Are the GST Regulations dealing with Financial Supplies beyond power?
Interpreting deeming provisions in the GST Law

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Overview

The narrow issue to be addressed in this paper is whether that part of regulation 40-5.09 which deems an acquisition of certain interests to be a financial supply is beyond the scope of the regulation making power.

Before turning to that narrow issue I propose to discuss the interpretation of deeming provisions generally and, in particular, two 'forgotten' sales tax decisions of the High Court that shed light on the interpretation of deeming provisions in the GST law.

The interpretation of deeming provisions

In *R v The County Council of Norfolk* (1891) 60 LJQB 379 at 380-381, Cave J said that, 'generally speaking, when you talk of a thing being deemed to be something, you do not mean to say that it is that which it is to be deemed to be. It is rather an admission that it is not what it is to be deemed to be, and that, notwithstanding it is not that particular thing, nevertheless, for the purposes of the Act, it is to be deemed to be that thing.'

In *Muller v Dalgety & Co Ltd* (1909) 9 CLR 693, Griffith CJ stated that the word 'deemed' is commonly used '. . .for the purpose of creating . . . a 'statutory fiction' . . . that is, for the purpose of extending the meaning of some term to a subject matter which it does not properly designate. When used in that sense it becomes very important to consider the purpose for which the statutory fiction is introduced.'

It is well known that deeming provisions are to be construed strictly. In *Telstra Corporation Ltd v Australasian Performing Rights Association Ltd* (1997) 191 CLR 140 at 174, McHugh

J stated that ‘a deeming provision must be read strictly. It is improper . . . to extend by implication the express application of such a statutory fiction.’

To like effect is the statement by Fisher J in *FCT v Comber* (1986) 64 ALR 451 at 458: ‘In my opinion deeming provisions are required by their nature to be construed strictly and only for the purpose for which they are resorted to. It is improper in my view to extend by implication the express application of such a statutory fiction. It is even more improper so to do if such an extension is unnecessary, the express provision being capable by itself of sensible and rational application.’

But deeming provisions do not always create statutory fictions. An obvious example drawn from the GST legislation can be found in the attribution rules in Division 29. Pursuant to section 29-5(1), the GST payable on a taxable supply for an accruals based taxpayer is attributable to the tax period in which any of the consideration is received for the supply, or the tax period in which an invoice is issued relating to the supply, whichever is earlier. There is nothing fictional about this. The Act is simply fixing upon one of two very real events.

I turn now to discuss two ‘forgotten’ sales tax decisions of the High Court that shed light on the interpretation of deeming provisions in the GST law.

Genex Corporation

In *Commonwealth v Genex Corporation and others* [1992] HCA 65, the taxpayers carried on the business of developing exposed photographic film and printing photographs. The Commissioner claimed that sales tax was payable on the negatives produced in the development process. Under the sales tax legislation, liability to sales tax depended on the negatives being found to fall within the statutory concept of ‘goods manufactured’ and being found to cross one of three taxing points: sale, treatment as stock for sale by retail; or application to own use by the taxpayer.

The production of a negative would not ordinarily fall within the meaning of manufacture. Since 1986, however, the sales tax legislation had defined ‘manufacture’ to include, relevantly, ‘the processing or treatment of exposed photographic . . . film to produce a

negative . . .'. The negatives were clearly 'manufactured' in this sense and it was therefore necessary to consider whether they were also 'goods' and therefore 'goods manufactured'.

The statutory definition of 'goods' excluded goods which had 'gone into use or consumption in Australia'. It was common ground that the rolls of exposed photographic film had already gone into use or consumption in Australia and were therefore not within the statutory definition of 'goods'. The question was therefore whether the photographic film, once it had undergone the process of development, fell within the statutory concept of goods. As stated above, however, the production of a negative would not ordinarily fall within the meaning of manufacture. The High Court agreed. Accordingly, the negatives remained in the relevant sense the same goods as the unexposed film which previously went into use or consumption on sale to and use by the purchaser.

The High Court considered that the expression 'goods' retained its ordinary meaning subject to the express exclusions in the legislation and those implications which could be drawn from its application in the legislation. One such implication was that the word 'goods' had a meaning which included the product of that which the legislation defined as manufacture as the correlation in the Act between 'manufacture' and 'goods' could not be gainsaid. Accordingly, the High Court held that since the definition of 'manufacture' included the processing or treatment of exposed photographic film to produce a negative, the negatives themselves were 'goods'. To put that another way, deemed manufacture led to deemed goods because of the correlation between manufacture and goods: 'This is not a case of impermissibly extending the scope of deemed manufacture. The statutory notion of goods is wide enough to catch the product of that which the statute defines as manufacture.' (per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron, and McHugh JJ, at [21])

It is ironic that the Commissioner, having won the point that deemed manufacture led to deemed goods, ultimately lost the case on the basis that deemed manufacture did not lead to a deemed sale. There was no actual sale because the exposed film was at all times the property of the customer. Because there was no actual sale, the 'sale' taxing point could only be crossed if there was a deemed sale. The High Court held that no deemed sale had taken place.

Thus, while there was a necessary correlation between 'manufacture' and 'goods', there was no necessary correlation between 'manufacture' and 'sale'.

The decision in *Genex* is clearly relevant to GST. For example, it can be said that there is a necessary correlation between 'supply' and 'acquisition' in the GST law in the same way that there was a necessary correlation between 'manufacture' and 'goods' in the sales tax law. At this conference four years ago I stated 'that under the Australian GST every supply has a corresponding acquisition . . . This conclusion can be drawn from three related propositions. Firstly, for every supply there is a supplier. Secondly, for every acquisition there is a recipient. Thirdly, for every supply there is a corresponding acquisition.': refer K O'Rourke, 'GST and Multiple Party Transactions', ATAX, April 2003, at p4. The reasoning in that paper was more recently adopted by the Commissioner in GSTR 2006/9, 'Supplies', at para 53ff: 'the meaning of 'acquisition' in section 11-10 is the corollary of the meaning of 'supply' in section 9-10.'

The correlation between supply and acquisition is such that a deemed supply would almost certainly be a deemed acquisition, even if the definition of acquisition were silent on the point. But it would be a step too far to say that a deemed supply would, for example, also be deemed to be made for consideration. There is no necessary correlation between supply and consideration, in much the same way that there was no necessary correlation between manufacture and sale in *Genex*.

Mutual Pools

In *Mutual Pools and Staff Pty Ltd v FCT* [1992] HCA 4, the High Court was asked to determine the constitutional validity of sales tax legislation which deemed swimming pools constructed in situ to be manufactured goods. Section 55 of the Constitution provides that laws imposing duties of excise shall deal with duties of excise only. It had been accepted that a duty of excise was a tax directly related to goods, imposed on some step in their production or distribution before they reached the consumer.

The plaintiff argued that a sales tax upon goods was a duty of excise but that a sales tax upon something which could not be described as goods, even though deemed by the legislation to be goods, was not a duty of excise.

Dawson, Toohey and Gaudron JJ, with whom Mason CJ, Brennan and McHugh JJ agreed, stated, at paras 7-8:

> It is true that a deeming provision does not always create what has been called a 'statutory fiction'. It may also be used for the purpose of definition or for expressing a conclusion. . . But in this case there can be no doubt that, in deeming a swimming pool constructed in situ to be manufactured goods, the legislature was deeming it to be something which it is not and never has been.
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> It may be, and it is unnecessary to decide the point in this case, that there are things not ordinarily within the concept of goods which may be brought within that concept by a deeming provision which widens the definition of goods in such a way that the imposition of a tax upon those things may nevertheless remain a duty of excise. If that is so it will be because the tax is in the nature of a tax upon goods even though imposed upon things not ordinarily within the concept of goods. But in this case, the deeming provision does not seek merely to extend the definition of goods or manufactured goods; it seeks to bring within that definition things which are plainly not goods – swimming pools constructed in situ. The tax imposed by the use of the deeming provision is not a tax upon goods but a tax upon land.

The decision in *Mutual Pools* highlights the problems created at the intersection between a deeming provision and the scope of a power (whether in the context of legislation subordinate to the Constitution or Regulations subordinate to an Act) if the deeming provision is used to bring something within power which otherwise falls outside it. Has this happened with the GST Regulations dealing with financial supplies?

Validity of the GST Regulations relating to Financial Supplies

The validity of the GST Regulations was raised, but unanswered, by Hill J in *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126 at [19]:

> A financial supply will be one which falls within the meaning of that expression in reg 40. It is unnecessary to discuss that definition in any detail, save in one respect. There will be a financial supply where there is the provision, acquisition or disposal of an interest recognised at law or in equity as property in any form, provided that provision, acquisition or disposal is for consideration and in the course of, or furtherance of, an enterprise, has the necessary connection with Australia and the supplier is a financial supply provider as defined in the Regulations: see reg 40-5.09. Perhaps counter-intuitively therefore, a financial supply will include something that is not a supply but an acquisition. . . It suffices to say that it is common ground in the present case that the activity of the Trustee in acquiring the debts in the course of its enterprise will be an input taxed supply. This accepts that the Regulations have both the effect of rendering an acquisition a supply and further, as requiring that a supply **made** includes an

> acquisition **received**. This rather strange use of the regulation making power compounds confusion in the present case. It may raise at some stage a question of the validity of the Regulations themselves. However, that is not an issue which is before us.

The source of the GST regulation making power

Section 177-15 of the GST Act provides that the Governor-General may make regulations prescribing matters:

(a) required or permitted by the Act to be prescribed; or
(b) necessary or convenient to be prescribed for carrying out or giving effect to the Act.

An example of a regulation 'permitted' by the Act can be found in the predecessor to section 40-5 of the GST Act. As originally drafted, section 40-5(2) contained a table setting out the supplies that were financial supplies, while section 40-5(3) contained a table setting out the supplies that were not financial supplies. Section 40-5(4) supplemented these tables by providing that the 'regulations may provide that a particular supply is, or is not, a financial supply. The regulations have effect despite subsections (2) and (3).' This regulation making power was clearly permissive in character. The provisions were repealed with effect from 1 July 2000.

It is arguable that the regulations concerning financial supplies are 'required' by the GST Act to be prescribed. Section 40-5(2) provides that '***Financial supply*** has the meaning given by the regulations.' This appears to assume that regulations will be made and does not contemplate the absence of such regulations. The failure to make regulations would no doubt invite questions about whether the operation of the GST Act should be postponed in any way, either wholly or in part: *Downey v Pryor* (1960) 103 CLR 353. Once regulations are made, however, the fact they were 'required' says little about the scope of the power.

The phrase 'necessary or convenient' is the most common of the statutory formulations granting the power to make regulations. According to the High Court:

> . . . such a power does not enable the authority by regulations to extend the scope or general operation of the enactment but is strictly ancillary. It will authorise the provision of subsidiary means of carrying into effect what is enacted in the statute itself

> and will cover what is incidental to the execution of its specific provisions. But such a power will not support attempts to widen the purposes of the Act, to add new and different means of carrying out or to depart from or vary the plan which the legislature has adopted to attain its ends: *Shanahan v Scott* (1957) 96 CLR 245 at 250.

The power is not absolute. While there is 'no doubt [that] . . . the Parliament may delegate legislative power it may not abdicate it': *Giris v FC of T* (1969) 119 CLR 365 at 373 per Barwick CJ. Thus, the regulations may complement, but not supplement, a granted power:

> It is not open to the grantee of the power actually bestowed to add to its efficacy, as it is called, by some further means outside the limits of the power conferred, for the purpose of more effectively coping with the evils intended to be met. The authority must be taken as it is created, taken to the full, but not exceeded. In other words, in the absence of express statement to the contrary, you may complement, but you may not supplement, a granted power: *Carbines v Powell* (1925) 36 CLR 88 at 92 per Isaacs J.

The detail in the Act determines the scope of the power:

> The ambit of the power must be ascertained by the character of the statute and the nature of the provisions it contains. An important consideration is the degree to which the legislature has disclosed an intention of dealing with the subject with which the statute is concerned. In an Act of Parliament which lays down only the main outlines of policy and indicates an intention of leaving it to the Governor-General to work out that policy by specific regulation, a power to make regulations may have a wide ambit. Its ambit may be very different in an Act of Parliament which deals specifically and in detail with the subject matter to which the statute is addressed: *Morton v The Union Steamship Company of New Zealand Ltd* (1951) 83 CLR 402 at 410 per Dixon, McTiernan, Williams, Webb, Fullager and Kitto JJ. See also Pearce and Argument, 'Delegated Legislation in Australia' (2nd ed, 1999) at [14.7].

The Legislative Scheme

'Broadly speaking, the GST is a tax on private consumption in Australia' which 'taxes the consumption of most goods, services and anything else in Australia, including things that are imported': The taxing of private consumption in Australia is generally achieved by:

- imposing tax on supplies made by entities registered for GST; but
- allowing those entities to offset the GST they are liable to pay on supplies they make against input tax credits for the GST that was included in the price they paid for their business inputs: Explanatory Memorandum, page 6.

In this way GST is effectively a tax on 'final' private consumption in Australia, and is imposed on a registered supplier in respect of a supply made to a recipient. As discussed above, there exists a strong case for stating that every supply has a corresponding acquisition within the context of the Australian GST. The correspondence between supply and acquisition is evident from the language used to define those concepts.

The general scheme of the Australian GST was described by Hill J in *ACP Publishing Pty Ltd v Commissioner of Taxation* [2005] FCAFC 57 at [2]-[3] as follows:

> The GST is, in essence, the tax known in most countries as value added tax, a name which, perhaps, best describes the essence of the tax. The characteristics of a value added tax were aptly described by the European Court of Justice in *Dansk Denkavit ApS v Skatteministeriet* [1994] 2 CMLR 377 at 394-5 as being that it 'applies generally to transactions relating to goods or services; it is proportional to the price of those goods or services; it is charged at each stage of the production and distribution process; and finally it is imposed on the added value of goods and services, since the tax payable on a transaction is calculated after deducting the tax paid on the previous transaction.
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> These characteristics are displayed in the Australian legislation by the tax ('output tax') being levied, in effect, upon substantially all supplies (referred to in the GST Act as 'taxable supplies') being generally, although not exclusively, supplies of goods or services made by a registered person, or person required to be registered, for consideration . . . and the deduction referred to in *Dansk* (popularly known as an 'input tax credit') being given to a registered person, or person required to be registered, who makes a creditable acquisition, as that expression is defined.

Hill J in *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126 at [16]-[17] discusses how this general scheme applies to financial supplies:

> In terms of GST theory, it is generally accepted that there are certain kinds of activities where the basic system of output tax on supplies and input tax credits on acquisitions will not lead to taxation on the value added by each supplier in the chain. The most important example is said to be financial transactions of financial institutions such as, but not confined to, banks, because they constantly borrow and lend and turn over money in a way that amounts, such as interest charged, will not represent the real value added by the financial institutions. Indeed, as the explanatory memorandum distributed with the bill which, as amended, later became the GST Act says in Chapter 1 [5.140]: "…there is no readily agreed identifiable value for supplies consumed by customers of financial services". In such a case, it is the margin or imputed margin that is the real economic subject of the supply. There are other examples where this may be the case, one of which is the leasing of, or other dealings with, residential property (not being new residential property).

> By way of what may be seen as a compromise for the difficulties of applying the normal system of value added taxation to financial supplies and other difficult cases, value added taxation design has created a form of supply which is referred to in Australia as an input taxed supply but which, in international value added tax parlance, is referred to as an "exempt" supply. An input taxed or exempt supply (and financial supplies made by financial institutions will be the main example) will not, generally speaking, attract output tax, but the entity which makes financial supplies will, likewise, not obtain an input tax credit for the tax payable on acquisitions it makes in the course of its enterprise of making input taxed supplies. This is subject to a unique Australian invention that certain kinds of activities, being, generally speaking, those which might be outsourced by entities making financial supplies and are in aid of making such supplies will, albeit that those activities might be defined as financial supplies, attract a reduced input tax credit of 75 per cent of the credit otherwise available.

Section 9-5 of the GST Act provides, among other things, that you 'make a ***taxable supply*** if: (a) you make the supply for *consideration . . .'. This involves both a supply and the making of a supply. Section 9-10(1) of the GST Act provides that a '***supply*** is any form of supply whatsoever.' The ordinary meaning of the expression 'supply' is then expanded by section 9-10(2) to include, among other things, 'a *financial supply'.

Conversely, section 11-5 of the GST Act provides, among other things, that you 'make a ***creditable acquisition*** if: (a) you acquire anything solely or partly for a *creditable purpose . . .'. This involves both an acquisition and the making of an acquisition. Section 11-10(1) of the GST Act provides that an '***acquisition*** is any form of acquisition whatsoever.' The ordinary meaning of the expression 'acquisition' is then expanded by section 11-10(2) to include, among other things, an 'acquisition of something the supply of which is a *financial supply'.

The structure of the GST Act is very clear – supply and acquisition are two very different things. Even in the case of the acquisition of a financial supply, the statute refers to the acquisition of something the supply of which is a financial supply – supply and acquisition are again treated as two very different things.

Some might point to Division 189 of the GST Act as evidencing a contrary intention. That Division deals with an entitlement to input tax credits for acquisitions relating to financial supplies where the financial acquisitions threshold is not exceeded. In particular, section 185-15 of the Act provides that a '***financial acquisition*** is an acquisition that relates to the making of a *financial supply (other than a financial supply consisting of a borrowing).'

It is the words in brackets that are of particular interest as it assumes that a borrowing is a financial supply. If a borrowing is an acquisition rather than a supply then it might lend weight to the view that the GST Act contemplates that supplies might embrace acquisitions, particularly within the context of financial supplies. However, the expression 'borrowing' is not to be found in the regulations, where the relevant financial supply would be more accurately described as an interest in or under a credit arrangement: refer regulation 40-5.09(3), Item 2.

Section 195-1 of the GST Act provides that the expression '***borrowing*** has the meaning given by section 995-1 of the *ITAA 1997', which defines that expression in turn to mean 'any form of borrowing, whether secured or unsecured, and includes the raising of funds by the issue of a bond, debenture, discounted security or other document evidencing indebtedness.' On closer examination, the language of supply is used, namely, the 'issue' of documents evidencing indebtedness.

It is noteworthy that the expression 'financial acquisition' was thought to be something quite different from 'financial supply' in the definition section. While that is hardly conclusive of the issue, as each are separately defined expressions, the language employed reinforces the impression that supplies and acquisitions are different things even in the world of financial services. So confusing is the language, the ATO has had to invent an expression, 'acquisition-supply', to refer to those acquisitions purportedly deemed by the regulations to be supplies: refer GSTR 2002-2 at paragraph 26.

Division 189 does not depart from the structure of the GST Act, which treats supply and acquisition as two very different things.

It might also be argued that there is a discernable legislative intent to ensure a denial of input tax credits for acquisitions relating to financial services generally. However, section 11-15(2) is quite clear: 'you do not acquire the thing for a creditable purpose to the extent that . . . the acquisition relates to making supplies that would be *input taxed'. It says nothing about acquisitions relating to making acquisitions that would be input taxed.

It is also not to the point that the legislature could have achieved the same result in a different way. A valid end cannot be achieved by invalid means: refer Pearce and Argument, 'Delegated Legislation in Australia' (2nd ed, 1999) at [12.13]. 'A power to do one thing cannot be validly exercised by doing something different even if the effect of what is done is the same as that which would have resulted from doing what was permitted.': *Paull v Munday* (1976) 9 ALR 245 at 251 per Gibbs J.

The Scope of the Regulation Making Power

With these considerations and the general legislative scheme in mind, what is the scope of the power to make regulations concerning financial supplies?

Section 40-5 of the Act provides that a '*financial supply is ***input taxed***.' Section 40-5(2) provides that '***Financial supply*** has the meaning given by the regulations.' Likewise, section 195-1 of the GST Act provides that the expression '***financial supply*** has the meaning given by the regulations made for the purposes of subsection 40-5(2).'

Subdivision 40-A of the A New Tax System (Goods and Services Tax) Regulations 1999 ('the Regulations') covers 'financial supplies'. Regulation 40-5.01 provides that the 'object of this Subdivision is to identify a supply that is or is not a financial supply.' That object appears to be entirely consistent with what the GST Act requires to operate effectively in relation to financial supplies. It should be noted that it is not the stated object of the subdivision to identify an acquisition that is or is not a financial supply. This is reinforced by a note attached to the regulation which states: 'For the meaning of ***supply***, see subsection 9-10(2) of the Act.' This is a 'signpost definition' as that expression is used in regulation 3(1). This suggests that, in order to identify a financial supply, you must first identify a supply, as that expression is understood in the GST Act.

The scope of the regulation making power is therefore stated with admirable clarity in the regulations themselves: to identify a supply that is or is not a financial supply.

Summary and Conclusion

The deeming of an acquisition to be a supply is 'an admission that it is not what it is to be deemed to be': cf *R v The County Council of Norfolk*. It is 'very important to consider the purpose for which the statutory fiction [was] introduced': *Muller v Dalgety & Co Ltd*. The deeming provision must be read strictly; it is improper to extend by implication the express application of such a statutory fiction: *Telstra Corporation Ltd v Australasian Performing Rights Association Ltd*.

The correlation between supply and acquisition is such that a deemed supply would almost certainly be a deemed acquisition, even if the definition of acquisition were silent on the point: cf *Commonwealth v Genex Corporation and others*. But the structure of the GST Act treats supplies and acquisitions as two very different things, even in the case of financial supplies.

The regulation making power 'will not support attempts to widen the purposes of the Act, to add new and different means of carrying out or to depart from or vary the plan which the legislature has adopted to attain its ends': *Shanahan v Scott*. The Parliament may delegate but not abdicate legislative power: *Giris v FC of T*. The regulations may complement, but not supplement, a granted power: *Carbines v Powell*. The detail in the Act determines the scope of the power: *Morton v The Union Steamship Company of New Zealand Ltd*. And it is not to the point that the legislature could have achieved the same result in a different way: *Paull v Munday*.

It is reasonably arguable that regulation 40-5.09 goes beyond the scope of the regulation making power found in sections 40-5(2) and 177-15 of the GST Act to the extent that it goes beyond identifying a supply that is or is not a financial supply. The regulation purports to identify things that are not supplies at all, namely, acquisitions: cf *Mutual Pools and Staff Pty Ltd v FCT*. The logical consequence is that a court would read down the Regulations to that extent.