# *GSTD 2005/3 - Goods and services tax: are contracts for difference and financial spread betting contracts financial supplies?*



This document has changed over time. This is a consolidated version of the ruling which was published on *22 June 2005*

# Goods and Services Tax Determination

## Goods and services tax: are contracts for difference and financial spread betting contracts financial supplies?

***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.*

1. Yes. When the conditions for making a financial supply under regulation 40-5.09 of the A New Tax System (Goods and Services Tax) Regulations 1999 (GST Regulations) are satisfied, financial spread betting contracts and contracts for difference are financial supplies, being interests in derivatives mentioned in item 11 of the table in subregulation 40-5.09(3).

### Background

***The products***

2. Financial spread betting contracts are legally enforceable contracts between licensed providers and investors that are regarded by both the GST law[1] and the *Corporations Act 2001* as derivatives. The contracts relate to movements in closing levels for individual shares and market indices as well as futures or options in equities, indices, bonds, interest rates, currencies and commodities. No commission is payable in relation to a financial spread betting contract.

3. Contracts for difference are contracts between a provider (a broker or market maker) and an investor. They are also derivatives for the purposes of the *Corporations Act 2001* and the GST law[2] and are settled daily on the basis of movements in the prices of underlying financial instruments. Contracts for difference are most commonly created in major international indices and their constituents. A fee which is described as a commission may be paid to the provider on entering into and closing out contracts for difference.

4. For the purposes of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) and the GST Regulations, financial investment in the form of a financial spread betting contract or contract for difference is a cash-settled derivative.[3]

[1] See paragraph 20.
[2] See paragraph 20.
[3] See paragraph 20 for a discussion of the definition and treatment of a derivative for GST purposes.

5. The provider of financial spread betting contracts or contracts for difference is subject to applicable financial services laws as set out in the *Corporations Act 2001*,[4] and regulated by the Australian Securities and Investment Commission. Consequently, they are required to hold an Australian Financial Services Licence, and (for example) to issue Product Disclosure Statements in relation to their products.

### *How do they operate?*

*Financial spread betting contracts*

6. For a financial spread betting contract, the provider quotes a spread based on the relevant market price of the underlying instrument, the cost of hedging the contract and pending dividends and corporate actions as well as the spreads quoted by other providers. The spread changes as the price of the instrument changes in the underlying market.

7. The investor is said to make an 'up-bet' if they buy and a 'down-bet' if they sell. The contract is for a specified stake per 'point' (generally for each one cent change in the quoted price in the case of shares). Up-bets are made from the provider's buy-price and down-bets are made from the provider's sell-price. At any point in time the buy-price will always be higher than the sell-price. The difference between the quoted buy and sell prices is the spread.

8. Gains and losses are based on the points difference between the settlement/close-out prices and the opening buy/sell prices multiplied by the stake per point.

9. The financial spread betting contract may run to expiry or be closed out before expiry:

- At expiry, the close-out price will be an official settlement price calculated by the provider, based on the price of the instrument in the underlying market and set out in the customer agreement.
- An up-bet is closed out prior to expiry by making an equivalent down-bet from the sell-price at that time. A down-bet is closed out prior to expiry by making an equivalent up-bet from the buy-price at that time.

10. The investor is usually required to deposit sufficient margin with the provider to support all positions. The state of the margin account is monitored and if there is a shortage of equity in the account, the investor may have to pay a margin call.

*Contracts for difference*

11. A contract for difference is a contract between an investor and a provider, being a broker or market maker (which contracts as principal).

12. The basic unit of account for a contract for difference is one share and the contract is valued per point. The unit of account for an index contract for difference is usually the index itself. The value of the contract is the number of points in the index times the value per point.

13. The investor proceeds according to whether they have decided that the price of the underlying share or index will rise or fall. If they believe the index will rise, they buy a contract. Conversely, if they believe the price will fall, they sell a contract.

[4] See Chapter 7 of the *Corporations Act 2001*, and particularly the definition of 'derivative' in section 761D.

14. The broker usually requires a deposit (initial margin) on normal contracts of a proportion of the underlying exposure on each deal. The investor's position is marked to market each day, and their account is debited or credited accordingly. If the funds in the account fall below the minimum margin, a 'shortage in equity' arises and the investor will have to pay a margin call.

15. A feature of contracts for difference compared with dealing in the underlying shares is that the use of margin trading magnifies the potential gains or losses. Although under contracts for difference investors never have an interest in the underlying shares, the cash equivalent of dividends are credited to their accounts, sometimes at a discount to the full distribution. Other corporate actions (for example splits or rights issues) may be reflected in cash adjustments to the ledger account.

16. The investor's mark to market account is debited or credited daily in accordance with the movement of the underlying share price or index until the contract expires, or is closed out by taking out an equal and opposite contract. This crystallises gains or losses in the mark to market account which are posted to the investor's ledger account.

17. Investors in contracts for difference are subject to a number of charges from the provider such as:

- the sell-buy spread which reflects the spread in the cash market;
- a fee described as a dealing commission;
- transaction costs; and
- cost of carry for buyers.

When an investor buys a contract for difference, the contract is treated by the parties as though the provider is lending the investor money. The investor is charged an interest equivalent called 'cost of carry' or 'long interest'. Similarly, investors that sell a contract for difference receive an interest equivalent called 'short interest'. This amount is calculated at the specified benchmark rate minus the provider's margin. Each of the charges listed above, including the fee/commission paid to the provider, represents additional consideration for the financial supply of the derivative.

## Explanation

18. Under section 9-5 of the GST Act a supply is not a taxable supply to the extent that it is input taxed. Input taxed supplies are provided for in Division 40 of the GST Act. Under subsection 40-5(2) of the GST Act a financial supply is defined to have the meaning given by the GST Regulations.

19. Regulation 40-5.09 of the GST Regulations sets out supplies that are financial supplies. A supply is a financial supply if there is the provision, acquisition or disposal of an interest[5] mentioned in subregulation 40-5.09(3) or (4), and the other requirements of paragraphs 40-5.09(1)(a) and (b) are satisfied.

[5] Defined in regulations 40-5.02 to 40-5.05 of the GST Regulations.

20. Financial spread betting contracts and contracts for difference are the provision of an interest in or under a derivative mentioned in item 11 of the table in subregulation 40-5.09(3) of the GST Regulations. A derivative is defined in the dictionary of the GST Regulations to mean '*an agreement or instrument the value of which depends on, or is derived from, the value of assets or liabilities, an index or a rate*'.[6] Financial spread betting contracts and contracts for difference are such agreements. The value of these contracts depends on and is derived from the movement of the value or price of assets, an index or a rate from the date they are bought or sold to the date they are closed out or expire.

21. Under the United Kingdom legislation *'the provision of any facilities for the placing of bets or the playing of any 'game of chance''* is exempt from value added tax (VAT). Financial spread betting is treated as exempt from VAT on the basis that it is betting on financial instruments and works the same way as sports spread betting. In contrast, the Australian GST legislation qualifies the meaning of a gambling supply in paragraph 126-35(1)(b) of the GST Act by relating a bet to a gambling event as *'the acceptance of a bet (however described) relating to the outcome of a gambling event'*. A gambling event is then defined in subsection 126-35(2) as:

(a) the conducting of a lottery or raffle, or similar undertaking; or

(b) a race, game, or sporting event, or any other event, for which there is an outcome.

22. The supply of interests in financial spread betting contracts and contracts for difference do not constitute gambling supplies, as defined in section 126-35 of the GST Act. These transactions do not represent a gambling event,[7] as they are not related to a race, game, or sporting event or, any other event for which there is an outcome.

23. They are clearly not related to *'a race, game, or sporting event'*, and the words *'any other event, for which there is an outcome'* should be interpreted *(ejusdem generis*)[8] with reference to those words immediately preceding them. The finance-related underlying instruments of financial spread betting contracts or contracts for difference, which fall within the definition of a derivative in the GST Regulations, cannot be characterised as part of the class or genus of activities established by the words *'a race, game, or sporting event'*.

24. The financial speculation that forms the basis for financial spread betting contracts and contracts for difference, therefore does not fit the definition of a gambling event. Sports spread betting, however, although it works in the same way as financial spread betting, does fit that definition as it relates to a race, game or sporting event, or similar event that has an outcome.

25. Additionally, the character of the supplies under financial spread betting contracts or contracts for difference is that of input taxed financial supplies being interests under a derivative for the purposes of item 11 of subregulation 40-5.09(3) of the GST Regulations.

---

[6] The term 'derivative' is explained in the Glossary (Schedule 1) to GSTR 2002/2 Goods and services tax: GST treatment of financial supplies and related supplies and acquisitions, and examples of derivative products are set out in Part H to Schedule 2 to that Ruling.

[7] Subsection 126-35(2).

[8] *Ejusdem generis* is defined in *CCH Macquarie Dictionary of Law*, 1993, Second Edition, Sydney NSW as a rule of interpretation of contracts, statutes, and other instruments to the effect that where general words follow an enumeration of particular things, the general words are restricted to matters of the same kind as those specifically enumerated.

26. On entering into a financial spread betting contract or a contract for difference the investor enters into an obligation to make a payment[9] to the provider if the price (or interest rate, index or other applicable indicator) underlying the contract moves in a particular direction. Similarly the provider enters into an obligation to make a payment to the investor if the price (or interest rate, index or other applicable indicator) underlying the contract moves in the opposite direction. This payment is calculated at the time of the close out or maturity of the contract, and is calculated by taking into account not only the gain or loss on the financial spread betting contract or contract for difference, but any other charges.[10]

27. A financial spread betting contract or a contract for difference, by its nature, involves both the acquisition and disposal of interests in the derivative contract by each of the participants. Each party to the contract supplies an interest under a derivative at the time of entry into the contract. That is, each party both makes a supply of the interest and provides non-monetary consideration to the other entity in the form of an interest under the derivative. The payment, which may be payable by either party, that arises from the operation of the contracts is additional consideration for the supply of the interests under the financial spread betting contract or the contract for difference.

***Example: calculation of payment in a contract for difference***

28. *XYZ shares are quoted by CFD Provider Pty Ltd (CFD) at $1.50/$1.51 (representing the current sell and buy prices respectively). Gerald believes the market price of the shares will rise, and buys a contract for difference for [to use the terminology above] 1,000 shares in XYZ at the buy-price of $1.51. CFD and Gerald both provide an interest in a derivative to the other, each of which also represents consideration for the other supply. CFD charges a fee/commission on the transaction of 0.3%, being $4.53 ($1.51 × 1,000 × 0.3%).*

29. *An interest equivalent amount is calculated each day, by application of the agreed interest rate (in this case 6.5%) to the closing price of the shares. On the first day the position is open, the closing price of XYZ shares is $1.55. The closing value of the 1,000 XYZ shares is therefore $1,550.00, and the interest equivalent amount for the day is $0.28 ($1,550 × 6.5%/365). As Gerald has bought a contract, this interest equivalent amount is debited to his account. An amount is calculated similarly each day the contract for difference remains open, at the daily closing value of the shares quoted by CFD. Over the next 30 days, this totals $7.80.*

30. *While the contract for difference remains open, XYZ pays a dividend of 5c per share. As Gerald has bought a contract, a dividend equivalent amount of $50.00 ($0.05 × 1,000 shares) is credited to him.*

31. *30 days later, XYZ shares have fallen to a price quoted by CFD of $1.30/$1.31 and Gerald decides to close the contract. He closes the contract when XYZ shares reach the quoted price of $1.30, and becomes liable for further commission payable to CFD of $3.90 ($1.30 × 1,000 × 0.3%), making a total fee/commission charge of $8.43.*

[9] The payment is referred to in the industry as a 'net payment'.
[10] See paragraph 17.

32. *The payment from Gerald on the contract for difference takes into account the opening and closing price of the shares, commission, transaction fees and interest and dividend equivalent amounts which represent additional consideration for the financial supplies under the contract as follows:*

| | | |
|---|---|---|
| *Closing price:* | *$1.30* | |
| *Opening price:* | *$1.51* | |
| *Difference:* | *($0.21)* | |
| *Loss on trade: 1,000 × ($0.21) =* | | *($210.00)* |
| *Total commission:* | | *($8.43)* |
| *Total interest equivalent amount:* | | *($7.80)* |
| *Dividend equivalent adjustment:* | | *$50.00* |
| ***Overall loss (payment):*** | | ***$176.23*** |

*CFD and Gerald have each made an input taxed financial supply to the other. The consideration Gerald provides to CFD is the interest under the derivative plus $226.23 being the loss on trade, the interest equivalent and the commission. The consideration CFD provides to Gerald is the interest under the derivative, plus $50.00 being the dividend equivalent amount. This results in a net payment by Gerald to CFD of $176.23.*

## Date of effect

33. This Determination explains our view of the law as it applied from 1 July 2000. You can rely upon this Determination 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.

34. If this Determination 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.

**Commissioner of Taxation**
22 June 2005

*Previous draft:*
GSTD 2004/D4

*Related Rulings/Determinations:*
GSTR 1999/1; GSTR 2002/2

*Subject references:*
- contracts for difference
- derivatives
- financial spread betting contract
- financial supplies

*Legislative references:*
- ANTS(GST)A 1999 9-5
- ANTS(GST)A 1999 Div 40
- ANTS(GST)A 1999 40-5(2)
- ANTS(GST)A 1999 126-35
- ANTS(GST)A 1999 126-35(1)(b)
- ANTS(GST)A 1999 126-35(2)
- ANTS(GST)R 1999 40-5.02

- ANTS(GST)R 1999 40-5.03
- ANTS(GST)R 1999 40-5.04
- ANTS(GST)R 1999 40-5.05
- ANTS(GST)R 1999 40-5.09
- ANTS(GST)R 1999 40-5.09(1)(a)
- ANTS(GST)R 1999 40-5.09(1)(b)
- ANTS(GST)R 1999 40-5.09(3)
- ANTS(GST)R 1999 40-5-.09(4)
- Corporations Act 2001
- Corporations Act 2001 Chapter 7
- Corporations Act 2001 761D
- TAA 1953 37

*Other references:*

- CCH Macquarie Dictionary of Law, 1993, Second Edition, Sydney NSW

ATO references

NO: 2003/16461
ISSN: 1443-5179
ATOlaw topic: Goods and Services Tax ~~ Financial supplies ~~ financial supplies and acquisitions