23 May 2014

Brendan Sheen
Director
Financial Supplies – Compliance Strategy
Australian Taxation Office
3 Collins Square
DOCKLANDS VIC 3008

Via Email: brendan.sheen@ato.gov.au

Dear Brendan,

Draft ATO Publications
GST and Brokerage and Foreign Exchange Products

The Australian Financial Markets Association (AFMA) represents the interests of over 130 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets.

AFMA welcomes the opportunity to provide feedback to the ATO in respect of the Draft GST Determination regarding the circumstances under which the supply of brokerage services in respect of overseas securities will be GST-free (**the Draft Determination**) and the Draft GST Ruling regarding the GST treatment for foreign currency products (**the Draft Ruling**).

We understand that these publications will subsequently be issued for consultation to the public, inviting comment on the technical merits of the positions set out therein. AFMA will provide a submission as part of this process and accordingly, as requested by the ATO, has focussed at this juncture on the practical issues that would arise were the technical positions set out in the publications to represent the ATO's concluded views. Notwithstanding, we have included some umbrella comments in relation to the technical positions reached in each publication below to assist in framing our comments on the practical issues arising.

Draft GSTD – Brokerage

Technical Comments

At a high level, and as shall be elaborated upon in our subsequent submission, AFMA takes issue with the approach adopted by the ATO in the Draft Determination.

Under the position adopted in the Draft Determination, the GST treatment of the brokerage services supplied, as either GST-free or taxable, will depend entirely on the intention of the recipient of the services. It is AFMA's contention that a general principle of taxation administration is that the intention of a party other than the taxpayer should not be definitive of the taxpayer's taxation outcome. Rather, the taxation outcome for the maker of the supply should be determined only with reference to the circumstances of the taxpayer or criteria that are readily ascertainable, such as the counterparty's location.

Further, AFMA is of the view that the place where rights are used, where such rights attach to securities located offshore, is the location of such securities. Even for those counterparties that are seeking to acquire securities with a view to holding the securities not for the purpose of trading stock, the securities themselves confer upon the acquirer rights that are, by definition, exercisable offshore. In the case of shares, such rights collectively comprise the right to dividends, the right to vote and the right to capital upon wind up of the issuing entity. All of these rights would be exercisable outside of Australia for foreign listed shares. Similarly, for derivatives, the claim for damages or specific performance of the contract in the event of default by the counterparty would be exercised offshore. To this end, we disagree with the comment in Paragraph 36 of the Draft Determination that "where the rights are for use should reflect where the recipient or the relevant part of their enterprise is located as this reflects where they are using the rights."

It strikes AFMA as incongruous that, in the case of an Australian customer holding the foreign-listed securities for the purposes of investment, that there would not be symmetry between the GST treatment between acquisition and disposal. That is, the circumstance whereby the brokerage for the acquisition is taxable but the brokerage for the disposal is GST-free does not appear to be sound. If the key determinant of the GST treatment is where the rights attaching to the securities are to be enjoyed, then it should not be relevant, in AFMA's view, whether the services are provided for the acquisition or the disposal of those rights.

Finally, the position in the Draft Determination imports concepts such as "trading stock" that are novel in the GST space, and effectively require for a broker to ascertain whether the recipient of the services is holding the assets on revenue or capital account. These are vexed issues with considerable jurisprudence behind them and have, such as in the example of Managed Investment Trusts, necessitated the existence of a specific electing provision deeming all investments to be on capital account. There does not appear to be a technically robust basis for importing these concepts into the interpretation of the GST provisions, especially given they apply not to the taxpayer but the counterparty.

Practical Considerations

AFMA's view is that the approach adopted in the Draft Determination is unworkable from a practical perspective.

The only possible opportunity for providers of brokerage services to ascertain the intention of the clients with respect to the transactions undertaken by the clients is at the commencement of the relationship between the broker and the client, i.e. at the on-boarding stage. Given light-touch brokerage models such as Direct Market Access and Straight Through Processing, which are becoming increasingly prevalent, the broker will have little to no visibility in respect of the transactions undertaken by the client in advance of them being undertaken, let alone any opportunity to ascertain the client's intention.

In addition, having more than one GST treatment for a particular client, based on different intentions for each acquisition, would impose significant difficulties from an operational and systems perspective. How this would look in practice would be that a client would need to open two brokerage accounts and designate at the time of the transaction whether the transaction was one which qualified for the indicia of GST treatment; given the size and extent of some customers, especially complying superannuation entities, imposing this additional requirement and rigorous enforcement is unachievable.

Ultimately it is AFMA's view that given the trigger for determining the GST treatment of the brokerage services is the intention of the client, the only possible way this issue could be administered is through a declaration (on an account by account basis) by the client to the ATO (i.e. on an ATO form) as to the intention of holding the assets through that account. The ATO would need to ensure, and communicate, that the ramifications for an incorrect declaration to the ATO would be on the customer and not on the broker. That is, to the extent that the broker does not collect GST on the brokerage services based on a false declaration from the customer, the ATO will pursue the customer, and not the broker, for the excess GST and any interest/penalties. AFMA notes that this solution would need to be rolled out to large volume of retail investors as well, who will bear the burden of the additional tax should they not be registered for GST and will be difficult in terms of obtaining the declaration given they generally trade more sporadically (and in many cases have been on-boarded already).

In short, should the ATO wish to pursue the technical position set out in the Draft Determination, it should be responsible for the administration and not expose the broker to any additional risk, given it is the intention of the customer, and not the broker, that is definitive of the GST treatment.

Policy Comments

From a policy perspective, AFMA is of the view that the predominant effect of the finalisation of the Draft Determination in its current form will be to drive both registered and unregistered customers that wish to acquire foreign listed securities to utilise the services of offshore brokers. Any attempt to obtain the necessary information from customers to ensure to determine whether the indicia for GST-free treatment can be

satisfied will ultimately be onerous and operationally difficult. This is especially the case for those enterprises for which there would be full recoverability of input tax credits, and for whom, therefore, there are no revenue implications associated with treating the brokerage services as taxable.

We further note the comments from the ATO that an enterprise registered for GST would not be required to reverse charge in respect of brokerage services provided by an offshore broker. To the extent that the enterprise does not have full recoverability of input tax credits, being above the financial acquisitions threshold and applying an apportionment methodology, there may be a commercial incentive associated with engaging an offshore broker in addition to the reduced operational burden.

For those enterprises that are not registered for GST (such as retail customers), there will be a clear commercial benefit associated with engaging an offshore broker where the underlying securities are to be held not for a purpose of trading stock.

These outcomes would appear contrary both to enhancing Australia's status as a financial services centre and also to the Government's deregulation agenda, by imposing operational burdens on business for little/no revenue benefit and by driving business offshore.

Draft GSTR – Foreign Exchange

Technical Comments

At a high level, and as shall be elaborated upon in our subsequent submission, AFMA takes issue with the approach adopted by the ATO in the Draft Ruling.

Similar to the Draft Determination, the Draft Ruling focusses on the intention of the counterparty to the foreign exchange transaction as determining whether the supply is GST-free or input taxed. This infers, in AFMA's view incorrectly, that the supply is a service. In fact, the hedge provider is entering into a transaction as principal with a counterparty and accordingly the analysis needs to be contrasted against the brokerage services being provided in the Draft Determination.

This distinction would lead, in AFMA's view, to a conclusion that a transaction will be GST-free where the supply is made in relation to rights outside Australia, as per Item 4 in the table in Section 38-190.

The Draft Ruling also assumes that each foreign currency transaction is entered into to hedge a discrete exposure, i.e. each hedge transaction can be matched to an external transaction or risk which has arisen either in Australia or offshore. Such a stance does not reflect commercial reality, whereby institutions will hedge exposures on a portfolio basis. Accordingly, to the extent that a hedge is in respect of the net position of a number of risks, such risks could not be stated as being either in respect of the Australian operations or an offshore presence.

Practical Considerations

AFMA's view is that the approach adopted in the Draft Determination is unworkable from a practical perspective.

Many of the comments above regarding the impracticalities of ascertaining counterparty's intention/circumstances in respect of acquiring foreign-listed securities apply equally to determining the location of the risks arising for the counterparty to a foreign exchange transaction.

However, in the context of the Draft Ruling, it is AFMA's submission that obtaining any information from the counterparty is practically more difficult as the information will have no bearing on the counterparty's tax position. Given the characterisations of the supplies from a GST perspective are either input-taxed or GST-free then the only implications of the ATO's technical view are in respect of the recoverability of input tax credits for the hedge provider and there are no implications for the customer.

AFMA notes the experience in other jurisdictions (such as Singapore) where it has been explicitly acknowledged that determining the counterparty's basis for entering into the transaction is impractical and legislative solutions have been provided.

Policy Comments

Similar to the comments in respect of the Draft Determination, the position set out in the Draft Ruling, by imposing upon hedge providers the requirement to interrogate counterparties to determine the use of the products entered into, will place Australian providers of such products at a disadvantage vis-à-vis their international competitors. Accordingly, as per the Draft Determination, the view expressed by the ATO is contrary both to enhancing Australia's status as a financial services centre and also to the Government's deregulation agenda.

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We are happy to continue to engage with the ATO both in respect of the technical positions set out in the Draft Ruling/Draft Determination and also the practical issues for members, particularly given the relatively short timeframe for consultation thus far. We reiterate that we propose to provide additional comments on the technical positions set out in the Draft Ruling/Draft Determination as part of the public consultation process.

Please contact me on (02) 9776 7996 with any queries.

Yours sincerely,

Rob Colquhoun
Director, Policy