Introduction

Imitation is supposedly the sincerest form of flattery. If that is so, then New Zealand can feel somewhat flattered by the new Australian goods and services tax regime. Of course Australians would respond, with some validity, that New Zealand was not the first jurisdiction to develop a goods and services tax. Nevertheless, the core principles underlying both GST regimes are very similar and the Australian legislation is littered with details that have been uplifted directly from the New Zealand legislation.

A cynic might even suggest that some of the differences that do exist are only superficial and are simply attributable to the Australian drafters staking a claim to legislative independence. Perhaps the best example is the unfortunate decision of Australia to adopt the term "input taxed" supplies. The New Zealand term "exempt" would surely have fulfilled the role perfectly adequately. One wonders if the author of the Australian term played some part in developing the rather inelegant title of the core piece of Australian GST legislation, the A New Tax System (Goods and Services Tax) Act 1999 (the Australian Act). It may just be old fashioned parochialism but I have a clear preference for the somewhat simpler name of the New Zealand legislation, the Goods and Services Tax Act 1985 (the New Zealand Act).

While there are many similarities between the New Zealand and Australian regimes, there are also many differences. Generally speaking, the Australian regime is significantly more complex and contains a much greater number of exceptions to the core principles. In the development of the regime conceptual purity was often pushed aside by its more robust cousin, political pragmatism.

The most immediate difference to an adviser between the two GST regimes is size. The version of the New Zealand Act that I work with runs to about 200 pages. The equivalent Australian law runs to more than 800 pages and incorporates a range of legislation from the Australian Act itself through to such delights as the A New Tax System (Wine Equalisation Tax and Luxury Car Tax Transition) Act 1999.

Some of the most significant differences between the New Zealand and the Australian GST regimes arise in the context of the financial services sector. Those differences go primarily to the scope of what financial services are treated as input taxed/exempt supplies and to the availability of input tax credits (mercifully the same terminology is used in both jurisdictions) for acquisitions made in supplying financial services.

New Zealand's GST regime is in its fifteenth year. Many, but certainly not all, of the GST implications of financial services are known and accepted by the Inland Revenue Department (the IRD), participants in the financial services sector and tax advisers. That is certainly not the case in Australia. At times it can seem that there are still more uncertainties than certainties.

The Australian Tax Office (the ATO) has done an enormous amount of work in preparing public rulings on a wide range of GST matters. However, at the time of writing this paper a ruling on the scope of financial supplies remains a conspicuous exception. A substantial draft ruling has been prepared but it has not yet been publicly released. The ATO has consulted
extensively with representative bodies of various groups within the financial services sector including the Australian Bankers’ Association and the Investment and Financial Services Association, and has produced numerous private rulings and commentaries on relevant issues.

One of the major difficulties to date has been the unequal dissemination of the ATO’s views. This has meant that different taxpayers and advisors have different knowledge of the ATO’s current views on contentious issues. Given the importance attached to the ATO’s views on GST issues in Australia, that is an unsatisfactory position.

In the last year disagreements have frequently arisen as to the correct GST treatment of various financial services. For example, I have been involved in a number of cases where the GST treatment of underwriting has been in dispute. This has been caused in part by the ambiguity of the relevant legislation, in part by the absence of any accepted market practice and in part by uncertainty as to the ATO’s position on the issue. The latter has been exacerbated by different levels of knowledge about what the ATO has said and written about the treatment of underwriting and in particular whether or not it constitutes a guarantee for GST purposes and how that treatment will be applied.

Nevertheless, GST will remain a relatively more significant issue in the financial services sector than elsewhere. It also means that this is a sector that is more likely to be the subject of close scrutiny by the ATO. In other words, there will be more audits and more disputes in this area.

In drafting its GST regime, Australia has drawn on the experience of New Zealand together with the experience of other jurisdictions with similar taxes. The Australian regime contains a number of significant features not present in the New Zealand regime, including in particular the reverse charging rules and the reduced input tax credit rules. It will be interesting to see whether New Zealand will pick up on some of these refinements. In the short term at least it is likely to be happy to simply observe the impact of these rules in Australia.

I would also not expect to see any major changes to the Australian regime in the short term. Prior to the introduction of GST in Australia (and indeed in New Zealand), there was much discussion about the input taxed treatment of financial supplies. Other possibilities were considered. However, while there are no absolutes in politics, I feel certain that in Australia at least that treatment will not be changed in the foreseeable future. Having experienced the political turmoil (and associated media feeding frenzy) whipped up over issues such as the imposition of GST on caravan park charges, it is inconceivable that any Australian Government would contemplate imposing GST on mortgage interest payments.

The purpose of this paper is to provide an overview of how GST impinges on the financial services sector in Australia and New Zealand. It highlights some of the similarities and differences between the two regimes. There is a greater emphasis within the paper on the Australian regime primarily because it is a more complex regime and also because it is newer and therefore currently subject to many more uncertainties of interpretation.

Set out below is a brief summary of the basic structure of the GST regime in each jurisdiction. That is followed by a more detailed outline of the two most significant GST issues for financial services sector, namely how financial services are treated for GST purposes and how that treatment impacts on a taxpayer’s ability to claim input tax credits.
A major exception to the imposition of GST at the standard rate of 12.5 per cent is the taxation of certain supplies at the rate of 0 per cent pursuant to s 11. This is known as "zero-rating". It applies primarily to the exporting of goods and services and to the supply of going concerns.

Section 12 of the New Zealand Act imposes GST on the importation of goods. There is no GST imposed on the importation of services.

A registered person is entitled to claim input tax credits for the GST component of the cost of acquiring goods and services where those goods and services are acquired for the principal purpose of making "taxable supplies", ie supplies subject to GST at the standard rate of 12.5 per cent or zero-rated supplies. The GST component of the cost of goods and services acquired for the principal purpose of making exempt supplies cannot be claimed back by way of input tax credit. There are apportionment and adjustment rules to deal with situations where an acquisition is made for more than one purpose or the purpose changes.

For each taxable period a registered person files a GST return setting out the amount of output tax payable by reference to taxable supplies made less the amount of input tax credits available. The net surplus is payable to the IRD and any net deficit is refundable.

**Australia**

Section 7-1 of the Australian Act imposes GST on "taxable supplies" and "taxable importations".

A "taxable supply" is defined in s 9-5 as a supply connected with Australia that is made for consideration by a registered (or registrable) person in the course or furtherance of an enterprise that it carries on. However, specifically excluded from the ambit of taxable supplies is any supply to the extent that it is GST-free or input taxed.

In substance, the definition of the term "supply" is the same in the Australian Act as in the New Zealand Act. It is "any form of supply whatsoever". However, s 9-10 of the Australian Act sets out a series of specific inclusions. Some of those inclusions have created much of the uncertainty in the early days of the Australian regime. For example, the definition includes as a supply the "surrender of any right" and "an entry into, or release from, an obligation to do anything". That wording led to the view that the act of settling any dispute might constitute a supply in its own right independent of the underlying subject matter of the dispute. That is now the subject of a draft ruling.

Numerous items that constitute terms and conditions in commercial contracts can potentially constitute separate taxable supplies in their own right based on the expansive definition in s 9-10. Take for example the situation where a loan contract contains a number of undertakings on the part of the borrower. On the basis that entering into an obligation to do anything is a supply, there is an issue as to whether such undertakings can give rise to taxable supplies in their own right. The absence of express consideration for such supplies is not necessarily an obstacle to the existence of a taxable supply. The consideration could effectively be a proportion of the consideration provided under the relevant contract. I suggest that if too literal an approach is taken by the ATO to such contractual terms and conditions, then GST will become unworkable. This has not been a problem in New Zealand.

Unlike the New Zealand regime, the Australian regime does not adopt a residence concept in defining the GST base. That base is determined instead by reference to connection with Australia. The relevant rules in this regard are set out in s 9-25 of the Australian Act. Broadly speaking, a supply of goods is connected with Australia if the goods are delivered or made available in Australia, are removed from Australia or are imported into Australia or installed in Australia by the supplier. A supply of real property is connected with Australia if the real property is in Australia. A supply of anything other than goods or real property is connected with Australia if either "the thing is done in Australia" or the supplier makes the supply through an enterprise that it carries on in Australia.

The term "the thing is done" is a delight to scholars of statutory interpretation. Its scope is fairly clear when the supply involves some kind of physical performance of services. It becomes more problematic in the area of intellectual property and other intangible rights. Based on the approach demonstrated in GST Ruling GSTR 2000/31, the ATO focuses primarily on the issue of contractual execution. In other words a supply of rights is done in Australia if the last act creating the contractual rights is occurs in Australia.

An enterprise is carried on in Australia if it is carried on through a permanent establishment as defined in s 6(1) of the Income Tax Assessment Act 1936 or what would be a permanent establishment under that definition if certain exclusionary paragraphs of that definition did not apply.

As in New Zealand, registration is fundamental to the operation of the GST regime. Only persons who are registered or required to be registered are subject to the regime. In Australia an entity can register voluntarily. An entity is required to register if it is carrying on an enterprise that has an annual turnover of more than A$50,000 of supplies connected with Australia excluding supplies that are input taxed. A higher threshold applies to non-profit bodies. As input taxed supplies are not taken into account in determining the registration threshold, an enterprise that only makes input taxed supplies is not required to register whether or not its turnover exceeds the $50,000 threshold.

A supply is only a taxable supply if it is made for consideration. "Consideration" is defined in s 9-15 of the Australian Act. That definition includes any payment or any act or forbearance in connection with, in response to, or for the inducement of a supply. It clearly incorporates non-monetary consideration. The value of a supply, and therefore the level of GST imposed, is determined by the consideration for the supply. The rules in this regard are very similar to New Zealand.

The value of a supply is determined by the amount of money to the extent that the consideration takes the form of money and the market value of the consideration to the extent that it is non-monetary.

Section 9-20 of the Australian Act contains a comprehensive definition of "enterprise". It includes an activity or series of activities done in the form of a business, in the form of an adventure or concern in the nature of trade or on a regular or continuous basis in the form of a lease, licence or other grant of an interest in property.
A supply is not a taxable supply to the extent that it is either a GST-free supply or an input taxed supply. The use of the words “to the extent” raises the possibility that a single supply can be broken down into its taxable and non-taxable components. This is an issue that has arisen in the context of consumption taxes in a number of other jurisdictions and warrants a paper in its own right. Broadly speaking, my own view is that the approach taken in the United Kingdom and evidenced in cases such as British Airways plc v Customs & Excise Commissioners [1990] STC 643 should be applied in Australia even though the Australian legislation more clearly contemplates some kind of apportionment. The essence of the United Kingdom approach is that where a feature of an acquisition is incidental to an exempt supply, that feature will not be treated for GST purposes as a separate supply.

Division 38 of the Australian Act defines GST-free supplies in some detail. Like the New Zealand equivalent of zero-rated supplies, they include exports of goods and services and supplies of going concerns. However, the list in Australia is far more extensive and includes supplies of food, health, education, childcare and numerous other items.

Division 40 of the Australian Act defines input taxed supplies. They include supplies of residential premises and financial supplies. The nature of financial supplies is addressed in more detail below.

Australia imposes GST on the importation of goods. It also effectively imposes GST on the importation of some services through the reverse charging rules in Division 84.

Broadly speaking, a registered person is entitled to an input tax credit for the GST component of the cost of an acquisition or importation if the acquisition or importation is made for a “creditable purpose”. An acquisition or importation is not made for a creditable purpose to the extent that it relates to importing goods or services and is of a private or domestic nature. Unlike New Zealand, input tax credit entitlement is not based on a principal purpose test and therefore is not an all or nothing entitlement. The legislation provides for apportionment by reference to the purpose of an acquisition.

The input tax credit rules in Australia are subject to a number of specific concessions that are directly relevant to the financial services sector. These are discussed in more detail below.

**EXEMPT/INPUT TAXED SUPPLIES**

As noted above, the New Zealand and Australian regimes both contain major exclusions from the scope of GST for the supply of certain financial services. Broadly speaking, the effect in each jurisdiction is similar. The relevant supplies are not liable to GST and, subject to numerous exceptions in Australia, an entity making those supplies is not entitled to input tax credits for the GST component of acquisitions made in making those supplies. However, there are major differences between the scope of exempt financial services in New Zealand and input taxed financial supplies in Australia. Set out below is a summary of the relevant rules in each country.

**New Zealand**

Section 14(1)(a) of the New Zealand Act exempts the following supplies from GST.

The supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being –

1. A supply of financial services which, for this paragraph, would be charged with tax at the rate of zero percent pursuant to section 11A; or
2. A supply of goods and services which (although being part of a supply of goods and services which, but for this subparagraph, would be an exempt supply under this paragraph) is not in itself, as between the supplier of that first-mentioned supply and the recipient, a supply of financial services in respect of which this paragraph applies.

There are a number of points to note in relation to this provision. First, it makes clear that zero-rating takes precedence over exempt status. This means that where a financial service is provided to a non-resident in circumstances that attract zero-rating, the relevant supply is treated as a zero-rated supply rather than an exempt supply. That is important to the entitlement of the supplier to claim input tax credits for the GST component of costs that it incurs in making the relevant supply.

The second point to note is the relation to provision dictates that while a supply may form part of an exempt financial supply, it will not itself be exempt unless it constitutes a financial service as between the supplier and the recipient. This aspect of the provision was partly in response to the decision of the Court of Appeal in CIR v Databank Systems Ltd (1989) 11 NZTC 6,093. That case involved the GST treatment of computer services provided by Databank to the New Zealand trading banks in order to enable those trading banks to provide financial services to their customers. The Court of Appeal held that services supplied by Databank were financial services. That decision was subsequently overruled by the Privy Council which held that while the services of Databank were part of a wider financial service, as between Databank and the trading banks Databank’s services were computing services not financial services. The legislation now makes it clear that the status of a supply turns on its nature as between the supplier and the recipient. This issue is also addressed in the Australian Act.

One of the most significant aspects of the s 14 exemption, and a continuing cause of some difficulty, is the extension of the exemption to supplies of goods and services that are not financial services but that are supplied with financial services by a supplier of financial services and which are reasonably incidental and necessary to that supply of financial services. Understandably, there have been numerous disputes with the IRD as to when this statutory provision is satisfied and in particular when one supply is reasonably incidental and necessary to another. Unfortunately, there is no substantive case law on the point and the commentary of the IRD on the issue is minimal. The Australian legislators have attempted to overcome some of the difficulties inherent in incidental financial supplies by the use of a more comprehensive definition.

The term “financial services” is defined in s 3(1) of the New Zealand Act as follows.

(a) The exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise):
The payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme, or futures contract:

(i) Agreeing to do, or arranging, any of the activities specified in paragraphs (a) to (ka) of this subsection, other than advising thereon.

This is a comprehensive list of activities undertaken in the financial services sector. It includes the issuing and transferring of all debt securities and equity securities. A debt security is defined as any interest in or right to be paid money and an equity security is defined as any interest in or right to a share in the capital of a body corporate.

Of particular significance is para (i) of the above definition. It brings within the ambit of financial services agreeing to do or arranging any of the other services identified but excludes advising thereon. This means that the financial services definition encompasses not only financial transactions undertaken on principal account but also services provided by entities that facilitate or arrange financial transactions. For example, where a person sells shares through a sharebroker both the sale of the shares by the vendor and the provision of the brokerage services by the broker are financial services. As discussed below, this is quite different to the position in Australia where, generally speaking, only financial transactions undertaken on principal account are treated as financial supplies.

Difficulties arise in the New Zealand jurisdiction in drawing a distinction between arranging a financial service and advising on a financial service. That can be a difficult distinction to draw in practice. The IRD has issued a number of rulings that comment on this distinction. Public Ruling PUB 95/11 addresses the GST treatment of financial planning fees. It provides that the provision of actual planning advice is not a financial service because of its advisory nature. To the extent that monitoring services constitute advice, those services are also not financial services. By contrast, where monitoring involves the collection of income from investments it is an exempt financial service. Implementation services are similarly exempt where they involve arranging the acquisition of investments. Product Ruling PRD 96/30 addresses the supply of services by insurance brokers who act as intermediaries to negotiate and document loans. The ruling provides that the activities of the brokers constitute the arranging of financial services and are therefore financial services themselves.

As is so often the case with legislation, the more specific a provision is the greater its potential to create uncertainty and ambiguity. One example in section 3 is paragraph (i) which specifically includes within the financial services definition the management of a superannuation scheme. In the absence of that specific inclusion those aspects of the management of a superannuation scheme that involve advising would not constitute financial services. In a number of analogous situations such as the management of a unit trust, there is no equivalent specific inclusion within the financial services definition. Accordingly, in those situations the advisory component of the management fee would seem to not be a financial service. It is difficult to identify any policy rational for that distinction.

**Australia**

Section 40-5 of the Australian Act provides that "a financial supply is input taxed". It also provides that the term "financial supply" has the meaning given by the A New Tax System (Goods and Services Tax) Regulations 1999 (the Regulations). That meaning is set out in significant detail in Div 40 of the Regulations. Regulation 40-5.09 establishes the following requirements for a financial supply.

- The supply must be a provision, acquisition or disposal.
- The subject matter of the provision, acquisition or disposal must be an interest in one of the items identified in Regulation 40-5.09(3) or (4).
- The supply must be for consideration.
- The supply must be in the course or furtherance of an enterprise.
- The supply must be connected with Australia.
- The supplier must be registered or required to be registered.
- The supplier must be a financial supply provider in relation to the supply of the interest.

Some of the implications raised by these requirements are discussed below.
The nature of the supply
A financial supply can be the provision, acquisition or disposal of an interest identified in the Regulations. The inclusion of acquisitions is unusual. Acquiring a thing would not normally be interpreted as making a supply of that thing. This somewhat unnatural extension of the financial supply definition means that where there is a sale of shares there are two financial supplies, one by the vendor and one by the purchaser. Similarly, where there is a loan of money there are two financial supplies, one by the lender and one by the borrower.

This treatment is relevant in the context of the availability of input tax credits. Because the purchase and receipt of financial assets are treated as financial supplies, an entity is not able to claim back by way of input tax credit the GST component of an acquisition that it makes in carrying out those particular activities. This somewhat contorted approach is required because Div 11 of the Australian Act effectively provides an automatic entitlement to input tax credits unless an acquisition relates to making input taxed supplies. This can be compared with the New Zealand regime where input tax credits are only available for acquisitions made in making taxable supplies. As the receipt or purchase of financial assets do not involve making taxable supplies, there is no entitlement to input tax credits. In the absence of any requirement for a nexus to making taxable supplies in the Australian regime, acquisitions of financial interests must be brought within the ambit of financial supplies in order to prevent input tax credits being available for the GST component of costs associated with those acquisitions.

Consideration
It is sufficient in the context of the financial supply definition that some consideration be identified. It is not necessary that that consideration be valued as is the case in calculating the GST payable on taxable supplies.

Connected with Australia
As noted above, the concept of connection with Australia is addressed in s 9-25 of the Australian Act. That section determines connection by reference to supplies of goods, supplies of real property and supplies of anything else. Given the nature of financial services, the relevant provision is s 9-25(5) which provides that a supply, other than a supply of goods or real property, is connected with Australia if it is done in Australia or the supplier makes the supply through an enterprise that the supplier carries on in Australia.

A financial supply provider
A financial supply can only be made by a financial supply provider. The latter is defined in Regulation 40-5.06. It is the entity that either owns or creates the interest that is the subject of the supply. However, in order to cope with the fact that a financial supply can include the acquisition of an interest, the financial supply provider definition also encompasses the acquirer of an interest.

A specified interest
The key feature of a financial supply is that it must involve the provision, acquisition or disposal of an interest in one of the items identified in the table in Regulation 40-5.09. An “interest” is specifically defined in the Regulations as “anything that is recognised at law or in equity as property in any form”. The concept of property under the general law is a very wide one indeed. The table in Regulation 40-5.09(3) is central to the scope of financial supplies. A financial supply can only arise where there is a provision, acquisition or disposal of an interest in one of the following items.

1. An account made available by an Australian ADI (authorised deposit-taking institution) in the course of:
   (a) its banking business within the meaning of the Banking Act 1959; or
   (b) its State banking business
2. A debt, credit arrangement or right to credit, including a letter of credit
3. A charge or mortgage over real or personal property
4. A regulated superannuation fund, an approved deposit fund, a pooled superannuation trust or a public sector superannuation scheme within the meaning of the Superannuation Industry (Supervision) Act 1993, or an RSA (retirement savings account) within the meaning of the Retirement Savings Accounts Act 1997
5. An annuity or allocated pension
6. Life insurance business to which subs 9 (1) of the Life Insurance Act 1995, or a declaration under subs 12 (2) or s 12A of that Act, applies, or related reinsurance business
7. A guarantee, including an indemnity (except a warranty for goods or a contract of insurance or reinsurance)
8. Credit under a hire purchase agreement in relation to goods, if:
   (a) the credit for the goods is provided for a separate charge; and
   (b) the charge is disclosed to the recipient of the goods
9. Australian currency, the currency of a foreign country, or an agreement to buy or sell currency of either kind
10. Securities, including:
    (a) a debenture described in para (a), (b), (c), (d), (e) or (f) of the definition of debenture in s 9 of the Corporations Law; and
    (b) a document issued by an individual that would be debenture if it were issued by a body corporate; and
    (c) a scheme described in para (e), (f), (k) or (m) of the definition of managed investment scheme in section 9 of the Corporations Law; and
    (d) the capital of a partnership or trust
11. A derivative

Items 1 and 2 mean that standard lending transactions are financial supplies subject to satisfying the other requirements of Regulation 40-5.09. Therefore, lenders are not be required to account for GST on consideration received for lending transactions including establishment fees, commitment fees, loan fees and interest. Similarly, no GST is payable on either the advancing or repayment of a loan. In practice, one of the difficulties with lending transactions has been terminology. The banking community employs a plethora of different terms for loan related fees. It is often difficult to ascertain the true nature of a supply from the title ascribed to the fee for that supply. That has been the cause of some interpretative problems to date.

Any transaction that creates an interest in a charge or a mortgage can be a financial
supply. However, where the sale of an asset by a mortgagee in possession occurs, the GST treatment of the sale will depend on the nature of the asset and the surrounding circumstances.

A similar situation arises in the context of asset based financing. The normal GST rules apply to the sale of financed property. However, if a sale arises as part of a hire purchase agreement pursuant to which there is a separate credit charge that is disclosed, the credit component gives rise to a financial supply.

Interests in relation to regulated superannuation funds, annuities, allocated pensions and life insurance can also give rise to financial supplies where the requirements of Regulation 40-5.09 are satisfied.

Item 7 in the table covers an interest in “a guarantee, including an indemnity”. As mentioned above, there has been some confusion as to whether the ATO interprets this item as including debt and equity underwriting. My current understanding is that it does, however, this is an issue that requires public clarification.

This is another area where terminology has created difficulties in applying the law. An underwriting fee frequently encompasses both the provision of underwriting services and the provision of arranging services. Take for example, the situation of an underwritten issue of shares where the underwriter undertakes to arrange the placement of shares with investors in a number of different markets and guarantees that it will subscribe for any shares that it is unable to place. In this case there is potentially both an input taxed supply of underwriting services and a taxable supply of arranging or placement services.

One of the most significant items in the table in Regulation 40-5.09(3) is item 10 which refers to “securities”. That term encompasses shares, debentures, subordinated notes, units in a unit trust, the capital of a partnership or a trust, promissory notes, bills of exchange and warrants. Transactions on principal account in these securities constitute financial supplies subject to satisfaction of the other requirements of the financial supply definition. However broking or arranging services in relation to these securities do not constitute a provision, acquisition or disposal of an interest in a security and therefore do not qualify as financial supplies.

Derivatives are also included in the table. This means that forward contracts, future contracts, option contracts, reciprocal repurchase agreements and securities lending can give rise to financial supplies. The definition of “derivative” in the Dictionary in the Regulations is “an agreement or instrument the value of which depends on, or is derived from the value of assets or liabilities, an index or a rate”. That is an extremely wide definition and could be applied to many commercial contracts that would not normally be considered to be derivative contracts.

Incidental financial supplies

As is the case in New Zealand, the Australian regime includes a concept of incidental financial supplies. Regulation 40-5.10 provides that an incidental financial supply arises where a financial supply provider makes a financial supply to a recipient and at or about the same time makes a further supply to the recipient that is incidental to the financial supply, that is not the subject of separate consideration and that it is the usual practice of the supplier to make with the financial supply in the ordinary course of its enterprise. This definition is more specific than the New Zealand equivalent and therefore allows less room for ambiguity. Nevertheless, the meaning of the word “incidental” and the phrase “at or about the same time” will no doubt give rise to disagreements between the ATO and taxpayers.

There is also an issue as to whether an incidental financial supply can arise where incidental advice is provided to the recipient of a financial supply by an associate of the supplier of that financial supply. Regulation 40-5.10 requires that an incidental supply be supplied by the same party that provides the primary financial supply. In my view that requirement is still satisfied in the above example because the incidental supply being provided by the financial supply provider is a procurement service. In other words, the financial supply provider is procuring its associate to give advice to the recipient of the financial supply. It is the procurement of the advice, rather than the advice itself, that is the incidental financial supply.

However, this procurement arrangement raises a different issue. While incidental financial supply treatment will be available as between the financial supply provider and its customer, there may be a taxable supply to the financial supply provider by its associate. Division 72 of the Australian Act will effectively deem that supply to be made for market value consideration. The financial supply provider will not be entitled to a full input tax credit for the resulting GST component.

In relation to many financial transactions it is advisable to carry out an explicit apportionment of fees between financial supplies and taxable supplies. That will avoid any potential for dispute with the ATO or other parties at a later date. However, the act of apportioning and setting separate fees will mean that the requirement for no separate consideration for an incidental financial supply will not be satisfied.

Determining the scope of the items in the table in Regulation 40-5.09 is assisted in part by the examples of these items identified in Schedule 7 of the Regulations and also by the specific table of exclusions in Regulation 40-5.12. The supply of an interest in an item identified in the latter table is specifically excluded from the financial supply definition. That table is as follows.

1. Cheque and deposit forms and books supplied to an Australian ADI in connection with an account mentioned in item 1 in the table in Regulation 40-5.09

2. Special forms, or overprinting of standard forms, by an Australian ADI to holders in connection with an account mentioned in item 1 in the table in Regulation 40-5.09

3. Professional services, including information and advice, in relation to a financial supply

4. A payment system

5. Stored value facility cards and prepayments not linked to accounts provided by an Australian ADI in connection with an account mentioned in item 1 in the table in Regulation 40-5.09

6. Goods in accordance with agreements under which the goods are supplied under a lease, and:
(a) the lessees have no obligation or
option to acquire the rights of the
lessors in the goods; or
(b) the lessors dispose of their rights in
the goods to the lessees
7. An option, right or obligation to make or
receive a taxable supply, except a
mortgage or charge mentioned in Item
3 in the table in Regulation 40-5.09
8. A supply made as a result of the
exercise of an option or right, or the
performance of an obligation, to make
or receive a taxable supply, including
an option, right or obligation under a
mortgage or charge mentioned in Item
3 in the table in Regulation 40-5.09
9. Facilities for:
(a) trading securities or derivatives; and
(b) clearance and settlement of those
trades
10. Insurance and reinsurance business,
except business mentioned in item 6 of
the table in Regulation 40-5.09
11. Broking services
12. Management of the assets or liabilities
of another entity, including investment
portfolio management and administration
services for trusts or superannuation,
pension or annuity funds
13. Debt collection services
14. Sales accounting services under a
factoring arrangement, or an arran-
gement having the same effect as a
factoring arrangement
15. Trustee services
16. Custodian services in relation to
money, documents and other things
17. Australian currency, or the currency of
a foreign country, the market value of
which exceeds its stated value as legal
tender, or an agreement to buy or sell
currency of either kind the market value
of which exceeds its stated value as
legal tender
18. An arrangement for the provision of
goods to an entity for display or
demonstration pending disposal of the
goods to a third party

This regulation means that advisory
services in relation to financial supplies,
options over most non-financial assets,
brokering services, investment management
and administration services, debt
collection services, trustee services and
custodian services are all specifically
removed from the ambit of financial
supplies. These are significant and
extensive exclusions. They cover many
activities undertaken in the financial
services sector. Many of them are treated
as exempt financial services in New
Zealand.

It can be seen from the above analysis
that the major distinction between the New
Zealand and Australian regimes in the
context of financial services is the scope
of what is treated as an exempt/input
taxed supply. The New Zealand regime
encompasses both financial transactions
undertaken on principal account and
services provided in arranging financial
transactions. By contrast, the Australian
regime is restricted primarily to financial
transactions on principal account. It does
not extend to arranging or facilitation
services.

The reasoning for the Australian approach
is set out in a paper released by the
Australian Government in 1999 entitled
"The Application of Goods and Services
Tax to Financial Services". That paper
recognises that financial services are
treated as input taxed supplies in most
overseas jurisdictions due to the difficulty
of determining the value added
component in a financial intermediary's
margin. The paper notes at page 5 that
"international practice is to also input tax
many explicit fees or commissions related
to the provision of financial services (even
where these fees and commissions can be
readily valued)". The Australian Government
rejected that approach and has generally
attempted to restrict input taxed treatment
to supplies charged for by way of margin.
Therefore, the Australian regime imposes
GST on a much broader range of financial
services than is the case in New Zealand.

According to the policy paper one of the
reasons why many jurisdictions incorpo-
rates the arranging of financial transactions
as a financial supply is to overcome
concerns about the bias toward self
supply. The Australian Government's
objection to this approach was that it just
increases the compliance burden on
suppliers in the financial services sector.
The Government saw the reduced input
tax credit regime as addressing this
particular concern by reducing the
incentive on financial services organi-
sations to move to self supply.

The paper also suggests that excluding
the arranging of financial services from the
financial services definition removes an
area of potential dispute. That view is
consistent with the New Zealand
experience.

**GST-free override**

Section 9-30(3) of the Australian Act
provides that where a supply would
otherwise be both GST-free and input
taxed, it is treated for the purposes of the
regime as GST-free and not input taxed.
This operates in the same manner as s
14(1)(a)(i) of the New Zealand Act. As the
making of input taxed supplies imposes a
limitation on the availability of input tax
credits and the making of GST-free
supplies does not, it is therefore important
to determine when financial supplies
satisfy the requirements for GST-free
treatment in Div 38. Primarily this is where
financial supplies are exported.

**Imported services**

Unlike New Zealand, Australia imposes
GST on the importation of services in
some instances. This is addressed in Div
84 of the Australian Act. That Division
provides that the supply of anything other
than goods or real property that is not
connected with Australia will nevertheless
be a taxable supply if it is not acquired
solely for a creditable purpose by the
recipient. The GST is payable by the
Australian recipient rather than the foreign
supplier. However, a supply is not a
taxable supply pursuant to this section to
the extent that it is GST-free or input taxed.

As noted above, the definition of a
financial supply requires a connection with
Australia. However, that requirement is
specifically removed in determining
whether a supply is an input taxed
financial supply for the purposes of Div 84.
If that were not the case, financial
transactions such as the borrowing of
money could give rise to a GST imposition
by way of reverse charging.

Something is not acquired for a creditable
purpose to the extent that it relates to
making supplies that are input taxed or it
relates to a private or domestic matter.
Therefore, Div 84 is very relevant for
entities making input taxed financial
supplies. Supplies imported into Australia by such entities will give rise to reverse charged GST unless the services themselves constitute financial supplies. This means for example that when a bank obtains legal advice from a foreign law firm in relation to a transaction involving the making of financial supplies, the bank will have to account for GST equal to 10 per cent of the fee charged by the foreign law firm.

**INPUT TAX CREDITS**

The second major consideration in relation to the impact of GST on the financial services sector is the operation of the input tax credit rules. As noted above, most businesses making taxable supplies in both New Zealand and Australia account for GST on the supplies that they make and then claim back by way of input tax credit the GST component of the cost of acquisitions made. However, the ability to claim input tax credits is restricted to varying degrees in the two jurisdictions where an entity makes exempt/input taxed supplies. A summary of the relevant rules is set out below.

**New Zealand**

Section 20 of the New Zealand Act provides that in calculating its GST liability for a period, an entity is entitled to deduct input tax from the amount of output tax attributable to that period. "Input tax" is defined in s 3A. Broadly speaking it is the amount of GST imposed on a supply of goods and services acquired by an entity for the principal purpose of making taxable supplies. As financial services are not taxable supplies, an input tax credit is not available for the GST component of the cost of an acquisition made for the principal purpose of providing financial services.

Not surprisingly, the principal purpose test has been considered by the courts in New Zealand. The key points to note are that "principal" means the main or primary or fundamental purpose. It does not mean more than 50 per cent. The term "purpose" means the object or the end which the taxpayer has in mind.

In my view one of the most useful decisions in this area is the decision of the High Court in **CIR v BNZ Investment Advisory Services Limited** (1994) 16 NZTC 11,111. The taxpayer in that case gave financial planning advice that was subject to GST. It then provided implementation and maintenance services in accordance with its planning advice and those services were exempt financial services. 90 per cent of the time spent and overheads incurred related to the planning advice although that generated less than 10 per cent of the taxpayer’s fees. More than 90 per cent of the fees were generated by the implementation and maintenance services that utilised less than 10 per cent of resources.

The IRD argued that the principal purpose of the taxpayer was to generate income from the exempt implementation and maintenance services. Accordingly its principal purpose was to make exempt supplies and not taxable supplies and therefore input tax credits for its costs were not available. The taxpayer argued that its principal purpose should be determined by the time and effort expended in its activities. As 90 per cent of that was attributable to making the taxable planning services, the principal purpose test was satisfied in full and input tax credits should have been available.

The High Court found in favour of the IRD. In my view, that finding accords with logic. The principal purpose of any business must be to generate income and to carry out the activities that generate that income.

While the Australian regime does not contain a principal purpose test, the rationale underlying the decision in **BNZ Investment Advisory Services** could be relevant in some cases in determining the extent to which an acquisition “relates” to making taxable supplies or input taxed supplies. Take the example of a taxpayer in Australia that acquires a good and uses that good half the time for making taxable supplies and half the time for making input taxed supplies. However, assume that it generates 90 per cent of its income from the taxable supplies. Applying the reasoning in **BNZ Investment Advisory Services** an argument could be made that while the use of the good is split 50/50 on a time basis, a more appropriate apportionment is its contribution to profitability. In other words, it might be said that if the principal purpose of acquiring something is to do with it the activity that generates the most income, then it can also be said that it relates primarily to that activity.

Of course, the appropriate method will vary in different situations. For example, the concept of contribution to income may not be appropriate if the asset is acquired partly for business purposes and partly for private purposes. Income based apportionment would also not be appropriate at the commencement of a business where the business made no money during the commencement period.

As the principal purpose test operates on an all or nothing basis, the New Zealand regime contains provisions for making adjustments where a good or service is acquired partly for making taxable supplies and partly for making other supplies. In my experience, those adjustment provisions are more awkward than the Australian upfront apportionment based on the extent of creditable purpose. However, only time will tell on this point.

The New Zealand Act also contains adjustment provisions to deal with situations where there is a change of use. For example, these provisions apply where a good is acquired solely for the purpose of making taxable supplies but the initial use is subsequently changed and the good is applied in making exempt supplies.

At the time that GST was introduced in New Zealand both the banking industry and the IRD recognised the practical difficulties of calculating input tax credit entitlements for banks making both taxable and exempt supplies. It was realised that complying precisely with the legislation would carry a very high cost. As a result the banking industry and the IRD negotiated an agreement as to an appropriate methodology for calculating input tax credit entitlements based on a formula that determines an input recovery ratio.

**Australia**

Division 11 of the Australian Act allows input tax credits for a creditable acquisition. The primary requirement for creditable acquisition status is that something is acquired for a creditable purpose. As noted above, something is not acquired for a creditable purpose to the extent that its acquisition relates to making input taxed supplies or is of a private or
domestic nature. The use of the "to the extent" wording means that an upfront apportionment is required.

The ATO has issued GSTR 2000/22 entitled "Goods and Services Tax: Determining the Extent of Creditable Purpose for Providers of Financial Supplies". That Ruling provides guidance on appropriate methodologies for determining the extent of creditable purpose and also for calculating any subsequent adjustments. The Ruling states that the apportionment methodology adopted must:

- be appropriate and reasonable,
- accurately reflect the planned use of that acquisition, and
- be well documented and justifiable.

The Ruling sets out a series of possible methodologies and the circumstances in which they would be appropriate.

There is a fundamental distinction in the drafting of the input tax credit rules in New Zealand and in Australia. In the former, entitlement to credits is based on a positive requirement for a nexus to the making of taxable supplies. In the latter, there is a prima facie entitlement to a full input tax credit on an acquisition provided that the acquisition does not relate to either making input taxed supplies or a private a domestic matter. Some commentators have suggested that the relationship required is a direct one and that the overhead costs of a financial services organisation making both taxable and input taxed supplies do not relate to making input taxed supplies. The argument goes that therefore input tax credits are available in relation to such costs. The ATO has understandably rejected that approach on a number of occasions including publicly in GSTR 2000/15.

Section 11-15 of the Australian Act contains a number of concessions directly relevant to the making of financial supplies. The first is s 11-15(3). That provision dictates that where an acquisition relates to making financial supplies through an enterprise, or part of an enterprise, carried on outside Australia, the acquisition is not treated as one that relates to making input taxed supplies in determining creditable purpose status.

Section 11-15(4) provides that an acquisition is not treated as relating to making input taxed supplies if the only reason it would be so treated is because it relates to making financial supplies and the relevant taxpayer does not exceed the financial acquisitions threshold. Under this concession an entity can obtain input tax credits for acquisitions that relate to making financial supplies provided that, both in the relevant month and the preceding 11 months and in the relevant month and the succeeding 11 months, the total of all input tax credits relating to financial supplies exceeds neither A$50,000 nor 10 per cent of the total input tax credits of the entity for the relevant period, including input tax credits in relation to financial acquisitions. A “financial acquisition” is an acquisition that relates to the making of a financial supply other than a financial supply consisting of a borrowing.

Essentially this concession means that where input tax credits on an acquisition would otherwise be denied because of a relationship to the making of input taxed supplies, input tax credits will be available if the taxpayer does not exceed the relevant thresholds. This concession is obviously not aimed at financial services organisations but at small taxpayers that are primarily involved in the making of taxable supplies.

The final concession in Div 11 involving financial supplies is s 11-15(5). That provision states that in determining whether an acquisition is for a creditable purpose, an acquisition is not treated as relating to making input taxed supplies to the extent that the acquisition relates to making a financial supply consisting of a borrowing and the borrowing relates to making supplies that are not input taxed. This concession is intended to ensure that taxpayers that borrow money for the purpose of a business that involves making financial supplies, that entity is not otherwise entitled to an input tax credit if the acquisition falls within one of the wide range of categories of acquisition known as reduced credit acquisitions. The Government’s objective in providing this concession was essentially to remove the incentive that financial supply providers would otherwise have had to self-supply the services that now come within the ambit of reduced credit acquisitions.

Reduced Input Tax Credits

The most concessional feature of the Australian GST regime for the financial services sector is the availability of reduced input tax credits for many acquisitions. The essence of this concession is that where an entity is not otherwise entitled to an input tax credit for an acquisition because it is making financial supplies, that entity is entitled to 75 per cent of the full input tax credit if the acquisition falls within one of the wide range of categories of acquisition known as reduced credit acquisitions. The Government’s objective in providing this concession was essentially to remove the incentive that financial supply providers would otherwise have had to self-supply the services that now come within the ambit of reduced credit acquisitions.

This is best illustrated by way of example. In the absence of the reduced input tax credit regime, if a bank obtained a valuation from a valuer as part of making a loan, the GST charged by the valuer to the bank would not be able to be claimed back by the bank as an input tax credit. Accordingly, the net cost of the valuer...
would have increased to the bank as a result of the introduction of GST. Given that employment services are not taxable supplies, under that scenario it would be better for the bank to employ the valuer directly and thereby avoid the imposition of a GST cost on outsourced work. The argument is that by allowing the bank a reduced input tax credit equal to 75 per cent of the GST charged by the valuer, the bank will not have a strong financial incentive to bring the relevant valuation service inhouse.

The Government was also concerned about the potential of GST to create a comparative disadvantage for smaller financial services organisations. This issue was summarised as follows at page 22 of the paper “The Application of Goods and Services Tax to Financial Services”:

A higher effective tax burden would be faced by smaller financial supply providers who outsource proportionately more of their business inputs. Larger market participants generally have a greater ability to insource services. For example, smaller financial service providers, such as credit unions or building societies, would have less scope to insource mortgage valuation services than would a large bank. Therefore, input taxing financial supplies has important implications for the relative competitiveness of different segments of the financial sector.

The list of reduced credit acquisitions is contained in Regulation 70-5.02 of the Regulations. It includes the following categories.

- Transaction banking and cash management services;
- Payment and fund transfers services;
- Securities transaction services;
- Loan services;
- Credit union services;
- Debt collection services;
- Asset based finance services;
- Trade finance services;
- Capital market and financial instruments services;
- Funds management services;
- Insurance services;
- Services remunerated by commission and franchise fees;
- Trustee and custodial services.

Within each category there is a detailed list of specific items. An examination of the full list makes it clear that many activities undertaken in the financial services sector, and on the periphery of that sector, enjoy concessional input tax credit treatment. As a result, the implications of the GST regime in Australia are less adverse than in New Zealand for participants in that sector. Perhaps the only downside is the increased compliance burden associated with the need to classify input tax credit entitlements into three categories – full input tax credits, reduced input tax credits and no input tax credits. Because of the way in which some reduced credit acquisitions are determined by reference to the use of particular services, it is possible that in some cases services will have to be apportioned by some taxpayers between the three different categories of input tax credit entitlements. The compliance difficulties of calculating input tax credit entitlements for financial services organisations should not be underestimated.

An issue of particular interest to lawyers advising financial services organisations is the extent to which the supply of legal services can constitute reduced credit acquisitions. The most relevant item in the table in Regulation 70-5.02 is item 14. It includes the following.

... 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 caveats to titles.

Legal services in relation to loan transactions would not normally be categorised as “application, management and processing services”. Nevertheless, some of the specific paragraphs seem inevitably to apply to some of the activities of lawyers including the preparation of loan documents. My understanding of the current view of the ATO is that it takes a reasonably restrictive view of the words in item 14. While it accepts the documentation point, it does not view item 14 as extending to legal advice on the structure of a loan facility or the terms and conditions of the facility or any other associated matter. It is likely to be some time before this issue is completely clarified.

Conclusion

As the first anniversary of the Australian GST regime approaches, the spectre of ATO audits looms large, particularly for those in the financial services sector still struggling to come to terms with both the technical ambiguities and compliance burden of the regime. There is also the wild card of political uncertainty and the Labour Party’s amorphous promise of GST “rollback”. Whatever that means it is unlikely to bring any major benefits for the financial services sector.

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