GSTR 2003/11 - Goods and services tax: payment on early termination of a lease of goods

Goods and Services Tax Ruling
Goods and services tax: payment on early termination of a lease of goods

Contents Para

Preamble

This document is a ruling for the purposes of section 37 of the ***Taxation Administration Act 1953****. You can rely on the information presented in this document which provides advice on the operation of the GST system.*

What this Ruling is about

1. This Ruling considers the goods and services tax (GST) consequences resulting from a payment made on early termination of a lease of goods.[1] It examines payments made in connection with early terminations in the context of:

- a right to terminate early in accordance with the original terms of the lease (at paragraphs 27 to 37);
- a mutual agreement to terminate early not provided for in the original terms of the lease (at paragraphs 38 to 50);
- a statutory right to terminate early under State or Territory consumer credit legislation (at paragraphs 51 to 65)[2];
- a default by the lessee (at paragraphs 66 to 89); or
- a casualty occurrence (at paragraphs 90 to 99).

2. This Ruling does not deal with:

- payments made on early termination of other types of leases or contractual agreements[3];
- payments made as a result of a court order;[4] or

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[1] A lease of goods is also commonly referred to as a chattel lease. Reference to a lease in this Ruling includes reference to both a finance lease and an operating lease. A finance lease is a lease where the risk of ownership is regarded as having passed from the lessor to the lessee. By contrast, an operating lease is a lease under which that risk is not effectively passed to the lessee.

[2] See for example, section 157 of the *Consumer Credit (Queensland) Code*.

[3] However, the principles discussed in this Ruling may have broad application to payments made on early termination of other types of agreements, depending on the individual facts.

- the GST consequences resulting from an insurance settlement.[5]

3. The Ruling explains the circumstances in which a payment on termination represents consideration for a supply. It also considers whether there is a sufficient nexus between the payment and a supply. The Ruling does not examine the other requirements of a taxable supply.

4. There are alternative views to the Commissioner's view of the GST treatment of lease terminations. For ease of reference, these alternative views are presented together at paragraphs 100 to 113.

5. Unless otherwise stated, all legislative references in this Ruling are to the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act).

Date of effect

6. This Ruling explains our view of the law as it applied from 1 July 2000. You can rely upon this Ruling on and from its date of issue for the purposes of section 37 of the *Taxation Administration Act 1953*. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and our view of when you can rely on our interpretation of the law in GST public and private rulings.

7. If this Ruling conflicts with a previous private ruling that you have obtained, this public ruling prevails. However, if you have relied on a private ruling, you are protected in respect of what you have done up to the date of issue of this public ruling. This means that if you have underpaid an amount of GST, you are not liable for the shortfall prior to the date of issue of this later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

Background

8. A lease agreement is terminated when the agreement is brought to an end. Termination discharges the lessor and the lessee from the obligation to perform (or to be ready and willing to perform) their respective contractual duties under the lease.

9. A lease is terminated early where the agreement is brought to an end before the expiry of the contracted period.

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[4] This is covered in Goods and Services Tax Ruling GSTR 2001/4 which deals with the GST consequences of court orders and out-of-court settlements.

[5] This Ruling examines, in part, the application of monies after an insurance settlement has been reached.

10. In particular, early termination can occur as a result of:

- the unilateral exercise of a right to terminate early in accordance with the original terms of the lease;
- a mutual agreement by the parties to terminate the lease agreement early, by way of a separate agreement not provided for under the terms of the original agreement;
- the unilateral exercise by the lessee of a statutory right to terminate early in accordance with State or Territory consumer credit legislation[6];
- the unilateral exercise by the lessor of a right to terminate early arising out of a default by the lessee; or
- a casualty occurrence which prevents the lessee's continued enjoyment of the benefits of the lease.

11. A lease may provide for automatic termination, or termination at one party's option, on the occurrence of specified defaults or casualty events. The lease may also provide for the lessee to be liable to make a termination payment, with a mechanism for calculating the amount of the payment also included.[7]

12. A payment made on early termination may be a global amount or divided into separate parts. Where the payment is a global amount for a mixed supply, it may consist of a number of components with different characterisations. For example, a component of the payment may be arrears of lease instalments for periods prior to the early termination of the lease. Other components of the payment may be paid to compensate the lessor for damages or loss suffered as a consequence of a default by the lessee that gave rise to the lessor exercising a right to terminate early or other defaults by the lessee.

13. The early termination of a lease may happen concurrently with the transfer of title to the goods. The parties may enter into a separate agreement to transfer title to the goods to the lessee in return for payment of an agreed amount.

14. Alternatively, the lessor may sell the goods to a third party. Where this occurs, the lessee may be liable under the original terms of the lease to pay to the lessor the difference between the net sale proceeds and the residual value of the goods adjusted to present value as specified in the lease. Where the net sale proceeds exceed the

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[6] See for example, section 157 of the *Consumer Credit (Queensland) Code*.

[7] References in this Ruling to 'payment' include monetary payments and non-monetary payments. Goods and Services Tax Ruling GSTR 2001/6, which deals with non-monetary consideration, provides guidance on the application of the GST Act to non-monetary consideration.

residual value, the lease may provide that the lessee is entitled to the excess.[8]

Legislative context

What is a taxable supply?

15. Early termination of a lease of goods involves a taxable supply where the requirements of section 9-5 are met.

16. Section 9-5 provides:

> You make a taxable supply if:
>
> (a) you make the supply for consideration;
>
> (b) the supply is made in the course or furtherance of an enterprise that you carry on;
>
> (c) the supply is connected with Australia; and
>
> (d) you are registered or required to be registered.
>
> However, the supply is not a taxable supply to the extent that it is GST-free or input taxed.

17. In considering the GST consequences of payments made on early termination, the main issue is whether a 'supply' has been made and whether the supply is 'for consideration'. This Ruling considers these requirements only.

Is there a supply made for consideration?[9]

18. For there to be a supply made for consideration, three requirements must be met:

(i) the supplier must make a supply; and

(ii) there must be a payment; and

(iii) there must be a sufficient nexus between the supply and the payment.

What is a supply?

19. A 'supply' is defined in subsection 9-10(1) as 'any form of supply whatsoever'. Essentially, a supply is something that passes from one party to another.

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[8] This occurs mainly in relation to finance leases.
[9] The following analysis is based on GSTR 2001/4, and draws on Goods and Services Tax Ruling GSTR 2000/11 which deals with grants of financial assistance.

20. Without limiting this general meaning, subsection 9-10(2) provides a non-exhaustive list of activities or occurrences that are included within the meaning of supply. The list, as relevant for this Ruling, includes:

> (a) a supply of goods; …
>
> (e) a creation, grant, transfer, assignment or surrender of any right; …
>
> (g) an entry into, or release from, an obligation:
>
> > (i) to do anything; or
> >
> > (ii) to refrain from an act; or
> >
> > (iii) to tolerate an act or situation.
>
> (h) any combination of any 2 or more of the matters referred to in paragraphs (a) to (g).

What is consideration?

21. Consideration is defined in section 195-1 to mean 'any consideration within the meaning given by section 9-15, in connection with the supply or acquisition.'

22. Subsection 9-15(1) provides that a payment, or any act or forbearance, is consideration for a supply if it is 'in connection with', 'in response to' or 'for the inducement of' a supply. A payment, act or forbearance may be consideration for a supply even though it is made voluntarily, and regardless of whether it is made by persons other than the recipient of a supply.[10]

Is there a sufficient nexus?

23. Paragraphs 49 to 72 of GSTR 2001/6 are about consideration. They explain that a payment, act or forbearance is consideration for a supply where there is a sufficient nexus between the payment, act or forbearance and the supply.[11]

24. One of the requirements of section 9-5 for an entity to make a taxable supply is that the entity makes ‘the supply for consideration’. Additionally, section 9-15 provides that a payment is consideration for a supply if the payment is ‘in connection with’, ‘in response to’ or ‘for the inducement’ of a supply. Therefore, there must be a sufficient nexus between a supply and a payment, which is provided for that supply, for there to be a supply for consideration.[12]

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[10] Subsection 9-15(2).
[11] Paragraph 68 of GSTR 2001/6.
[12] See paragraphs 55 to 72 of GSTR 2001/6.

Ruling with explanation

25. In determining the GST consequences of a payment made on early termination of a lease, regard needs to be had to the true character of the transaction. An arrangement between the parties will be characterised not merely by the description the parties give to the arrangement, but by looking at the transactions entered into and the circumstances in which the transactions are made.[13] The character of a payment may not necessarily be determined by the description given to it by the parties. In *Radaich v. Smith* (1959) 101 CLR 209 at 214 McTiernan J said[14]:

> … the parties cannot by the mere words of their contract turn it into something else. Their relationship is determined by the law and not by the label they choose to put on it.

26. Further, in *Rotherwood Pty Ltd v. FC of T* (1996) 64 FCR 313 at 324[15] Lee J stated:

> The description of the payment in the contract may be only part of a matrix of facts from which the character of the payment, as paid or received, is to be determined: see *Reuter v. FCT* (1993) 27 ATR 256 at 261-2; 93 ATC 5030 at 5036; *FCT v. Cooling* (1990) 22 FCR 42 at 53 per Hill J.

Early termination by agreement in accordance with the original terms of the lease

27. This part of the Ruling considers early termination as a result of a party, usually the lessee, exercising a right to terminate in accordance with the original terms of the lease which allow for early termination at the option of that party without any default or other event occurring.

28. For example, the original terms of the lease may provide that the lessee may terminate the lease at any time, by giving written notice, returning the goods and making a termination payment to the lessor.

29. Where the lease is terminated in these circumstances, the termination payment is considered to change the consideration for the earlier supply of the goods by way of lease. Accordingly, there is an adjustment event in relation to that earlier supply.[16]

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[13] *Marac Finance Ltd v. Virtue* (1981) 1 NZLR 586.
[14] Adopting Lord Denning's comments in *Facchini v. Bryson* (1952) 1 T.L.R. 1386.
[15] (1996) 32 ATR 276 at 286; 96 ATC 4203 at 4213.
[16] Paragraph 19-10(1)(b).

30. A payment made on early termination in accordance with the original terms of the lease may consist of a number of components with different characterisations. A component of the payment may be paid in connection with other current or earlier supplies.[17] This depends on the agreement reached and implemented by the parties.

31. For example, a component of the payment may be arrears of lease instalments and, as such, part of the consideration for the original supply of goods by way of lease.

32. A component of the payment may be in return for transferring title to the goods to the lessee on termination. Any such sale of the goods is a separate transaction from the earlier supply of the goods by way of lease.[18] A payment in return for a supply of title to the goods is consideration for the supply of title to the goods. This supply is subject to GST where the other requirements of a taxable supply are met.

33. Where the goods are sold to a third party on termination, under the terms of the lease the lessee may be liable for, or entitled to, the difference between the net sale proceeds and the residual value of the goods and future rental (commonly adjusted to present values).

34. If the sale proceeds are less than the adjusted residual value and future rental, so that a shortfall payment is required, there is an adjustment event in relation to the earlier supply of the goods by way of lease. This adjustment event gives rise to an increasing adjustment for the lessor where the supply is a taxable supply. Where the lessee's acquisition of the goods by way of lease was a creditable acquisition, the lessee has a decreasing adjustment.

35. Where the sale proceeds exceed the adjusted residual value and future rental and the lessor is required under the lease to pay the difference to the lessee, there is an adjustment event in relation to the original supply of goods by way of lease. The lessor has a decreasing adjustment where the supply of the goods by way of lease is a taxable supply. Where the acquisition of the leased goods by the lessee was a creditable acquisition, the lessee has an increasing adjustment.[19]

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[17] A more detailed explanation of the concept of an 'earlier supply' and a 'current supply' is contained in GSTR 2001/4, particularly in paragraphs 45 to 49.

[18] The sale of goods by a lessor on expiry of a lease agreement is discussed further in Goods and Services Tax Determination GSTD 2001/2 which deals with whether the sale of goods by a lessor on expiry of a lease agreement is a separate supply to the lease of the goods. GSTD 2001/2 concludes that a payment made by a lessee on the expiry of the lease for a residual shortfall gives rise to an adjustment event. Goods and Services Tax Ruling GSTR 2000/19, which deals with making adjustments under Division 19 for adjustment events, provides further guidance on adjustments.

[19] The sale of goods by a lessor on expiry of a lease agreement is discussed further in GSTD 2001/2. GSTR 2000/19 provides further guidance on adjustments.

36. Examples 1 and 2[20] illustrate the GST implications of early termination in accordance with the original terms of the lease. See also Table 1 at Appendix A, which represents the examples in table form.

37. The alternative views to the Commissioner's view appear at paragraphs 100 to 113.

Early termination under a separate agreement

38. Early termination under a separate agreement between the parties may occur where it is not provided for in the original terms of the lease. The lessor may agree to terminate the lease early, provided the lessee pays an agreed amount to the lessor.

39. In these circumstances, if the parties implement the agreement to terminate early on these terms, the payment is consideration for a supply by the lessor. A sufficient nexus exists between the payment and the supply. This supply is separate to the original supply of the goods by way of lease and is subject to GST where the other requirements of a taxable supply are met.

40. A payment on early termination under a separate agreement may consist of a number of components with different characterisations. This depends on the agreement reached and implemented by the parties, as determined from their written agreement and the surrounding circumstances.

41. A component of the payment may be paid in connection with other current or earlier supplies.[21]

42. For example, a component of the payment may be arrears of lease instalments for periods prior to the early termination. This component of the payment is part of the consideration for the earlier supply of the goods by way of lease. GST is payable on this supply where the other requirements of a taxable supply are met.

43. A component of the payment may be paid in return for transferring title to the goods to the lessee. Any such sale of the goods is a separate transaction from the earlier supply of the goods by way of lease. A payment in return for supply of title to the goods is consideration for a separate supply. GST is payable on this supply of title to the goods where the other requirements of a taxable supply are met.

44. The lessor may sell the goods to a third party, and under the terms of the original lease, the lessee may have been liable for, or

[20] See paragraphs 130 to 137.
[21] A more detailed explanation of the concept of an 'earlier supply' and a 'current supply' is contained in GSTR 2001/4, particularly in paragraphs 45 to 49.

entitled to, the difference between the net sale proceeds and the sum of the residual value of the goods and future rental if the lease had continued for its original term (commonly adjusted to present values).

45. In this situation, the parties may agree to terminate on the basis that the lessee makes a shortfall payment if the sale proceeds are less than the adjusted residual value and future rental. In these circumstances, the shortfall payment is part of the consideration for the lessor terminating the lease early.

46. Alternatively, the net sale proceeds may exceed the adjusted residual value and future rental, so that no amount is payable by the lessee to the lessor for terminating the lease early. In that case, there is no consideration for the supply by the lessor in terminating the lease early and therefore there is no taxable supply by the lessor[22]. Accordingly, in these circumstances no GST is payable in respect of the lessor terminating the lease early.

47. If the parties agree that the lessor will pay the excess to the lessee, there is an adjustment event in relation to the original supply of goods by way of lease as there is a change to the consideration for that supply.[23] The lessor has a decreasing adjustment where the supply of the goods under the lease was a taxable supply. Where the acquisition of the leased goods by the lessee was a creditable acquisition, the lessee has an increasing adjustment.[24]

48. Examples 3, 4 and 5[25] illustrate the GST implications of early termination under a separate agreement. See also Table 2 at Appendix A, which represents the examples in table form.

49. The same principles apply where the lease allows for early termination at the lessor's discretion and provides the terms, including the termination amount, that apply if the lessor agrees to the early termination. See example 9[26] and Table 5 at Appendix B.

50. The alternative views to the Commissioner's view appear at paragraphs 100 to 113.

Early termination pursuant to State or Territory consumer credit legislation

51. Early termination may occur as a result of the lessee exercising a right to terminate early created by State or Territory consumer credit legislation.

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[22] Assuming the parties are not associated so that Division 72 can not apply.
[23] Paragraph 19-10(1)(b).
[24] The sale of goods by a lessor on expiry of a lease agreement is discussed in GSTD 2001/2. GSTR 2000/19 provides further guidance on adjustments.
[25] See paragraphs 138 to 151.
[26] See paragraphs 169 to 171.

52. The Consumer Credit Code ('Code') [27] regulates certain consumer leases relating to goods. The Code confers statutory rights on the lessee which cannot be excluded by agreement between parties. It also contains procedural requirements.

53. Part 10 of the Code regulates certain leases where a natural person or strata corporation hires goods and does not have a right or obligation to purchase those goods.

54. Where a lease is covered by Part 10 of the Code, a statutory right is conferred on the lessee, which may be exercised at any time, to terminate the lease early by returning the goods.[28]

55. The amount payable by a lessee on exercising this statutory right is the lesser of:

a. the amount payable under the lease on such a termination; or

b. the amount determined in accordance with the principles (if any) set out in the regulations.[29]

56. Where parties enter into a lease covered by Part 10 of the Code, the right to terminate early forms part of the framework of their bargain. This is so whether or not it is referred to expressly in the lease.

57. The statutory right to terminate early is therefore akin to a term implied by statute. It follows that the GST implications of early termination pursuant to the statutory right are similar to those arising out of early termination in accordance with an express term of the original lease, as discussed at paragraphs 27 to 37 above.

58. A lease covered by Part 10 of the Code may be terminated in circumstances where the lessee exercises the statutory right to terminate early upon making a termination payment provided for in the original terms of the lease. In these circumstances, the payment is considered to change the consideration for the earlier supply of the

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[27] The *Consumer Credit (Queensland) Code* ('Code') is set out in the Appendix to the *Consumer Credit (Queensland) Act 1994 (Qld)*. Part 10 of the Code in Queensland is mirrored in Part 10 of the *Consumer Credit (Western Australia) Code*, which is set out in the Appendix to the *Consumer Credit (Western Australia) Act 1996 (WA)*. All the other States and Territories have incorporated the Queensland Code by reference; see section 5, *Consumer Credit (New South Wales) Act 1995 (NSW)*; section 5, *Consumer Credit (Victoria) Act 1995 (Vic)*; section 4, *Consumer Credit (Australian Capital Territory) Act 1995 (ACT)*; section 5, C*onsumer Credit (South Australia) Act 1995 (SA)*; section 4, *Consumer Credit (Northern Territory) Act 1995 (NT)*; and section 5, *Consumer Credit (Tasmania) Act 1996 (TAS)*. Accordingly, the present discussion refers to the Code in Queensland.

[28] See subsection 157(1) of the Code.

[29] See subsection 157(2) of the Code.

goods by way of lease. Accordingly, there is an adjustment event in relation to that earlier supply.[30]

59. A payment made on termination in accordance with the original agreement as a result of exercising the statutory right to terminate early may consist of a number of components with different characterisations. A component of the payment may be paid in connection with other current or earlier supplies.[31] This depends on the agreement reached and implemented by the parties.

60. For example, a component of the payment may represent arrears of lease instalments and, as such, is part of the consideration for the original supply of goods by way of lease.

61. A component of the payment may be paid in return for transferring title to the goods to the lessee on termination. Any such sale of the goods is a separate transaction from the earlier supply of the goods by way of lease. A payment in return for a supply of title to the goods is consideration for the supply of title to the goods. This supply is subject to GST where the other requirements of a taxable supply are met.

62. Where the goods are sold to a third party on termination, under the terms of the lease the lessee may be liable for, or entitled to, the difference between the net sale proceeds and the residual value of the goods (commonly adjusted to present value).

63. If the sale proceeds are less than the adjusted residual value and future rental so that a shortfall payment is required, there is an adjustment event in relation to the earlier supply of the goods by way of lease. The lessor has an increasing adjustment where the supply is a taxable supply. Where the lessee's acquisition of the goods by way of lease was a creditable acquisition, the lessee has a decreasing adjustment.[32]

64. Where the sale proceeds exceed the adjusted residual value and the lessor is required under the lease to pay the difference to the lessee, there is an adjustment event in relation to the original supply of goods by way of lease. The lessor has a decreasing adjustment where the supply of the goods by way of lease is a taxable supply. Where the acquisition of the leased goods by the lessee was a creditable acquisition, the lessee has an increasing adjustment.

65. The alternative views to the Commissioner's view appear at paragraphs 100 to 113.

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[30] Paragraph 19-10(1)(b).
[31] A more detailed explanation of the concept of an 'earlier supply' and a 'current supply' is contained in GSTR 2001/4, particularly in paragraphs 45 to 49.
[32] The sale of goods by a lessor on expiry of a lease agreement is discussed in GSTD 2001/2. GSTR 2000/19provides further guidance on adjustments.

Early termination following default by the lessee

66. Early termination following default by the lessee occurs where a lease is terminated by the lessor unilaterally exercising a right to terminate early due to the lessee's failure to properly perform (or to be ready and willing to perform) its contractual duties.

67. The lessor may exercise its common law right to terminate and recover damages or the lease may give the lessor an express right to unilaterally terminate the lease early on the occurrence of specified defaults. This may include breach of a non-fundamental (non-essential) term in the lease, in addition to a breach of a fundamental (essential) term which would be recognised at common law in any case.

68. Therefore, early termination due to the lessee's default may arise from the lessor exercising a right to terminate following a breach or repudiation at common law, as well as a breach of a non-fundamental (non-essential) term as agreed by the parties.[33] At common law, the lessor may terminate the lease as a result of the lessee's default where:

- the lessee repudiates the lease by evincing an intention to no longer be bound by the lease agreement, or the lessee shows it intends to fulfil the lease agreement only in a manner substantially inconsistent with its obligations and not in any other way;
- the lessee is unable to perform its obligations under the lease agreement and that default goes so much to the root of the agreement that it makes further commercial performance of the agreement impossible; or
- the lessee breaches a fundamental term of the lease agreement. The term is one which the parties have agreed either expressly or by necessary implication or which the general law regards as a condition going to the root of the agreement, so that any breach of the term may be regarded by the lessor as a fundamental breach.[34]

69. Examples of defaults by the lessee which, under the terms of the lease, may result in early termination as a consequence of the lessor exercising a right to terminate, include:

- the lessee defaults in payment of the lease instalments;

[33] See, for example, *AMEV-UDC Finance Ltd v. Austin* (1986) 162 CLR 170; (1986) 68 ALR 185.
[34] These principles are discussed by Gibbs CJ in *Shevill v The Builders Licensing Board* (1981) 149 CLR 620 at 625-626; (1982) 42 ALR 305 at 308-309.

- the lessee misuses the leased goods or fails to maintain them in good repair; or
- the lessee does not insure the leased goods in accordance with the terms of the lease agreement.

70. Where a lease is terminated early because of the lessor exercising a right to terminate early arising out of a default by the lessee, the termination does not occur as a consequence of any mutual agreement between the lessor and the lessee. It is the action of the lessor in exercising the lessor's right to terminate which brings the lease to an end.

71. The lease may require payment to be made by the lessee to the lessor to compensate the lessor for any damage or loss suffered because of the early termination. Genuine damage or loss cannot be characterised as a supply made by the lessor, because the damage or loss does not in itself constitute a supply under section 9-10.[35]

72. A payment received to compensate the lessor for genuine damage or loss flowing from early termination as a result of a default by the lessee is not consideration for a supply, even though the lessor brings the lease to an end by exercising the right to terminate the lease. There is no taxable supply because a payment for genuine damages, which is not consideration for any earlier or current supply, is not made in connection with any supply. The lessor merely exercises its right to terminate and the payment is in the nature of damages for the lessee's breach of the lease which gave rise to the lessor's right to terminate.

73. Damages was defined in *Haines v Bendall* (1991)172 CLR 60[36] at 63, by Mason C.J., Dawson, Toohey and Gaudron JJ as:

> The settled principle governing the assessment of compensatory damages, whether in actions of tort or contract, is that the injured party should receive compensation in a sum which, so far as money can do, will put that party in the same position as he or she would have been in if the contract had been performed or the tort had not been committed.

74. Therefore a payment by the lessee for damages includes amounts calculated with reference to putting the lessor in the position it would have been in if the lease had expired at the end of the contracted period. This may include an amount to compensate the lessor for its loss of bargain, depending on the circumstances

[35] This includes any payment of penalties or punitive damages. The principles discussed in paragraphs 71 to 73 of Goods and Services Tax Ruling GSTR 2001/4, in relation to where the subject of a claim is not a supply, have application here.
[36] (1991) 99 ALR 385.

surrounding the default which lead to early termination.[37] Where this occurs, the damages payable by the lessee may be calculated by reference to the residual value of the goods and the future rental (commonly adjusted to present values) less any net sale proceeds from sale of the goods by the lessor[38].

75. Only genuine damages which are not consideration for any earlier or current supply are considered not to be consideration for a supply. The character of any such payment is not necessarily determined by the description given to it by the parties.

76. In particular, payments on termination of a lease are not considered to be damages unless they arise out of a genuine default and dispute between the parties. A payment would not be considered to be damages if, for example, parties contrive to create circumstances in which an action or inaction of the lessee strictly falls within the description of one of the nominated default events in the lease, but there is no real dispute between the parties.

77. The UK VAT Tribunal's decision in *Financial and General Print Ltd v. Commissioners of Customs and Excise* (1995) VAT Dec No 13795[39] involved early termination and payment of an amount to the lessor following the appointment of a receiver to the lessee. In determining what, if anything, was supplied by the lessor in consideration of the payment, the Tribunal held:

> In summary and looking at 'the entire transaction' the position is this. While the lease is running, the lessee provides consideration in the form of rent for the quarter and in return the lessor supplies or continues to supply possession of the equipment. If the lessee fails to pay his quarter's rent (or commits any other act of 'default' ...) the lease may be terminated and the lessor may recoup possession. If so, the lessor's obligation to provide the service is spent and any termination payment compensates the lessor for the latter's loss of opportunity to provide that service …
>
> … the lessor's termination of the lease was not a supply of services. It was simply a unilateral act of the lessor. It terminated the lease and so terminated all further supplies of the services of granting possession of the equipment to the lessee ... There was no relevant service to which the compensation payment could be directly linked. The termination can not, therefore, be properly described as a supply of services effected for consideration …

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[37] See *Shevill v. Builders Licensing Board* (1982) 149 CLR 620; (1982) 42 ALR 305, where it was held that the lessor, having re-entered into possession of leased premises following the lessee's default in payment of the rent, was not entitled to damages for loss of bargain.

[38] See paragraph 86.

[39] The principles in the *Financial and General Print* case have also been applied in: *Lloyds Bank Plc v. Commissioners of Customs and Excise* (1996) VAT Decision No. 14181 and *Croydon Hotel & Leisure Company Limited v. Commissioners of Customs and Excise* [1997] VAT Decision No. 14920.

78. In the *Financial and General Print* case, the Tribunal was also of the view that a compensatory payment to remedy early termination was not part of the consideration for the supply of the goods by way of lease. The Tribunal considered this to be so despite the lease providing for payment of the amount in the event of early termination due to default by the lessee. The Tribunal stated:

> And the fact the liability to make the compensation payment was a contingent obligation assumed by F&G from the time it first entered into the lease and took possession of the equipment does not make the compensation payment consideration for the supply of possession.

79. After a default termination (that is, where the lessor exercises a right to terminate early arising out of the lessee's default), a separate settlement agreement may be made between the parties in relation to the payment of damages. In other cases, the quantum of the damages may be specified in a liquidated damages clause in the original lease.

80. The fact that a payment is made under a separate agreement does not, in itself, mean that it is consideration for a supply. A separate agreement as to the quantum of damages payable, where the lessor has exercised a right to terminate the lease as a consequence of the lessee's breach, has a different character to a mutual agreement for early termination under which the lessor terminates the lease early on a consensual basis in return for payment of a termination amount. As discussed at paragraphs 38 to 50 above, a separate agreement for early termination may involve a supply for consideration. In contrast, a separate agreement as to the quantum of damages records the terms upon which compensation is paid following an early termination as a result of the lessor exercising a right to terminate arising out of the lessee's default. Payment of the agreed damages for loss, which has no connection with an earlier or current supply, is not consideration for a supply.[40]

81. However, a payment made on early termination due to the lessee's default may consist of a number of components with different characterisations. This depends on the agreement reached and implemented by the parties as determined from their written agreement and other relevant surrounding circumstances. A component of the payment may be paid in connection with an earlier or current supply.[41]

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[40] This principle is considered in *Themis FTSE Fledgling Index Trust PLC v. Commissioners of Customs and Excise* (2001) VAT Dec No. 17039.

[41] The concept of 'earlier' and 'current' supplies is discussed in GSTR 2001/4, particularly at paragraphs 45 to 49.

82. Where the payment on termination has a sufficient nexus with one or more supplies, and is also partly for a purpose not connected with any supply, the payment must be apportioned between those components and the GST payable or input tax credits determined accordingly.[42]

83. For example, a component of the payment may be arrears of lease instalments for periods prior to the early termination. This component of the payment is part of the consideration for the earlier supply of the goods by way of lease. GST is payable on this supply where the other requirements of a taxable supply are met.

84. Where the goods are sold to a third party on termination, under the terms of the lease or a separate settlement agreement the lessee may be liable for, or entitled to, the difference between the net sale proceeds and the residual value of the goods (adjusted to present values).

85. If the net sale proceeds are less than the adjusted residual value and future rental so that a shortfall payment is required, this forms part of the damages for the lessor's loss. This component of the payment is not consideration for a supply where it constitutes genuine damages.

86. The net sale proceeds may be equal to or exceed the damages which would otherwise be payable, such that there is no loss suffered by the lessor. If the lessor returns any excess to the lessee, whether under the terms of the original lease or a separate settlement agreement, the payment is considered to have the effect of changing the consideration for the original supply of the goods by way of lease. Accordingly, in these circumstances, there is an adjustment event.[43] The lessor has a decreasing adjustment and the lessee has an increasing adjustment.

87. The lease may also provide for the lessee to pay interest if the lease instalments are not paid by the due date. Where the lease contemplates late payment and stipulates an interest or other charge if a lease instalment is not paid on time, a credit arrangement exists.[44] The credit arrangement is provided for no consideration unless a lease instalment is not paid by the due date, at which point consideration is required. The amount payable on late payment of lease instalments is consideration for the supply of an interest in a credit arrangement and is consideration for a financial supply.[45] Financial supplies are input taxed.[46]

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[42] Further discussion on apportionment in these circumstances can be found in GSTR 2001/4, paragraphs 115 to 125.
[43] Paragraph 19-10(1)(b).
[44] Item 2 of regulation 40-5.09.
[45] For other types of late payment arrangements, see GSTR 2000/19.
[46] For a discussion of financial supplies see GSTR 2002/2, which deals with the GST treatment of financial supplies and related supplies and acquisitions.

88. Examples 6, 7 and 10[47] illustrate the GST implications of early terminations arising out of default by the lessee. See also Table 3 at Appendix A and Table 6 at Appendix B, which represent the examples in table form.

89. The alternative views to the Commissioner's view appear at paragraphs 100 to 113.

Early termination following a casualty occurrence

90. Early termination as a result of a casualty occurrence occurs where an external event frustrates proper performance of the parties' contractual obligations.

91. A casualty occurrence is usually beyond either party's control. For example, a casualty occurrence may arise where the leased goods are:

- stolen by a third party and not recovered;
- totally destroyed as a result of a natural disaster or by fire; or
- compulsorily acquired by a government agency.

92. The lease agreement may require the lessee to pay an amount to the lessor on early termination resulting from a casualty occurrence. For example, the lease may require the lessee to pay to the lessor the full insurable value of the goods or, if the lessor requires, an amount equivalent to the remaining lease instalments and the specified residual value of the goods, both adjusted to present values.

93. Effectively, such clauses determine which party is to bear the risk of loss in the event of a casualty occurrence. As such, payment may be required to be made by the lessee to the lessor to compensate the lessor for its loss or damage suffered because of the early termination caused by the casualty occurrence. This loss or damage cannot in itself be characterised as a supply made by the lessor.

94. The payment received to compensate the lessor for its loss or damage flowing from early termination as a result of a casualty occurrence is not consideration for a supply. There is no GST liability because no supply is made in connection with the payment.

95. This outcome is not altered by the inclusion or omission of a mechanism under the lease for calculating the amount payable on early termination as a consequence of a casualty occurrence.

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[47] See paragraphs 152 to 165 and 172 to 176.

96. However, a payment made on early termination as a result of a casualty occurrence may consist of a number of components with different characterisations. This depends on the agreement reached and implemented by the parties. A component of the payment may be paid in connection with other current or earlier supplies.

97. Where a payment made on early termination does have more than one component, it must be apportioned as to its relevant components. For example, a component of the payment on termination may be arrears of lease instalments for periods prior to the casualty occurrence. That component has a sufficient nexus with the earlier taxable supply of the goods by way of lease and therefore forms part of the consideration for that supply.

98. Examples 8 and 11[48] illustrate the GST implications of early termination resulting from a casualty occurrence. See also Table 4 at Appendix A and Table 7 at Appendix B, which represent the examples in table form.

99. The alternative views to the Commissioner's view appear at paragraphs 100 to 113.

Alternative view on the GST treatment of early termination resulting from a separate agreement[49], a default by the lessee[50] or a casualty occurrence[51] - Payments made on early termination alter the consideration for the supply by way of lease

100. There is an alternative view that all amounts which may become payable in accordance with the terms of a lease are part of the consideration for the supply by way of lease. This would include all amounts contemplated by the lease which arise for payment in the event of various contingencies arising, such as early termination following default or a casualty event.

101. This alternative view is based on the reasoning that a lease of goods involves the lessor making a single supply in return for consideration payable on a progressive basis. The amount of consideration payable in return for this supply is determined according to various contingencies covered by the terms of the lease.

102. Therefore, the alternative view is that where a lease is terminated early and a payment is made in accordance with the terms of the lease, the payment is part of the consideration for the earlier supply by way of lease.

[48] See paragraphs 166 to 167 and 177 to 178.
[49] The Commissioner's view is discussed at paragraphs 38 to 50.
[50] The Commissioner's view is discussed at paragraphs 66 to 89.
[51] The Commissioner's view is discussed at paragraphs 90 to 99.

103. This outcome would not be consistent with the decision in the *Financial and General Print Ltd*[52] case. Where a lease is breached or terminated early, the most common form of remedy claimed is damages. Genuine damages cannot in itself be characterised as a supply made by the aggrieved party.[53] We also do not consider that there is ordinarily a sufficient nexus between genuine damages and the earlier supply by way of lease.[54] The House of Representatives Supplementary Explanatory Memorandum to the A New Tax System (Indirect Tax and Consequential Amendments) Bill (No 2) 1999 states that consideration in respect of claims of compensation or damages will only be subject to GST when the claim relates to a taxable supply of goods or services.[55] In the Commissioner's view it is not intended that the GST treatment differ depending on whether the monies are payable pursuant to a liquidated damages clause in the lease (due to a default by the lessee) or where a payment is made under an out of court settlement (made by the parties when a dispute arises to settle the amount of damages), or pursuant to a court order.

104. The Commissioner does accept that there is a sufficient nexus between a payment and the earlier supply by way of lease where termination results from the exercise of a right to terminate early in accordance with the original terms of the lease (see paragraphs 27 to 37), under a separate agreement (see paragraphs 38 to 50),[56] or under consumer credit legislation (see paragraphs 51 to 65). However, the Commissioner does not accept that a sufficient nexus exists between a payment and the earlier supply by way of lease where the payment constitutes genuine damages, except to the extent it represents consideration for a supply (such as arrears of lease instalments), paid following a default by the lessee (see paragraphs 66 to 89) or a casualty occurrence (see paragraphs 90 to 99).

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[52] See paragraphs 77 and 78 above.
[53] See GSTR 2001/4, paragraphs 71 to 73.
[54] See paragraphs 72 and 81 to 87.
[55] See paragraph 1.7 of the Supplementary Explanatory Memorandum.
[56] However, an exception to this is where the lease is terminated early by separate agreement and the goods are sold to a third party, and the lessee is liable under the lease to pay the lessor the shortfall between the net sale proceeds and the adjusted residual value and future rental. In this situation, the Commissioner considers there is a sufficient nexus between the payment and a separate supply, rather than the earlier supply by way of lease. The Commissioner does accept that there is a sufficient nexus between the payment and the earlier supply by way of lease, where the lessor pays the lessee the excess of the net sale proceeds over the adjusted residual value and future rental (on sale of the goods to a third party).

Alternative view on the GST treatment of early termination resulting from exercising a right to terminate early either in accordance with the original terms of the lease[57] or under consumer credit legislation[58] - Payments made on early termination by the lessee under the original terms of the lease are not consideration for a supply

105. A further alternative view is that where the original terms of a lease allow the lessee to terminate the lease early upon payment of an agreed amount to the lessor, there is no supply made in connection with that termination payment. The alternative view would hold that there is no liability for GST where this occurs.

106. The alternative view reasons that where the original terms of the lease provide for the lessee to terminate the lease early, this provision is made in return for agreeing to the other terms contained in the lease. Therefore, if the lessee subsequently terminates the lease early and makes a payment in accordance with the original terms of the lease, according to the alternative view the lease is brought to an end without the lessor making any further supply. According to this alternative view, there is no liability for GST as no supply is made by the lessor in return for the termination payment. Rather, according to the alternative view, the lessee simply exercises its existing right to terminate.

107. The Commissioner considers that in these circumstances the better view is that the termination payment has the effect of changing the consideration for the original supply of goods by way of lease. The Commissioner does not accept that this payment, which is contemplated by the lease as part of the commercial terms negotiated between the parties, is not consideration for a supply.

Alternative view on the GST treatment of early termination resulting from exercising a right to terminate early in accordance with the original terms of the lease[59], under a separate agreement[60] or under consumer credit legislation[61] - Payments made on early termination are compensatory and do not have a sufficient nexus with a supply

108. Another alternative view is that, where a lease is terminated early as a result of a mutual agreement, any component of the termination payment representing the present value of future rentals or a residual shortfall (that is, a shortfall between the residual value

[57] The Commissioner's view is discussed at paragraphs 27 to 37.
[58] The Commissioner's view is discussed at paragraphs 51 to 65.
[59] The Commissioner's view is discussed at paragraphs 27 to 37.
[60] The Commissioner's view is discussed at paragraphs 38 to 50.
[61] The Commissioner's view is discussed at paragraphs 51 to 65.

adjusted to present value and the net sale proceeds where the goods are sold by the lessor to a third party) is not consideration for a supply. Under this alternative view, this component of the payment is made to compensate the lessor for the loss suffered because of the early termination.

109. This alternative view is that a sufficient nexus does not exist between a supply and any component of the payment made to compensate the lessor for its loss as a result of the early termination by mutual agreement. As such, on this alternative view, there is no liability for GST because there is no payment in connection with the supply.

110. The Commissioner considers the better view is that a sufficient nexus does exist between a payment and the earlier supply by way of lease where early termination results from exercising a right to terminate early in accordance with the original terms of the lease (see paragraphs 27 to 37), under a separate agreement [62](see paragraphs 38 to 50), or under consumer credit legislation (see paragraphs 51 to 65).

Alternative view on the GST treatment of interest resulting from early termination following a default by the lessee[63] – Interest on overdue lease instalments

111. There is an alternative view that interest on lease instalments not paid by the due date is part of the consideration for the supply of the lease. This alternative view is based on the reasoning that the interest has a sufficient nexus with the supply of the lease and as such, changes the consideration for that earlier supply. Accordingly, the alternative view is that there is an adjustment event in relation to that earlier supply.

112. Another alternative view is that interest on lease instalments not paid by the due date is not consideration for a supply. Under this alternative view, the interest is considered to be more accurately characterised as compensation for the lessee's breach of the terms of the lease requiring payment by the due date. In particular, this alternative view reasons that interest for late payment is not consideration for the supply of an interest in a credit arrangement as

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[62] However, an exception to this is where the lease is terminated early by separate agreement and the goods are sold to a third party, and the lessee is liable under the lease to pay the lessor the shortfall between the net sale proceeds and the adjusted residual value and future rental. In this situation, the Commissioner considers there is a sufficient nexus between the payment and a separate supply, rather than the earlier supply by way of lease. The Commissioner does accept that there is a sufficient nexus between the payment and the earlier supply by way of lease, where the lessor pays the lessee the excess of the net sale proceeds over the adjusted residual value and future rental (on sale of the goods to a third party).

[63] The Commissioner's view is discussed at paragraph 87.

there is no assent by the lessor to the deferral of payment. Additionally, although a lease may incorporate a credit arrangement by allowing for the consideration for the lease to be paid by instalments, the late payment charges are not consideration for the provision of that credit.

113. The Commissioner considers the better view (see paragraph 87) is that the interest is consideration for the supply of an interest in a credit arrangement and as such is consideration for a financial supply. The Commissioner considers that a credit arrangement exists under a lease where the lease contemplates late payment and provides for an amount to become payable in the event that late payment occurs.

Attribution

114. 'Attribution' is the term used in the GST law to describe when you account for GST payable, input tax credits and adjustments in order to work out your net amount[64] for a tax period. GST payable and input tax credits are attributed to particular tax periods rather than being remitted or refunded, as the case may be, each time a taxable supply or creditable acquisition is made. Adjustments are also attributed to a particular tax period.[65]

115. Attribution in relation to GST payable, input tax credits or adjustments is not required to the extent that a component of a payment on early termination is not consideration for a supply.

116. However, attribution is required for the GST payable, input tax credits or adjustments relating to the component or components of a termination payment which are consideration for an earlier or current taxable supply.

117. The basic attribution rules, which differ depending on whether you account for GST on a cash basis, are set out in Division 29 of Part 2-6. Where you do not account for GST on a cash basis, special rules for the attribution of GST and input tax credits in relation to supplies for a period or on a progressive basis, such as leases, are set out in Division 156.

Attribution where you account for GST on a cash basis

118. If you account for GST on a cash basis, you attribute GST payable on a taxable supply to the tax period in which the consideration for the supply is received, but only to the extent the consideration is received in that tax period.

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[64] Section 7-5.
[65] Section 29-20.

119. Provided you have a tax invoice at the required time, you attribute an input tax credit for a creditable acquisition to the tax period in which you provide consideration for that acquisition, but only to the extent of the consideration you provided in that tax period.

120. For example, a lease may be terminated early as a result of the lessor exercising a right to terminate the lease as a consequence of the lessee's default in payment of the lease instalments. Where the lessee makes a termination payment to the lessor, the payment may consist of a number of components with different characterisations. A component of the payment may not be consideration for a supply if its true character is as a payment to compensate the lessor for its loss resulting from early termination due to the lessee's default. There is no attribution required for this component of the payment, as it is not consideration for a supply.

121. However, a component of the payment may be arrears of lease instalments for periods prior to the early termination. This component of the payment is consideration for the earlier supply of the goods by way of lease and GST is payable on the supply where the other requirements of a taxable supply are met. If the lessor accounts for GST on a cash basis, the GST payable on this supply is attributed to the tax period in which the payment is received by the lessor. If the lessee accounts for GST on a cash basis and makes a creditable acquisition of the goods by way of the lease, the input tax credits relating to the arrears component of the termination payment are attributed to the tax period in which the lessee provides the payment.

Attribution where you do not account for GST on a cash basis

122. Where you do not account for GST on a cash basis, the special rules dealing with the attribution of GST and input tax credits in relation to supplies for a period or on a progressive basis, such as leases, set out in Division 156 apply.

123. Under Division 156, each periodic or progressive component of the supply is treated as a separate supply for attribution purposes.

124. Therefore, if the lessor does not account for GST on a cash basis, the lessor attributes all the GST payable, on each periodic or progressive component, to the earlier of the tax period during which the lessor:

- receives any of the consideration for that component of the supply; or
- issues an invoice for that component of the supply.

125. Provided the lessee has a tax invoice at the time of lodgement of the business activity statement, the input tax credit to which a lessee (who does not account on a cash basis) is entitled for a creditable acquisition, is attributed to:

- the tax period in which the lessee provides any of the consideration for that component of the acquisition; or
- if, before the lessee provides any of the consideration, an invoice is issued relating to that component of the acquisition, the tax period in which the invoice is issued.

126. An invoice is defined in section 195-1 as 'a document notifying an obligation to make a payment'. This definition is designed to capture the essence of a commercial invoice. Consistent with commercial practice, the issue of an invoice is likely to be proximate to or after the supplier's completion of all it is required to do to become entitled to payment.[66]

127. For example, the lease may provide for the lessee to apply for early termination, to be allowed at the lessor's discretion and subject to payment of a calculable sum. Where the lessor consents to the early termination, the lease may provide for the lessor to give the lessee written notice of the early termination and liability for payment. This document is an invoice for GST purposes where it notifies the lessee that it has an obligation to make the payment to the lessor. To constitute a tax invoice for the supply, the written notice must meet the requirements of subsection 29-70(1).

128. Accordingly, if the lessor does not account for GST on a cash basis, and assuming the notice is issued before the lessee makes any payment, the GST payable on the supply by the lessor in these circumstances is attributed to the tax period in which the written notice is issued. Similarly, where this is a creditable acquisition for the lessee, the input tax credit is also attributed to the tax period in which the written notice is issued.[67]

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[66] Refer to the discussion on invoices for attribution purposes in Goods and Services Tax Ruling GSTR 2000/34, which deals with what is an invoice for the purposes of the GST Act, particularly at paragraphs 53 to 55.

[67] Assuming the notice meets the requirements for a tax invoice or the lessor provides a separate tax invoice which the lessee holds when it lodges its return. For the requirements of a tax invoice in relation to the supply of the goods by way of lease, refer to GSTR 2000/17, which deals with tax invoices. Paragraphs 68 to 70 of GSTR 2000/17 discuss the requirements for a tax invoice in the context of supplies made for a period or on a progressive basis, such as a supply by way of lease.

Examples

Examples - A finance lease

129. The following facts are relevant to each of examples 1 to 8 below. A summary of the GST treatment for each example is included in table form in Appendix A.

Lessor: Finco Ltd

Lessee: Dustin McArby

Leased goods: one light truck

Lease rental amounts: $700 per month

Term of lease: 48 months

Agreed damages: Where:

(a) a default event occurs; and

(b) the lessor subsequently takes possession of the goods, the lessor will sell the goods and, in addition to any arrears of lease instalments and interest on those arrears calculated at 10% per annum on the balance outstanding, if the termination amount exceeds the net sale proceeds of the goods, the lessee must pay the difference to the lessor. If the net sale proceeds exceed the termination amount, the lessor will pay the difference to the lessee.

Casualty occurrence: in respect of the leased goods, their total loss, destruction or damage beyond repair, theft or disappearance. On the happening of a casualty occurrence, the lessee must pay the termination amount to the lessor.

Default events: Where:

(a) failure to pay rent by the due date occurs on 2 or more occasions the lessor may terminate the lease – in which case the lessee will provide the lessor with possession of the leased goods.

Termination amount: the present value of the residual value plus the present value of all rent not yet due at the termination date.

Termination date:

(a) date of voluntary termination;

(b) date on which a casualty occurrence occurs; or

(c) date on which the lessor terminates the lease on the happening of a default event.

Voluntary termination: Where the lessee wants to terminate the lease:

(a) the lessee will provide possession of the goods to the lessor;

(b) the lessee will pay the termination amount;

(c) the lessor will sell the goods;

(d) the lessor will pay to the lessee the net sale proceeds; and

(e) the termination amount in paragraph (b) and the net sale proceeds in paragraph (d) may be set off against each other, so that a net amount is payable by the relevant party.

All amounts are exclusive of GST. However, the lease provides that to the extent that any amount payable under the lease is consideration for a taxable supply it is to be grossed up for GST. Dustin uses the truck solely for a creditable purpose. Finco and Dustin are registered for GST and all supplies and acquisitions are made in Australia in the course or furtherance of their respective enterprises. The lease is not regulated by the Consumer Credit Code. However if it was, the GST consequences resulting from the early termination would be the same as examples 1 and 2.[68]

Example 1 – early termination in accordance with the original terms of the lease – shortfall between termination amount and net sale proceeds

130. Dustin exercises his right to terminate the lease early in accordance with the terms of the lease. At the termination date, the termination amount is $25,000 exclusive of GST. This amount comprises $15,000 for future rental and $10,000 for the residual value (both adjusted to present values).

131. Finco obtains possession of the truck and sells it to a third party for $22,000. Finco makes a taxable supply of the truck to the third party and is liable for GST of 1/11 of the selling price (that is, $2,000). The net sale proceeds are $20,000.[69]

[68] See paragraphs 51 to 65.
[69] For simplicity, selling costs are ignored in these examples.

132. As the net sale proceeds of the truck are less than the termination amount, under the terms of the lease Dustin must pay the difference between the GST exclusive termination amount and the net sale proceeds to Finco. This requirement gives rise to an adjustment event in relation to the supply of the truck under the lease because it changes the consideration for that supply. Accordingly, the payment must be grossed up for GST in accordance with the terms of the lease.

133. Therefore Dustin pays Finco $5,000 x 11/10 =$5,500 (being the difference between the GST exclusive termination amount and the net sale proceeds, grossed up for GST). Finco has an increasing adjustment of $5,500 x 1/11 (that is, $500). Finco is required to issue an adjustment note to Dustin. Dustin has a corresponding decreasing adjustment of $5,500 x 1/11(that is, $500).

Example 2 – early termination in accordance with the original terms of the lease – net sale proceeds exceed termination amount

134. Dustin terminates the lease early in accordance with the terms of the lease. At the termination date the termination amount is $25,000 exclusive of GST. This amount comprises $15,000 for future rental and $10,000 for the residual value (both adjusted to present values).

135. Finco obtains possession of the truck and sells it to a third party for $33,000. Finco makes a taxable supply of the truck to the third party and is liable for GST of 1/11 of the selling price (that is, $3,000). The net sale proceeds are $30,000.

136. As the net sale proceeds exceed the termination amount, under the terms of the lease Finco must pay Dustin the difference between the net sale proceeds and the termination amount. This requirement gives rise to an adjustment event in relation to the supply of the truck under the lease because it changes the consideration for that supply. Accordingly, the payment must be grossed up for GST in accordance with the terms of the lease.

137. Therefore Finco pays Dustin $5,000 x 11/10 =$5,500 (being the difference between the GST exclusive termination amount and the net sale proceeds, grossed up for GST). Finco has a decreasing adjustment of $5,500 x 1/11 (that is, $500). Finco is required to issue an adjustment note to Dustin. Dustin has an increasing adjustment of $5,500 x 1/11 (that is, $500).

Example 3 – early termination under a separate agreement - shortfall between termination amount and net sale proceeds

138. For this example ignore the clauses in the lease regarding voluntary termination and the termination amount.

139. Dustin seeks a voluntary early termination of the lease and Finco agrees to this. As there is no provision in the lease for voluntary termination, the parties enter into a separate agreement.

140. Under the separate agreement:

- Dustin agrees to return possession of the truck to Finco;
- Finco agrees to sell the truck for not less than its market value;
- Finco terminates the lease in return for Dustin paying to Finco the amount by which the net sale proceeds fall short of a termination amount of $25,000 (this amount comprises $15,000 for future rental and $10,000 for the residual value, both amounts being adjusted to present values and exclusive of GST); and
- To the extent that any amount payable under the separate agreement is consideration for a taxable supply, it is to be grossed up for GST.

141. Finco obtains possession of the truck and sells it to a third party for $22,000. Finco makes a taxable supply of the truck to the third party and is liable for GST of 1/11 of the selling price (that is, $2,000). The net sale proceeds are $20,000.

142. As the net sale proceeds of the truck are less than the GST exclusive termination amount, under the terms of the separate agreement, Dustin must pay the difference to Finco. This payment is consideration for Finco terminating the lease early. As such, the payment is consideration for a taxable supply by Finco and must be grossed up for GST in accordance with the terms of the separate agreement.

143. Therefore Dustin pays Finco $5,000 x 11/10 =$5,500 (being the difference between the GST exclusive termination amount and the net sale proceeds, grossed up for GST). Finco is liable for GST of 1/11 of that amount (that is, $500) and Dustin has a corresponding input tax credit.

Example 4 – early termination under a separate agreement - net sale proceeds exceed termination amount

144. For this example ignore the clauses in the lease regarding voluntary termination and the termination amount.

145. Dustin seeks a voluntary early termination of the lease and Finco agrees to this. As there is no provision in the lease for voluntary termination, the parties enter into a separate agreement.

146. Under the separate agreement:

- Dustin agrees to return possession of the truck to Finco;
- Finco agrees to sell the truck for not less than its market value;
- Finco terminates the lease in return for Dustin being liable for, or entitled to, the difference between the net sale proceeds and a termination amount of $25,000 (this amount comprises $15,000 for future rental and $10,000 for the residual value, both amounts being adjusted to present values and exclusive of GST); and
- To the extent that any amount payable under the separate agreement is consideration for a taxable supply, it is to be grossed up for GST.

147. Finco obtains possession of the truck and sells it to a third party for $33,000. Finco makes a taxable supply of the truck to the third party and is liable for GST of 1/11 of the selling price (that is, $3,000). The net sale proceeds are $30,000.

148. As the net sale proceeds of the truck exceed the GST exclusive termination amount, under the terms of the separate agreement, Finco must pay the difference to Dustin. This requirement gives rise to an adjustment event in relation to the supply of the truck under the lease because it changes the consideration for that earlier supply. Accordingly, the payment must be grossed up for GST in accordance with the separate agreement.

149. Therefore Finco pays Dustin $5,000 x 11/10 =$5,500 (being the difference between the GST exclusive termination amount and the net sale proceeds, grossed up for GST). Finco has a decreasing adjustment of 1/11 of that amount (that is, $500) and Dustin has a corresponding increasing adjustment of $500.

Example 5 - early termination under a separate agreement – lessee purchases goods from lessor

150. For this example ignore the clauses in the lease regarding voluntary termination and the termination amount.

151. Dustin seeks a voluntary early termination of the lease. He also seeks to purchase the truck from Finco. Finco agrees to these requests and the parties calculate a payout amount under a separate agreement as follows:

- Dustin pays $660, which represents the final rental up to the date of termination, inclusive of GST. This amount is part of the consideration for Finco's supply of the truck by way of lease. Finco is liable for GST of 1/11 of that amount (that is, $60) and Dustin has a corresponding input tax credit of $60; and
- Dustin also pays $22,000, an amount which represents the GST-inclusive residual value and future rental adjusted to present values. This amount is consideration for Finco terminating the lease early, and for transferring title to the truck to Dustin. Finco is liable for GST of 1/11 of that amount (that is, $2,000) and Dustin has a corresponding input tax credit of $2,000.[70]

Example 6 – default – residual shortfall

152. Dustin is in arrears for four lease instalments when Finco exercises its right under the terms of the lease to terminate the lease because of Dustin's default. Finco takes possession of the truck and sells it to a third party for $22,000. Finco makes a taxable supply of the truck to the third party and is liable for GST of 1/11 of the selling price (that is, $2,000). The net sale proceeds are $20,000.

153. At the termination date, the termination amount is $25,000 exclusive of GST. This amount comprises $15,000 for future rental and $10,000 for the residual value, both adjusted to present values.

154. Under the agreed damages clause in the lease, the following amounts are payable by Dustin to Finco:

- arrears of 4 x $700 = $2,800 plus GST;
- interest on the arrears of $2,800 (plus GST) x 10% per annum = (say for example, $90); and
- damages in the amount by which the termination amount exceeds the net sale proceeds of the truck, $25,000 - $20,000 = $5,000.

155. The arrears of $2,800 are in respect of the earlier taxable supply by Finco of the truck under the lease. As such, the payment is part of the consideration for the taxable supply by Finco and must be grossed up for GST in accordance with the terms of the lease. Therefore Dustin pays Finco $2,800 x 11/10 =$3,080 (being the arrears of rent grossed up for GST). Finco is liable for GST of 1/11 of

[70] How this amount is apportioned is determined on the facts of each transaction, having regard to the agreement in the particular case and the circumstances in which the transaction is entered into and completed.

that amount (that is, $280) and Dustin has a corresponding input tax credit.

156. The interest on the arrears of $90 is consideration for a financial supply. As such, it is consideration for an input taxed supply.

157. The amount of $5,000 is in the nature of damages.[71] This amount is not connected with any supply. Accordingly, it is not consideration for a taxable supply.[72]

Example 7 - default – net sale proceeds exceed termination amount

158. Dustin is in arrears for four lease instalments when Finco exercises its right under the lease to terminate the lease because of Dustin's default. Finco takes possession of the truck and sells it to a third party for $33,000. Finco makes a taxable supply of the truck to the third party and is liable for GST of 1/11 of the selling price (that is, $3,000). The net sale proceeds are $30,000.

159. At the termination date, the termination amount is $25,000 exclusive of GST. This amount comprises $15,000 for future rental and $10,000 for the residual value, both adjusted to present values.

160. Under the agreed damages clause of the lease, Finco is entitled to arrears of 4 x $700 = $2,800 plus GST. The arrears of $2,800 are in respect of the earlier taxable supply by Finco to Dustin of the truck by way of lease. As such, the payment is part of the consideration for a taxable supply by Finco under the lease and must be grossed up for GST in accordance with the terms of the lease. Therefore, Dustin pays Finco $2,800 x 11/10 =$3,080 (being the arrears of rent grossed up for GST). Finco is liable for GST of 1/11 of that amount (that is, $280) and Dustin has a corresponding input tax credit of $280.

161. Dustin must also pay interest on the arrears of $2,800 (plus GST) x 10% per annum = (say for example, $90). This amount is paid as consideration for a financial supply. As such, it is consideration for an input taxed supply.

162. As the net sale proceeds exceed the termination amount, any loss Finco may have suffered because of the early termination, has been wholly mitigated.

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[71] Only genuine damages which are not consideration for any earlier or current supply are considered not to be consideration for a supply. See paragraphs 74 to 76.

[72] An amount for damages may also include a component to cover the lessor's legal costs, net of input tax credits, in recovering the leased goods. This component is not connected with any supply and has the same GST treatment as other damages. It is not consideration for a taxable supply.

163. Under the agreed damages clause, Finco must pay to Dustin the difference between the net sale proceeds and the termination amount. This requirement gives rise to an adjustment event in relation to the supply of the truck by way of lease because it changes the consideration for that earlier supply. The payment must be grossed up for GST in accordance with the terms of the lease.

164. Therefore Finco pays Dustin $5,000 x 11/10 =$5,500 (being the difference between the GST exclusive termination amount and the net sale proceeds, grossed up for GST). Finco has a decreasing adjustment of $5,500 x 1/11 (that is, $500). Finco is required to issue an adjustment note to Dustin. Dustin has an increasing adjustment of $5,500 x 1/11 (that is, $500).

165. Under the lease, Dustin must pay Finco $3,080 + $90 =$3,170 and Finco must pay Dustin $5,500. The parties may agree to net these amounts off, so that Finco ultimately pays Dustin $5,500 - $3,170 =$2,330. Whether or not the parties come to such an arrangement, their GST liabilities arising from the payments made under the lease agreement are as outlined above.

Example 8 – casualty occurrence

166. The truck leased by Dustin is stolen and is not recovered. At the termination date, the termination amount is $25,000 exclusive of GST. Dustin receives $22,000 insurance proceeds from his insurer and passes this amount on to Finco. Under the terms of the lease, he is also required to pay another $3,000.

167. Neither of the above payments by Dustin is connected with a supply. Accordingly, neither payment is consideration for a taxable supply, nor does either payment give rise to an adjustment event.

Examples - An operating lease

168. The following facts are relevant to each of examples 9 to 11 below. A summary of the GST treatment for each example is included in table form in Appendix B.

Lessor: Fish Fleet Ltd

Lessee: Tuna Processing Pty Ltd

Leased goods: one van

Lease rental amounts: $800 per month

Term of lease: 36 months

Agreed damages: Where:

(a) a default event occurs; and

(b) the owner subsequently takes possession of the goods; then

(c) the termination amount will immediately become payable by the lessee.

Interest on arrears: Where the lease instalments are not paid by the due date, the lessee agrees to pay interest on the arrears calculated at 10% per annum on the balance outstanding.

Casualty occurrence: in respect of the leased goods, their total loss, destruction or damage beyond repair, theft or disappearance. On the happening of a casualty occurrence, the lessee must pay the termination amount plus the market value of the van to the lessor.

Default events: Where:

(a) failure to pay rent by the due date occurs on 2 or more occasions, the lessor may terminate this lease – in which case the lessee will provide the lessor with possession of the leased goods.

Market value: with respect to the leased goods at any time, the market value of the leased goods as at that time as assessed by the lessor on the basis that the goods are in satisfactory condition reasonably corresponding with careful use and maintenance having regard to age, fair wear and tear.

Termination amount: the amount which, when added to the market value of the goods at that time, will provide the lessor with the same rate of return on its investment which the lessor would have received if this lease had continued pursuant to its terms. The termination amount will be calculated on the assumption that:

(a) all amounts outstanding under this lease have been paid; and

(b) the lessor receives the market value on a sale of the goods.

Termination date:

(a) date of voluntary termination;

(b) date on which a casualty occurrence occurs; or

(c) date on which the lessor terminates the lease on the happening of a default event.

Voluntary termination: Where the lessee wants to terminate the lease and the lessor agrees to this:

(a) the lessee will provide possession of the goods to the lessor; and

(b) the lessee will pay the termination amount.

All amounts are exclusive of GST. However, the lease provides that to the extent that any amount payable under the lease is consideration for a taxable supply it is to be grossed up for GST. Tuna uses the van solely for a creditable purpose. Fish Fleet Ltd and Tuna are registered for GST and all supplies and acquisitions are made in Australia in the course or furtherance of their respective enterprises. The lease is not regulated by the Consumer Credit Code.

Example 9 – early termination at discretion of lessor in accordance with the terms of the original lease

169. Tuna seeks a voluntary early termination of the lease under its original terms and Fish Fleet agrees to this. At the termination date the termination amount is $5,000 exclusive of GST.

170. This amount is consideration for a taxable supply by Fish Fleet.

171. Therefore Tuna must pay $5,000 x 11/10 =$5,500 (being the termination amount grossed up for GST in accordance with the terms of the agreement) to Fish Fleet. Fish Fleet is liable for GST of 1/11 of that amount (that is, $500) and Tuna is entitled to a corresponding input tax credit of $5,500 x 1/11 (that is, $500).

Example 10 – default

172. Tuna is in arrears for four lease instalments when Fish Fleet unilaterally exercises its right to terminate the lease because of Tuna's default. Fish Fleet takes possession of the van and sells it to a third party for the market value. There is a taxable supply of the truck to the third party. Fish Fleet is liable for GST of 1/11 of the price for which the truck was supplied to the third party.

173. Under the terms of the lease, Fish Fleet is entitled to a termination amount of $5,000 and the arrears of 4 x $800 =$3,200. Both these amounts are exclusive of GST. Fish Fleet is also entitled to interest on the arrears of $3,200 (plus GST) x 10% per annum = (say for example, $95).

174. The arrears of $3,200 are in respect of the earlier taxable supply by Fish Fleet to Tuna of the van by way of lease. As such, the payment is part of the consideration for a taxable supply by Fish Fleet and must be grossed up for GST in accordance with the terms of the lease. Therefore Tuna pays Fish Fleet $3,200 x 11/10 =$3,520 (being the arrears of rent grossed up for GST). Fish Fleet is liable for GST of

1/11 of that amount (that is, $320) and Tuna has a corresponding input tax credit of $320.

175. Interest on the arrears of $95 is consideration for a financial supply. As such, it is consideration for an input taxed supply.

176. Under the agreed damages clause of the lease agreement, Fish Fleet is also entitled to the amount of $5,000. This sum is in respect of future rental foregone and is in the nature of damages. This amount is not connected with any taxable supply.[73]

Example 11 – casualty occurrence

177. While fish is being loaded at the dock, the handbrake malfunctions and the van rolls into the ocean. The van is a complete write-off. At the termination date, the termination amount is $5,000 exclusive of GST and the market value of the van is $10,000. Tuna receives $10,000 insurance proceeds from its insurer and passes this amount on to Fish Fleet. Under the terms of the lease, Tuna is also required to pay another $5,000 to Fish Fleet.

178. Neither of the above payments is connected with a taxable supply.

Detailed contents list

179. Below is a detailed contents list for this Goods and Services Tax Ruling:

[73] The amount for damages may also include a component to cover the Lessor's legal costs, net of input tax credits, in recovering the leased goods. This component is not connected with a supply by the lessor and is not consideration for a taxable supply.

Commissioner of Taxation
3 September 2003

Previous draft:
GSTR 2003/D2

Related Rulings/Determinations:
GSTR 1999/1; GSTR 2000/19; GSTR 2000/17; GSTR 2000/34; GSTR 2001/4; GSTR 2001/6; GSTD 2001/2; GSTR 2002/2

Subject references:
- acquisitions
- attribution
- adjustment events
- adjustment notes
- conditional contracts
- consideration
- contracts
- creditable acquisition
- goods and services tax
- GST
- GST consideration
- GST payable
- GST supply
- in connection with
- input tax credit
- taxable supply

Legislative references:
- ANTS(GST)A99 7-5
- ANTS(GST)A99 9-5
- ANTS(GST)A99 9-10
- ANTS(GST)A99 9-10(1)
- ANTS(GST)A99 9-10(2)
- ANTS(GST)A99 9-15
- ANTS(GST)A99 9-15(1)
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- ANTS(GST)A99 195-1
- ANTS(GST)A99 Div 29
- ANTS(GST)A99 Div 72
- ANTS(GST)A99 Div 156
- Consumer Credit (ACT) A95 4
- Consumer Credit (NSW) A95 5
- Consumer Credit (NT) A95 4
- Consumer Credit (Qld) A94
- Consumer Credit (Qld) Code Part 10
- Consumer Credit (Qld) Code 157
- Consumer Credit (Qld) Code 157(1)
- Consumer Credit (Qld) Code 157(2)
- Consumer Credit (SA) A95 5

- Consumer Credit (Tas) A96 5
- Consumer Credit (Vic) A95 5
- Consumer Credit (WA) A96
- Consumer Credit (WA) Code Part 10
- TAA 1953 37

Case references:

- *AMEV-UDC Finance Ltd v. Austin* (1986) 162 CLR 170
- *Croydon Hotel & Leisure Company Limited v. Commissioners of Customs and Excise* [1997] VAT Decision No. 14920
- *Facchini v. Bryson* (1952)1 T.L.R. 1386
- *FCT v. Cooling* (1990) 22 FCR 42 at 53 per Hill J.
- *Financial and General Print Ltd v. Commissioners of Customs and Excise* (1995) VAT Dec No 13795
- *Haines v. Bendall* (1991)172 CLR 60 (1991) 99 ALR 385
- *Lloyds Bank Plc v. Commissioners of Customs and Excise* (1996)VAT Decision No. 14181
- *Marac Finance Ltd v. Virtue* (1981)1 NZLR 586
- *O'Dea v. Allstates Leasing System* (WA) Pty Ltd (1983) 152 CLR 359
- *Radaich v. Smith* (1959)101 CLR 209
- *Rotherwood Pty Ltd v. FC of T* (1996)64 FCR 313
- *Reuter v. FCT* (1993) 27 ATR 256 at 261-2; 93 ATC 5030 at 5036
- *Shevill v The Builders Licensing Board* (1981) 149 CLR 620 at 625-626; (1982) 42 ALR 305 at 308-309
- *Themis FTSE Fledgling Index Trust PLC v. Commissioners of Customs and Excise* (2001) VAT Dec No. 17039

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APPENDIX A

The tables in this Appendix are a general guide only and should be read in conjunction with the relevant paragraphs of the Ruling.

Each table in this Appendix summarises the GST consequences resulting from payments made on early termination in accordance with the terms of the example finance lease referred to in paragraph 129 of the Ruling. That lease is not regulated by the Consumer Credit Code. However if it was, the GST consequences resulting from early termination would be the same as examples 1 and 2 in Table 1.

- Table 1 considers the unilateral exercise of a right to terminate early in accordance with the original terms of the lease (examples 1 and 2);
- Table 2 considers early termination under a separate agreement (examples 3, 4 and 5);
- Table 3 considers the unilateral exercise of a right to terminate early by the lessor arising out of a default by the lessee (examples 6 and 7); and
- Table 4 considers a casualty occurrence which prevents the lessee's continued enjoyment of the benefits of the lease (example 8).

TABLE 1: TERMINATION BY LESSEE UNDER THE ORIGINAL TERMS OF THE LEASE and GOODS SOLD TO A THIRD PARTY		
EVENT	**TERMS**	**GST STATUS**
1. Shortfall (Example 1 – paragraph 130) The lease is terminated by the lessee exercising a unilateral right to terminate early in accordance with the original terms of the lease and the goods are sold to a third party. • Termination amount exceeds the net sale proceeds; • Lessee must pay shortfall to lessor.	Lessor receives: 1.1 the GST inclusive sale proceeds from the third party in return for supplying the goods; and 1.2 the shortfall between the GST exclusive termination amount and the net sale proceeds, grossed up for GST, from the lessee. i.e.: (the residual value and future rental both adjusted to present values) - net sale proceeds = $____ x 11/10 to gross up for GST.	1.1 **taxable supply** by lessor to the third party. 1.2 **adjustment event** to earlier supply of the goods by lease. • Lessor has an increasing adjustment; and • Lessee has a decreasing adjustment.

TABLE 1: TERMINATION BY LESSEE UNDER THE ORIGINAL TERMS OF THE LEASE and GOODS SOLD TO A THIRD PARTY		
EVENT	**TERMS**	**GST STATUS**
2. Excess (Example 2 – paragraph 134) The lease is terminated by the lessee exercising a unilateral right to terminate early in accordance with the original terms of the lease and the goods are sold to a third party. • Net sale proceeds exceed termination amount; • Lessor must pay lessee the excess.	Lessor receives: 2.1 the GST inclusive sale proceeds from the third party in return for supplying the goods. Lessee receives: 2.2 the difference between the net sale proceeds and the GST exclusive termination amount, grossed up for GST, from the lessor. i.e.: net sale proceeds – (the residual value and future rental both adjusted to present values) = $__ x 11/10 to gross up for GST.	2.1 **taxable supply** by lessor to third party. 2.2 **adjustment event** to earlier supply of the goods by lease. • Lessor has a decreasing adjustment; and • Lessee has an increasing adjustment

TABLE 2: TERMINATION BY SEPARATE AGREEMENT		
EVENT	**TERMS**	**GST STATUS**
1. Shortfall (Example 3 – paragraph 138). The lease is terminated by the lessor and the lessee making a separate agreement. The goods are sold to a third party. • Termination amount exceeds the net sale proceeds; • Lessee must pay shortfall to lessor.	Lessor receives: 1.1 the GST inclusive sale proceeds from the third party in return for supplying the goods; and 1.2 the shortfall between the GST exclusive termination amount and the net sale proceeds, grossed up for GST, from the lessee. i.e.: (the residual value and future rental both adjusted to present values) – net sale proceeds = $___ x 11/10 to gross up for GST.	1.1 **taxable supply** by lessor to the third party. 1.2 **taxable supply** by lessor to lessee.

TABLE 2: TERMINATION BY SEPARATE AGREEMENT		
EVENT	**TERMS**	**GST STATUS**
2. Excess (Example 4 – paragraph 144) The lease is terminated by the lessor and the lessee making a separate agreement. The goods are sold to a third party. • Net sale proceeds exceed termination amount; • Lessor must pay lessee the excess.	Lessor receives: 2.1 the GST inclusive sale proceeds from the third party in return for supplying the goods. Lessee receives: 2.2 the difference between the net sale proceeds and the GST exclusive termination amount, grossed up for GST, from the lessor. i.e.: net sale proceeds – (the residual value and future rental both adjusted to present values) = $__ x 11/10 to gross up for GST.	2.1 **taxable supply** by lessor to third party. 2.2 **adjustment event** to earlier supply of the goods by lease. • Lessor has a decreasing adjustment; and • Lessee has an increasing adjustment.

TABLE 2: TERMINATION BY SEPARATE AGREEMENT		
EVENT	**TERMS**	**GST STATUS**
3. Lessee obtains title to goods (Example 5 – paragraph 150) The lease is terminated by a separate agreement. The lessee obtains title to the goods. Note that the agreement in the example includes payment of rental instalments up to the date of termination.	Lessor receives: 3.1 the GST inclusive residual value and future rental (both adjusted to present values) from the lessee in return for terminating the lease early and/or transferring title to the goods. (How this amount is apportioned depends on the facts of each transaction, see paragraph 151) 3.2 the GST inclusive final rental amount which is part of the consideration for the earlier supply of the goods by way of lease.	3.1 **taxable supply/ supplies** by lessor to lessee. 3.2 **taxable supply** by lessor to lessee.

TABLE 3: DEFAULT and GOODS SOLD TO A THIRD PARTY		
EVENT	**TERMS**	**GST STATUS**
1. Shortfall (Example 6 – paragraph 152) Lessor terminates the lease early, because the lease instalments are in arrears, and sells the goods to a third party. • Termination amount (liquidated damages) exceeds the net sale proceeds; • Lessee must pay lessor the shortfall, and the arrears grossed up for GST.	Lessor receives: 1.1 the GST inclusive sale proceeds from the third party in return for supplying the goods; and 1.2 the shortfall between the GST exclusive termination amount and the net sale proceeds, from the lessee as compensation for the lessor's damage. i.e.: (the residual value and future rental both adjusted to present values) - net sale proceeds 1.3 arrears of lease instalments, grossed up for GST, from the lessee in return for supply of the goods by way of lease. 1.4 interest on arrears of the lease instalments.	1.1 **taxable supply** by lessor to third party. 1.2 payment is **not consideration for a supply**. 1.3 **taxable supply** by lessor and creditable acquisition by lessee. 1.4 payment is consideration for an **input taxed supply** by lessor.

TABLE 3: DEFAULT and GOODS SOLD TO A THIRD PARTY		
EVENT	**TERMS**	**GST STATUS**
2. Excess (Example 7 – paragraph 158).		
Lessor terminates the lease early, because the lease instalments are in arrears, and sells the goods to a third party. • Net sale proceeds exceed termination amount (liquidated damages); • Lessor must pay lessee the excess, grossed up for GST; • Lessee must pay lessor the arrears, grossed up for GST.	Lessor receives: 2.1 the GST inclusive sale proceeds from the third party in return for supplying the goods; and 2.2 arrears of lease instalments, grossed up for GST, from the lessee in return for supply of the goods by way of lease. 2.3 interest on arrears of the lease instalments.	 2.1 **taxable supply** by lessor to third party. 2.2 **taxable supply** by lessor and creditable acquisition by lessee. 2.3 payment is consideration for an **input taxed supply** by lessor.
	Lessee receives: 2.4 the difference between the net sale proceeds and the GST exclusive termination amount, grossed up for GST, from the lessor. i.e.: net sale proceeds – (the residual value and future rental both adjusted to present values) = $___ x 11/10 to gross up for GST.	 2.4 **adjustment event** to earlier supply of the goods by lease. • Lessor has a decreasing adjustment; and • Lessee has an increasing adjustment.

TABLE 4: CASUALTY OCCURRENCE		
EVENT	**TERMS**	**GST STATUS**
1. Lease is terminated early on theft of goods and lessee receives insurance payout (Example 8 – paragraph 166). • Insurance proceeds are less than the termination amount; • Lessee must pay lessor the insurance proceeds and balance of the termination amount.	Lessor receives: 1.1 insurance proceeds passed on by the lessee; and 1.2 the shortfall between the insurance proceeds and the GST exclusive termination amount, from the lessee. i.e.: (the residual value and future rental both adjusted to present values) – insurance proceeds	1.1 payment is **not consideration for a supply** 1.2 payment is **not consideration for a supply**.

APPENDIX B

The tables in this Appendix are a general guide only and should be read in conjunction with the relevant paragraphs of this Ruling.

Each table in this Appendix summarises the GST consequences resulting from payments made on early termination in accordance with the terms of the example operating lease referred to in paragraph 168 of the Ruling. The lease is not regulated by the Consumer Credit Code.

- Table 5 considers early termination at the discretion of the lessor in accordance with the original terms of the lease (example 9);
- Table 6 considers the unilateral exercise of a right to terminate early by the lessor arising out of a default by the lessee (example 10); and
- Table 7 considers a casualty occurrence which prevents the lessee's continued enjoyment of the benefits of the lease (example 11).

TABLE 5: TERMINATION AT THE DISCRETION OF THE LESSOR IN ACCORDANCE WITH THE ORIGINAL TERMS OF THE LEASE		
EVENT	**TERMS**	**GST STATUS**
1. Lease is terminated early at the request of the lessee and at the discretion of the lessor, in accordance with the terms of the original lease (Example 9 – paragraph 169). • Lessee must pay termination amount to lessor.	Lessor receives: 1.1 the termination amount, grossed up for GST, from the lessee. i.e. (the residual value and future rental both adjusted to present values) x 11/10 to gross up for GST.	1.1 **taxable supply** by lessor.

TABLE 6: DEFAULT		
EVENT	**TERMS**	**GST STATUS**
1. Lessor terminates lease early because lease instalments are in arrears (Example 10 – paragraph 172). • Lessee must pay lessor the arrears grossed up for GST, and the termination amount.	Lessor receives: 1.1 arrears of lease instalments, grossed up for GST, from the lessee in return for the goods by way of lease; and 1.2 interest on arrears of the lease instalments. 1.3 the termination amount from the lessee as compensation for the lessor's damage. i.e. (the residual value and future rental both adjusted to present values)	1.1 **taxable supply** by lessor and creditable acquisition by lessee. 1.2 payment is consideration for an **input taxed supply** by lessor. 1.3 payment is **not consideration for a supply**.

TABLE 7: CASUALTY OCCURRENCE		
EVENT	**TERMS**	**GST STATUS**
1. Lease is terminated early on destruction of goods and lessee receives insurance payout (Example 11 – paragraph 177). • Lessee must pay lessor the insurance proceeds and balance of the termination amount.	Lessor receives: 1.1 insurance proceeds passed on by the lessee; and 1.2 the shortfall between the insurance proceeds and the GST exclusive termination amount, from the lessee. i.e. (the residual value and future rental both adjusted to present values) – insurance proceeds.	1.1 payment is **not consideration for a supply**. 1.2 payment is **not consideration for a supply**.