GSTR 1999/D11 - Goods and Services Tax: transitional arrangements - GST-free supplies under existing agreements

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There is an Erratum notice for this document.
This document has been finalised.

Draft Goods and Services Tax Ruling
Goods and Services Tax: transitional arrangements – GST-free supplies under existing agreements

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Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered, views of the Australian Taxation Office. This draft may not be relied on by taxation officers, taxpayers and practitioners, as it is not a ruling or advice in terms of section 37 of the ***Taxation Administration Act 1953****. When officially released it will be a public ruling for the purposes of section 37 and may be relied upon by any person to whom it applies.*

What this Ruling is about

1. This Ruling considers the extent to which a supply made on or after 1 July 2000, which is identified in a written agreement made before 8 July 1999, will be GST-free under section 13 of the *A New Tax System (Goods and Services Tax Transition) Act 1999* ('GST Transition Act'). All legislative references in this Ruling are to this Act unless otherwise stated.

2. The Ruling sets out our views on the criteria an agreement must satisfy for section 13 to apply.

3. Where section 13 applies to an agreement, this Ruling considers whether a review opportunity arises under the agreement.

4. For agreements made on or after 2 December 1998 but before 8 July 1999, the Ruling considers the requirement for the supplier to establish whether the recipient would be entitled to a full input tax credit for the supply.

5. This Ruling does not examine the special transitional rules that apply to a supply of:

- a right granted for life;
- a funeral; or
- construction or civil engineering work.

These special transitional rules are in sections 14, 15 and 19 respectively.

Background

6. An agreement may be made before 1 July 2000 (the date the Goods and Services Tax ('GST') starts), to supply goods, services, real property or any other thing after that date. Generally, the time of supply will be when goods are removed, real property is made available, services are performed or the thing is done.[1]

7. It will also be common for an agreement to provide for a supply to be made for a period or progressively over a period that begins before 1 July 2000 and ends after that date. In these cases, the supply is taken to be made continuously and uniformly throughout the period.[2] Examples are supplies by way of lease or hire.

8. Under the general transitional rule applying to arrangements spanning 1 July 2000, GST is only payable on a supply to the extent that it is made on or after that date.[3] The general rule applies whether or not consideration passed or an invoice was issued prior to 1 July 2000.[4]

9. There are exceptions to the general transitional rule. Special rules in section 13 may apply to make a supply GST-free when it is specifically identified in a written agreement. If not for these special rules, GST would be payable on a taxable supply made on or after 1 July 2000, but the supplier may not have the opportunity to change the consideration to include GST in the price.

10. Where the recipient would be entitled to a full input tax credit for the supply, the written agreement must be made before 8 July 1999, which is the date the GST Transition Act received Royal Assent. Otherwise, the written agreement must be made before 2 December 1998, which is the date the A New Tax System (Goods and Services Tax Transition) Bill 1998 ('GST Transition Bill') was introduced into Parliament. The rationale for having a later date where the recipient is entitled to a full input tax credit is that the net tax result is nil.

11. A GST-free supply is not subject to GST. A supplier who makes a GST-free supply is generally entitled to claim an input tax credit for GST paid on acquisitions used in making the supply. A recipient of a GST-free supply is not entitled to an input tax credit for the supply because no GST is payable on that supply.

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[1] Section 6.
[2] Section 12.
[3] Section 7.
[4] Section 10.

12. Section 13 may apply to an agreement for any type of supply. However, it will be necessary to also apply sections 14, 15 and 19 respectively, in determining the GST consequences for the supply of:

- a right granted for life;
- a funeral; or
- construction or civil engineering work.

Date of effect

13. This Ruling, when finalised, applies on or from 9 July 1999 (the date of commencement of the GST Transition Act).

Ruling

14. For section 13 to apply, an agreement must satisfy subsection 13(1). In this Ruling we refer to the date before which you must make an agreement as the 'relevant date'. The relevant date is:

- **8 July 1999** if the recipient of the supply would be entitled to a full input tax credit for the supply; or
- **2 December 1998** if the recipient of the supply would **not** be entitled to a full input tax credit for the supply.

15. The supply identified in such an agreement is GST-free to the extent it is made before a review opportunity which arises on or after the relevant date. A supply made on or after 1 July 2005 cannot be GST-free under section 13, unless all of the consideration was paid before 2 December 1998 and the supply is made before a review opportunity, arising on or after the relevant date.

The agreement

16. Section 13 will only apply if you make a written agreement made before the relevant date. Section 13 will not apply to an oral agreement made before the relevant date even if you put it in writing on or after that date. An agreement to which section 13 applies must be an agreement between two or more parties which is binding on those parties.

17. The written agreement must specifically identify a supply. An agreement that does not specify the quantity, volume or number of units of a supply will satisfy section 13, if it identifies a way of working out the consideration in money.

18. The written agreement must identify the consideration in money, or a way of working out the consideration in money, for the supply. If the agreement specifies a formula to be used for the calculation of the consideration in money, it will meet the requirements of section 13. Where the agreement identifies more than one supply, it is not necessary for it to identify the consideration for each supply separately.

19. Whether you made a written agreement before the relevant date, may not be clear in some cases. It will depend on the circumstances. You will not have made an agreement if the documentation, combined with actions and intentions of the parties before the relevant date, only amount to negotiations. A document containing the terms of an agreement which is signed by parties who contemplate that a 'formal contract' will subsequently be executed will not normally be a binding agreement. However, depending on the circumstances, it may be binding if it is the parties' intention to be bound. If you make the binding written agreement before the relevant date but the 'formal contract' is executed after the relevant date, section 13 can apply.

20. Section 13 cannot apply to a supply that you identify in an agreement made on or after the relevant date unless:

- you specifically identified that supply in an earlier written agreement that meets the requirements of subsection 13(1); and
- the supplier was bound by the earlier agreement to make the supply identified in the later agreement.

21. A variation after the relevant date that does not change either the supply specifically identified or the consideration identified in the original agreement, will not result in a supply made under the varied agreement ceasing to be GST-free under section 13.

22. A party to an agreement made before the relevant date may be replaced after that date by assignment or the operation of law. A mere change of parties to a written agreement to which section 13 applies will not result in the section ceasing to apply to the agreement where there is no alteration to the supply or consideration identified. However, the section will cease to apply if it is an agreement made on or after 2 December 1998 but before 8 July 1999 and the new recipient is not entitled to a full input tax credit.

Review opportunity

23. A review opportunity is an opportunity that arises under the agreement for the supplier to:

- change the consideration because of the imposition of the GST;
- take account of the imposition of GST in conducting a general review, renegotiation or alteration of the consideration before 1 July 2000; or
- conduct a general review, renegotiation or alteration of the consideration after 1 July 2000.[5]

24. The opportunity must be the supplier's opportunity. This includes an opportunity for the supplier which requires the agreement of one or more of the other parties.

25. An opportunity arises for the purposes of section 13 even if the supplier does not take advantage of that opportunity. In addition, it is possible for an opportunity to arise even if the review does not result in a change to the consideration.

26. An opportunity can arise 'under the agreement' if it arises under an express or implied term of the agreement or under a law which affects the operation of the agreement.

27. Where an agreement specifically identifies more than one supply and does not separately identify the consideration for each supply, a review opportunity which arises will be a review opportunity for all the supplies identified in the agreement. However, if the agreement separately identifies consideration for each supply, a review opportunity which arises under the agreement in respect of one supply will not mean that a review opportunity arises for any other supply identified in the agreement.

28. If the agreement provides for a change in the consideration as a result of a condition being met, and the imposition of GST is the predominant cause of that increase, it will be an opportunity to change the consideration 'directly or indirectly because of the imposition of GST'. It is, therefore, a review opportunity.

29. A general review does not need to enable the supplier to review the total consideration if the supplier can review most of the consideration.

30. A change to the consideration based on an economic indicator will not constitute a review opportunity. Economic indicators include the consumer price index ('CPI') and exchange rate changes.

31. A change to the consideration based on the recipient's turnover will not constitute a review opportunity.

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[5] This definition includes amendments which are awaiting Royal Assent as at 17 December 1999. Refer to the footnote to paragraph 87 for details.

32. A change to the consideration based on a fixed increase will not constitute a review opportunity unless the purpose of including the increase was to take the GST into account.

33. An agreement which allows the supplier to recover certain of its outgoings from the recipient will contain a review opportunity if it allows the supplier to recoup the GST. This will depend on the terms of the particular agreement.

34. A market review will be a review opportunity if conducted on or after 1 July 2000. If the review is conducted before 1 July 2000 the supplier must have the opportunity to take account of the imposition of the GST for a review opportunity to arise. If the supplier can take GST into account but does not do so, a review opportunity will still have arisen.

Recipient's entitlement to a full input tax credit

35. For an agreement made on or after 2 December 1998 but before 8 July 1999, a supplier will need to establish whether the recipient is entitled to a full input tax credit for the supply. If the recipient is not entitled to a full input tax credit for the supply, section 13 does not apply to the agreement.

36. A recipient is entitled to a full input tax credit for a supply if the recipient acquires it solely for a creditable purpose. The supply must be a taxable supply but for the operation of section 13. If the recipient is not registered or required to be registered, or acquires the supply wholly or partly for a private purpose, the recipient is not entitled to a full input tax credit. In addition, there are special rules which may apply to particular supplies that reduce, wholly or in part, the recipient's entitlement to an input tax credit.

37. The supplier is not required to monitor a recipient's entitlement on an ongoing basis. The test of whether the recipient is entitled to a full input tax credit needs to be done only once, provided the recipient does not change. Where the recipient changes in circumstances where section 13 can still apply, the supplier must establish the entitlement of the new recipient if the agreement was made on or after 2 December 1998 but before 8 July 1999.

38. The supplier should establish the recipient's entitlement at the time of making the agreement. However, it will be sufficient if the supplier establishes this at the time the supply is first made on or after 1 July 2000. The supplier will need to ask the recipient whether the recipient is entitled to a full input tax credit. If the supplier is unable to obtain this information from the recipient, the supplier must be satisfied on reasonable grounds that the recipient is entitled to a full input tax credit for the supply before treating it as GST-free.

39. Where suppliers can demonstrate they had a reasonable basis for concluding the recipient would be entitled to a full input tax credit, we will not amend the supplier's liability for GST in respect of supplies that have already been made.

Explanations (this forms part of the Ruling)

40. An agreement will satisfy subsection 13(1) if the agreement:

- is a written agreement;
- specifically identifies a supply;
- identifies the consideration in money, or a way of working out the consideration in money, for the supply; and
- was made before the relevant date.

The relevant date will be:

- 8 July 1999 if the recipient of the supply would be entitled to a full input tax credit for the supply; or
- 2 December 1998 if the recipient of the supply would not be entitled to a full input tax credit for the supply.[6]

41. If these conditions are satisfied a supply identified in the agreement is GST-free to the extent that it is made[7] before the earlier of:

- 1 July 2005; or
- a review opportunity that arises on or after the relevant date.

However, a supply made on or after 1 July 2005 will be GST-free under section 13 if all the consideration was paid before 2 December 1998, and the supply is made before a review opportunity that arises on or after the relevant date.[8]

The agreement

42. It is implicit in section 13 that 'agreement' requires an agreement between two or more parties which is binding on those parties. Otherwise, the parties would be able to alter their obligations under the agreement at any time to take GST into account.

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[6] Refer to subsections 13(1) and 13(4).
[7] Section 6 sets out how to determine when a supply is made for the purposes of the GST Transition Act.
[8] Subsection 13(3).

Written agreement

43. The agreement must be a written agreement. A written agreement made before the relevant date will satisfy subsection 13(1) provided all the essential terms of the agreement, including terms relating to the supply and the consideration, are in writing. The agreement must specifically identify the supply and identify the consideration in money, or a way of working out the consideration in money, for the supply.[9]

'Specifically identifies a supply'

44. Subsection 13(1) requires the agreement to specifically identify a supply. Whether an agreement specifically identifies a supply depends on the nature of the supply.

45. An agreement will still satisfy subsection 13(1) when the agreement does not specify the quantity, volume or number of units which the supplier will be bound to make under the agreement, but identifies a way of working out the consideration in money, based on the quantity actually supplied.

Example 1[10]

46. Consultant Ltd made a written agreement on 1 July 1998 to supply Big Ltd with engineering services for a period of 3 years from that date. The agreement specifies the rate per hour Consultant will charge for the services. During the three year period Consultant is bound under the agreement to supply the services at this rate in the quantity requested by Consultant, up to a limit specified in the agreement. There is no review opportunity under the agreement.

47. Although the number of hours to be provided by Consultant over the three years is not specified, the agreement has specifically identified the supply because it provides a sufficient description of the supply and has identified a way of working out the consideration for the supply. As the binding written agreement was made before 2 December 1998 the agreement satisfies subsection 13(1). The supply identified in the agreement will be GST-free until 30 June 2001.

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[9] Paragraph 13(1)(a).

[10] All entities in the examples in this Ruling are registered or required to be registered for GST unless otherwise stated.

48. If more than one supply is made under an agreement only those which are specifically identified can be GST-free under section 13.

'Identifies the consideration in money…'

49. Subsection 13(1) requires the agreement to identify the consideration in money or a way of working out the consideration in money for the supply.

50. One of the elements of a taxable supply as defined in the *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act')[11] is that the supply is made for consideration. The requirement in section 13 is narrower than the definition of 'consideration' in the GST Act. Consideration for the purposes of defining a taxable supply includes an act or forbearance or a payment other than in money[12]. However, agreements in which the consideration is identified in a form other than money (or a way of working it out in money) will not satisfy the requirements of section 13. Therefore, certain supplies cannot be GST-free under section 13 due to the form of the consideration.

Example 2

51. Matthew and Verouska make a written agreement on 1 November 1998 that Verouska will maintain the grounds of Matthew's house for the next four years in consideration for Matthew not setting up a new business in competition with her landscaping business over that period.

52. The supply of maintenance by Verouska would be taxable under the GST Act, but it cannot be GST-free under section 13 because the agreement did not identify Matthew's consideration for the supply in money or a way of working it out in money.

53. Where multiple supplies are made under a single agreement section 13 does not require that the consideration for a particular supply be separately identified for the supply to be GST-free.

54. If the consideration is not identified in money, the agreement must identify a way of working out the consideration in money. This requirement will be satisfied if the agreement specifies a formula to work out the consideration in money.

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[11] Section 9-5 of the GST Act.
[12] Section 9-15 of the GST Act.

Made before the relevant date

55. The parties must have been bound by a written agreement before the relevant date.

Example 3

56. On 1 July 1999, Ian orally agreed to lease office space to Tony for a period of three years for an agreed annual rental to be paid monthly in advance. They agree that the lease is to start immediately. Tony pays Ian one month of rent in advance and begins occupancy of the premises. A month later on 1 August 1999, they sign a written lease agreement.

57. Section 13 does not apply because the written agreement was not made before 8 July 1999. Therefore, the supply made under the agreement cannot be GST-free under section 13.

58. The question of whether the parties are bound by a written agreement before the relevant date will arise when there is written documentation that could be a binding agreement and a formal contract is to be drawn up. For the purposes of section 13, the question will be relevant in the following circumstances:

- there is written documentation signed by the parties *before the relevant date* which could be a binding agreement, but which indicates that the parties intend to draw up and execute a formal contract (e.g., by the words 'subject to the preparation of a formal contract');
- the written documentation specifically identifies a supply and identifies the consideration in money or a way of working out the consideration in money for the supply; and
- a formal contract is not executed until *on or after the relevant date*.

59. Section 13 will not apply unless there was a binding agreement pending the execution of the formal contract. Whether or not there was a binding agreement depends on the circumstances.

60. The parties may have finalised the details for a contract but wish to record their agreement in a formal document. A question arises as to whether the parties are bound immediately or whether they are bound only when the formal document is executed. If the words 'subject to contract' are used there is a presumption that there is no intention to be bound until formal contracts have been exchanged

(*Masters v Cameron*).[13] This implication may be displaced by a contrary intention disclosed by the words or actions of the parties.

61. The question of whether an agreement concluded 'subject to contract' is a binding agreement to which section 13 applies will arise only if the correspondence between the parties or other documents constitute a written agreement.

62. Subsection 13(1) is not satisfied by:

- a written agreement concluded after the relevant date;
- an oral agreement put in writing after the relevant date;
- an oral acceptance of a written offer; or
- an exchange of documentation, such as letters, which only amounts to negotiations.

Example 4

63. Rough Pty Ltd and Ready Pty Ltd, in the course of negotiating an agreement for the supply of services for a five year period from 1 July 1999, sign a draft contract. The draft contract specifically identifies the supply and identifies the consideration in money. The draft contract states that the terms are 'subject to a formal contract'. The formal contract is not made until 1 August 1999. The services are provided from this date.

64. Whether the draft contract constituted a binding agreement is a question of law. In these circumstances the parties were not bound until the formal contract was executed after the relevant date. Subsection 13(1), therefore, does not apply.

65. However, it may be otherwise where the parties intended the contract to have immediate contractual force. This intention would be supported if the supplier actually began to supply the services from 1 July 1999.

Supply is identified in another agreement after the relevant date

66. Section 13 cannot apply to a supply that is identified in an agreement made on or after the relevant date unless:

- that supply was specifically identified in an earlier written agreement that meets the requirements of subsection 13(1); and
- the supplier was bound by the earlier agreement to make the supply identified in the later agreement.

[13] (1954) 91 CLR 353.

67. If there is any difference between the earlier and later agreements in respect of the supply and/or the consideration identified, section 13 cannot apply to the supply made under the later agreement.

Example 5

68. Nathan & Garry Enterprises (N&G), a property developer, purchased a block of land to construct an office building. Hardworker Pty Ltd made a written agreement on 1 September 1998 with N&G for Hardworker to lease the building from 1 July 2000, subject to completion of the construction before that date. The agreement to lease includes a copy of the lease that the parties will execute and all the essential terms of the agreement. The agreement identifies the amount of rent and all other payments to be made by the lessee in money. The lease is executed on 1 June 2000.

69. Although the supply is the subject of an agreement made after the relevant date, in this case the supply made under the lease was specifically identified and consideration identified in the agreement to lease, as required by subsection 13(1). The supply under the lease will be GST-free to the extent it is made before the earlier of the first review opportunity or 1 July 2005.

Renewal of agreement after the relevant date

70. Under some agreements the recipient of a supply has the right to renew the agreement to receive the supply for a further period. Common examples are options to renew a commercial property lease or a franchise agreement. If a supplier is bound to make a supply because of a written agreement made before the relevant date that specifically identifies the further supply and identifies the consideration in money or a way of working out the consideration in money, section 13 can apply to that supply. The critical requirement is that the earlier agreement specifically identifies the further supply and the consideration in money or a way of working out the consideration in money.

71. In practice the exercise of an option to renew an agreement will frequently provide the supplier with an opportunity to review the consideration. We consider whether this will be a review opportunity at paragraphs 86 to 145.

Example 6

72. Ashantha has an agreement with Fred, a franchisor. The agreement is for a period of three years. It meets the requirements of

subsection 13(1) and was made before the relevant date. The agreement expires on 31 December 1999. Ashantha has an option in the agreement to renew the franchise agreement for a further three years on the same terms by paying a renewal fee of $25000. Ashantha renews the agreement on 15 December 1999.

73. The supply and consideration for the further period were identified in the agreement made before the relevant date. The supply made by Fred for the further period will be GST-free to the extent it is made before any review opportunity arises.

Variation of an agreement

74. The distinction between the mere variation of an existing agreement and the making of a new agreement is not always clear. Where the variations are substantial and go to the 'root' of the original contract, the variation may be treated as a rescission of the original contract.[14]

75. It is not possible to state whether a variation to an agreement to which section 13 applies will cause the section to cease to apply without examining the terms of the variation. A variation that has no effect on the supply specifically identified or the consideration identified in the agreement will not result in section 13 ceasing to apply. If the consideration is calculated according to a formula, then a variation to the formula will mean that section 13 will cease to apply.

Example 7

76. Kathleen and Phong make a written agreement on 1 March 1999 for Phong to supply goods to Kathleen. The agreement satisfies section 13 in that it specifically identifies the goods to be supplied and the consideration in money. There is no review opportunity under the agreement.

77. Kathleen moves premises on 1 October 1999. Kathleen and Phong vary the agreement by altering terms relating to the delivery of the goods. On 1 August 2000 after Phong can no longer obtain the goods identified in the agreement, they again vary the agreement to provide for Phong to supply substitute goods from a different source. In neither case do the parties intend that a new agreement is created.

78. The first variation does not affect the application of section 13 and the supply specified in the original agreement will be GST-free. However, the supply made under the agreement varied under the second variation is not specifically identified in any agreement made

[14] See Kitto J in *Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd* (1957) 98 CLR 93 at 135.

before the relevant date so this supply is not GST-free under section 13.

Change of parties to an agreement

79. One or more parties to an agreement may change after the relevant date. This can occur when one party assigns its rights and obligations under the agreement to another person or entity. A common example of an assignment is when the owner of leased premises sells the property and assigns rights and obligations under the lease agreement to the new owner. A change of parties can also be a result of a statutory subrogation or by operation of law, for example under succession law.

80. If an existing agreement to which section 13 applies continues after the change of parties and the change of parties does not provide a review opportunity, the change of parties, in itself, will not mean section 13 ceases to apply to the agreement. However, section 13 will no longer apply if the agreement was made on or after 2 December 1998 and before 8 July 1999 and the new recipient is not entitled to a full input tax credit. See paragraphs 146 to 158 for further explanation.

Example 8

81. Adam owns a commercial property. He enters into a lease agreement for a ten year term with Ben on 1 November 1998. The lease meets the requirements of subsection 13(1) and does not have a review opportunity. On 1 November 2000, Adam sells the property to Annabel and assigns his rights and obligations under the lease to Annabel. The existing lease agreements remain in force.

82. The assignment will not result in section 13 ceasing to apply to the agreement.

Statutory subrogation

83. Changes to the laws affecting public managed investment schemes were introduced on 1 July 1998 by amendments made to the Corporations Law by the *Managed Investments Act 1998*. By virtue of sections 601FS and 1462 of the Corporations Law, on registration of a scheme, the rights, obligations and liabilities of the trustee company and the management company in relation to the scheme become the rights, obligations and liabilities of the new responsible entity.

84. Under section 601FT of the Corporations Law, if the responsible entity changes, a document to which the former

responsible entity was a party or under which the former responsible entity has acquired or incurred a right, obligation or liability has effect as if the new responsible entity is a party or has acquired or incurred the right, obligation or liability. The same rights and duties which attached to the original person or entity attach to the substituted person or entity.

85. If an agreement satisfies subsection 13(1) before the statutory subrogation, the subrogation, in itself, will not result in section 13 ceasing to apply to the agreement.

Review opportunity

86. If an agreement meets the requirements of subsection 13(1), subsection 13(2) provides that the supply identified in the agreement is GST-free to the extent that it is made before the earlier of the following:

(a) 1 July 2005; or

(b) if a review opportunity arises on or after the relevant date - when that opportunity arises.

87. **Review opportunity** is defined in subsection 13(5) as:

'an opportunity that arises under the agreement:

(a) for the supplier under the agreement (acting either alone or with the agreement of one or more of the other parties to the agreement) to change the consideration directly or indirectly because of the imposition of GST; or

(b) for the supplier under the agreement (acting either alone or with the agreement of one or more of the other parties to the agreement) to conduct, on or after 1 July 2000[15], a general review, renegotiation or alteration of the consideration; or

(c) for the supplier under the agreement (acting either alone or with the agreement of one or more of the other parties to the agreement) to conduct, before 1 July 2000, a general review, renegotiation or alteration of the consideration that takes account of the imposition of the GST.'[16]

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[15] The words 'on or after 1 July 2000,' are proposed to be inserted into paragraph 13(5)(b) of the GST Transition Act by the A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999. As at 17 December 1999, this Bill is awaiting Royal Assent.

[16] Paragraph (c) is proposed to be inserted as paragraph 13(5)(c) of the GST Transition Act by the A New Tax System (Indirect Tax and Consequential

88. A review opportunity will arise if it comes under one of the above paragraphs in subsection 13(5). In some circumstances, the supplier will have an opportunity to conduct a 'general review' under paragraph 13(5)(b) or 13(5)(c) as well as an opportunity to 'change the consideration … because of the imposition of GST' under paragraph 13(5)(a).

89. Some of the common categories of changes to the consideration under an agreement are considered in paragraphs 126 to 145.

Opportunity

90. The purpose of section 13 is to give relief to suppliers who have entered into agreements that do not make provision for GST and do not provide for the consideration to be reviewed to take it into account. The transitional provisions operate on the basis that if suppliers have an opportunity to take GST into account, they should do so. Therefore, provided an agreement gives the supplier a review opportunity the supply will cease to be GST-free when the opportunity arises. It does not matter whether the supplier takes advantage of the opportunity.

91. 'Opportunity' is defined as 'a time or condition favourable for a particular action or aim; occasion, chance' – *The New Shorter Oxford English Dictionary*. An opportunity does not have to be an event or incident. A provision in an agreement which allows the supplier to recover GST from the recipient will be a review opportunity, even if the agreement does not specify a particular date for the review.

Opportunity for the supplier

92. The opportunity must be an opportunity for the supplier. An opportunity for the recipient alone to change the consideration is not a review opportunity.

Supplier acting either alone or with the agreement of one or more of the other parties

93. An agreement may provide an opportunity for the supplier and the recipient to negotiate a change in the consideration. The time and circumstances in which the parties can renegotiate the consideration will depend on the terms of the agreement.

Amendments) Bill 1999. As at 17 December 1999, this Bill is awaiting Royal Assent.

94. An opportunity will arise whether or not it is initiated by the supplier or another party to the agreement, provided the change to the consideration requires the agreement of the supplier. For example, the agreement may allow the recipient of a supply to initiate renegotiation of the consideration at a time of their choice. An opportunity will arise when the recipient initiates the renegotiation. In this case, even though the supplier cannot initiate the opportunity it will still be an opportunity, for the supplier.

95. Even if the recipient does not agree to change the consideration to take GST into account, a review opportunity will arise. If the supplier decides not to undertake a review or not to implement any change resulting from the review a review opportunity will still arise.

96. An agreement may give the supplier an opportunity to change the consideration because of GST or conduct a general review at any time over a certain period. In such cases, the opportunity will arise when the supplier first has the opportunity.

Example 10

97. On 1 May 1999, Ling enters into an agreement with Zena to lease premises to Zena for a period of 5 years. Section 13 applies to the agreement. The relevant date is 8 July 1999. The agreement provides for a market review at any time during the last three years of the lease, ie at any time on or after 1 May 2001.

98. A review opportunity will arise on 1 May 2001 because the Ling can conduct a general review within the meaning of paragraph 13(5)(b).

99. An agreement may cap the amount of adjustment to the consideration so that the full amount of the GST cannot be passed on by the supplier. The agreement will nevertheless provide a review opportunity if it otherwise satisfies paragraphs 13(5)(a), (b) or (c).

Opportunity … under the agreement

100. The opportunity must arise 'under the agreement'. Whether a review opportunity arises will depend on the express and implied terms of the agreement and all laws which affect the operation of the agreement.

101. The word 'under' requires a direct connection between the relevant opportunity and the agreement.

Example 11

102. A commercial lease provides for a rent review due on 1 September 2000 to be on the basis of either of two methods at the lessor's option. The State retail tenancies legislation which applies to the lease has the effect of making that provision void and providing for the rent review to be the rent as agreed between the parties, or in the absence of agreement, the market rent as determined by a valuer.

103. Even though it is the legislation which specifies the form of the review, the opportunity arises 'under the agreement' because the agreement triggered the operation of the legislation.

104. If the agreement provides for a condition to be met before an opportunity to change the consideration arises, then a review opportunity will not arise until the condition is satisfied.

Example 12

105. An agreement satisfies subsection 13(1). The agreement provides for the consideration to be reviewed to a market rate only if the $US exchange rate reaches a certain value.

106. A review opportunity will not arise unless the exchange rate reaches the value.

More than one supply made under an agreement

107. An agreement which specifically identifies multiple supplies may provide for review opportunities on the various supplies on different dates. An early review opportunity on one supply would not bring forward the review opportunity on another supply as long as the consideration is separately identified for each supply. As discussed above, section 13 applies separately to each supply.

Paragraph 13(5)(a): 'change the consideration directly or indirectly because of the imposition of GST'

108. An opportunity for the supplier 'to change the consideration directly or indirectly because of the imposition of GST' will be a review opportunity under paragraph 13(5)(a). Such an opportunity will not be restricted to a term of an agreement which specifies 'GST', an 'indirect tax' or 'tax' generally.

109. If the agreement provides for a change in the consideration as a result of a condition being met and the imposition of GST is the predominant cause of that change, this will be an opportunity to

change the consideration 'directly or indirectly because of the imposition of GST'.

Example 13

110. On 1 July 1999 Tom, the owner of a taxi licence, entered into a written agreement with Liz, a taxi operator, for the use of the licence for a five year period. The agreement does not provide for any increase in the consideration other than where the relevant authority approves an increase in fares. The agreement provides that Tom and Liz will share equally any such increase.

111. The relevant authority subsequently approves an increase, effective from 1 July 2000, to take GST into account. The opportunity to increase the consideration for the use of the licence will constitute a review opportunity as the consideration is changed indirectly 'because of the imposition of GST'. It will be a review opportunity even though the owner is only entitled to half of the increase. Supply of the licence on or after 1 July 2000 will not be GST-free under section 13.

112. 'Indirectly' in paragraph 13(5)(a) does not mean any change, however remote. In order for an opportunity to be a review opportunity under paragraph 13(5)(a), there should be a link between the imposition of GST and the change in the consideration. The change would need to be predominantly due to GST and not a range of factors. For example, a CPI increase does not satisfy paragraph 13(5)(a) because the increase may be the result of a combination of a range of factors.

113. Where an agreement identifies a way of working out the consideration in money under a formula, a review opportunity will arise if the formula allows the consideration to change because of the imposition of GST. For example, a formula based on the supplier's current price list at the time the supply is made is an opportunity for the supplier to change the consideration because of the imposition of GST.

Paragraphs 13(5)(b) & 13(5)(c): 'general review, renegotiation or alteration of the consideration…'

114. Whether an opportunity 'to conduct a general review, renegotiation or alteration of the consideration' is a review opportunity will depend on whether that opportunity arises before 1 July 2000 or on or after that date. Where such an opportunity arises on or after 1 July 2000, it will constitute a review opportunity. Where the opportunity arises before 1 July 2000, it will only be a review opportunity if the imposition of GST can be taken into account.

115. Whether a general review gives an opportunity to take GST into account will depend on the terms of the agreement. Where the agreement does allow GST to be taken into account in conducting the general review, renegotiation or alteration a failure to do so will not prevent the opportunity being a review opportunity.

116. An opportunity to make changes to the consideration based on a fixed increase or an economic indicator (e.g., the CPI) is not an opportunity to conduct a 'general review, renegotiation or alteration of the consideration'.

Example 14

117. Alan, an athlete, enters into a sponsorship agreement that satisfies subsection 13(1) with Sponsor Ltd. The agreement provides for monthly payments of $1,000. In the event that Alan wins an Olympic gold medal the agreement requires the monthly payment to increase to $5,000 per month for each medal.

118. The review of the consideration is not a 'general review' so will not constitute a review opportunity if Alan wins a gold medal.

119. A general review does not need to enable the supplier to review the total consideration if most of the consideration can be reviewed.

120. In *Case M58*[17] the New Zealand Taxation Review Authority ('TRA') determined that a lease with an option to renew, which was not finalised until after the relevant date (in the New Zealand legislation), was not a 'non-reviewable contract'. This was because the terms of the lease contemplated a 'general review' of the consideration in money for the supply of the tenancy, and this review occurred shortly after the relevant date when parties to a contract were deemed to have knowledge of GST and were expected to use that knowledge in contractual negotiations.

121. The TRA found that on renewal of the lease the rent was to be reviewed, in the sense that it was to be renegotiated, within certain limits. Bathgate DJ believed that the review could easily be described as 'a general review of the consideration in money' because it was a review of most or nearly all the consideration for the supply under the lease.

122. In that case, Bathgate DJ stated:

> 'A "general review" means … a review generally, rather than of a specific part or parts of the consideration payable under the lease. A "general" review is not the same as a "total"

[17] (1990) 12 NZTC 2333.

> review of all the consideration, nor is it in certain circumstances the same as a "partial" review of some of the consideration.'[18]

123. Bathgate DJ considered that a review of a minor component of the consideration should be classified as a 'special review'.

Example 15

124. A written agreement made before the relevant date for the lease of premises has the following clause:

> 'The landlord shall have the right to review the rent on 1 August 2000 for the balance of the term and to request the tenant to pay an increased rent for the remainder of the term, provided always that if there be no agreement between the tenant and the landlord as to the amount by which the rent is to be increased, the same shall be determined by arbitration pursuant to the Arbitration Act.'

125. In this case the right to review the rent is a review opportunity that arises on 1 August 2000. Whether or not the landlord and tenant can agree on the increase or the matter goes to arbitration, the review opportunity will arise on 1 August 2000.

Common bases for review

Economic indicators

126. Adjustment to the consideration on the basis of an indicator such as the consumer price index ('CPI') may partially compensate the supplier for the GST payable on the supply. This will not be a review opportunity under paragraphs 13(5)(b) or 13(5)(c) because it is not a general review, renegotiation or alteration. To be a review opportunity under paragraph 13(5)(a), the opportunity to change the consideration must arise because of the imposition of GST. Even if part of the CPI increase is attributable to the GST, the amount of the increase is not because of the imposition of GST but a range of economic factors. An opportunity to change the consideration based on the CPI does not give an opportunity to change the consideration because of the GST in relation to the particular supply identified in the agreement.

127. Even though paragraph 13(5)(a) states that the opportunity to change the consideration may arise indirectly because of the imposition of GST, we consider that the connection between the GST and changes to the CPI is too remote to satisfy the paragraph.

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[18] (1990) 12 NZTC 2333 at 2338.

A change to the CPI is not necessarily related to the supply identified in the agreement.

128. Similarly, an opportunity to change the consideration to reflect a change in an exchange rate, would not of itself be a review opportunity.

Example 16

129. Rusty Pty Ltd entered into a written agreement to supply steel to a manufacturer on 1 April 1999 for a ten year period. The consideration is calculated by a formula that allows adjustments to reflect exchange rates. No other adjustment to the consideration is possible.

130. An adjustment based on an exchange rates does not constitute a review opportunity and the supply of steel will be GST-free until 1 July 2005.

Recipient's turnover

131. An adjustment to consideration on the basis of the recipient's turnover is common under commercial property leases and franchise agreements. A change to consideration under an agreement which is based on the recipient's turnover will not be a review opportunity because the opportunity to make the change is not 'because of the imposition of GST'. The connection with the imposition of GST is too remote. It is also not a general review.

Fixed increment

132. An adjustment to the consideration by way of a fixed increase, either on the basis of a set amount or a percentage of the existing consideration, will not constitute a review opportunity in the absence of any indications that the increase was made to take into account the imposition of GST.

133. An adjustment to the consideration based on a formula of combining CPI with a fixed increase will also not constitute a review opportunity.

Recovery of outgoings

134. An agreement may allow the supplier to recoup defined outgoings from the recipient. Amounts payable by the recipient will form part of the consideration for a supply. This type of clause is common in commercial leases. The consideration for a supply by way of a lease includes, in addition to the rent, amounts paid by the lessee

under the lease in respect of the lessor's outgoings. Therefore, a change in the amount paid under the outgoings clause will 'change the consideration' in terms of paragraph 13(5)(a).

135. Under paragraph 13(5)(a), if a supplier has the opportunity under the agreement to change the consideration because of the imposition of GST, there is a 'review opportunity'. The terms of the outgoings clause in a particular agreement must be examined to determine if this opportunity arises.

136. *Case L29I*,[19] a New Zealand Taxation Review Authority case, considered section 85 of the New Zealand *Goods and Services Tax Act 1985* which is similar in effect to section 13.

137. The covenants in one of the leases considered in that case were expressed as follows:

> '… the lessee will pay all rates, taxes, charges, assessments, impositions and outgoings whatsoever which now are or which during the said term shall be taxed, rated, charged, assessed or imposed on the said premises, or on the landlord or tenant in respect thereof, by authority of Parliament, local authority or otherwise.'

138. It was unsuccessfully argued in that case that the leases were 'non-reviewable' for the purposes of the New Zealand legislation because GST is a tax imposed on the leasing activity itself and is not a tax imposed on the premises or on the lessor in respect of the premises.

139. Keane DJ reviewed the scheme of the New Zealand legislation and found it was clear that GST is a liability 'taxed', or 'charged', or 'assessed' or 'imposed' on the landlord. He found that the leasing activity and the taxable activity were identical, and the words 'in respect of' taken even in the narrowest sense relate both back to their source - the registered person or landlord. He held such clauses impose directly on the lessee or tenant a duty to pay GST from its inception to the landlord or to the government on the landlord's behalf.

140. In the New Zealand case *Smale v Fletcher Homes Ltd*,[20] a lessee was given an option to purchase the leased land during the first term of the lease. The parties disputed whether the purchaser was liable to pay an amount equal to the GST in addition to the nominated price. The relevant outgoings clause provided that 'the Lessee … pay to the Lessor … all rates, taxes (but excluding the Lessor's Land Tax … and the Lessor's income tax), charges, assessments and outgoings

[19] (1989) 11 NZTC 1175.
[20] (1996) 17 NZTC 12662.

of the Lessor … paid or payable or otherwise incurred in respect of the Land…'. The Court of Appeal observed that:

> 'The breadth of these words has been recognised by the express exclusion of the lessor's land tax for the first three years of the lease, and of the lessor's income tax. It may be that these exclusions were inserted *ex abundante cautela*, but the fact that they have been inserted is significant. There would seem little doubt that GST on the rental under the lease would be payable by the lessee under this clause as being "in respect of" the land. The GST on the purchase of the land may be in a different category. The clause must be read in its context in a lease for a term of years, and cannot sensibly apply to taxes incurred after the lease has expired.'[21]

141. Our view is that a tax 'in respect of the premises' in the context of an outgoings clause can include GST payable by the lessor is also supported by *Brett v Rogers*.[22] In that case, a lessee disputed that a covenant to 'pay… duties … imposed on or in respect of the … premises' required her to reimburse the lessor for the cost of fixing a drain. The court found that the obligation to build a new drain was a 'duty imposed in respect of the premises'. The Court stated:

> 'The expenses in question in the present case were incurred by virtue of a duty imposed in respect of the premises. If the words had been inserted, "assessed or imposed upon any person or persons in respect of the premises," the added words would not, as it seems to us, have given any greater scope to the covenant. The words "in respect of the premises" are used in contradistinction to the words "on the premises," and an assessment or duty made or imposed not on the premises, but in respect of the premises, must be made or imposed upon some person in respect of the premises; and an assessment duly made or imposed upon any person in respect of the premises seems to us to come within the meaning of the covenant.'[23]

142. Some outgoings clauses will not constitute a review opportunity because they are not broad enough to encompass a GST. In *Case L29* certain other leases were considered. One was found to be a 'non-reviewable contract' because the lessee was only obliged to pay 'taxes and other outgoings levied or charged against the premises' rather than in respect of the premises. Another lease was also categorised as a 'non-reviewable contract' because it only required the lessee to pay 'charges' and not 'taxes'.

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[21] (1996) 17 NZTC 12662 at 12665.
[22] (1897) 1 QB 525.
[23] (1897) 1 QB 525 at 529.

Market review

143. An agreement may provide an opportunity for the supplier to make the consideration for a supply the market value of the supply. A review based on market value or market price - a 'market review' - is a 'general review, renegotiation or alteration of the consideration'. An opportunity to conduct a market review on or after 1 July 2000 is a review opportunity.[24]

144. If a supplier has an opportunity before 1 July 2000 to conduct a market review which does not give an opportunity to take account of the imposition of the GST, this will not be a review opportunity.[25] However, it is expected that in most cases, a market review conducted after the relevant date and before 1 July 2000 will give the supplier the opportunity to take the GST into account. This is because at this time the supplier should be aware of the impact of GST for a supply to be made on or after 1 July 2000. Whether or not the supplier has this opportunity will depend on the circumstances of the particular case. If the supplier is able to, but does not take advantage of an opportunity to take account of the imposition of the GST in conducting the market review, a review opportunity will still arise.

145. There is no requirement that an opportunity to review results in an increase of the consideration under a market review for section 13 to apply. In a case where GST is taken into account, other factors may cause the consideration to decrease, or remain the same.

Recipient's entitlement to a full input tax credit

Relevant date

146. The relevant date before which a written agreement must be made depends on whether or not the recipient of the supply is entitled to a full input tax credit. The requirement to establish the entitlement is only relevant to agreements made on and after 2 December 1998 but before 8 July 1999.

147. The later date of 8 July 1999 is the relevant date if the recipient of the supply is entitled to a full input tax credit. The earlier date of 2 December 1998 is the relevant date if the recipient is not be entitled to a full input tax credit for the supply.

Full input tax credit

148. The entitlement of the recipient to a full input tax credit depends on the provisions of the GST law. Division 11 of the GST Act deals with creditable acquisitions. A recipient is entitled to an

[24] Paragraph 13(5)(b).
[25] Paragraph 13(5)(c).

input tax credit for any creditable acquisition made.[26] A full input tax credit is what would have been the amount of the input tax credit for the acquisition if it had been made solely for a creditable purpose and the recipient had provided, or had been liable to provide, all of the consideration for the acquisition.[27]

149. The requirements for a creditable acquisition include the following:

- the acquisition must be solely for a creditable purpose, therefore the acquisition must not relate to the making of supplies by the recipient that would be input taxed, or be of a private or domestic nature;
- the supply must be a taxable supply, but for the operation of section 13;
- the supply must be connected with Australia;
- the recipient must provide or be liable to provide consideration for the supply;
- the recipient must be registered or required to be registered; and
- the acquisition must not be specifically excluded from being a creditable acquisition, for example a non-deductible expense.

150. In addition, the acquisition must not be one in relation to which input tax credits are specifically reduced or not allowable, for example an acquisition of a motor vehicle to which section 20 of the GST Transition Act applies.

Example 17

151. Julie makes a written agreement to supply services to a credit union for a period of three years on 1 March 1999. On 1 June 2000, Julie asks the credit union whether it would be entitled to a full input tax credit for the acquisition of the supply from 1 July 2000. The credit union advises Julie they would use the supplies to make financial supplies and, therefore, cannot claim an input tax credit for the acquisition.

152. As the recipient would not be entitled to a full input tax credit for the acquisition of the supply, the relevant date is 2 December 1998. The supply is not GST-free under section 13 because the agreement was made after the relevant date.

[26] Section 11-20 of the GST Act.
[27] Subsection 11-30(3) of the GST Act.

Supplier's responsibility

153. For agreements made on or after 2 December 1998 but before 8 July 1999, the supplier has the responsibility of ascertaining whether the recipient is entitled to a full input tax credit. This is because the entitlement affects whether subsection 13(1) applies to the agreement and, therefore, whether the supply made is GST-free under section 13.

154. Subsection 13(4) does not specify a time at which the supplier is required to establish whether the recipient is entitled to a full input tax credit. While the supplier should establish the recipient's entitlement at the time of making the agreement, it will be sufficient if the supplier establishes this at the time the supply is first made on or after 1 July 2000.

155. The supplier is only be required to establish the recipient's entitlement to a full input tax credit on a single, once only basis. In the case of an agreement that provides for supplies to be made progressively or for a period, the supplier is not required to establish the entitlement of the recipient to a full input tax credit on an ongoing basis.

156. The supplier must take all reasonable steps to ascertain whether a recipient is entitled to a full input tax credit and must have reasonable grounds for deciding a recipient is entitled to a full input tax credit. What is reasonable will depend on all the circumstances. In most cases this will require the supplier to ask the recipient whether or not they are entitled to a full input tax credit. If the supplier is unable to obtain this information from the recipient, the supplier must be satisfied that the recipient is entitled to a full input tax credit for the supply before treating it as GST-free. Where suppliers can demonstrate they have acted reasonably in concluding the recipient is entitled to a full input tax credit, we will not retrospectively amend the supplier's liability for GST.

157. In some situations, it may be possible to ascertain from the nature of the supply that the recipient is not entitled to an input tax credit. For example, a supply of residential premises by way of lease covered by section 40-35 of the GST Act is input taxed and not a taxable supply, therefore the recipient is not entitled to an input tax credit. Also, if not registered for GST the recipient is not entitled to an input tax credit.

158. It is stated at paragraph 80 that a change in parties to an agreement, if there is no change in the supply and consideration identified in the agreement, will not result in section 13 ceasing to apply to the agreement. However, if a recipient who is entitled to a full input tax credit for the supply is replaced by a party who is not so entitled, section 13 will no longer apply if the agreement was made on or after 2 December 1998 but before 8 July 1999.

Example 18

159. An employer, employee and a finance company enter into a five year lease novation agreement on 1 February 1999. The employer is entitled to a full input tax credit for the supply. There is no review opportunity under the agreement. On 1 July 2000, the employee ceases employment with the employer and is required to make the lease payments as from this date.

160. The employee is not entitled to a full input tax credit so the supply is not GST-free under section 13. This is because the agreement was not made before 2 December 1998.

Your comments

161. If you wish to comment on this draft Ruling, please send your comments promptly by **18 February 2000** to:

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Commissioner of Taxation
24 December 1999

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Related Rulings/Determinations:

Subject references:
- goods and services tax
- GST consideration
- GST free
- GST supply
- GST transitional stream

Legislative references:
- ANTS(GSTT)A99 6
- ANTS(GSTT)A99 7
- ANTS(GSTT)A99 10
- ANTS(GSTT)A99 12
- ANTS(GSTT)A99 13(1)
- ANTS(GSTT)A99 13(2)
- ANTS(GSTT)A99 13(3)
- ANTS(GSTT)A99 13(4)
- ANTS(GSTT)A99 13(5)(a)
- ANTS(GSTT)A99 13(5)(b)
- ANTS(GSTT)A99 13(5)(c)
- ANTS(GST)A99 9-5
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Case references:
- Brett v Rogers (1897) 1 QB 525
- Elmslie v FC of T (1993) 46 FCR 576
- Masters v Cameron (1954) 91 CLR 353
- Smale v Fletcher Homes Ltd (1996) 17 NZTC 12662
- Case L29 (1989) 11 NZTC 1175
- Case M58 (1990) 12 NZTC 2333
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