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Dear Michael,

### **Exposure Draft - GST and Representatives of Incapacitated Entities**

The Institute of Chartered Accountants in Australia (the Institute) welcomes the proposed new regime for the application of GST to representatives of incapacitated entities, and we appreciate this opportunity to provide our comments on the exposure draft legislation and Explanatory Memorandum (EM).

The Institute is the professional body representing Chartered Accountants in Australia. Our reach extends to more than 62,000 of today's and tomorrow's business leaders, representing over 50,000 Chartered Accountants and 12,000 of Australia's best accounting graduates who are currently enrolled in our world class Chartered Accountants postgraduate program. Our members work in diverse roles across commerce and industry, academia, government and public practice throughout Australia and in 140 countries around the world.

It is our view that the proposed regime is an improvement of the current legislation and particularly the uncertainties flowing from it. As an overall observation, however, the Institute found it quite difficult to follow the exposure draft and the EM. We consider that the exposure draft and EM do not articulate the intended policy underlying the responsibilities of the incapacitated entity and representative, and the resulting GST obligations. A clear statement of the intended policy is needed to assist in determining whether the draft legislation achieves the intended effect, and if it does not, the drafting changes that may be necessary to achieve this outcome. Our detailed comments in relation to the proposed regime and the particular provisions follow below.

#### **Section 58-5**

The Institute welcomes the overall effect of section 58-5 to clarify that the incapacitated entity will always be liable for, or entitled to, the GST consequences that arise from supplies, acquisitions and importations made during the period of the representative's appointment regardless of whether it was the incapacitated entity or the representative that undertook the transactions.

It is suggested that a further subsection be inserted confirming that any adjustment that an entity has in the capacity of representative of another entity that is an incapacitated entity is taken to be an adjustment that the other entity has. The circumstance here is where the supply, importation or acquisition to which the adjustment relates was before the representative's appointment and is not within the representative's capacity (hence section 58-10 does not apply). Note further that subsection 58-10(4) does not address the scenario where the incapacitated entity issued or received an invoice before the representative was appointed but consideration had not been payable prior to the appointment.

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It is arguable that subsection 58-5(2)(c) only has the effect of determining whether an adjustment arises and not who has the adjustment. Paragraph 1.28 of the EM indicates that the intention is that incapacitated entity will have the adjustment but the Institute is not certain that section 58-5 has that effect.

### Sections 58-5 and 58-10 – Attribution Issues

The exposure draft introduces a novel transaction decoupling during periods of incapacity whereby the transactions are taken to be those of the incapacitated entity (section 58-5) yet the representative is liable for the GST consequences of those transactions, where they are within the scope of the representative's responsibility or authority for managing the incapacitated entity's affairs (section 58-10).

In the Institute's view, the exposure draft and EM do not articulate the intended policy with respect to the demarcation between the incapacitated entity and representative's responsibility and the resulting GST attribution. A clear expression of the intended policy with examples in the EM might assist in determining whether the draft legislation achieves the intended effect. The transaction decoupling per sections 58-5 and 58-10 may need to be reworded to achieve the intended effect. We also recommend that a table be included, outlining whether the incapacitated entity or representative is liable for the GST in respect of various transactions before, during or after appointment and under the different accounting basis i.e. cash or accruals.

The exposure draft legislation does not clarify the intended policy in respect of various transactions. Examples include:

- **Consideration received by representatives** – consider where an entity accounting for GST on a cash basis, makes a supply and issues an invoice prior to becoming incapacitated and prior to the appointment of a representative, and the representative receives the consideration for that supply. Arguably “the making of the supply” is not within the scope of the representative's responsibility, but only receiving the payment for it. It appears to the Institute that the representative is not liable to pay the GST on that supply. Yet paragraph 1.44, addressing the new section 58-40 for representatives accounting on a non-cash basis, states:

*“In addition, liability for a supply should not be attributed to an entity that did not receive consideration in respect of the supply”.*

- **Progressive or periodic supplies** – consider where an entity makes and commences a supply or acquisition under a progressive or periodic basis e.g. entering a real property lease. When the representative is appointed, it decides to continue to pay the lease rentals. The Institute suspects that the policy intention is that the representative is liable for any input tax credits in respect of the periods of the lease for which it pays lease rental as consideration. However, again it is arguable that “the making of the ...acquisition” is not within the representative's responsibility. The acquisition being the receipt of the granting of a lease was made previously by the now incapacitated entity. Division 156 does not assist because it does not treat each periodic component as a separate acquisition but merely attributes it as if it were a separate acquisition. The outcome of *Westley Nominees Pty Ltd v Coles Supermarkets Australia Pty Ltd* (2006) 62 ATR 682 may assist in achieving the desired policy outcome but the Institute suggests it better to provide for that outcome in the draft legislation, rather than relying on case law for this common transaction scenario.
- **Incapacitated entities and representatives accounting on a non-cash basis** – It is not easy to identify where section 58-40 applies. The typical circumstance where the GST on a supply will be attributable to a tax period ending before the representative is appointed would be where a non-cash basis entity issued an invoice for a supply it made prior to becoming incapacitated. However, in those cases, it is difficult to see how the representative would be liable for the GST payable on that supply (after all, section 58-10 only applies where the making of the supply is within the representative's responsibility).

### Sections 58-5 and 58-10 in relation to Division 105

A weakness of the current GST regime concerns supplies made in satisfaction of debts. In practice, insolvency firms are typically appointed by financiers to realise assets in satisfaction of debts, known as “mortgagee in possession” sales. Division 105 provides the legislative mechanism by which the mortgagee in possession accounts for the GST on sales of assets under security. However, there is currently some doubt whether Division 105 applies in practice because the better legal view seems to be that mortgagee in possession does not actually make the supplies in satisfaction of the debts. Rather, the incapacitated entity continues to hold legal title to the assets being sold and the argument is that it makes the supplies for GST purposes (refer to section 9-40 which states that “(y)ou must pay the GST payable on any taxable supply that you make”). Division 105 does not appear to deem the mortgagee in possession to make the supplies. The incapacitated entity will usually not receive the proceeds from the sale nor otherwise have the available funds to meet the liability on the sale. Anecdotally, it appears that large sums of GST are not remitted on these transactions.

Insolvency firms that are typically appointed by mortgagees in possession to realise assets in satisfaction of debts are often described as “receivers” but are not “receivers” as defined under the Corporations Law. Legally, they are typically agents of the mortgagee in possession. They distribute the proceeds from the sale of the assets at the direction of the mortgagee in possession. It is likely then that the section 58-5 does not have the effect of correcting the legislative flaw described above. As the appointed insolvency firm is not a representative of the incapacitated entity as such, the GST liability will not be taken to be that of the mortgagor and the representative will not be liable to pay any applicable GST.

It is suggested that the proposed bill tabled before Parliament is a fitting opportunity to correct the current anomaly and to remove an uncertainty that insolvency firms currently have to face. As the exposure draft bill currently stands, uncertainties remain regarding the GST treatment of a significant proportion of an insolvency firm’s appointments, even though they are not covered by Division 147.

### Sections 147-20 and 58-55

The removal of section 147-20 is welcome and necessary. It is the Institute’s view that the transfer of the underlying GST liability from the incapacitated entity to become the personal liability of the representative for what amounts to a reporting mistake is unreasonable. The Institute takes the view that section 147-20 should be repealed from 1 July 2000.

The new notification provision, section 58-55, is a much more acceptable approach to protecting the Commissioner’s debt without transferring a liability to the representative. To that end, the exposure draft does not indicate the consequences if the representative fails to make the notification in the approved form. Whether the failure will be treated as a statutory offence under the *Taxation Administration Act 1953* with a statutory penalty imposed is unclear.

The reference in section 58-55(1) that the representative “becomes aware, or could reasonably be expected to have become aware” that the entity is liable for an amount of GST or has an increasing adjustment is a welcome reflection on the problem of limited information that the representative often has. Section 58-55 could be improved by expanding the expression in the manner of subsection 58-50(4)(c):

*“taking into account the availability of books and records which might determine whether the representative could reasonably be expected to have become aware”.*

A prerequisite for section 58-55 applying is that “*the entity is liable for an amount of GST, or has an increasing adjustment*”. This confirms the Institute’s earlier point that section 58-5 needs to make it clear that, for all purposes, the incapacitated entity has any adjustment triggered by any act or omission of the representative.

Another prerequisite for section 58-55 is that the amount of GST or the adjustment is attributable to a tax period applying to the incapacitated entity for which a GST return has not been given to the Commissioner. The implication is that the representative is not required to notify the Commissioner of any liabilities or adjustments of the incapacitated entity, that it becomes aware of, which were not accounted for in a GST return that has been given to the Commissioner. Thus, if the representative becomes aware that the incapacitated entity failed

to report some taxable supplies in the last GST return it lodged, it is not required to report that to the Commissioner per section 58-55, although it may be required to do so under the Corporations Law. If this is not the case, then the provision may need amending or clarification.

The Institute is also concerned with the timing of the notification per subsection 58-55(2)(c). Consider an example where a representative is appointed on 1 July to an incapacitated entity with quarterly tax periods. On 5 October there is an adjustment event, the final transaction that the representative manages before calculating the dividend it wishes to declare. That adjustment is attributable to the tax period ending 31 December. Is the representative required to wait until after 31 December to make the notification before it can declare the dividend? Should section 58-55 be amended to allow the representative to make the notification before the end of the tax period to enable timely declaration of the dividend? The Institute is concerned that the provision as currently drafted might actually delay declaration and payments of dividends and the completion of administrations.

### Section 27-39

In relation to the end of the incapacitated entity's tax period, section 27-39 is an improvement on existing subsection 27-40(1)(b) which only dealt with liquidations and receiverships. However, it repeats what is arguably an unintended consequence in the existing provision. Most appointments of representatives occur during the course of or after the completion of a day of business trading. They occur as a result of a decision made or an event that has happened during that day. Thus, there are often scenarios where business transactions have occurred during that day both before and after the appointment.

The effect of section 27-39 in conjunction with section 58-35 is that the first day of a representative's first tax period is the day of its appointment. It appears that the effect of section 58-10 is that the transactions occurring during the day of the appointment but before the actual appointment will not be within the scope of the representative's responsibility or authority for managing the incapacitated entities affairs. The representative will not be liable to pay GST or be entitled to input tax credits for such transactions. Rather, the transactions will be attributed to the tax period of the incapacitated entity that commences on the day of the appointment and ends on the day that the usual monthly or quarterly period, as the case may be, would otherwise end. This issue is particularly important where retail or cash based business become incapacitated during a day of trading.

### Section 58-50

The scope of requirement, in certain circumstances, for the representative to lodge a GST return for a tax period applying to an incapacitated entity is not completely clear. The likely effect of section 58-5 is that transactions occurring after the representative's appointment are still those of the incapacitated entity. Therefore, even though the representative may be liable for any GST that the incapacitated entity would be liable to pay on supplies that are within the scope of the representative's responsibility, the Institute suggests that subsection 58-10(1)(a) may not alter the consequence that the supplies are to be included in the incapacitated entity's GST return. If this is not the intended policy, and the Institute suspects it is not, then a clarifying provision is required.

If the policy is that those supplies are intended to be included in the incapacitated entity's GST return, then section 58-50 is defective because it is only triggered where the Commissioner directs the representative in writing. It would seem preferable if the representative had an obligation to lodge GST returns for the incapacitated entity in such circumstances.

The Institute suspects that section 58-50 is primarily directed at transactions that do not fall within the representative's responsibility or authority for managing the incapacitated entity's affairs; representatives should not be required to prepare and lodge incapacitated entities GST returns. Rather, the Institute believes that the notification requirement under section 58-55 should be sufficient to protect the revenue. Otherwise, that section 58-50 might impose a responsibility on the representative to audit or review an incapacitated entity's affairs to detect transactions that it was otherwise not aware of or could not reasonably be expected to be aware of.

The Institute also queries the application of section 58-50 to partial appointments e.g. limited receivership. We cannot see any circumstance where a representative appointed as receiver in relation to a particular asset

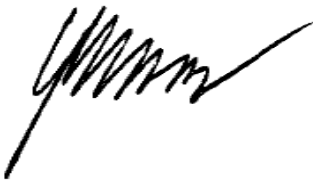
should have a requirement to prepare and lodge GST returns in respect of matters not directly related to the securing and realization of that asset. At the very least, partial appointments should be a matter the Commissioner is required to take into account (per subsection 58-50(4)) before deciding whether to require lodgment of a GST return by the representative. The Institute also suggests that any Commissioner's direction per subsection 58-50(1)(b) should be a reviewable decision.

### Section 58-60

The Institute does not believe that section 58-50 provides the sufficient indemnity to representatives that paragraph 1.66 of the EM does. While it may not be easy to identify them, the Institute would not be surprised if, in specific circumstances, the representative has a liability to pay a net amount per section 58-10 which cannot be recovered from the money the representative receives per section 58-60. It is suggested that any net amount payable per section 58-10 be limited to monies the representative receives in his or her capacity.

If you need any further information in relation to any aspect of this submission, please contact Donna Bagnall on 02 9290 5761.

Yours sincerely,



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