

GST tie breaker – are you the representative of an incapacitated entity or a creditor?

We might be forgiven for suggesting that Australia's various tax laws are not the easiest documents to understand and interpret. This is particularly the case where there are apparent overlapping and conflicting provisions, such as the GST provisions relating to supplies by a representative of an incapacitated entity where the representative is also a creditor of that entity.

Tax Update

As it stands, there are situations in which both Div 58 and Div 105 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST Act) might apply. The most obvious example is where a mortgagee in possession sells the mortgagor's property.

In February 2012, the Government released a draft bill titled *Tax Laws Amendment (2012 Measures No. 3) Bill 2012* (Cth) (draft Bill) to address the uncertainty created from previous amendments made by the *Tax Laws Amendment (2009 Measures No. 5) Act 2009* (Cth) (2009 Amending Act).

It is not yet known when the draft Bill will be introduced into Parliament or whether it will remain in its current form. Treasury is currently reviewing submissions on the contents of the draft Bill.

To understand why and how the draft Bill should add clarity to GST obligations, it is helpful to recap on the current problem and how it has arisen.

The 2009 Amending Act

The 2009 Amending Act was introduced in response to the Queensland Federal Court case in *Deputy Commissioner of Taxation v PM Developments Pty Ltd*. In that case, Logan J held that a liquidator of an incapacitated entity was not personally liable for GST on a post appointment transaction. Logan J held that a liquidator acts as an agent of an incapacitated company and that it incurs any GST liability on behalf of that company.

The Government passed the 2009 Amending Act to ensure that representatives of incapacitated entities are made personally liable for any GST liability arising on taxable supplies made by an incapacitated entity (or a representative of an incapacitated entity acting on its behalf). This allows the GST liabilities to enjoy a priority under s 556 of the *Corporations Act 2001* (Cth).

Who does this affect?

Liquidators and representatives of incapacitated entities, mortgagees and creditors.

Article Highlights

- The Government released a draft bill to add clarity to GST obligation.



The 2009 Amending Act inserted Div 58 which applies to representatives of incapacitated entities. It amended the definition of representative in s 195-1 to cover all types of representatives of incapacitated entities, including a controller within the meaning of s 9 of the Corporations Act. Accordingly, Div 58 may apply to a person in control or possession of a corporation's property for the purposes of enforcing a mortgage or charge.

Division 105 can also apply to a mortgagee in possession (as Div 105 applies to any creditor who supplies a debtor's property in satisfaction of its debt).

The potential overlap in the application of Div 58 and 105 has created uncertainty, particularly for financiers, as the divisions impose different obligations and contain different requirements.

In 2010, the Australian Taxation Office (ATO) released Interpretive Decision 2010/224 in an attempt to counteract the confusion, by stating that in the ATO's view, Div 105 overrides Div 58 for mortgagees in possession. An interpretive decision is not binding on the Commissioner because it does not have the status of a ruling. Accordingly, there is a need for a "tie breaker provision" (as it is described in the draft Explanatory Memorandum to the draft Bill).

Current law — Div 105

Division 105 typically applies where a mortgagee takes possession of property or a creditor repossesses goods for resale. A creditor is liable for GST payable on supplies of a debtor's property where the supply is in satisfaction of a debt owed to the creditor. This is the case even where the debtor signed the initial contract for sale because a supply does not generally occur until a transfer is executed.

If the creditor is liable to pay GST, it will account for GST under its existing ABN. If the creditor is not registered it must submit a return and pay the GST within 21 days of the end of the month in which a sale is completed (ss 105-15 and 105-20). The creditor will not be entitled to any input tax credits.

Section 105-5(3) provides that the creditor will not be liable for GST on a supply where:

the debtor provides written notice in which it states (with full supporting reasons) that the supply would not have been a taxable supply had the debtor made the supply; or

the creditor believes on the basis of reasonable information that the supply would not be a taxable supply if the debtor were to make it.

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Current law — Div 58

Division 58 provides that a representative of an incapacitated entity is responsible for certain GST consequences which arise from a supply, acquisition or importation that falls within the scope of the representative's responsibility or authority for managing the incapacitated entity's affairs.

According to the Explanatory Memorandum to the 2009 Amending Act, Div 58 places all types of representation on a common footing and provides a consistent base from which a representative becomes liable for relevant liabilities and becomes entitled to relevant entitlements.

"Incapacitated entity" is defined to include any entity that has a representative (s 195-1). Hence, the application of Div 58 is dependent on whether a representative exists rather than the solvency of the entity.

A representative must be registered in that capacity if the incapacitated entity was registered or required to be registered for GST (s 58-20). A representative who ceases to be a representative of an incapacitated entity must notify the Commissioner within 21 days of that cessation in the approved form (s 58-30).

A representative is given specific authorisation to apply money received by the representative in that capacity to pay any amount for which the representative is liable as a result of Div 58 (s58-65). The representative is also afforded protection from criminal and civil proceedings for an act done in good faith on the performance or purported performance of the representative's duties or power under the *GST Act* (s 58-70).

A representative is not liable for GST payable on a supply to the extent that the incapacitated entity received the consideration for the supply before the appointment of the representative (s 58-10(2)). The ATO has indicated its support for this position in Interpretative Decision 2012/7. It states that a representative should not be liable for GST if the incapacitated entity receives consideration for a supply that was made prior to the appointment of the representative, as the making of the supply did not fall within the representative's responsibility or authority for managing the incapacitated entity's affairs at the time the supply was made. Instead, the incapacitated entity should be liable for GST under s 9-40 of the *GST Act*. However, in certain circumstances, the representative is still obliged to notify the Commissioner of the incapacitated entity's GST liability (s 58-60).

A representative is entitled to an input tax credit if the supply is within the scope of the representative's responsibility or authority for managing the incapacitated entity's affairs (s 58-10). Earlier this year, the ATO released Interpretative Decision 2012/6 stating that an administrator acting in its capacity as a representative for an incapacitated entity is entitled to input tax credits under s 58-10 of the *GST Act* for its payment of administration fees.



Under s 58–50, the Commissioner can direct a representative to provide a GST return for a tax period applying to the incapacitated entity even if that period was prior to the appointment of the representative. Any direction made by the Commissioner under this provision is a reviewable GST decision. In deciding whether to make such a direction, the Commissioner may consider factors including: the availability of books and records that would make it possible to prepare the GST return; the possibility that the return will reveal a GST liability; and whether the costs incurred would have an unreasonable impact on creditors. Compiling the GST return could be quite a burdensome task for a representative.

Differences between Div 58 and Div 105

In summary, while there are a number of differences between Div 58 and Div 105, the most relevant differences follow.

Registration and reporting: Under Div 58, a representative must register separately for each incapacitated entity it represents. Under Div 105, a creditor can account for GST under its existing ABN.

Input tax credits: Under Div 58, a representative is entitled to an input tax credit to the extent that the input tax credit is within the scope of the representative's responsibility or authority for managing the incapacitated entity's affairs. There is no provision within Div 105 which entitles a creditor to an input tax credit.

Exclusion of GST liability: Under Div 105, a creditor is able to exclude a supply from GST liability if the debtor provides the required notice or the creditor relies on reasonable information to determine that it would not have been a taxable supply if the debtor had made it. There is no such provision in Div 58.

Issues to consider

If the draft Bill is passed in its current form, there will still be no allowance in Div 105 for a creditor to claim input tax credits. The focus in the consultation paper preceding the draft Bill and the proposed Explanatory Memorandum for the draft Bill is on mortgagees in possession. However, it is worth noting that Div 105 is not confined to mortgagees in possession, but applies to all who might fall within the description of a creditor who supplies the property of a debtor to a third entity in or towards the satisfaction of a debt owed to the creditor. Further to this, it is interesting to consider the position where a representative is also an agent appointed by the creditor to effect the supply. For instance, an insolvency practitioner might be appointed as agent for mortgagee in possession, or a receiver and manager might be the agent of the secured creditor. If the draft Bill is passed, then the creditor would presumably be liable under Div 105 even though the agent is also a representative for the purposes of Div 58..5



Conclusion

Any proposal to reduce the current uncertainty caused by the potential overlap of Div 58 and Div 105 is welcome. Assuming that the draft Bill is passed in its current form, then where a supply may fall under both Div 58 and Div 105, Div 105 will apply to the exclusion of Div 58.

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