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Australian GST Journal

GST apportionment and industry superannuation funds

by Dr Diane Kraal *

(2008) 8 AGSTJ 265

Summary

The Federal Government has directed the Board of Taxation to review the legal framework for the administration of the GST and identify ways to reduce compliance costs, streamline and improve its operation, and remove anomalies. The Board's review strategy includes consulting and inviting submissions from interested parties. As an early initiative the Board released an issues paper in July 2008: *Review of the Legal Framework for the Administration of the Goods and Services Tax*, which sets the parameters for review submissions.

In response to the call for review and consultation, this article presents the detail on the complexities and extra costs incurred by industry superannuation funds sector in the claiming of input tax credits under the various indirect apportionment methods since the introduction of the GST Act.

The author recommends that a new GST regulation be introduced to specify an extension to the current entitlement to a "reduced input tax credits" (RITC) to those acquisitions that indirectly relate to non-input taxed supplies, which will only apply when direct attribution is not possible. It is proposed that the extension of entitlement to RITCs be an additional sub-item in section 70-5 of the GST Regulations. The intention is that the suggested regulation would operate in the same manner as the existing Reduced Credit Acquisition rules. A specific rate would replace the variety of indirect methods described within GSTR 2006/3[1] and remove the need for industry superannuation funds to rely on complex, costly and time consuming methods of apportionment.

Scope of this article

The Board of Taxation issues paper *Review of the Legal Framework for the Administration of the Goods and Services Tax* (July 2008) has specified the following areas of consultation: liabilities and entitlement as provided for in the *Taxation Administration Act 1953*; the adjustment and entity rules as prescribed in the GST Act; and accounting for GST on various aspects, for example attribution of GST and input tax credits, tax periods and invoice requirements.[2] The Board has been asked to consult entities and other parties on the merits of any proposed changes.

The scope of this article is limited to problems with accounting for GST and costs associated with claims for input tax credits (on an apportionment basis) within the industry superannuation fund sector. This investigation only focuses on industry superannuation funds because of its size, in terms of members and assets. It excludes self-managed superannuation funds and other entities that might use apportionment. Whether or not the principles and recommendations discussed in this article ought to apply to other entities could be the subject of a separate study. The industry superannuation fund sector has not been surveyed as a whole to determine individual approaches to claims for entitlement to input tax credits on acquisitions that indirectly relate to non-input taxed supplies; such an investigation is also outside the scope of this paper.

This article first covers the background of the superannuation industry with some statistical data, a description of typical industry superannuation fund structures, and a discussion on costs that affect fund members' returns. The next section presents the legislation and rulings that provide the basis for entitlements to reduced input tax credits (on an apportionment basis),

Notes:

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1 Goods and Services Tax Ruling GSTR 2006/3: *determining the extent of creditable purpose for providers of financial supplies.*

2 See *Review of the Legal Framework for the Administration of the Goods and Services Tax* (July 2008), Appendix A: Terms of Reference, pp 93-94.

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Editorial

A test case heard by a President of the AAT in late October will go to the heart of a fundamental GST issue – the limits of "supply". Hornsby Shire Council is arguing it is entitled to an input tax credit in respect of its acquisition of the old Hornsby Quarry from CSR Ltd. It is likely the dispute will then proceed to the Full Bench of the Federal Court.

Readers may recall an earlier dispute between the Council and CSR in relation to the same transaction. In that instance the argument was about the withholding of a GST component from payments to CSR in the absence of a tax invoice. Gzell J ordered that the Council pay the withheld amount and resisted its plea to order CSR to issue a tax invoice.[1]

Between the time of the relevant acquisition and the AAT's hearing, the Tax Office has ruled that CSR had made a taxable supply of Hornsby Quarry and it has ruled that CSR had not made a taxable supply of Hornsby Quarry. Currently, it is arguing that despite CSR taking and winning court action to force the Council to acquire the land, CSR did not do anything in relation to the acquisition of the land (achieved by gazettal of a notice by the Council) and this "fact" suffices to fall within the exclusion to the definition of "supply", as per Underwoood J in *Shaw's* case,[2] a decision ignored by the Tax Office for several years until *Westley Nominees*.[3]

The final outcome of this dispute will, it is hoped, create precedent of similar if not broader value than *HP Mercantile*,[4] and will be the subject of a detailed analysis in this Journal.

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Notes:

1. *CSR Ltd v Hornsby Shire Council* [2004] NSWSC 946; 57 ATR 201.
2. *Shaw v Director of Housing (No 2)* (2001) 10 Tas R 1; 46 ATR 242.
3. *Westley Nominees Pty Ltd v Coles Supermarkets Australia Pty Ltd* [2006] FCAFC 115; (2006) 62 ATR 682.
4. *HP Mercantile Pty Ltd v FCT* [2005] FCAFC 126; (2005) 60 ATR 106.

including concepts such as "extent of creditable purpose" as it applies to industry superannuation funds. This is followed by an analysis of the complexities associated with the practical implementation of legislation and precedent. The following section appraises the current literature on GST apportionment appraised, with the article making a recommendation in terms of an extension to the existing RITC entitlements. The final section shows how an apportionment methodology is established, and analyses it shortcomings, and the article's conclusion and recommendations follow.

Introduction

Superannuation funds appoint trustees to discharge their GST obligations and so where this article makes reference to superannuation funds and GST, it is understood that the fund trustee is the legal entity carrying out the legislative requirements. Under its trust deed, a typical large industry superannuation fund appoints a trustee company to carry out its taxation obligations for income tax, GST, Fringe Benefits Tax, and so forth. A fund's trustee board works in the interests of members to obtain investment returns as cost effectively as possible. Prudent trustees often outsource the following responsibilities: contributions and expense payments processing; annual statutory accounting; and monthly management accounting, including administrative requirements such as the regular Business Activity Statement preparation and lodgement. The industry fund sector is competitive in terms of investment returns and administrative fees, much of which is being driven by factors such as the "Choice of Fund" legislation.[3] Given the competitive environment in which industry superannuation funds operate, additional service time spent on routine administrative matters, such as GST code allocations in payables processing, inevitably impact upon fees levied upon fund members.

The current profile of the superannuation sector may be summarised by the 2007 annual statistics published by the Australian Prudential Regulation Authority.[4] The tables below show distribution and types of superannuation entities in Australia with the data on industry superannuation funds bolded as they are the focus of this article.

Notes:

3. The "Choice of fund" legislation, contained in Part 3A of the *Superannuation Guarantee (Administration Act 1992*, has been promoted widely; see for instance the "Choosing a Super Fund" form, NAT 13080, http://www.ato.gov.au/content/downloads/n13080.pdf (accessed 21 October 2008).
4. Australian Prudential Regulation Authority, *Statistics: Annual Superannuation Bulletin June 2007* (issued 26 March 2008).

***Table A:** Distribution of Entities June 2007*

– by fund type

	Number of Entities	Number of Member accounts ('000)	Assets ($ billion)
Corporate	289	676	69.2
Industry	**74**	**10,654**	**197.3**
Public Sector	40	2,925	177.6
Retail	172	15,437	369.7
Small	365,992	702	286.6
Pooled superannuation trusts	101		
Balance of life office funds			42.8
Total	**366,668**	**30,394**	**1143.2**

Source: Australian Prudential Regulation Authority, Statistics: *Annual Superannuation Bulletin June 2007*, p 27.

***Table B:** Superannuation Entities June 2007*

– by regulatory classification

	Number of Entities	Assets ($ billion)	Average account banace ($'000)
– APRA regulated			
Public offer superannuation funds	255 (Industry: 42)	544.7	27
Non-public offer superannuation funds	308 (Industry: 32)	153.5	54.1
Approved deposit funds	155	0.3	30.9
Eligible rollover funds	17	5.7	1.1
Small APRA funds	6,017	3.7	405.1
Total	**6,722**	**708**	**25**
– ATO regulated			
Self-managed superannuation funds	359,825	282.7	408.8
– Other			
Exempt schemes	20	109.7	76.9
Pooled superannuation trusts	101	83.7	
Balance of life office funds		42.8	
Total	366,668	1,143.2	

Source: Australian Prudential Regulation Authority, *Statistics: Annual Superannuation Bulletin June 2007*, p 27.

As can been seen from Tables A and B above, the industry superannuation fund sector is significant with regard to number of members and value of assets held. Industry funds are spread between public offer and non-public offer funds. It is contended that were industry superannuation funds able to use a compliant but simple and cost effective approach to claim entitlements for input tax credits on acquisitions that indirectly relate to non-input taxed supplies, it would be a step toward lowering costs – and therefore investment returns – for the millions of industry superannuation fund members. This approach would only be applicable when direct attribution was not possible.

Costs would be lowered through the extension of entitlements to reduced input tax credits, for it would remove administrative inefficiencies intrinsic to GST apportionment (eg methodology construction, calculations, annual reviews, etc). Individual superannuation members' fund balances are, *inter alia*, impacted by the rate of return on the various classes in their investment mix (eg capital stable, growth, high growth, etc). Tax liabilities and the cost of managing the superannuation fund are key elements that underpin the derivation of the "crediting rate" (return on investment) for a fund member. It is maintained that were another RITC rate to be introduced (or the current rules extended) then the GST policy objective of a widely-based consumption tax would still be met, as would the government policy of promoting self-funded retirement.

About Australian GST Journal

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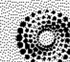
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"In the case of an acquisition that is partly for a creditable purpose, it is also necessary to establish the extent of creditable purpose."

In a March 2008 convention for industry superannuation funds, the Minister for Superannuation, Nick Sherry, spoke about the importance of superannuation, highlighting it as an effective savings vehicle so long as operating costs were kept to a minimum.[5]

The next section describes the legislation and rulings that prescribe the current approach to claims for entitlements of input tax credits.

Legislation and guidance on claiming input tax credits

The rules for claims for entitlements to input tax credits on acquisitions are provided for in GST legislation, interpreted through case law, and guided by Taxation Office rulings, as discussed below.

GST legislation

Industry funds supply an interest in superannuation to their members, which in accordance with section 40-5 of the GST Act, is classified as an input-taxed financial supply. Under the basic GST rules superannuation fund expenses are only creditable when the following conditions are satisfied: the acquisitions or importations are solely or partly for a creditable purpose (ie purchased for a GST-free or taxable supply); the acquisition by the fund is a taxable supply; there is consideration; and the entity is registered for GST.[6] As financial supplies are input taxed, it can be seen that the basic rules might prevent tax credit entitlements on related acquisitions.

The GST legislation at Division 70, however, provides an exception to the basic rules that prevent tax credits for financial supplies: a sub-set of costs called "reduced credit acquisitions" (RCAs). Under Division 70 a registered entity making financial supplies may claim input tax credits at a reduced rate of 75% from the full amount of GST for specific RCAs listed in the GST Regulations.[7]

Notes:

5 Senator the Hon. Nick Sherry, Minister for Superannuation and Corporate Law, "Super and the New Government" (Speech delivered at the Conference of Major Superannuation Funds, Brisbane, 19 March 2008).

6 See GST Act, ss 11-5 (Creditable acquisitions) and 15-5 (Creditable importations).

7 Acquisitions that attract "reduced input tax credits" for super funds are listed under reg 70-5.02 as items: Debt collection services (17); Investment consultancy fees (23); Administration fees (24); Commissions to facilitators (brokerage) (27); and Trustee and custodial fees (29).

For example, a superannuation fund may claim RITCs for statements processing and compliance accounting. RCA rules, then, allow for the efficient claiming of entitlements to tax credits, as the acquisitions eligible are clearly stated and the rate is prescribed.

Superannuation funds may also claim input tax credits through the apportionment approach. The relevant rules are contained in Div 11 of the GST Act ("Creditable Acquisitions"). An entitlement to input tax credits arises from acquisitions or importations that are solely or partly for a "creditable purpose". Under Div 11, one acquires a thing for a creditable purpose to the extent that the acquisition in question is for the purposes of carrying on an enterprise.[8] Acquisitions of input-taxed supplies, or of a private or domestic nature, are deemed not to be acquisitions for a creditable purpose.[9] In the case of an acquisition that is partly for a creditable purpose, it is also necessary to establish the extent of creditable purpose.[10]

The phrase "to the extent that" derives from income tax law and precedent, as described in the next section.

'To the extent...'

The words "to the extent" are found in the *Income Tax Assessment Act 1997* under the general deductions provision in s 8-1 (1), which states, "you can deduct from your assessable income ... ***to the extent*** that" the expense is incurred in producing assessable income or carrying on a business. The interpretation of the words "to the extent" has been drawn from principles of the High Court decision in *Ronpibon Tin NL v FCT*,[11] whereby if costs are capable of dissection, one must apportion between identifiable components. The methodology must be fair, reasonable and appropriate.[12] In the GST context of creditable acquisitions,[13] for those acquisitions that are solely for creditable purpose, there is a basis for

Notes:

8 s 11-15(1).

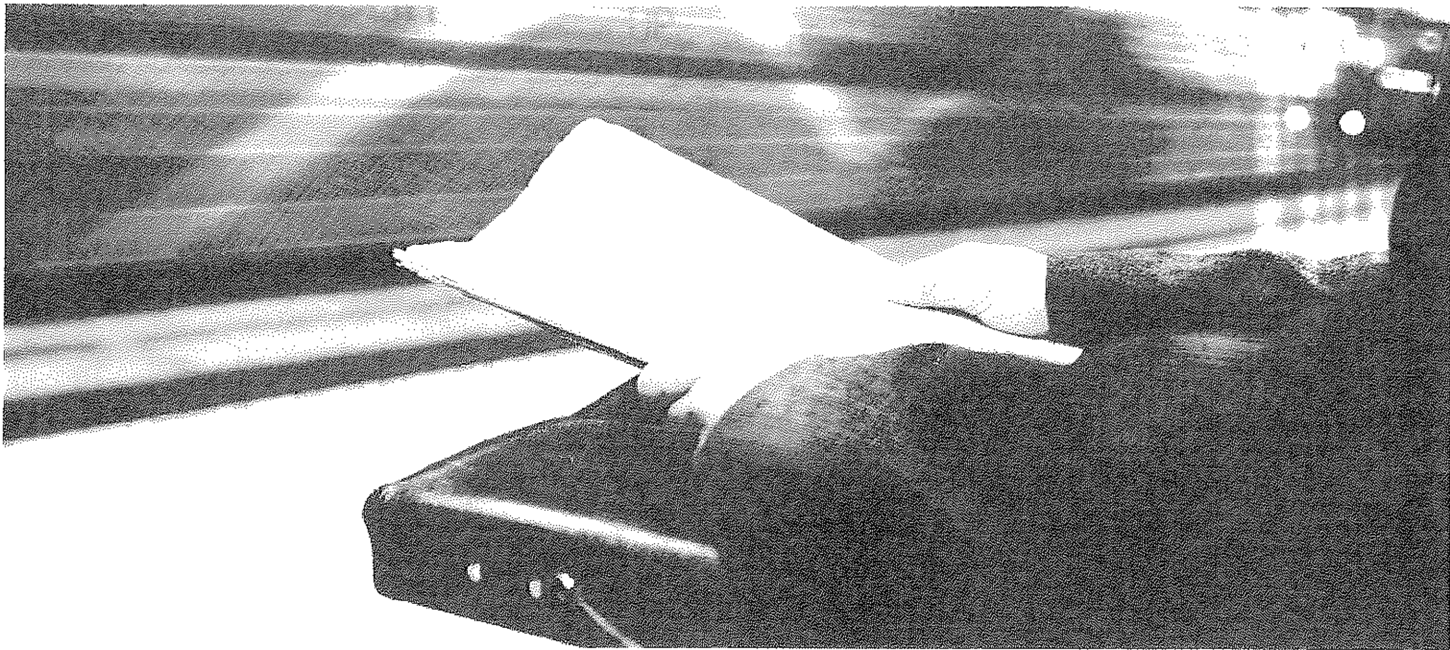
9 GST Act, s 11-15(2).

10 GST Act, s 11-5(a).

11 *Ronpibon Tin NL Tongkah Compound NL v FCT* (1949) 78 CLR 47.

12 (1949) 78 CLR 47 at 55-56. Note that in determining deductibility under s 8-1(1) none of the 4 negative limbs of 8-1(2) should apply.

13 GST Act, s 11-15.



entitlement to full input tax credits; for those acquisitions that the taxpayer regards as at least partly for creditable purposes, the next step is to calculate a claim for input tax credits based on the "fair and reasonable" principles expressed in *Ronpibon Tin*.

Tax Office views

GSTR 2006/3 contains the Commissioner's views on apportionment methods for the dissection between creditable and non-creditable purposes. The Ruling endorses the approach taken by the High Court in *Ronpibon Tin:* one must "adopt a method of estimating the extent of creditable purpose of your acquisitions...that is fair and reasonable..."[14]

More recently, in GSTR 2008/1,[15] the Commissioner confirmed that the essence of the concept of GST apportionment involves dissecting between input taxed and non-input taxed supplies as per the principles established in *Ronpibon Tin*. The Commissioner also endorsed the approach taken by the Full Federal Court in *HP Mercantile*.[16] The following points were made:

- The words in s 11-15(2)(a) do not infer the need for tracing between acquisition and actual supply.
- Whether or not an acquisition relates to an input taxed supply does not depend on the sequence of events.
- There must be a connection between an acquisition and the making of input taxed supplies, which can be direct or indirect, substantial or real.17

In regard to the required connection between an acquisition's creditable purpose and the making of input-taxed supplies, the Ruling commented: "[T]he case did not deal with every aspect of the possible operation" of paragraph 11-15(2)(a)." The Commissioner's views in GSTR 2008/1 do not offer any further descriptions of the limitations to or expansion on the various methods for calculating "extent of creditable purpose" beyond what is contained in GSTR 2006/3. The principles enunciated in *Ronpibon Tin* therefore remain the benchmark with regards to GST apportionment.

Practical methods for claiming input tax credits

GSTR 2006/3 provides guidance for a combination of a direct and any indirect method so long as it conforms with the principles in *Ronpibon Tin*, even if the method is advantageous to the taxpayer. A ***direct*** method for the claiming input tax credits is the most appropriate where a clear nexus can be established between acquisition and supply. The Commissioner has stated that direct estimation methods are preferable to indirect methods and that where possible one should match individual acquisitions with individual supplies or revenue streams.[18] No objection is raised in this article to the use of a direct method, for in practice industry superannuation funds use a combination of direct and indirect methods.

There are a variety of ***indirect*** methods in two main classes: the input-based method (one variation is called the "balance sheet" method) and the output-based method (one variation is referred to as the "revenue" method). As GSTR 2006/3 does not promote or proscribe any particular indirect method, the final choice only needs to reflect the extent to which an acquisition indirectly relates a non-input taxed supply and adheres to the principles from *Ronpibon Tin*. Selected indirect methods in the balance sheet and revenue category are further analysed below.

Balance sheet (input) method

The balance sheet approach, an indirect method of apportionment, is based on established uses of some inputs to estimate the use of other inputs not able to be allocated.[19]

Notes:

14 GSTR2006/3, [80].

15 Goods and Services Tax Ruling GSTR 2008/1: *when do you acquire anything or import goods solely or partly for a creditable purpose.*

16 *HP Mercantile Pty Ltd v FCT* (2005) 60 ATR 106.

17 GSTR 2008/1, [118].

18 GSTR2006/3, [93] and [101].

19 For a detailed explanation, see GSTR 2006/3 from [125].

This method can be unreliable if the non-allocated inputs are high in relative value as the percentage calculated would be overstated. Some industry superannuation funds use the balance sheet method as per Table 1.[20]

***Table 1:** Balance Sheet (input) method example*

INPUTS	
Capital Acquisitions – for making non input-taxed supplied (eg direct overseas investments)	A 100
Capital Acquisitions – making input-taxed supplies (Australian investments)	B 400
Non-Capital Acquisitions (overhead expenses)	C 200
Extent of creditable purpose	=A/(A+B)
	=100/ (100+400)
Extent of creditable purpose (expressed as a percentage)	=20%

The lines in Table 1 show how the 20% percentage is derived and applied to apply the GST on overhead costs (non-capital acquisitions) to claim tax credits. Note that the numerator (A) might include non-input taxed supplies such as international equities bought through an overseas broker, which is a GST-free.[21] Another example is Australian commercial property, a taxable acquisition.

A criticism of the balance sheet method is that the approach does not adequately relate acquisitions to outputs or supplies. Given the recent differences in volatility between Australian investment returns (dividends, interest, rent, realised gains/ losses etc) compared with overseas investments (sub-prime loans, bank equities etc) it could be argued that this method is less appropriate than other methods. If the outputs or supplies show irregular peaks and troughs, then there is the possibility of an "increasing" or "decreasing" GST adjustment.[22] The time a superannuation fund takes to address this issue adds further administration costs, to the detriment of fund members.

Anther aspect of GSTR 2006/3 is for the balance sheet method to "...exclude factors which may distort results..."[23] Normally a rate for the ensuing 12 months is calculated based on historical data. The question arises, however, how one might smooth data based on directly held US investments given the September 2008 Wall Street financial failures and "bail-out" initiatives passed by the United States Congress. Attempts to remove such distortions by superannuation administrators introduce the problem of subjectivity.

Revenue (output) method

One of the indirect methods is referred to as the general formula or "revenue" method. The GST ruling on this variation states it should:

> *Provide an estimate of the use (or intended use) of acquisitions or importations based on the proportion of revenues from non-input taxed activities of the enterprise, expressed as a percentage of total revenues of the enterprise. A decision taken to use this method should be based on a fair and reasonable expectation that the use of acquisitions or importations will be accurately reflected in the revenue flows (input taxed and non-input taxed) of the overall enterprise...*[24]

The revenue approach is termed an output method because it is based on the supplies (outputs) of an entity. Note that a significant portion of superannuation fund revenue comprises non-input-taxed employer and employee contributions, which are included in the numerator. An example is shown in Table 2 below.

***Table 2:** Revenue (output) method example*

INPUTS	
Revenue – non input-taxed supplies (eg. direct overseas investments, supperannuation contributions)	A 200
Revenue – input-taxed supplies (Australian dividents, rent, interest, realised capital gains *less* profit from sale land)	B 2,000
Non-Capital Acquisitions (overhead expenses)	C 100
Extent of creditable purpose	=A/(A+B)
	=200/ (200+2,000)
Extent of creditable purpose (percentage)	=9%

GSTR2006/3 requires that a revenue method must have certain items excluded from the numerator and denominator to eliminate distortion. One example might be a capital gain from a one-off sale of land.[25] The Ruling requires a sample of revenue items covering a continuous period of at least three months, for example: foreign exchange transactions, futures, options, hedges etc.[26] GSTR 2006/3 has not factored in the newer types of financial products, such as sub-prime loan investments and collateralised debt obligations (CDOs) and their negative, unpredictable impact on all investments, not just superannuation. In a newspaper article written just before the major banking collapses in the United States, it was reported that organisations in the financial services sector were "washing their hands of complicated products such as CDOs, wary of their unpredictable returns."[27] In the current financial climate it is unrealistic to expect those funds that opt for the revenue method to reasonably adjust it to eliminate revenue distortions and then apply the rate calculated to its acquisitions for the forthcoming year. In all, whilst the legislative and case law bases for the theoretical framework of GST apportionment are acknowledged, the complexities associated with their practical implementation only add to the cost of administering superannuation.

Notes:

20 For reasons of confidentiality, the names of the industry funds have been withheld.

21 In acquiring equities directly from an overseas supplier that is not registered in Australia, the Australian super fund makes a financial supply (an acquisition-supply) to the overseas entity. The acquisition-supply satisfies the requirements of s 38-190 (1), Item 2 and is GST-free. See Goods and Services Tax Ruling GSTR 2002/2: *treatment of Financial supplies and related supplies and acquisitions*, [150].

22 See GST Act, Div 129 (Changes in extent of creditable purpose). Discussion on Division 129 is outside the scope of this paper.

23 GSTR 2006/3, [132].

24 GSTR 2006/3, [105].

25 GSTR 2006/3, [131]; [162]; [163]-[171].

26 GSTR 2006/3, [164].

27 Vanessa O'Shaughnessy, "CDOs", Business Section, *The Age* (Melbourne), 22 August 2008, p 1.

Review of papers on apportionment

In 2004 two articles on GST apportionment were written by Caroline James, Ian Jeffrey and Heydon Miller.[28] In the first paper the authors analysed the terms "to the extent" and "relates to", from section 11-15 of the GST Act.[29] The second article further appraised s 11-15 and concluded that the "notable lack of prescription allows for a flexible approach."[30] The authors noted that s 11-15(2) required a clear association between acquisition and supply, recommending that this be achieved via some mechanism that adopted a "proxy" for the allocation process.[31] They did not detail a preferred methodology, so all that can be concluded from the latter-mentioned paper is that any indirect apportionment method that can be justified is acceptable. When GSTR 2006/3 was finally issued, no definitive method was prescribed (as James, Jeffrey and Miller had surmised); rather, the ruling listed a range of concepts and approaches.

In a 2005 article by Eugene Choi, principles from the *HP Mercantile* case were analysed and argued to be relevant to the financial services sector approach to GST apportionment.[32] Choi discussed at some length four principles arising from the *HP Mercantile* judgment capable of guiding the determination of creditable purpose: substance; intended use or purpose; neutrality; and factual determination. Choi argued that the case judgment only provided limited guidelines, leaving financial institutions with "difficult decisions" concerning apportionment. Further GST litigation was necessary, the author maintained, in order to clarify the situation, although he failed to canvass the alternative – that further case law might have the effect of complicating GST apportionment. Nor did he suggest or develop any positions for legislative change.

In 2006, after the issue of GSTR 2006/3, one of the large accounting firms released a paper on GST apportionment for fund clients.[33] Their approach used a combination of direct and indirect revenue methods. The methodology advocated is prescriptive and rather cumbersome; the indirect component requires the exclusion of realised capital losses in investments but the inclusion of realised gains on the basis that it removes the volatility of negative investment returns. In addition, their method excludes employer contributions revenue from the numerator while including it in the denominator, significantly decreasing the ITC recoverable percentage (possibly for the purposes of conservatism). The accounting firm also recommend a five year moving average.

Other large accounting firms' (unpublished) methodologies have been sourced for this article. All claim their approach complies with the "fair rand reasonable" requirement of *Ronpibon Tin*. One firm uses the revenue method and calculates two apportionment rates for one client, and then the balance sheet approach for another client with four apportionment rates. In both cases the notes for the methods are unclear as to when to use the more conservative rates. The same firm has issued a third paper, but used the balance sheet approach that prescribes two apportionment rates. Again, the document provides no clear client guidance on selection of rate.[34]

In 2007 Andrew McLouchlin and Eugene Choi wrote an article about problems arising from differing approaches to apportionment between principal and ancillary activities in underwriting the issue of securities.[35] Their article highlights the universality of the apportionment problem in the financial services sector. The authors also mention the difficulties posed by income tax anti-avoidance provisions if organisations appear too aggressive in their approach to claiming back input tax credits.[36] The authors argue that prescriptive rules are not appropriate and the focus should be on interpreting the legislation and devising "principles, methodologies and mechanisms" that encompass flexibility.[37]

What can be surmised from the papers published to date is that theoretical and practical approaches to GST apportionment have consistently pointed to a combination of direct and indirect methods. However, in practice such methods can be unwieldy, prescriptive and difficult. Complex indirect methodologies promoted by external consultants add to the time and therefore cost to industry superannuation funds when producing in their monthly Business Activity Statements.

In the latest relevant AAT case, *Harvey and FCT*,[38] the taxpayer was denied a deduction for expenditure relating to the management of his tax affairs. The taxpayer had failed to establish a fair and reasonable basis for apportioning fees paid to his adviser, a solicitor, under s 25-5 of the *Income Tax Assessment Act 1997*.. This outcome reinforces the principle from *Ronpibon Tin* about the deductibility of costs incurred "to the extent" that they relate to the generation of assessable income. The *Harvey* case is worth noting in relation to the GST concepts of "extent of creditable purpose" and apportionment; however, it embeds more conservative approaches to the claiming entitlements to tax credits to the detriment of fund members' returns. This is in addition to the administrative inefficiencies that affect the fund 'crediting rates', as mentioned previously in the Introduction. Together, both conservatism in claiming ITCs and high administrative costs adversely affect the accumulation of retirement income.

Notes:

28 James C, Jeffrey I and Miller H, "Apportionment Principles: Part 1", (2004) 4 AGSTJ 10 and "Apportionment Principles: Part 11", (2004) 4 AGSTJ 35.

29 That section concerns the meaning of "creditable purpose", in relation to the making of acquisitions or importations

30 James C et al, Part 11, p 35.

31 Ibid, pp 40, 43, 46.

32 Choi E, "Principles of creditable purpose following *HP Mercantile*", (2006) 6 AGSTJ 117.

33 *Extent of creditable purpose for enterprise costs acquired by [industry superannuation funds] for the general purpose of facilitating the carrying on of it enterprise*, unpublished paper, 30 June 2006. [Accounting firm's name withheld by author for commercial-in-confidence reasons.]

34 *Appendix F: Industry superannuation fund input tax credit recovery methodology*, unpublished paper, c. 2000; *GST Advice to Industry superannuation fund*, unpublished paper, 25 October 2005; and *Appendix F: Industry superannuation fund GST Analysis*, unpublished paper, 17 February 2005. [Accounting firms' names withheld by author].

35 McLouchlin A and Choi E, "GST Aspects of Underwriting", 42(4) *Taxation in Australia* (October 2007), pp 229-332.

36 *Income Tax Assessment Act 1936*, Part IVA.

37 McLouchlin A and Choi E, n 34 above, pp 229-332.

38 *[2008] AATA 457, Re Harvey and FCT* (Allen SM and Frost M, 3 June 2008).

Establishment of a standard apportionment methodology

On the basis of the author's experience, many industry superannuation funds do not establish their own in-house method of apportionment; rather, they take advice on apportionment methodologies from external consultants, as discussed previously. Anecdotal evidence indicates that some industry superannuation funds do not claim back their full entitlement to input tax credits via indirect methods because it is seen as too complex or costly to obtain external professional advice on the process. Other funds delay their claims for up to one to three years because they fail to undertake timely reviews of their apportionment rates. Superannuation funds are conservatively administered, and are averse to any perceived GST risk, but this is to the detriment of their members. The paragraphs below describe how a typical industry superannuation fund might establish an in-house apportionment methodology.

Step One requires the pre-setting of GST tax codes to individual general ledger accounts in a fund's financial accounting system. This is to minimise error rates by clerical staff and is fundamental to the establishment of an in-house standard. GST codes include taxable, GST-free, export, input-taxed, reduced credit acquisition, apportionment, outside the scope of GST legislation etc. A typical set of GST codes for a superannuation fund for pre-setting in a general ledger is shown in Table 3 below.

***Table 3:** Typical GST codes*

Tax Code	Description	Rate
T	Taxable good and services	10.00
X	Export sales	0.00
E	GST-free (or not GST in price)	0.00
I	Input taxed supplies	0.00
C	Capital purchases	10.00
N	Non-claimable taxed exp	0.00
D	Private use	0.00
R	RITC	7.50
Z	Outside the scopt of GST	0.00
F	Apportionment rate	variable

Step Two requires a comparison of results between selected indirect methods of apportionment. Here, apportionment percentages under both revenue and balance sheet methods are calculated and compared for the differences in outcome.

For this article, it would have been preferable to use actual data from a superannuation fund; however, published statutory accounts do not provide the required detail, for instance, on the split between direct overseas and Australian investment revenue. Therefore, the approach taken here involves using the methodologies of external consulting firms, described in the previous section, then applying these to hypothetical data, as depicted in Table 4 below. Tables 5, 6 and 7 show the calculations to derive the percentage for a reduced input tax credit (ITC) claim under three different methodologies, all of which have been put forth as "fair and reasonable".[39]

***Table 4:** XY Superannuation Fund – Operating statement for 12 months ended 30 June*

Table 4. XY Superannuation Fund		
Operation Statement for 12 months ended 30 June	2008	2007
	$M	$M
Direct overseas investments	5	20
Dividends from Australian equities	180	280
Australian bank interest	70	80
Capital agins (net of 2008 $120M & 2008 $70M real. loss)	10	200
Changes in market value of Australian investments	-10	230
Contributions revenue from members	30	50
Contributions revenue from employers	110	100
Australian commercial property leases	10	20
Total Revenue	405	980
less Administrative expenses	120	110
Benefits paid	110	120
Benefits accrued after income tax	175	750
Balance Sheet for XY Superannuation Fund	2008	2007
	$M	$M
Cash at Bank	5	5
Investment Assets –		
Australian Equities	495	645
Direct Overseas Equities	50	250
Australia Commercial Property	100	150
Total Assets	650	1050
Less Liabilities		
Benefits Payable	260	250
Accounts payable	50	50
Tax liabilities	50	55
Total Liabities	360	355
Net Assets Available to pay Benefits	290	695
Members' Funds	290	695

Notes:

39 Note the numerator in three variations includes equities directly from an overseas supplier not registered in Australia. Where an Australian registered entity makes a financial supply (an acquisition-supply) to the overseas entity, the acquisition-supply satisfies the requirements of s 38-190 (1), Item 2, and is GST-free. See further GSTR 2002/2, [150].

Table 5: Revenue method – Variation 1

Table 5 Revenue method Variation 1.

Numerator: Include revenue from direct overseas investments, Australian commercial property and contributions revenue

Denominator: Total Revenue

2007 percentage to claim ITC`	=$200M/$980M=20%
2008 percentage to claim ITC	=$155M/$405M=38%

	2007	2008
GST inclusive acquisitions indirectly related to non-input taxed supplies	$2M	$3M
GST (1/11)	$181K	$272K
Reduced ITC-claim	$36K	$103K
	(20%)	(38%)

Table 6: Revenue method – Variation 2

Table 6 Revenue method Variation 2.

Numerator: Include revenue from direct overseas investments, Australian commercial property but excluse employer contributions revenue for conservatism

Denominator: Total Revenue except for realised cap. Losses to smooth volatility

2007 percentage to claim ITC	=$90M/$1050M=8.5%
2008 percentage to claim ITC	=$45M/$525M=8.5%

	2007	2008
GST inclusive acquisitions indirectly related to non-input taxed supplies	$2M	$3M
GST (1/11)	$181K	$272K
Reduced ITC-claim	$15.4K	$23.1K
	(8.5%)	(8.5%)

Table 7: Balance sheet method – Variation 3

Table 7 Revenue method Variation 3.

Numerator: Assets – direct overseas investment + commerical property

Denominator: Assets – all investments

2007 percentage to claim ITC	=$400M/$1045M=38%
2008 percentage to claim ITC	=$150M/$645M=23%

	2007	2008
GST inclusive acquisitions indirectly related to non-input taxed supplies	$2M	$3M
GST (1/11)	$181K	$272K
Reduced ITC-claim	$68.7K	$62.5K
	(38%)	(23%)

Step Three involves selecting the best method, following consideration of the "fair and reasonable" and volatility factors described in GSTR 2006/3. Smoothing the methodology to address volatility is where complexities are introduced in what should be a straightforward calculation. This is yet another reason why a set rate for entitlement to tax credits on acquisitions that indirectly relate to non-input taxed supplies should replace the variety of indirect apportionment methods. Table 8 summarises the calculated percentages for a reduced input tax credit claim under three different methodologies. It can be seen that the percentages vary substantially from method to method and from year to year. Given that in 2007 industry funds represented 35% of all fund members, for equity reasons the differing results from the varying methodologies need to be addressed.

Table 8: Summary of ITC reduced claim percentages under different methodologies

Table 8 Summary of ITC reduced claim %tages under different methodologies

	2008	2007
Revenue Var. 1	20%	38%
Final ITC claim	$36K	$103K
Revenue Var. 2	8.5%	8.5%
Final ITC claim	$15.4K	$23.1K
Balance Sheet Var. 3	38%	23%
Final ITC claim	$68.7K	$62.5K

Conclusion

Problems arising from the various indirect methodologies include subjectivity and volatility issues. The revenue method presents similar compliance problems for funds, whereby GSTR 2006/3 lists items that must be excluded from the numerator and denominator to eliminate distortion. In the current financial climate it is unrealistic to expect that the revenue method is capable of removing fluctuations any more than the aforementioned balance sheet method.

"[A] new regulation should be introduced to operate in the same manner as the current RCA rules ... "

It is recommended that much like the current GST Regulations, which specify a rate of 75% of the 10% GST on a limited range of items, a new regulation should be introduced to operate in the same manner as the current Reduced Credit Acquisition rules, that is, a reduced entitlement rate for input tax credits. It is preferable that an extension of the existing RITC should replace the variety of indirect methods described within GSTR 2006/3, and remove the need for industry superannuation funds to rely on complex, costly and time consuming methods of apportionment. The rate would be an additional sub-item under section 70-5 of the GST Regulations. A set RITC rate would also take away the uncertainly over the value of input tax credit entitlements.

Once the proposed regulation is in place, a new GST Public Ruling or Bulletin for industry superannuation funds should be issued detailing the practical aspects of calculating entitlements to input tax credits under apportionment. It would replace GSTR 2006/3.

These changes should provide the certainty that taxpayers (such as industry superannuation funds) require in conducting their business. Administrators of industry superannuation funds should be enabled to administer a standard approach for claiming entitlements to input tax credits on superannuation fund acquisitions that indirectly relate to non-input taxed supplies but only apply when direct attribution is not possible. This will deliver more cost-effective returns to millions of fund members.

(2008) 8 AGSTJ 265

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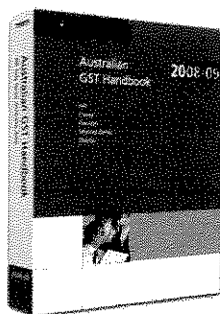

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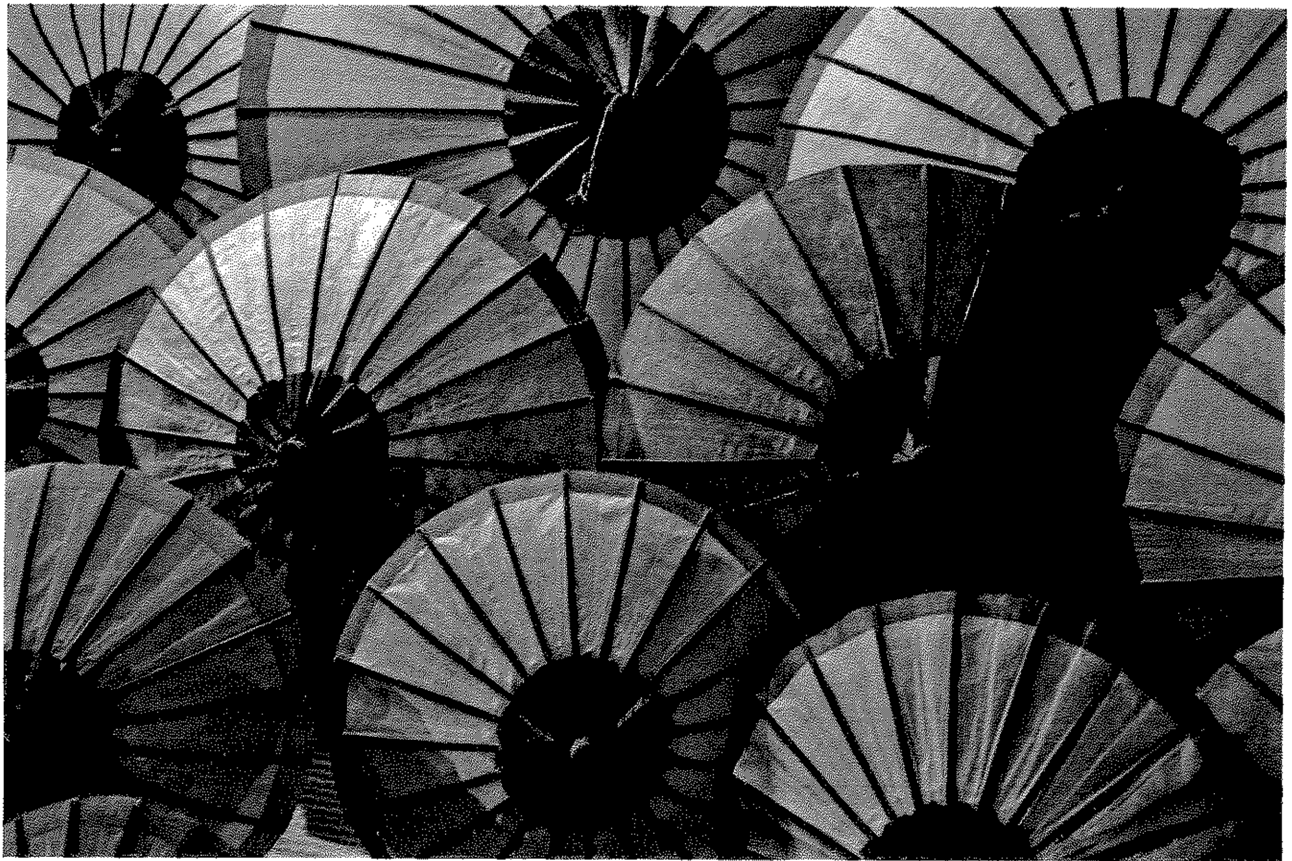

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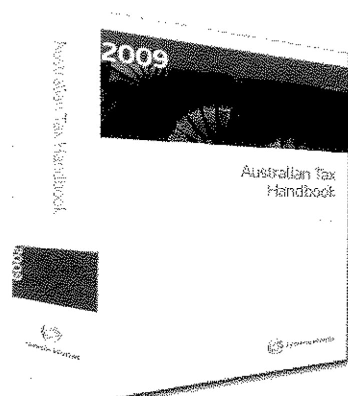

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