

GSTD 2004/D3 - Goods and services tax: can book entries amount to the provision or receipt of consideration for attribution purposes, in the absence of actual payment?

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This document has been finalised.



Draft Goods and Services Tax Determination

Goods and services tax: can book entries amount to the provision or receipt of consideration for attribution purposes, in the absence of actual payment?

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 taxpayers and practitioners as it is not a ruling or advice for the purposes of section 37 of the **Taxation Administration Act 1953**. The final Determination will be a public ruling for the purposes of section 37 and may be relied upon by any entity to which it applies.*

1. Yes. In the absence of actual payment, book entries can amount to the provision or receipt of consideration for the purposes of attributing GST payable and input tax credits, provided there is agreement, of the kind discussed in this Determination, between the parties.
2. Book entries can amount to the provision or receipt of consideration for a taxable supply where the supplier and the recipient agree to discharge mutual liabilities by way of set-off. A set-off can occur if each party has made a supply to the other and each party is required to pay the other for the supply made to it. A set-off can also occur, in certain circumstances, if one party makes a supply to the other and the parties agree that payment is to be achieved by the supplier lending, or arranging to lend, the recipient the money needed to pay for the supply. This Determination explains the circumstances in which this can occur, with particular reference to associated entities.
3. In each of these cases, the consideration is provided or received on the date that the book entries are made. This is because the payment can only occur at the time the book entries are effected, even if the obligation to pay arose at an earlier time.

Background

4. For the purposes of this Determination, a 'book entry' is an entry recording the accounting information for a business transaction, made in the 'books of account' of an entity. The 'books of account' of an entity are the journals, ledgers or other accounting records of the entity. Book entries are made in accordance with relevant laws and the accounting and professional standards required for accountants in Australia.

5. A liability can be discharged by means other than payment by a transfer of funds or providing non-monetary consideration. It can be discharged by 'set-off'¹ – see paragraph 12 of this Determination.

6. Where entities make supplies to their associates,² normal commercial invoicing and payment may not take place. Instead they may have an agreement (entered into by duly authorised officers) that discharge of the indebtedness arising from the acquisitions is to be evidenced solely by making book entries. The book entries may be made retrospectively.

7. Retrospective book entries are often made after the end of a financial year, to reflect the true financial position of each entity at the end of the financial year. These types of book entries are also commonly referred to as 'balance day adjustments'.

8. Typically, the circumstances in which retrospective book entries are made are as follows:

- an entity has supplied goods or services to an associated entity throughout a financial year and no payments have been made for these supplies;
- after the end of the financial year, the value of the supplies and the corresponding acquisitions is calculated and retrospective book entries are made in the books of account of both entities to account for these supplies and acquisitions; and
- the book entries effectively discharge amounts payable to, or receivable from, each entity in the books of account of the two entities. They are typically made when the accounts are closed for the preparation of income tax returns. The same accounting personnel may make the entries for both entities. A tax invoice dated with the date the entries are made is usually issued at this time.

9. Where the entities are not members of a registered GST group, there may be GST consequences for either or both entities. However, if they are members of a GST group supplies and acquisitions within the group are taken out of the GST system. That is, supplies or acquisitions made between members of a GST group are treated as if they were not taxable supplies and not creditable acquisitions.³

Book entries as provision or receipt of 'consideration'

10. Determining the tax period in which the consideration is provided and received is relevant to attributing GST and input tax credits correctly under sections 29-5 and 29-10 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

11. In some situations, we consider that book entries alone may be evidence of the provision or receipt of consideration for a taxable supply within the meaning of the GST Act, in the absence of any actual physical payment.

¹ *In Re Harmony and Montague Tin and Copper Mining Co (Spargo's case)* (1873) LR 8 Ch App 407; *Whim Creek Consolidated NL v. FC of T* 77 ATC 4503; 8 ATR 154 and *FC of T v. Steeves Agnew & Co (Vic) Pty Ltd* (1951) 82 CLR 408.

² 'Associate' has the meaning given by section 318 of the *Income Tax Assessment Act 1936*: see section 195-1 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

³ Under sections 48-40 and 48-45 of the GST Act a supply or acquisition that an entity makes to or from another member of the same GST group is treated as if it were not a taxable supply or a creditable acquisition. However, these sections also set out some limited situations where this is not the case.

Set-off

12. For the doctrine of 'set-off' to apply there have to be mutual liabilities of equal amounts presently payable between two parties.⁴ In addition, there must be agreement between the parties to adopt the set-off method of payment of debts. Book entries which are made pursuant to an agreement are merely evidence of the agreement which has been reached between the parties. The agreement must be to discharge the liabilities and may be written, oral or implied. It is the agreement which has the legal effect of discharging the liabilities between the parties.

13. It is well established that the mere making of book entries cannot reflect a payment in the absence of such an agreement.⁵ Book entries record transactions having legal consequences but do not themselves constitute transactions. A unilateral action by one of the parties, such as a mere entry in its books of account, does nothing to change the liabilities between the parties.⁶

14. It is clear from the authorities cited that an entity can 'pay' an amount, in the sense of discharging its liability to another for that amount, by agreeing to set off that liability against a liability the other party has toward it. As emphasised by the courts, for there to be a discharge of the entity's liability by way of this mechanism, it must be demonstrated that:

- (a) mutual liabilities exist; and
- (b) the parties agree, expressly, tacitly or impliedly, to discharge their liability to each other in this way.

15. Mutual liabilities that are set off against each other may include obligations to pay that have arisen from taxable supplies or creditable acquisitions made. The set-off of these obligations, as evidenced by the relevant book entries in the entities' books of account, amounts to payment and is the provision or receipt of consideration for GST purposes

Example 1 – set-off

16. *A Ltd (A) and B Ltd (B) have been providing goods and services to each other. A has made taxable supplies to B that have a GST inclusive value of \$8,000 and B has made taxable supplies to A that have a GST inclusive value of \$12,000. A is liable to B for \$12,000 and B is liable to A for \$8,000. No invoices are issued. They both agree to set off their liabilities to the extent of \$8,000, with A paying by cheque an additional amount of \$4,000.*

17. *Respective book entries are made for the set-off and the receipt and payment of the cheque. All of the amounts owing are considered to have been paid. A has a GST liability for the taxable supplies it has made of 1/11 of \$8,000 and an entitlement to an input tax credit for its creditable acquisitions of 1/11 of \$12,000. B has a GST liability of 1/11 of \$12,000 and an input tax credit entitlement of 1/11 of \$8,000. All of these amounts are attributable to the tax period in which the payments are considered to have occurred.*

⁴ *FC of T v. P Lori & Sons Pty Ltd* 87 ATC 4775; (1987) 19 ATR 201 and in *Lend Lease Corporation Ltd v. FC of T* 90 ATC 4401; (1990) 21 ATR 402.

⁵ *Manzi and others v. Smith and Anor* (1975) 132 CLR 671; *Brookton Co-operative Society Ltd v. FC of T* (1981) 147 CLR 441; 11 ATR 880.

⁶ *Temples Wholesale Flower Supplies Pty Ltd v. FC of T* 91 ATC 4387; 21 ATR 1606.

Line of credit/overdraft

18. Some book entries that evidence either, or both, discharge of the obligation to pay and payment for a taxable supply may not appear to be a set-off, although a set-off has occurred.

19. For these book entries to evidence payment, the supplier and recipient must agree that the corresponding entries are to be the method by which payment is evidenced and that there is to be nothing else (such as funds or other property) provided as consideration for the supplies. The agreement may be written, oral or implied and can only be entered into by the supplier and the recipient or by duly authorised officers.

20. Paragraph 77 of Goods and Services Tax Ruling GSTR 2003/12 gives one set of circumstances in which the Tax Office accepts that book entries are the provision or receipt of consideration for GST purposes. It states:

Line of credit/overdraft

77. Where a supply is made by a supplier who also provides a line of credit or overdraft facility (with interest accruing) to the recipient of the supply, and if the payment for the supply is reflected by an increase in the amount owing in relation to the debt facility, consideration is both provided and received at the time the increase in the debt is recorded in the accounts of the supplier. Whether the line of credit or overdraft is provided by the supplier or another person is immaterial.

21. In this situation, the supplier agrees that, instead of accepting payment directly from the recipient, the supplier will lend the required amount, or arrange for the required amount to be lent, to the recipient. Rather than go through the formality of then advancing those loan moneys to the recipient only to have the recipient immediately return the amount by way of payment for the supply, the parties simply set off the obligation to advance the loan moneys to the recipient against the recipient's obligation to pay for the supply. In this way the recipient's obligation to pay for the supply is discharged and replaced with an obligation to repay the money lent (together with any interest that accrues on the money lent).

22. Paragraph 78 of GSTR 2003/12 goes on to say that where a supply is made on credit (for example, 30 days to pay) consideration is provided when the actual payment is eventually made. In the absence of a line of credit or overdraft facility, the mere recording of an account receivable and account payable in the books of account is not the receipt of consideration for GST purposes. The recipient remains obliged to pay for the supply under the original supply contract.

Set-off and associated entities

23. The requirement that interest accrue on the line of credit or overdraft facility ensures that the agreement to discharge the obligation to pay for the supply, and to reflect payment by making book entries, exists and is genuine. However, to impose the requirement that interest accrue in the case of liabilities arising from supplies made to associated entities would not be commercially realistic.

24. Accordingly, if all of the following conditions are met, the Commissioner regards the act of making book entries as amounting to the provision and receipt of consideration for GST purposes:

- an entity (Entity A) has an obligation to provide consideration to another entity (Entity B) for a taxable supply;

- entities A and B are associates of one another within the meaning of the GST Act and are not members of a registered GST group;
- entities A and B have an agreement (entered into by duly authorised officers) that, instead of Entity A making any payment (whether monetary or non-monetary) in respect of the obligation to Entity B, the entities will dispense with the obligation solely by making corresponding book entries in each entity's books of account;
- the agreement contemplates that, once the entries are made, the obligation to pay for the supply will no longer be recorded as an obligation in either entity's books of account and the statement of financial position of each entity at the end of the relevant financial year will reflect that the obligation has been replaced with an obligation to repay the amount lent to A. (That is, it is not treated as forgiven or otherwise discharged for less than its original amount);
- entity A and Entity B can demonstrate (other than solely by reference to the book entries themselves) the existence of that agreement, which may be written, oral or implied; and
- the book entries are made in accordance with relevant laws and the accounting and professional standards required for accountants in Australia.

Example 2 – set-off and associated entities

25. *A Ltd (A) and B Ltd (B) have a management agreement. The management agreement is not an invoice for the purposes of the GST Act.⁷ B provides management services to A in return for an annual management fee. The fee is based on the gross sales made by A during the year. The value of the fee for the year ended 30 June 2005 is \$15,000. B will lend this amount to A but not go through the formality of advancing the loan moneys and being immediately repaid. Book entries will be made in the books of account of A and B when the fee is quantified after the end of their financial year. A and B agree (separately from the management agreement) to discharge A's obligation to pay B by making retrospective book entries.*

26. *B will credit its revenue account and debit A's loan account to B. Correspondingly, A will credit its loan account to B and debit its expense account. These book entries will amount to payment and be the provision and receipt of consideration for attribution purposes.*

Attribution of GST and input tax credits

27. Under the attribution rules for GST and input tax credits, entities that account for GST on a cash basis are required to attribute to the extent that 'consideration' is received or provided for a taxable supply in a tax period.⁸ Where attribution of GST and input tax credits is made on a non-cash basis, attribution is in the tax period in which any of the consideration is received or provided for the supply or where, if before any consideration is received or provided, an invoice is issued for the supply.⁹ However, the recipient cannot

⁷ See paragraph 30 of Goods and Services Tax Ruling GSTR 2000/34 (which explains what is an invoice for the purposes of the GST Act).

⁸ Subsections 29-5(2) and 29-10(2) of the GST Act.

⁹ Subsections 29-5(1) and 29-10(1) of the GST Act.

attribute an input tax credit unless it holds a tax invoice for the creditable acquisition at the time it gives a GST return to the Commissioner.¹⁰

28. Where book entries amount to the provision or receipt of consideration, we take the view that the consideration is provided and received on the date that the entries are made in the books of account of the entities involved.¹¹ This is the case even if the entries are recorded as having an earlier date of effect such as the end of a financial year.

29. The book entries will normally be made on the same date for each entity, particularly where the same accounting personnel make these entries for both entities. A tax invoice dated with this date will also normally be prepared and issued at this time. Each entity will then attribute GST and input tax credits in accordance with the attribution rules.

Example 3 – attribution of GST and input tax credits

30. *Following on from Example 2, A and B also agree that B will issue a tax invoice at the same time that the retrospective book entries discharging the debt are made. Retrospective book entries are made in the books of account of each entity on 23 September 2005 and a tax invoice for \$15,000 is issued with this date.*

31. *For GST purposes, consideration for the supply of management services is provided by A and received by B on 23 September 2005. GST and input tax credits are attributed to the tax period in which 23 September 2005 falls for each entity.*

32. The book entries should be made concurrently by the entities in their books of account to ensure that the agreement to discharge the obligation to pay is properly reflected at that time. Where the entities do not make the book entries on the same date, then the consideration is regarded as having been provided and received on the later of the two dates that either entity has made the entries in its books of account.

Date of effect

33. This draft Determination represents the preliminary, though considered view of the Australian Taxation Office. This draft may not be relied on by taxpayers or practitioners. When the final Determination is officially released, it will explain our view of the law as it applies from 1 July 2000.

34. The final Determination will be a public ruling for the purposes of section 37 of the *Taxation Administration Act 1953* and may be relied upon, after it is issued, by any entity to which it applies. 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.

35. If the final public ruling conflicts with a previous private ruling that you have obtained, the 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 the final 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 effect of the later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

¹⁰ Subsection 29-10(3) of the GST Act. However, this subsection does not apply if circumstances determined by the Commissioner in writing apply to you.

¹¹ In *Whim Creek Consolidated NL v. Federal Commissioner of Taxation* 77 ATC 4503; 8 ATR 154 Bowen C.J. held that moneys payable for allotment of shares by journal set-off 'were paid and received at the time when the relevant book entries were made.'

Your comments

36. We invite you to comment on this draft Goods and Services Tax Determination. Please forward your comments to the contact officer by the due date.

Due date: **13 August 2004**
Contact officer: **Warren Kennedy**
E-mail address: **warren.kennedy@ato.gov.au**
Telephone: **07 3213 6034**
Facsimile: **07 3213 5055**
Address: **GPO Box 920**
Brisbane QLD 4001

Commissioner of Taxation

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Previous draft:

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- ANTS(GST)A99 48-45
- ANTS(GST)A99 195-1
- ITAA 1936 318
- TAA 1953 37

*Related Rulings/Determinations:*GSTR 1999/1; GSTR 2000/34;
GSTR 2003/12*Case references:*

- Brookton Co-operative Society Ltd v. FC of T (1981) 147 CLR 441; 11 ATR 880
- FC of T v. P Lori & Sons Pty Ltd 87 ATC 4775; (1987) 19 ATR 201
- FC of T v. Steeves Agnew & Co (Vic) Pty Ltd (1951) 82 CLR 408
- Re Harmony and Montague Tin and Copper Mining Co (1873) 8 Ch App 407
- Lend Lease Corporation Ltd v. FC of T 90 ATC 4401; (1990) 21 ATR 402
- Manzi & Ors v. Smith & Anor (1975) 132 CLR 671
- Temples Wholesale Flower Supplies Pty Ltd v. FC of T 91 ATC 4387; 21 ATR 1606
- Whim Creek Consolidated NL v. Federal Commissioner of Taxation 77 ATC 4503; 8 ATR 154

Subject references:

- attribution
- consideration
- creditable acquisitions
- tax invoice
- taxable supply

Legislative references:

- ANTS(GST)A99 29-5
- ANTS(GST)A99 29-5(1)
- ANTS(GST)A99 29-5(2)
- ANTS(GST)A99 29-10
- ANTS(GST)A99 29-10(1)
- ANTS(GST)A99 29-10(2)
- ANTS(GST)A99 29-10(3)
- ANTS(GST)A99 48-40

ATO references

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