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Dear Michael

Tax Laws Amendment (2009 Measures No. 5) Bill 2009: GST and representatives of incapacitated entities

The Taxation Institute of Australia (**Taxation Institute)** refers to the *Exposure Draft Tax Laws Amendment (2009 Measures No. 5) Bill 2009: GST and representatives of incapacitated entities* (**Exposure Draft**).

The Taxation Institute welcomes the opportunity to make comments and thanks you for the extension granted to make these comments.

The Taxation Institute has set out below a number of comments and observations. Please note that all legislative references are to the Exposure Draft or *A New Tax System (Goods and Services Tax) Act 1999* (**GST Act**) as applicable unless specifically stated.

1. Determining the entity that makes the supply

The intention of the proposed amendments is very clear. That is, a representative is responsible for the GST consequences that arise during its appointment.

One issue addressed by the Federal Court in *Deputy Commissioner of Taxation v PM Developments Ltd [2008] FCA 1886* (**PM Developments**) was which entity made the supply in question (the representative or the incapacitated entity). The Federal Court noted the general operation of the GST Act which imposes GST on taxable supplies that an entity makes. In that case, having regard to the general position under the *Corporations Act 2001*, beneficial ownership of assets in a company does not change on the appointment of a liquidator. On that basis, a liquidator does not, by mere virtue of its appointment, become the owner of the assets of the company (refer PM Developments [31] and [41]). Therefore, when looking at the identity of the entity that makes a supply of the company while in liquidation, the Federal Court held that it cannot be said, on general principles, that it is made by the liquidator.

Therefore, the Taxation Institute considers that any references to the representative *making* the supply or a supply *by* the representative needs to be clarified to ensure that no issues arise

regarding these basic principles in situations where the representative is not as a matter of law making the supply. The Taxation Institute notes that paragraph 1.28 of the Explanatory Memorandum to the Exposure Draft is a clear representation of the intention of the provisions and it should be ensured that this is reflected throughout the amendments. There is also acknowledgement in that paragraph that the purpose of the amendments is to place all types of representation on a common footing and provide a consistent base from which the relevant liabilities can be transferred to the representative. Accordingly, the Taxation Institute is concerned that these express intentions are not presently reflected in the amendments where the provisions, as currently drafted, proceed on the basis that *all* representatives of incapacitated entities are making the supply.

In some circumstances the representative is indeed making the supply (or acquisition, as the case may be) (eg bankruptcy and under s474(2) of the *Corporations Act 2001* where a vesting order is sought). Therefore, in some circumstances, it is appropriate to refer to the representative making the supply (section 58-5).

However, it should be made clear that where there is references to a representative making a supply, such provisions only apply where, as a matter of law, the representative is actually making the supply.

2. Straddle transactions

Overall the provisions set out in section 58-10 need to be carefully considered in relation to transactions that straddle the appointment. The Taxation Institute has set out below a number of observations about the outcome of these provisions and the practical issues that may arise.

For example, under section 58-10(2)(d) the representative is not liable for GST where the GST is attributable to a period that ends after appointment. This raises a number of questions. When will the representative's tax period end where the representative ceases its appointment? Is it the date that the appointment ceases? If that is the case, the use of the words "the GST payable would be attributable to a tax period applying to the representative, in the capacity of a representative of the incapacity entity that ends after the representative ceases to be a representative of the incapacity entity" is confusing as this scenario would never arise.

Alternatively, if it is the case that the tax period ends at the end of the month/quarter and therefore could continue after the representative's appointment ceases, section 58-10 would appear to exclude GST liabilities that arise in that period (even though the representative may still be appointed for part of it). The representative would not have a liability for these concluding transactions.

A further example is section 58-10(3) which provides that the representative cannot claim an input tax credit where the consideration was provided by the incapacitated entity prior to appointment of the representative. Can the incapacitated entity claim the input tax credit at this time by submitting a separate GST return? This may arise if it is discovered that an input tax credit was not claimed when it could have been. Such claims may provide vital funds for the incapacitated entity.

Under Section 58-10(4)(a) if there is an increasing adjustment as a result of an increase in consideration for a supply, this is the responsibility of the incapacitated entity and not the representative. This is the case even though the representative may have received the funds. Under section 58-55 the representative must notify the Commissioner of such an increasing adjustment if a GST return has not been given. Is it intended that the representative provide a GST return for the incapacitated entity but the representative has no liability in relation to the adjustment even though the funds may have been received during its appointment?

3. BAS of incapacitated entity during period of appointment

It appears that the incapacitated entity will be required to submit GST returns during the period of the appointment of the representative (there is no concluding tax period, see comments below regarding section 27-40). This is also the case given that there are circumstances where GST

obligations arise for the incapacitated entity as set out above. Has consideration been given to who is responsible for these GST returns? Under section 58-50 the representative is responsible if directed by the Commissioner.

The Taxation Institute notes that there was no equivalent provision in Division 147, so this requirement is new. The Taxation Institute is of the view that this can be quite onerous for the representative, depending on the information maintained by the incapacitated entity. More importantly, the Taxation Institute considers that the Commissioner enjoys an advantage in being in a position to direct the representative to spend costs on preparing GST returns, potentially to the detriment of the other unsecured creditors. In this regard, the Taxation Institute acknowledges that the Commissioner must take into account in deciding to give a direction, the matters listed, including the cost impact (s. 58-50(4)(d)). An issue for representatives will be compliance with any direction and the consequences for failure to comply, including where, for example, the GST returns lodged by the representative are not accurate.

4. Increasing adjustments for acquisitions

With the repeal of Division 147, the representative will be responsible for increasing adjustments that arise in relation to acquisitions where the incapacitated entity did not provide consideration for such acquisitions prior to the appointment of the representative (section 58-10(1)). For example, where the incapacitated entity received goods or services prior to the appointment of the representative, claimed input tax credits but did not pay the supplier.

As part of the representative's appointment, these debts may be paid in part or in full. In circumstances where the debts are only paid in part, the incapacitated entity will have over claimed input tax credits and an increasing adjustment would generally be required by the representative. The exception contained in section 58-10(4) will not apply.

Under the current section 147-20, if the representative gives notice of the increasing adjustment to the Commissioner, it is not is required to make the adjustment.

The Taxation Institute submits that this position should be retained in the legislation going forward by incorporating it into section 58-10(4). This was an important provision in the original (and current) legislation for representatives having to deal with a number of creditors. The Taxation Institute considers the original policy grounds should be respected, and the representatives (and creditors) should be provided with such relief provided the appropriate notice is given.

5. Concluding tax periods

The amendment proposed to section 27-40(1) is stated in the Explanatory Memorandum to be aimed at “ensur[ing] that all incapacitated entities have concluding tax periods. Currently, an incapacitated entity may or may not have a concluding tax period depending on the type of representation to which it is subject” (refer paragraph 1.52, incorrectly referring to Item 7 rather than item 15).

However, the Taxation Institute believes that the Explanatory Memorandum does not properly reflect the amendments. New section 27-39 ensures that all, not just some, incapacitated entities have to conclude a tax period so the representative starts with a new tax period. The proposed amendment to section 27-40 (Item 15 not 7) actually ensures that only entities which "cease to exist" will have a final tax period (called “concluding” in the heading).

The Taxation Institute suggests the Explanatory Memorandum is changed to properly reflect the amendments to avoid any confusion.

6. Application to the taxpayer

Whilst the Taxation Institute does not represent the interests of the taxpayer in *PM Developments*, the Taxation Institute would expect that the Exposure Draft will not apply to the taxpayer in relation to the transactions that were the subject of the Federal Court decision. The Taxation Institute has

not seen any commentary on this point. The Taxation Institute would be happy to discuss with you the grounds on which this should be the case.

7. Retrospective nature of provisions

Treasury has been clear that it was its intention to introduce retrospective changes. The Taxation Institute acknowledges that during the initial years of a new tax, retrospective changes of a clarifying nature may be warranted. However, the Taxation Institute considers that such wholesale changes as contained in the Exposure Draft, nine years into the GST system to be inappropriate and establishes a dangerous precedent. The Taxation Institute is particularly concerned as this area of the GST Act has been uncertain for a considerable period of time. This uncertainty, moreover, was confirmed in the case of *Sunnyville Pty Ltd* v *ADIG* [2006] QSC 249 at [57] – [58].

The Taxation Institute requests that, ten years since the GST Act was enacted, any future changes be prospective only.

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The Taxation Institute welcomes the opportunity to provide further clarification of any of the issues raised in this submission. Any queries concerning this submission should be directed to Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis on (02) 8223 0011 or Suzanne Kneen, Senior Associate, Blake Dawson on 03 9679 3066 who, with contributions from other members, wrote this submission.

Yours faithfully

David Williams
Vice President