Law Council
OF AUSTRALIA

Business Law Section

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Australian Taxation Office
GPO Box 9990
SYDNEY NSW 2001

By email: Virginia.Gogan@ato.gov.au; Ashley.Dunstan@ato.gov.au;
Peter.Joseph@ato.gov.au

Dear Virginia, Ashley and Peter,

GSTD 2020/D1 and PCG 2019/8DC1 (Draft Schedule 2)

This submission concerning both topics of GSTD 2020/D1 and PCG 2019/8DC1 (Draft Schedule 2) is made by the Taxation Law Committee of the Business Law Section of the Law Council of Australia (the **Committee**).

For simplicity and in deference to the commonality of issues across the two draft documents, the submissions in relation to PCG 2019/8DC1 (Draft Schedule 2) are set out in Annexure A and our submissions in relation to GSTD 2020/D1 are set out in Annexure B

If you would like to discuss this submission or if you have any questions or comments, please contact Clint Harding, Chair of the Taxation Committee (charding@abl.com.au or on 02 9266 7236).

Yours sincerely,

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Chair, Business Law Section

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ANNEXURE A – SUBMISSIONS IN RELATION TO PCG 2019/DC1 (DRAFT SCHEDULE 2)

Compliance strategy of using PCGs

The Committee notes that there has been a significantly expanded use of PCGs in recent years. PCG 2016/1 at paragraph 5 describes one of the key benefits of broader compliance guidelines as:

> *In addition to public rulings, taxpayers may also benefit from broader law administration guidance that conveys the ATO's assessment of relative levels of tax compliance risk across a spectrum of behaviours or arrangements. Such guidance may, for example, enable taxpayers to position themselves within a range of behaviours, activities or transaction structures that the ATO describes as low risk and unlikely to require scrutiny - to safely 'swim between the flags'.*

Whilst there are many instances in which PCGs can assist taxpayers in cost effectively meeting their tax obligations and can provide important protection for taxpayers, the Committee is concerned that PCG 2019/8 does not support these objectives or the broader principles set out in PCG 2016/1..

In particular, it is noted that Draft Schedule 2 relates to Authorised Deposit Taking Institutions (**ADIs**) that make supplies of "accounts" to customers. The affected taxpayers are drawn from a concentrated sector in an already heavily regulated environment. They are sophisticated taxpayers with a long history of direct engagement with the ATO, including comprehensive private rulings, the justified trust initiative and other compliance programs.

Further, the principles which determine the extent to which an entity is entitled to input tax credit are highly factually specific. In our view it is simply not possible for "broad brush" guidance products such as a PCG to have sufficient regard to the individual circumstances of these sophisticated taxpayers.

In these circumstances, it is not clear that a PCG is the appropriate product to provide guidance for this sector on this issue. In particular, the concern over the use of PCGs in this context stems from the ATO's views that ‘non-binding’ instruments are capable of providing certainty to highly factually specific circumstances.

Pejorative labelling

Part of the concern with the use of PCGs in general has been the established pattern of pejorative labelling adopted for different approaches within the identified "zones", such as the "Red Zone". The description (at paragraph 25 of the main part of the PCG) identifies the "Red Zone" as "High risk" and that the ATO's approach will be:

> "*High priority for review. Reviews are likely to be commenced as a matter of priority*."

Clearly, no responsible business would seek to put themselves in such a position.

However, the abovementioned concern is exacerbated in the context of Draft Schedule 2 because, in our submission, the "Red Zone" identified in Draft Schedule 2 is far too broad. For example, simply because a taxpayer's rate of input tax credit entitlement exceeds that

set out in the "Green Zone" and the taxpayer does not adopt the convoluted process set out in the "Blue Zone", the taxpayer will necessarily find themselves classified within the "Red Zone".

Further, if a taxpayer takes a different view to the ATO on one of a number of contentious technical issues, that taxpayer will be classified within the "Red Zone" unless their extent of creditable purpose is less than that stated in the "Green Zone". The Committee submits that there may be entirely appropriate circumstances specific to the taxpayer that would place taxpayers in the "Red Zone".

Consequently, it is considered that the approach taken by the ATO in Draft Schedule 2 is disproportionately harsh on those taxpayers who may, for entirely legitimate reasons, find themselves in what is described as the "Red Zone".

Limited scope for Green Zone

In a related way, it is submitted that the scope for satisfaction of the requirements for the "Green Zone" are far too limited. In particular, the statement that:

> "*… you are not eligible to use the green zone if more than 50% of the total number of transaction accounts you provide do not involve you making any taxable supplies of interchange services*"

materially narrows the scope for a taxpayer to benefit from the "Green Zone" approach, irrespective of the level of the extent of creditable purpose determined by that taxpayer.

The Committee submits that the ATO should consider a broader range of circumstances in which taxpayers can satisfy the requirements of the "Green Zone" and thereby enhance the effectiveness of the protections afforded by the PCG.

Onerous requirements for Blue Zone

The Committee notes that the requirements for a taxpayer to fall within the "Blue Zone" are extremely complex, onerous and again necessitate that taxpayers comply with ATO views on contentious technical issues, such as the treatment of "on-us" transactions.

Further, given that the level of protection that is afforded to a taxpayer in the "Blue Zone" is limited to the taxpayer being regarded as "Low to moderate priority for review", the requirements appear to be disproportionate to the benefits obtained.

Conclusion

It is accepted that, at least conceptually, the use of PCG products may lead to positive compliance benefits for the ATO and taxpayers. However, the Committee submits that Draft Schedule 2 does not promote these objectives. Rather, the Committee submits that the Draft Schedule does not represent a balanced approach and may unfairly punish taxpayers who,, for entirely legitimate reasons, find themselves at odds with the ATO's views on any one of a number of contentious factual and technical matters.

ANNEXURE B – SUBMISSIONS IN RELATION TO GSTD 2020/D1

Introduction

It is acknowledged that the issues associated with the appropriate determination of whether or not certain supplies will be GST-free under Item 3 or Item 4(a) of subsection 38-190(1) of the GST Act are complex and are prone to produce different results. This is amply demonstrated by the range of different conclusions reached by different judges and Courts in the *Travelex*[1] litigation. For this reason, published guidance on the ATO's views on these matters can be extremely useful in promoting certainty for taxpayers and supporting compliance.

However, the Committee submits that GSTD 2020/D1 (the **Draft Determination**) is inconsistent with existing guidance and reaches its stated views with little support from existing principles. Further, the tests adopted in GSTD 2020/D1 are likely to be unworkable for taxpayers and should be reconsidered in the light of the characteristics of modern transaction accounts.

Inconsistency with GSTD 2017/1

Guidance on the extent to which supplies to account holders are GST-free has previously been provided in the context of credit cards in GSTD 2017/1. That determination relates specifically to the issues relevant to determining when the supply of a credit card facility will be GST-free under Item 4(a) of subsection 38-190. As such, there is a high degree of commonality between the matters under consideration in GSTD 2017/1 and the Draft Determination. Indeed, in the context of functionality insofar as accessing the payment system, the use of these card products is almost identical. Further, the two products will impact on the same group of taxpayers and will in many cases involve the same accounting systems and processes.

In GSTD 2017/1, the conclusion is reached that a supply of the credit card facility will be GST-free for "card-present" and "card-not-present" transactions initiated by a cardholder when that cardholder is outside Australia at the relevant time. As stated at paragraph 23:

> "*The physical location of the cardholder at the time they initiate the transaction determines where the rights are 'for use'. The rights are 'for use outside of Australia' to the extent that it is anticipated that the credit card facility will be used by the cardholder to undertake transactions while they are physically outside Australia.*"

By contrast, the Draft Determination applies a further condition to the operation of the same tests in the context of transactions undertaken through transaction accounts (as opposed to credit cards). Paragraph 2 of the Draft Determination states that:

> "*Effective use or enjoyment of a transaction account will take place outside of Australia to the extent that:*
> - *transactions under the account are undertaken while the account holder is physically outside of Australia; and*
> - ***the account holder's presence outside of Australia is integral to that transaction**." (Emphasis added)*

[1] *Travelex Ltd v Commissioner of Taxation* [2010] HCA 33

Thus, a "card-not-present" transaction on a credit card account undertaken whilst the cardholder is physically outside Australia would involve a GST-free supply to the cardholder by the account issuer in accordance with GSTD 2017/1. However, a similar transaction undertaken on a transaction account would not, on the view taken by the Draft Determination, give rise to a GST-free supply by the account issuer to the account holder because the physical location of the account holder is not "integral" to the transaction.

Lack of principle to support approach taken

The abovementioned approach is illustrated by Example 2 in the Draft Determination (see paras 9 and 10). In that case, an account holder physically present in Japan transfers funds to pay a Japanese supplier in Japan for services that the account holder will consume in Japan.

Yet, the approach taken by the ATO in the Draft Determination is that the "effective use or enjoyment" of the account holder is not in Japan but is in Australia. This counter-intuitive conclusion is based solely on the view taken by the ATO that the account holder accesses her funds "in the same way regardless of [her] location". There is no analysis or explanation as to why the means of access is regarded by the ATO as the sole determinant of the statutory test which refers to the "effective use or enjoyment". A similar assertion is made at paragraph 20 of the Draft Determination (in the Explanation section). Indeed, the whole of the reasoning on this issue is encapsulated in a single sentence:

> "*Effective use or enjoyment of the supply of a transaction account will take place outside Australia to the extent that the account holder is outside of Australia at the time they undertake a transaction to access their account,* ***and their presence outside Australia is integral to the account holders' accessing of their account.***" (Emphasis added).

There is no explanation as to why the presence of the account holder outside Australia must be "integral" to the access of the account in order for a supply to the account holder to be GST-free. Further, there is no explanation as to why the service of facilitating payment by an individual who is outside of Australia to a service provider who is outside of Australia for consumption to take place outside of Australia could be regarded as not being a supply, the "effective use or enjoyment" of which does not take place outside of Australia.

It is noted that the Draft Determination cross-refers to GSTR 2007/2 which considers the question of when "effective use or enjoyment" will take place outside Australia. However, nothing in that ruling supports the approach relied by the ATO in paragraphs 9 and 10 of the Draft Determination. As stated above, those paragraphs conclude that where the "access method" is the same whether the account holder is in Australia or outside Australia, that of itself necessitates that "effective use or enjoyment" must be in Australia.

To the contrary, the approach taken in paragraphs 110 - 114 of GSTR 2007/2 refers to a test based on whether "the need for the supply" arises because the recipient is outside or not outside Australia. Such an approach is hard to reconcile with the ATO's approach in Example 2 of the Draft Determination.

Lack of analysis of the rights associated with modern accounts

It would appear from the Draft Determination that the ATO does not consider that Item 4 of subsection 39-190(1) necessarily extends or advances the extent to which the operation of a transaction account can be considered to be GST-free. In considering the application of Item 4(a) of subsection 38-190(1), it is critical to properly understand the character of the rights at issue. As discussed above, the divergence in views in *Travelex* can largely be explained by different approaches taken to the character of rights associated with a supply of foreign currency. Thus, the Committee submits that it is critically important for the ATO to properly consider the nature of a transaction account in reaching its views on the scope of Item 4(a) in this context.

The Committee is concerned that the ATO's reticence to apply Item 4 arises from a lack of understanding of the complexities associated with modern transaction accounts operating within a global banking environment. Modern banking is characterised by inherent complexities and a range of circumstances which extend beyond the simplistic "debtor-creditor relationship" that we are concerned underpins much of the ATO's approach in the Draft Determination. The additional services, range of access options and intertwined relationships which typify modern transaction accounts were never contemplated in cases such as *Foley v Hill* [1848] 9 ER 1002 and *Hart (Inspector of Taxes) v Sangster* [1957] 1 Ch 329 to which the ATO refers in the Draft Determination. These additional features are acknowledged by the ATO in paragraphs 32 – 34 of the Draft Determination but these are not considered as part of the analysis regarding the nature of the rights supplied by the account issuer to the account holder in paragraphs 25 and 26 of the Draft Determination.

Given the importance of this issue for the characterisation of the supply and the application of Item 4(a), the Committee submits that far more detail should be considered by the ATO than is currently canvassed. The Committee submits that the additional elements, when properly considered, would be expected to impact on the extent of the supplies made by account issuers that would fall within the operation of Item 4(a).

Conclusion

The Committee submits that there is a need to reconsider the approach and the conclusions reached by the ATO in the Draft Determination. The conflict between GSTD 2017/1 and the Draft Determination is confusing for taxpayers. The conclusions reached in relation to "effective use or enjoyment" are counter-intuitive and are not supported by GSTR 2017/2. Finally, more detailed analysis regarding the rights associated with the transaction accounts currently in use would support a more robust analysis of the operation of Item 4(a) in this context.