

Patrick Tuttle,  
Australian Securitisation Forum  
GPO Box 3655  
Sydney NSW 2001

30 June 2009

Dear Mr Tuttle,

The purpose of this letter is to provide a response to the proposals for settlement put forward by the Australian Securitisation Forum (ASF) on behalf of its members at a meeting on 5 May 2009 and in subsequent correspondence.

Since our meeting with the ASF and other representatives of the securitisation industry on 5 May 2009 we have considered the proposals in consultation with senior officers responsible for the settlement of income tax and GST matters. We can now confirm our position in relation to settlement is:

- We are able to settle GST for the past on a concessionary basis (generally referred to as the 1A=1B basis) as outlined in schedule 1 of the draft settlement deed (Attachment 1);
- The settlement will require agreement to the full cost recovery method for the future as outlined in schedule 2 of the draft settlement deed;
- We are unable to settle on a net GST basis, for the reasons outlined below; and
- We are unable to settle the Income Tax issues that arise from these GST liabilities for the reasons outlined below.

### **GST**

As stated above and previously, we are unable to settle GST amounts on a net basis because:

- It is our normal practice to assess the supplier (Corporate Entity) for the full GST payable and allow the input tax credits to be claimed by the recipient according to their entitlement;
- Settling the Corporate Entity's GST liability by settling on a net GST basis limits the associated recipient's statutory rights to input tax credits. There is considerable doubt that a recipient can in fact deny itself a statutory right to an input tax credit; and
- In certain circumstances a third party (e.g. creditors or other right holders) may be entitled to the cash flowing from the refund of reduced input tax credits to the Trust. This cash flow would be denied to either the creditor or other rights holder if we settled the Corporate Entities GST liability on a net basis.

We do however accept that GST can be settled on a net basis in situations where it can be demonstrated that the associated trust has been wound up such that there is no possibility of a claim for input tax credits. In this instance, the income tax consequences will be based upon the net GST assessment on the Manager. A separate settlement deed is currently being drafted to take into account settlement on a net GST basis when trusts have been wound up. Settlements on a net GST basis in these circumstances will apply regardless of whether supplies were made for no or inadequate consideration.

With respect to the interaction of Division 72 of the GST Act and Division 70, you state that;

*'It should also be borne in mind that it is by no means free from doubt that Division 72 in fact has any application in light of the extended meaning of creditable purpose that arises in relation to supplies made to parties entitled to claim an RITC. That is, entitlement at the Trust level to an RITC clearly points to the non application of Division 72, given that the GST Act itself then deems the supply to have been made for a wholly creditable purpose (refer Section 70-10 of the GST Act). Division 72 cannot apply in the presence of a wholly creditable purpose.'*

We do not agree with this view. Division 72 of the GST Act ensures that supplies to, and acquisitions from, your associates without consideration are brought into the GST system, and that supplies to associates for inadequate consideration are properly valued for GST purposes. Section 72-70 of the GST requires that the acquisitions by the associates must be *solely* for a creditable purpose if the section is not to apply, and the trusts do not acquire the services from the Corporate Entity *solely* for a creditable purpose. Section 70-10 of the GST simply extends the meaning of creditable purpose – it does not state that an acquisition that qualifies as a reduced credit acquisition is *solely* for a creditable purpose. Therefore we are of the opinion that section 70-10 of the GST Act only extends the meaning of creditable purpose to the extent that the acquisition is a reduced credit acquisition and that the term creditable purpose, for the purpose of Division 72 of the GST Act, is determined by reference to Division 11 of the GST Act.

### ***Income Tax***

The consequences for income tax were articulated to the ASF in our letter of 7 April 2009. In particular, it was explained that the amounts payable will be repayments of amounts that have been previously refunded by the Commissioner pursuant to Division 35 of the GST Act. A Division 35 net amount is not assessable income to a recipient. The adjustment to the Division 35 net amount, by applying Division 72 of the GST Act, will enable the Commissioner to recalculate the net amount to the refund that should have been refundable for that period.

It was further explained that for a Corporate Entity that has charged (inadequate) consideration, an adjustment is to be made to the gross consideration received from the relevant supply by the amount that is required to be refunded to the Commissioner. Section 17-15 of the *Income Tax Assessment Act 1997* (ITAA 1997) relevantly provides that in calculating an amount that is to be included in assessable income the assessable amount must not include an amount equal to the GST payable.

Where there has been no consideration charged by a Corporate Entity, section 17-15 of the ITAA 1997 cannot operate to exclude the refunded amount from assessable income because the condition precedent that there be an 'amount received or receivable', against which the GST could be offset, is not present. The words 'amount received or receivable' is in reference to the consideration received or receivable from the provision of that taxable supply.

In a recent submission you maintain that whilst you may not agree with the ATO's reasoning where there has been (inadequate) consideration, you nevertheless accept the outcome. However, where there has been no consideration you seek the same outcome by relying on the amount being deductible under subsection 8-1(1) of the ITAA 1997. The view is that Divisions 17 and 27 of the ITAA 1997 are the relevant Divisions of the ITAA 1997 for determining the effects of GST and input tax credits on assessable income.

However, as the issue of deductibility of this payment under subsection 8-1(1) of the ITAA 1997 has been raised, it requires consideration.

Subsection 8-1(1) of the ITAA 1997 is concerned with losses and outgoings incurred in:

- (a) in gaining or producing assessable income; or
- (b) necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

For an expense to be a loss or outgoing it must be '... an expenditure which has an effect in gaining or producing income': per Latham CJ in *Amalgamated Zinc (De Bavay's) Limited v. F C of T* (1935) 54 CLR 303 at page 303. Gaining or producing assessable income means 'in the course of gaining or producing such income': *Ronpibon Tin N.L. v. F C of T* (1949) 78 CLR 47.

A payment of the refund by a Corporate Entity to the Commissioner has no discernible effect on the gaining or production of assessable income by the Corporate Entity. Nor will the refund be incurred in the course of gaining or producing assessable income because all the payment does is reduce the Corporate Entity's entitlement to what is simply an amount that is not assessable income.

There is also no discernible nexus between the payment of the refund and an additional trust distribution that may arise because of the effect of Division 72 of the GST on the quantum of a deduction where consideration passes between the trust and the Corporate Entity. In an Administrative Appeals Tribunal case, Case V109 ATC 697, Deputy President Gerber ruled that expenses incurred by a beneficiary of a discretionary trust would not qualify for deduction under section 8-1 of the ITAA 1997 on the basis only that the trustee may distribute income to the beneficiary.

Accordingly, a payment that is in respect of a refund of a net amount under Division 35 of the GST Act does not qualify as a deduction under subsection 8-1(1) of the ITAA 1997.

In concluding, the income tax consequences are in accordance with the income tax provisions and any settlement would be contrary to the articulated policy reflected in the income tax law.

## **Next Steps**

We have considered this matter extensively and have advised the ASF and its members in earlier correspondence and this correspondence of our view regarding to the income tax consequences arising from the application of Division 72 of the GST Act. It is considered that you are now in a position to decide whether you wish to settle the GST payable under the terms outlined in the enclosed settlement deed.

We request that you decide whether you wish to settle by 31 July 2009 and by that time provide the calculations of additional GST payable, based upon the concessionary methodology in schedule 1 of the draft settlement deed for all prior periods, in order to quantify the assessments. We also request details of all associated trusts including ABN's to which the supplies for no or inadequate consideration were made.

Where the supplies for no or inadequate consideration were made by the Corporate Entity to trusts that have since wound up, we request the calculations of additional net GST liability, based upon the concessionary methodology in schedule 1 of the draft settlement deed for all prior periods less 75%. This reflects the methodology in the settlement deed currently being drafted to take into account settlement on a net GST basis where trusts have been wound up. We also request details of all wound up trusts including ABN's and date of the winding up.

We note that you have raised the matter of an industry wide payment arrangement in relation to the ultimate Tier 2 settlement amounts. We understand that the current global financial crisis has resulted in a deterioration in the financial circumstances of your members. Therefore we are willing to consider any proposal you put forward to assist in the payment of the settlement amounts.

We take the view that full cost recovery properly reflects the market value of supplies between the Corporate Entity and the various associated trusts. If you decide not to settle we ask that you to provide to us by 31 July 2009 the calculations of market value based upon the full cost methodology in order to allow us to quantify the assessments.

It is our view that the full cost recovery methodology should be adopted by all parties for all Business Activity Statements starting from 1 July 2009.

Please note that the Tax Office is willing to fully remit the General Interest Charge (GIC) for the period from 1 April 2008 to 31 July 2009.

Should you wish to discuss your particular circumstances please telephone Stephen Fenwick on (03) 9275 9830 or your normal GST contact.

Stephen Howlin  
Assistant Commissioner – GST Interpretative Assistance