


GSTD 2000/D6 - Goods and Services Tax : is the sale of goods by a lessor on termination of a lease agreement a separate supply to that of the lease of the goods ?

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This document has been finalised.



Draft Goods and Services Tax Determination

Goods and Services Tax: is the sale of goods by a lessor on termination of a lease agreement a separate supply to that of the lease of the goods?

Preamble

Draft Goods and Services Tax Determinations (DGSTDs) present the preliminary, though considered, views of the Australian Taxation Office. DGSTDs should not be relied on; only final Goods and Services Tax Determinations represent authoritative statements by the Australian Taxation Office.

1. Yes. The sale of the goods by the lessor is a separate supply to the supply by way of lease. This is the case whether the lessor sells the goods to the lessee or to a third party.
2. Lease agreements provide for the lessee to use the goods, e.g., motor vehicles, for the term of the lease for consideration in the form of periodic payments. Some lease agreements specify the residual value of the goods. They also often provide that the lessee is liable for, or entitled to, the difference between this residual value and the amount for which the goods are sold.
3. Lease agreements also include a provision that the lessee returns the goods to the lessor or has no right or obligation to purchase the goods on termination of the lease. A lease agreement that provides for the purchase by the lessee on termination of the lease would be a hire purchase agreement rather than a lease agreement. In the absence of an obligation or option to purchase in the agreement, it is nevertheless common practice for the lessee to acquire the goods on termination of the lease for an amount equal to the residual value. Where the lessee does acquire the previously leased goods, they are not acquired under the terms or conditions of the lease agreement, but under a separate or collateral agreement that is separately negotiated between the parties.
4. The supply of the goods by way of lease may be GST-free under the GST transitional rules.¹ As the sale of the goods by the lessor is a separate supply, not identified in the lease agreement, to the supply by way of lease, the sale of the goods on or after 1 July 2000 will not be a GST-free supply.
5. Where the sale of the goods to the lessee is a taxable supply, GST payable by the lessor is 1/11th of the consideration.

¹ See Goods and Services Tax Ruling GSTR 2000/16 'Goods and services tax: transitional arrangements – GST-free supplies under existing agreements' for further explanation on the application of section 13 of the *A New Tax System (Goods and Services Tax Transition) Act 1999*.

6. Where a lessee is liable for, or entitled to, the difference between the sale proceeds and the residual value of the goods, this will alter the amount of consideration for the supply by way of lease, not the consideration for the supply by way of sale.

Sale proceeds less than the residual value

7. Where the goods are sold to a third party on termination of the lease and the lessee is required to make a further payment because the sale proceeds are less than the residual value, an adjustment event arises for the lessor.² This adjustment event gives rise to an increasing adjustment where the supply is a taxable supply.³ The lessor will be required to issue an adjustment note to the lessee.⁴ Similarly there is an adjustment event for the lessee. Where the acquisition is a creditable acquisition a decreasing adjustment arises.⁵

8. A further amount payable by the lessee to the lessor is in respect of the supply of the goods by way of lease. Where this supply is a GST-free supply under the GST transition rules, an adjustment will not arise and the payment will not be subject to GST.

Sale proceeds exceed the residual value

9. Where the sale proceeds exceed the residual value and the lease agreement provides for the lessor to pay the difference to the lessee, an adjustment event arises for the lessor. This adjustment event gives rise to a decreasing adjustment where the supply is a taxable supply.⁶ The lessor will be required to issue an adjustment note to the lessee. There is an adjustment event for the lessee. Where the acquisition of the leased goods by the lessee is a creditable acquisition, an increasing adjustment arises.⁷

10. A surplus paid by the lessor to the lessee is in respect of the supply by way of lease. Where this supply is a GST-free supply under the GST transitional rules, an adjustment will not arise.

Example 1 – Sale of goods to the lessee for an amount equal to the residual value

11. *In November 1996, Tanya entered into a lease agreement with Finance Co. to lease a motor vehicle for 4 years to use 100% for her business. The lease agreement provides for consideration in the form of monthly lease payments. It also provides for a residual value of \$5,500. It does not provide for an opportunity to review the consideration, and it does not specify that the motor vehicle will be supplied to Tanya on termination of the lease.*

12. *As the GST transitional rules apply to the agreement the supply identified in the agreement, i.e., the supply by way of lease, is GST-free.*

13. *Tanya registers for GST from 1 July 2000. In November 2000, the lease agreement terminates. Tanya accepts an offer from Finance Co. under which she can acquire the vehicle in consideration for a payment equal to the residual value of \$5,500. She continues to use the vehicle for 100% business use and the purchase of the vehicle is a creditable acquisition. Finance Co. has made a taxable supply of the motor vehicle to Tanya, and GST of \$500 (1/11th of the \$5,500) is payable by Finance Co. Tanya is entitled to an input tax credit of \$500 (1/11th of the \$5,500).*

² Paragraph 19-10(2)(b) of the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act). See Goods and Services Tax Ruling GSTR 2000/19 'Goods and services tax: making adjustments under Division 19 for adjustment events' for further information.

³ Section 19-50 of the GST Act.

⁴ Subsection 29-75(1) of the GST Act and Goods and Services Tax Ruling GSTR 2000/1 'Goods and services tax: adjustment notes'.

⁵ Section 19-85 of the GST Act.

⁶ Section 19-55 of the GST Act.

⁷ Section 19-80 of the GST Act.

Example 2 – Adjustments where goods are sold for less than the residual value

14. Same lease agreement as in Example 1. On termination of the lease in November 2000, Tanya returns the motor vehicle to Finance Co. The terms of the lease agreement provide for Finance Co. to sell the motor vehicle by private sale. Finance Co. sells the motor vehicle to a third party for \$3,300. Finance Co. has made a taxable supply and GST payable is \$300 (1/11th of \$3,300).

15. Under the terms of the lease agreement, Tanya is required to pay any shortfall between the sale price of the vehicle and the residual value of \$5,500. Ignoring selling costs and charges, Tanya makes a final payment of \$2,200 to Finance Co.

16. The termination payment of \$2,200 gives rise to an adjustment event for Tanya and Finance Co. because of the change to the consideration for the supply by way of lease of the motor vehicle. As this lease agreement meets the requirements of the GST transition rules the supply is GST-free, an adjustment will not arise and Finance Co. is not liable for GST on the payment by Tanya.

Example 3 – Adjustments where goods are sold for more than the residual value

17. Craig entered into a motor vehicle lease agreement in August 2000 with Finance Co. The agreement requires Craig to pay \$500 per month for 3 years and guarantee the residual value of \$6,600 on termination of the lease. Craig uses the vehicle for 100% business use. Both Craig and Finance Co. are registered for GST.

18. On termination of the lease, Craig returns the vehicle to Finance Co. which sells the motor vehicle to a third party for \$11,000. Under the lease agreement Finance Co. refunds the excess, ignoring selling costs, of \$4,400 to Craig.

19. As the transitional rules do not apply, Finance Co. has made a taxable supply of the motor vehicle to the third party, and GST of \$1,000 (1/11th of \$11,000) is payable on this supply. However, the payment of \$4,400 to Craig is connected with the supply by way of lease of the motor vehicle, therefore both Craig and Finance Co. will have an adjustment event as the consideration for that supply has changed.

20. The GST on the supply of the lease of the vehicle by Finance Co. has decreased because of the adjustment event and Finance Co. will have a decreasing adjustment to its net amount. Craig's entitlement to the input tax credit for the acquisition by way of lease has also decreased so he will have an increasing adjustment to his net amount. The previously attributed GST amount for the supply of the lease is \$1,636.36 ($\$500 \times 36 = \$18,000 \times 1/11$)⁸. The corrected GST amount for this supply is \$1,236.36 ($\$18,000 - \$4,400 = \$13,600 \times 1/11$)⁹. Finance Co. has a decreasing adjustment of \$400.¹⁰ Similarly Craig has a previously attributed input tax credit amount of \$1,636.36, a corrected input tax credit amount of \$1,236.36 and an increasing adjustment of \$400.¹¹ Finance Co. is required to give Craig an adjustment note.¹²

⁸ Section 19-45 of the GST Act and Goods and Services Tax Ruling GSTR 2000/19 'Goods and services tax: making adjustments under Division 19 for adjustment events', paragraphs 81 – 83.

⁹ Section 19-40 of the GST Act and GSTR 2000/19, paragraphs 76 – 80.

¹⁰ Section 19-55 of the GST Act and GSTR 2000/19 paragraphs 84 – 87.

¹¹ Sections 19-70, 19-75 and 19-80 of the GST Act, and GSTR 2000/19 paragraphs 92 – 96, 97 – 99 and 100 – 103 respectively.

¹² Subsection 29-75(1) of the GST Act and Goods and Services Tax Ruling GSTR 2000/1.

Your comments

21. We invite you to comment on this Draft Goods and Services Tax Determination. We are allowing 3 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

Comments by Date: 8 December 2000
Contact Officer: Geoff Lawson
E-Mail address: geoff.lawson@ato.gov.au
Telephone: 02 9374 1558
Facsimile: 02 9374 1801
Address: GST Rulings Unit
GPO Box 920
BRISBANE QLD 4001

Commissioner of Taxation15 November 2000

Previously released:

Not previously released in draft form

Related Rulings/Determinations:

GSTR 2000/1; GSTR 2000/16; GSTR 2000/19

Subject references:

- agreements spanning 1 July 2000
- financial leases
- goods & services tax
- GST consideration
- GST free
- GST supply
- GST transitional issues
- lease & hire expenses
- lease & hire income
- lease residual
- special transitional rules
- taxable supply
- taxation determinations

Legislative references:

- ANTS(GSTT)A99 13
 - ANTS(GST) A99 19-10(2)(b)
 - ANTS(GST) A99 19-40
 - ANTS(GST) A99 19-45
 - ANTS(GST) A99 19-50
 - ANTS(GST) A99 19-55
 - ANTS(GST) A99 19-70
 - ANTS(GST) A99 19-75
 - ANTS(GST) A99 19-80
 - ANTS(GST) A99 19-85
 - ANTS(GST) A99 29-75(1)
-

ATO references:

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