, so determining the extent to which a particular cost relates to the making of the loan versus the making of the sale is a difficult proposition.

The profit to be made by a lessor is almost entirely based on the credit component. Generally, the goods are acquired and "on sold" by the lessor to the lessee at their actual cost price. The margin that the lessor then earns is based on the rate of interest charged to the lessee over the term of the arrangement. This could suggest the objective purpose of a lessor in incurring all of its costs is to make a profit through the provision of the input taxed supplies so that any costs which don't directly relate to the taxable supply of the goods should be treated as relating to the input taxed credit arrangement.

However, this would ignore the fact that lease transactions which don't have the right or option which signify a hire purchase for GST purposes have exactly the same financial outcome. To effectively input tax the vast majority of costs associated with hire purchase arrangement while treating costs associated with leasing as fully creditable, would place hire purchase transactions as a significant disadvantage to leasing. Further, at the heart of a hire purchase transaction is the supply to the lessee of the goods. This supply is taxable and the input taxed nature of one aspect of transaction should not be allowed to overshadow the entire arrangement.