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▼ Tax Analysis

## INTERMEDIARIES AND GST

# Who are "you"?

By David Marks

**David Marks shows why it is important to identify which "you" is the supplier, acquirer or importer. His examples from industry illustrate how GST affects dealings with intermediaries.**

The purpose of this paper is to dispel confusion about the way that the goods and services tax applies where an intermediary is involved.

In the first part of this paper, I demonstrate the significance of properly identifying the supplier, with a controversial example I have taken from the Explanatory Memorandum to the GST Act.

The second part of this paper deals briefly with the concept of agency. A tax law takes the general law as it finds it, unless the tax law deems some other state of affairs to be the case.

The third and fourth parts of the paper take a closer look at intermediaries in three industries: the travel, insurance broking and financial planning industries.

Finally, I consider specific provisions that will affect how representative agents, insolvency practitioners and creditors approach transactions in future.

### "YOU" ARE LIABLE TO GST

The foremost principle in relation to a taxable supply is stated in sec. 9-40 of *A New Tax System (Goods and Services Tax) Act 1999* (Cth):[1]

"You must pay the GST payable on any *taxable supply that you make."

The provisions related to entitlement to an input tax credit for a creditable acquisition, and related to a taxable or creditable importation, also refer to "you".[2]

An earlier version of this paper was presented to the Brisbane GST Discussion Group, and separately to colleagues, in November 1999. I value the comments of the discussion group, and of Peter Green. I retain responsibility for any remaining errors. The law is stated as at 8 November 1999.

### The Significance of "You"

The GST Act usefully defines "you":[3]

"... if a provision of this Act uses the expression you, it applies to entities generally, unless its application is expressly limited.

"Note: The expression "you" is not used in provisions that apply only to entities that are not individuals."

Division 184 of the GST Act defines "entity" and provides some useful machinery provisions. However, that definition and those provisions do not further this discussion.

Pausing for a moment, note also that "you" make a taxable supply if, amongst other things:[4]

"*(a)* you make the supply for *consideration; and

*(b)* the supply is made in the course or furtherance of an *enterprise that you *carry on; and

*(c)* ...; and

*(d)* you are *registered, or *required to be registered." [My emphasis]

The exclusionary provisions in the definition of "enterprise" provide a further clue. Section 9-20(2)(a) provides a general rule that an activity done as an employee is not an enterprise. The note to sec. 9-20(2)(a) states:

"Note: An employee's or PAYE earner's acts will still form part of the activities of the enterprise in which he or she is employed."

### When Is It "You"?

The Explanatory Memorandum[5] provides a brief practical example of how important it is to identify which "you" has made a supply.

Section 9-20(2)(a) contains an exception to the general rule about the activities of employees. An activity done in supplying services as the holder of an office, that the employee (or other PAYE earner) has accepted in the course of a business (or other enterprise), can still be an enterprise.

The EM states that if a partner of a law firm accepts a directorship in his or her capacity as a partner of a law firm, a supply is made to the company by the law firm. The EM asserts that the partner is not acting as an employee of the company. The consequence stated in the EM is that the director's fees are liable to PAYE, and the payment of the fees is subject to GST.[6]

This appears to show a worrying disregard for two things.

First TD 97/2, paragraph 5, says that where a partner is required to account for director's fees to a law firm, PAYE instalments need not be deducted.

Secondly, in better-ordered professional practices, a partner would not be permitted to accept a directorship of a company in his or her capacity as a partner of the firm. TD 97/2 states the ATO view. This is that a partner will be the agent of the law firm where:

- the partner takes on a directorship in the ordinary course of the partnership business, under circumstances where approval of the partnership is required; and
- the partner must account to the partnership for the director's fees.

In the modern environment, I doubt

that large professional firms would tolerate a partner being a director in the capacity of a partner of the firm. Instead, the partner acts on his or her own account, but is obliged (as a fiduciary) to account to the partnership for the director's fees. TD 97/2, paragraph 4, contemplates that the partner may not be the firm's agent, but still be under an obligation in equity to account for the fees.

In that situation, I think it doubtful that the law firm is making a supply to the company of which the partner is a director.

The first point perhaps simply indicates that persons not attuned to the income tax position drafted the EM.

However, the second point appears dangerous. The ATO may read that paragraph of the EM as applying in all situations where a partner is a director of a company. However, the relevant passage in the EM will not represent the commercial situation in many cases.

### Identifying the Supplier

The most fundamental question, then, is whether the intermediary stands in a relationship with the ultimate supplier such that the act of the intermediary is attributed to the ultimate supplier.

What flows from the resolution of that question is whether the intermediary has made the supply, or whether the ultimate supplier has done so.

## AGENCY

I will start by defining "agency". I then identify situations where there may be a misconception about whether a person is an agent of another.

### The Relationship

Under the general law, agency is a relationship between two persons. One, the "principal", expressly or impliedly consents that the other, the "agent", should act on the principal's behalf.[7] The agent consents to so act. It is a relationship of trust, called a "fiduciary relationship".[8]

Statute has intervened. For example, an insurance broker is deemed to be the agent of the insurer in certain circumstances, even though the broker might (at law) have been regarded as the insured's agent.[9]

### Misdescriptions and Misunderstandings

A real estate agent in Queensland generally has no authority to bind the vendor of a property to sell the property, nor even to accept part of the purchase price. There may be limited authority to make representations about the nature or quality of the property, but generally no authority to bind the vendor contractually to those representations.[10]

I do not wish to make too much of the particular example. Of course, a vendor can change the general arrangements to suit the vendor's needs in particular circumstances.

The point I do make is that not every intermediary is an agent. This is despite common and widespread misdescription of certain classes of persons as "agents". (In the case of the real estate agent, the better description might be "broker".)

### Authority

The actual or implied consent by the principal, or the legally deemed agency, operates to allow the agent to do things on the principal's behalf. The agent is said to have authority to act.[11] Within the scope of the agent's authority, the agent can affect the principal's legal relationships.[12]

An agent can only bind the principal within the scope of the agent's authority. Acting outside the scope of the authority, the agent is personally liable to the third party for breach of the agent's own warranty that the agent has authority.

Let us take the example of an employee, as this is referred to in sec. 9-20(2)(a) of the GST Act. An employee is not necessarily an agent of an employer.

Where the employer confers authority (expressly or impliedly), the employee cannot bind the employer in every manner of legal relationship. For example, a checkout attendant would generally have no actual or implied authority to sign a lease of the store on behalf of the shop's operator.

The checkout attendant does have ostensible authority, I would say, to conclude contracts for the sale of comestibles. Even then, I would have thought that the ostensible authority would be limited to cases where the items are available immediately from stock, the customer produces any necessary identification (as for cigarettes or alcohol), and payment in an approved form is tendered.

It is not necessary here to consider the complexities that occur in determining the scope of implied or ostensible authority.

However, in summary, not only must you identify the person concerned as an agent, but you must determine whether that person is acting within the scope of the authority conferred expressly or impliedly.

### Effect on Tax Laws

A tax law takes the general law as it finds it.

Deane and Fisher JJ in *Magna Alloys & Research Pty Ltd v Commissioner of Taxation*[13] said:

"It is no part of the function of the Act or of those who administer it to dictate

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to taxpayers in what business they shall engage or how to run their business profitably or economically. 'The Act must operate upon the result of a taxpayer's activities as it finds them': per Williams J, *Tweddle v FC of T* (1942) 7 ATD 186 at 190; 2 AITR 360 at 364; see also, *Ronpibon Tin NL v FC of T; Tongkah Compound NL v FC of T*, supra, 78 CLR at 56-7; 4 AITR 245; *Cecil Bros Pty Ltd v FC of T* (1962-1964) 111 CLR 430 at 434, 441; 8 AITR 523 at 525-6; 9 AITR 246 at 249; *IRComr (NZ) v Europa Oil (NZ) Ltd (No 1)*(1971) AC 760 at 772; 1 ATR 737 at 750; *FC of T v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645 at 653-4; 21 ALR 59 at 65; 8 ATR 879 at 883."

For example, a State law might deem a structure to be an item of property separate from the land. The Commonwealth income tax law then operates on the structure as if it were owned separately. This might facilitate depreciation of fixed equipment that was on Crown land.[14]

The law of agency often means that a passive principal (not the active agent) actually effects the supply. The agent may, indeed, conclude the deal without disclosing the existence of a principal.[15]

Nevertheless, where the agent does not contract personally, the legal effect is that the principal is bound, and the agent is a mere cipher. In the normal course, the agent becomes legally irrelevant to the relationship between the principal and the third party, after having introduced them or otherwise undertaken the agency.[16]

That is the state of the law. Absent specific provision in the GST Act to deem another result, the GST Act operates on the principal as the supplier, recipient, or the importer, as the case may be.

In fact, there is nothing surprising or alarming about this result. This result is certainly contemplated in the EM:

"6.277 If you make supplies through agents the general law of agency applies. That is, a thing done by your agent as agent for you is a thing done by you. You are liable for the GST on taxable supplies and importations made through your agent. You are entitled to the input tax credits on creditable acquisitions and importations you make through your agent. Your agent is not liable for the GST and is not entitled to the input tax credits.

"6.278 If you make a supply, or acquisition through someone else who is not acting as your agent there are two transactions. One between you and the other person, and one between the other persons and the person they supply it to or acquire it from."

While, at base, the GST is a simple tax, difficulties arise once the simple legal principles are applied in practice. Practical difficulties with agency revolve around:

- understanding how our clients actually do business at present; and
- re-engineering flows of information, cash, and paper to meet the challenge of the GST.

## TOURISM

I begin my discussion of practical issues by taking a relatively clean example from the tourism industry.

### The Deal

Let's say that a wholesaler approaches the operator of accommodation, transport or a venue.

The question is whether the operator will set aside capacity to enable the wholesaler (or a retailer buying from a wholesaler) to sell that capacity to the public.

As I understand it, the operator would generally receive no cash until the service is provided (or perhaps first provided). The operator has unsold capacity released back to the operator days or weeks before the date to which that capacity relates. (For example, the operator may be advised 14 days before the relevant night in question that a specified number of rooms at the operator's hotel remain unsold. The operator is then free to deal with those rooms.)

Until capacity is released back to the operator, the operator does not know whether any of that capacity has been sold.

The wholesaler will no doubt on-sell at a margin. A retailer will add its own margin.

In the simplest case, the thing that is sold to the traveller involves only one operator. However, you can imagine that a package tour (with many operators), or a self-planned tour (involving a customer's choice of airline, hotels and hire cars) begins to make the paper trail quite complex.

A wholesaler or a retailer usually does not contract as principal. It acts as the agent of the operator. If the hire car is defective or you slip in the hotel's foyer, the wholesaler and retailer will maintain that they are not responsible. The traveller's claim is against the operator.

The principles upon which the GST operates are simple. As always, the practice is more difficult.

### Agent or Principal

I should say at the outset that there are some who believe that GST reporting systems ought to be set up on the basis that each of the operator, wholesaler and retailer act as a principal. I understand why that pragmatic position is taken, but I do not agree.

I cannot see how reporting as a principal is permitted unless either:

- you are a principal; or
- the GST Act is amended especially for the tourism industry to treat you as if you are a principal.

As I understand it, no wholesaler or retailer will tolerate actually contracting to deliver a safe camel ride at a distant attraction on a Wednesday afternoon two months hence. Legally, they will insist that they are mere agents whose function is to facilitate the traveller contracting with the operator. They are not interested if the camel bites you.[17] Whether this assertion on the part of the retailer or wholesaler is correct will depend on the precise circumstances of the arrangement.

The GST Act takes the taxpayer's arrangements as it finds them. No amount of wishing on the part of systems designers will turn an agent into a principal.

### Cash Flow and Information Flow

I leave aside the issues of security deposits[18] and trust accounts.

At some point, the travel agent:

- issues an invoice to the traveller; or
- applies the security deposit toward the cost of the travel (or forfeits the security deposit); or

• gets in moneys beyond a mere security deposit.

Where the operator accounts for GST on an accruals basis, GST is attributable to the period in which the first of those points occurs.[19]

However, as mentioned above, the operator will often not know that capacity has been contracted until the date for release-back of the capacity. The operator does not receive a cash flow until the first provision of the services to the traveller.

This means that the operator cannot make its own GST return (if preparing on an accruals basis) and faces an unfunded GST liability due to the delay in cash flow. Obviously, something is going to have to change in this industry.

There are a number of possible solutions suggested by the GST Act itself. One approach would be for the operator to apply for permission to account on a cash basis in accordance with sec. 29-45.

Alternatively, the Commissioner might be prevailed upon to declare operators as an enterprise of a kind which may elect to account on a cash basis: sec. 29-40(1)(c), as proposed to be inserted by *A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999.*

Another approach would be for the Commissioner to make a written determination of tax periods to which output tax of operators' supplies might be attributable in accordance with sec. 29-25. The Commissioner may do so where the circumstances involve a supply occurring before the supplier knows it has occurred or knows the total consideration. Qualifying circumstances can also include supplies where the contract provides for retention of consideration.[20]

Finally, a standing extension of time to make GST returns might be requested by the operator.[21]

## Commissions

The Tourism Council of Australia said in October 1999 that the industry was negotiating with the Australian Taxation Office over the issue of travel agent commissions, amongst other things.[22] I am not certain of the issues raised with the ATO. However, some points occur to me.

Let's say that the operator sells capacity for $110 per unit.

The wholesaler adds its margin and on-sells for, say, $330 per unit.[23] The retailer adds its margin, and on-sells for, say, $660 per unit.

The traveller pays $660 per unit and is unaware of the amount of commissions. Typically, the operator is aware of the margins, at least in broad terms. For that reason, there is less sensitivity in this industry about disclosure of margins to the principal.

On the theory which I propounded earlier, an accruals basis operator has output tax of $60, based on a consideration of $660 per unit. The operator has to get in tax invoices totalling $550 from the wholesaler and retailer for their commissions, to reduce the net amount that must be remitted, to $10 instead of $60.

I anticipate that this will produce a merry paper chase, as the retailers and wholesalers compile and provide tax invoices for operators.

To exacerbate the potential cash flow problems, the wholesalers and retailers may be forced to raise their margins to maintain actual dollar margins in a post-GST environment.[24]

## Who Issues the Invoice for Whom?

A critical systems issue is whether a system can generate invoices for each supplier for the one excursion.

I anticipate that the usual business cash flows will continue, so that the retailer will be the one driving to conclude the transaction, by getting in the money from the traveller. I therefore anticipate that it will be the retailer's and wholesaler's systems issues which will need to be solved.

Either the operator or its agent can issue a tax invoice.[25]

The invoice must state, amongst other things, the Australian Business Number of the issuer (which may be the retailer or wholesaler).[26]

However, the tax invoice must also state, amongst other things, the name of the supplier, which will be the operator in cases of pure agency.[27]

Apparently, this is where some booking systems are presently challenged, also. From a systems perspective, it would be preferable if every party in the chain reported as if that party contracted as principal. This would accord with some overseas practices. However, those practices have legislative support.

For example, in New Zealand the agent may issue an invoice in respect of a taxable supply made on behalf of a principal "as if that agent had made a taxable supply".[28] In the United Kingdom, if an agent, acting in its own name, makes a supply of goods, there is a deemed supply by the principal to the agent, and a supply by the agent to the third party. A similar rule applies to the supply of services, at the discretion of the Commissioners of Inland Revenue.[29]

In Australia, where the rules are different, the regulatory requirement that the invoice include the name of the supplier will cause systems difficulties and upset established undisclosed principal arrangements.

Division 153 of the GST Act imposes a duty on the principal to issue a tax invoice even if the demand by the recipient is made to the agent. Section 45 of the *Taxation Administration Act 1953* (Cth) (TAA) makes it an offence, committed by the operator, if both the operator and the agent issue invoices. The statutory régime assumes a power relationship that does not exist in many cases.

For example, given current information and cash flows, the operator would often not know how much capacity had been contracted, or to whom, until the last minute. The operator would be relying on wholesalers or retailers to provide a system that gives a proper assurance of the ability of the wholesaler or retailer to meet a demand for an invoice.

## Accounting

Output tax can be audited easily by comparing reported outputs to turnover. The agent's turnover may include receipts on behalf of the principal. The agent must account for those receipts to the principal. So that matters are clear to an auditor, the agent could keep a separate account, or could report on the basis that receipts give rise to a liability.

Reporting problems can also face a

principal. For example, often the price is remitted by the agent to the principal net of commission. This may cause systems difficulties. The principal may be unable to prepare a tax invoice for the gross amount. The accounting system may be unable to produce an output tax result based on the gross amount.

## INSURANCE AND FINANCIAL PLANNING

There are a number of difficulties with the application of GST to intermediaries in the insurance and financial planning industries. I will concentrate on two points of more technical interest:

- for whom is an insurance intermediary acting as agent when effecting insurance?
- how is commission treated?

I mention at the outset that both points are complex, and there will be differing views. I also owe a debt to papers about insurance prepared by Oscar Shub and John Morgan,[30] which first drew my attention to these issues. However, the positions I put in this paper represent my personal conclusions, and I retain responsibility for any errors.

### Agent for Whom?

This part deals with insurance intermediaries.

I had intended to be briefer in my comments about identifying the principal. I had thought, at first glance, that proposed amendments to the GST Act corrected and simplified the position.[31]

However, if anything, the position is more complex. Distinctions that exist have largely been retained, though the proposed amendments to Division 153 change the significance of those distinctions.

The primary issue is to identify for whom the insurance intermediary acts.

The issue is governed, for the purposes of the general law, by the *Insurance (Agents and Brokers) Act 1984* (Cth). Section 12 provides:

> "*(1)* Subject to this section, an insurance intermediary shall be deemed, in relation to any matter relating to insurance and as between an insured or intending insured and an insurer, to be the agent of the insurer and not of the insured or intending insured.
>
> "*(2)* Subsection (1) does not apply to a general insurance broker in relation to any matter relating to general insurance business.
>
> "*(3)* Subsection (1) does not apply to a life insurance broker in relation to any matter relating to life insurance business.
>
> "*(4)* Subsection (1) does not affect any liability to which, if that subsection had not been enacted, an insurer would have been subject in respect of the conduct of an insurance intermediary."

An "insurance intermediary" means a person who:

> "*(a)* for reward; and
>
> "*(b)* as an agent for one or more insurers or as an agent for intending insureds;
>
> "arranges contracts of insurance in Australia or elsewhere, and includes an insurance broker."[32]

An "insurance broker" means:

> "a person who carries on the business of arranging contracts of insurance, whether in Australia or elsewhere, as agent for intending insureds;"[33]

The effect of these provisions is to reverse the general law in some cases.

I would summarise the position as follows, but I note that this summary is somewhat simplistic:

- An agent or employee of the insurer is naturally going to be treated as the insurer's agent under this consumer-oriented legislation. Statute in fact prevents the insurer from denying that the agent or employee was acting outside the scope of permitted authority, if the insured acted reasonably and in good faith.[34]
- The general law is that a broker is the agent of the insured.[35]
- Section 12 reverses that rule, so that the broker is treated as agent of the insurer, unless:
  - the broker is a general insurance broker acting in relation to general insurance business; or
  - the broker is a life insurance broker acting in relation to life insurance business.
- A broker acting under a "binder" effects contracts as agent for the insurer, and is regarded as the agent of the insurer.[36]
- Whether or not the insurance intermediary is acting as agent of the insurer, section 14 now means that payment to the intermediary of an amount on account of premium is a valid discharge of the liability of the insured to the insurer. (Note that this merely provides a defence of discharge, and does not change the general law position that a broker (acting as actual or deemed agent of the insurer) does not receive the money as agent of the insurer.)

This state of affairs could lead to the same types of problems in the insurance industry as in the tourism industry. In some circumstances, brokers' terms would not have required remission of premiums for a substantial time. An insurer would be unaware that they had made a supply of insurance until the broker advised.

On face, the simplest solution would be to deem brokers to be the agents of insurers for all purposes of the GST Act. There must be a serious question as to whether that solution would have been practical, however.

What is proposed in *A New Tax System (Indirect Tax and Consequential Amendments) Bill (No.2) 1999* only goes part of that way. The following section is to be added:

> "153-25 Insurance supplied through insurance brokers
>
> "*(1)* If an insurer supplies an *insurance policy through an *insurance broker acting on behalf of the *recipient of the supply, this Division has effect as if the supply were made through the insurance broker as an agent of the insurer.
>
> "*(2)* This section does not affect the application of this Division in relation to the acquisition of the *insurance policy through the insurance broker as an agent of the *recipient."

Note that all that this provision does is to affect provisions of Division 153, which relate to issue of invoices and adjustment notes by a non-principal. It does not turn an intermediary into an agent for all purposes.

The result is that there is still a live issue about whether a person is an agent of the

insurer or insured, for the purposes of liability for GST.

Though my conclusions might be regarded as controversial, I consider that the new provision will lead to the following results:

- receipt of consideration (premium) for an insurance policy by a general insurance broker in the course of general insurance work will still not amount to receipt of consideration by the insurer.[37] I assume for this purpose that the broker is not subject to a binder (or otherwise an agent of the insurer instead of the insured).
- issue to the insured of an invoice, by a broker who is the insured's agent, will (in itself) not trigger a GST liability in the accounting period of issue.[38] The result differs if the broker is the insurer's agent.
- the broker may issue a tax invoice on behalf of the insurer. This seems to fulfil a desirable practical end.[39] However, the issue for insurers will be to manage their relationships with brokers and agents so that the insurer (as principal) does not also issue a tax invoice.[40]
- if the broker is the agent of the insured, proposed sec. 153-25(2) still permits the insured to claim an input tax credit despite the invoice being in the hands of the broker.[41]
- however, if the broker is instead the agent of the insurer, the insured will have to get in the tax invoice itself.

As this amendment to Division 153 does not tackle the hard legal point of who is the principal, a number of undesirable distinctions therefore remain.

## Commission

Although a broker is often the agent of the insured, the remuneration of the broker largely comes from the insurer in the form of a commission.

Likewise, I understand that a financial planner earns a significant proportion of his or her income from commissions paid by the institution in which the investment is placed.

There are a number of issues relating to commission, in which insurance brokers and insurers are interested.

I deal with a number of issues quickly, then I wish to spend some time looking at an issue that is common to brokers and others in a similar position, such as financial planners.

### *(a) Other issues*

While I intend only to deal in detail with one issue relating to commissions, I should alert you to other possible issues.

For example, there is the issue of whether the commission is fully earned when paid, or is part of an arrangement that may involve claims handling and paperwork over the term of the policy and beyond. If the latter, there are issues about whether there is a supply of a right spanning 1 July 2000.

I suspect that those kinds of issues will turn on the particular facts of each arrangement. It is unhelpful to make general comments about the possible legal consequences, in the absence of detailed statements by parties to the arrangements.

Another broad issue relates to how persons remunerated by commission should deal with GST generally. Again, this will turn on their existing agreements, the basis of calculation of the commission, and margins involved. This is a substantial issue in itself.

Finally, there are issues related to disclosure of margins. That is as much a commercial issue as anything else. Note that *Insurance (Agents and Brokers) Act 1984*, sec. 35(1)(b), gives the insured a legal right to information about commissions received from the insurer in any case, if the insured requests those details.

### *(b) Who pays and how much?*

However, there is one issue of wider interest.

Both brokers and planners often receive their remuneration from commissions paid by the institution with which business is placed. There may be other fees charged by the intermediary to the customer, but commission is certainly a substantial issue.

The remuneration could be structured instead as an explicit fee charged to the client for arranging the insurance or investment, and a lower entry price or premium on the product (if the institution was agreeable). In that case it would be clear that:

- the broker would be liable for GST in relation to the fee.[42]
- the customer would be entitled to an input tax credit related to the fee, if the customer had made a creditable acquisition of the services.

However, to the extent that commission from the institution remains a significant part of remuneration, the water is very murky indeed.

## Paid for Services to Customer?

The simplest approach is to say that the commission is in fact consideration which the customer consents be paid by the institution as the broker's reward for services to the customer.

It is not clear that the customer would be entitled in that case to an input tax credit. In terms of sec. 11-5(c) of the GST Act, the customer arguably has not provided (nor been liable to provide) the consideration.[43] This leads to questions of constructive provision of consideration, which remain unresolved.

If the supply has been of services to the customer, not the institution, the institution has not made an acquisition, let alone a creditable acquisition.[44]

## Paid for Services to Institution?

Another approach is to treat the commission as paid by the institution for:

- introducing business to the institution;
- retaining business for the institution; and
- particularly in the case of insurance intermediaries - claims-handling and other customer services which an insurance intermediary commonly conducts.

The customer, in that case, is being charged full-fare for the brokerage or commission. In the case of a financial product or life assurance, the customer may not be entitled to an input tax credit to the extent that the entry price or policy fee has not been discounted.[45]

If the supply by the institution is of insurance (other than life insurance), the institution will be entitled to an input tax credit related to the commission. Brokerage of general and life insurance is eligible for reduced input tax credits.[46] This presumably assists if general insurance (such as income protection) is bundled into a life product, thus

becoming an incidental financial supply that is input taxed. *I thank Clifford Hughes of Clayton Utz for sharing this insight.*

Reduced input tax credits also apply to "supplies for which financial supply facilitators are paid commission by financial supply providers".[47] "Financial supply facilitator" is defined in delphic terms in regulation 40-11, but seems wide enough to cover insurance intermediaries and financial planners. As an aside, the consultative document, which pre-dated the regulations, used the expression "agent". This expression only caused confusion, hence the expression "financial supply facilitator".

### The Correct Approach

There is a significant level of frustration amongst the insurance community about the inability of government to provide an easy solution to the puzzles outlined above.

However, John Morgan has said:

> "This is an exercise based on fact. Unhappily at the moment a lot of imaginative minds are trying to determine the facts by reference to the best tax outcome rather than by reference to the ordinary criteria which lawyers would look to to determine a factual matter."[48]

The safest prediction is that commission-based arrangements will be replaced with arrangements involving an explicit fee to the customer for brokerage or advisory services (for which an input tax credit might be expected if the customer is eligible).

## OTHER MATTERS

For the sake of completeness, I mention a number of instances where there is a representative relationship.

### Resident Agent Acting for a Non-Resident

Division 57 provides for the liability to GST of a resident agent, through whom a non-resident makes a taxable supply or taxable importation.

A resident agent is an agent who is an Australian resident for income tax purposes. For that reason, it is again necessary to determine whether, as a matter of law, the parties are in a relationship of agent and principal.

The resident agent is subject to return requirements, and must be registered (even if below the normal threshold requirements).

### Incapacitated Entities

An incapacitated entity in Division 147 is:

- an individual who is bankrupt; or
- an entity which is in liquidation or receivership.

The representative of the entity is required to be registered in his or her capacity as a representative.

This rule seems to take over from the general law rules under which, in some of those circumstances, the representative is deemed to be acting on behalf of the incapacitated entity. The effect of this is that the Commissioner is likely to enjoy a priority in relation to the future trading or transactions by the entity.

As a sting in the tail for persons acting as such representatives, sec. 54 of the TAA makes two or more such representatives jointly and severally liable for tax payable by any representative. Similarly, an offence by one such representative is deemed committed by all others, subject to a due diligence defence. I imagine that this will worry a receiver when a liquidator is appointed to the company, and vice versa.

There are in fact significant issues surrounding these representatives, including a system under sec. 55 of the TAA under which the representative must set aside monies to pay the indirect tax liability. However, I leave discussion of GST insolvency issues for another day.

### Supplies in Satisfaction of a Debt

Division 105 makes a creditor accountable for the GST, and is treated as the supplier, where it supplies property of the debtor to a third party. The division applies if the supply is made in (or toward) satisfaction of a debt the debtor owes, and the debtor would have been liable to GST if the debtor had made the supply.[49]

The creditor has to register. It is irrelevant whether the creditor is making the supply in its business.[50]

There is a known problem with Division 105. In some cases, the debtor will have been deregistered (and thereby ceased to exist). When that occurs, property of the company vests in the ASIC.[51] However, the ASIC is not personally liable for the debt. ASIC holds the property subject to the security interest.[52]

In the absence of a debtor and a debt, Division 105 has no obvious application. A mortgagee in possession that sells in satisfaction of the debt owed by the deregistered company is not obviously caught.

Depending on the precise circumstances of the case, a commonsense approach might be to say that - in the absence of the former legal owner - the effective supplier is the creditor. The one objection to this is that the ASIC is the owner. The next stage is to say that legal ownership is not necessarily the criterion by which the supplier is to be determined.[53]

## IMPORTANCE OF AGENCY

By using the concept of agency, the GST Act draws on an everyday legal concept. This paper has drawn out aspects of the use of agency which might otherwise confuse. Where there are difficulties, this paper has shown the possible approaches, and suggested resolution. ❐

## REFERENCE NOTES

1. The Act is referred to here as the GST Act.
2. Sections 11-20 and 11-5 (input tax credit for a creditable acquisition) and secs 13-15, 13-5, 15-15 and 15-5 (importations).
3. Section 195-1 GST Act.
4. Section 9-5 GST Act.
5. Explanatory Memorandum to *A New Tax System (Goods and Services Tax) Bill 1998*, referred to afterward as the EM.
6. EM, paragraph 2.5.
7. Sometimes the principal's consent is imputed, even if not consciously given. The agent has ostensible authority.
8. FMB Reynolds, Bowstead on Agency (15ed), (London, Sweet & Maxwell, 1985), page 1.
9. *Insurance (Agents and Brokers) Act 1984*, sec. 12.
10. WD Duncan, Real Estate Agency Law in Queensland (Sydney, *The Law Book*

*Company Limited*, 1985), paragraphs [806] - [810].

11. Bowstead, page 1.

12. ibid.

13. (1980) 49 FLR 183, pages 205-6.

14. Cf. *Statutory Bodies Financial Arrangements Act 1982* (Qd), sec. 64. Obviously some of those problems were solved by Sub-division 42-I of the *Income Tax Assessment Act 1997*, which creates a category of quasi-ownership.

15. *Maynegrain Pty Ltd v Compfina Bank* (1984) 58 ALJR 389, pages 393-4 (Privy Council). See also *Construction Engineering (Aust.) Pty Ltd v Hexyl Pty Ltd* (1985) 59 ALJR 393 (High Court of Australia).

16. The agent will be personally liable if the agent contracts personally. Where the existence or identity of the principal is not disclosed, the agent will be personally liable.

17. I have deliberately overstated the point for effect. In fact, a wholesaler or retailer will take a vital interest in such things, but simply from the point of view of being better able to advise clients in future.

18. Security deposits are subject to special rules in accordance with Division 99 of the GST Act.

19. Sections 29-5 and 99-10(1) of the GST Act.

20. Section 29-25(2) of the GST Act.

21. Section 31-10(b) of the GST Act.

22. "Quiet Panic as Deadline Draws Near", *Australian Financial Review*, 20 October 1999, page 54.

23. I am deliberately disguising true industry margins.

24. For discussion of the requirement not to increase net dollar margins, refer to Australian Competition and Consumer Commission "Price Exploitation and the New Tax System", guidelines made under sec. 75AU of the *Trade Practices Act*, paragraph 47.

25. Section 153-15 of the GST Act.

26. Section 29-70(1)(b) of the GST Act.

27. Regulations 29-70(2)(c) and 29-70(3)(c) *A New Tax System (Goods and Services Tax) Regulations 1999* (GST Regulations).

28. Section 60(1) *Goods and Service Tax Act 1985* (NZ). See also Inland Revenue, "GST Guide", May 1999, page 22.

29. Halsbury's Laws of England (4th edition, Reissue), volume 49(1), paragraph 195, notes 6 and 7. Halsbury's cites secs 47(2A) and (3) of the *Value Added Tax Act 1994* (UK), as amended.

30. Oscar Shub "The Legal Principles Associated with Broker Based Insurance", unpublished paper presented on 31 August 1999; John K Morgan "The GST and Insurance - An overview", unpublished paper presented on 21 September 1999. See also The Insurance Council of Australia Limited "GST & The General Insurance Industry", August 1999.

31. *A New Tax System (Indirect Tax and Consequential Amendments) Bill (No.2) 1999*, schedule 1, part 1, items 48-50.

32. *Insurance (Agents and Brokers) Act 1984* (Cth) Section 9.

33. Ibid.

34. *Insurance (Agents and Brokers) Act 1984*, section 11.

35. *Norwich Fire Insurance Society Ltd v. Brennans (Horsham) Pty Ltd* [1981] V.R. 981, page 985.

36. DS Kelly and ML Ball, Principles of Insurance Law in Australia and New Zealand (Sydney, Butterworths, 1991), page 195, paragraph 5.44.

37. Likewise, such a receipt by a life insurance broker in the course of its life insurance business will not be a receipt by the insurer. This conclusion is subject to the broker in each case not being subject to a binder or like arrangement. The conclusion is based on sec. 12 of the *Insurance (Agents and Brokers) Act 1984*, which does not deem a broker to be the agent of the insurer in every case.

38. This conclusion may well be regarded as controversial, but it is probably neither here nor there. The broker will have received an invoice from the insurer on a renewal. Note, however, that the insurer may be unaware of the matter if it is new business.

39. Section 153-15(1)(b) GST Act, and proposed sec. 153-25(1).

40. That would be an offence under sec. 45 of the TAA.

41. Explanatory Memorandum, *A New Tax System (Indirect Tax and Consequential Amendments) Bill (No.2) 1999*, paragraph 2.41.

42. In accordance with the Regulations, the provision of professional advice by an independent financial planner in relation to a financial supply would not be input taxed, and nor would be the services of an independent insurance broker, as neither are listed in regulation 40-13. Such services, when provided independently, will also not be incidental financial supplies (regulation 40-14).

43. As with all these types of arrangements, the legal conclusion depends on the exact nature of the arrangements.

44. Sections 11-5 and 11-10 GST Act

45. Much depends on the structure of the entry arrangements.

46. Regulation 70-2, item 25.

47. Ibid., item 27.

48. JK Morgan "The GST and Insurance: An overview" (unpublished paper, 21 September 1999), page 19.

49. Section 105-5(5) GST Act.

50. Section 105-5(2) GST Act.

51. Section 601AD(1) Corporations Law.

52. Section 601AD(3) Corporations Law, and see *Re Hassell Holdings Pty Ltd* [1995] 1 QdR 516 at page 517 per Dowsett J.

53. Customs and Excise Commissioners v Oliver [1980] 1 All ER 353 (Griffiths J).