GSTD 2013/D2 - Goods and services tax: what are second-hand goods and when are they acquired for the purposes of sale or exchange (but not manufacture) in the ordinary course of business under Division 66 of the A New Tax System (Goods and Services Tax) Act 1999 (GST Act)?

This cover sheet is provided for information only. It does not form part of *GSTD 2013/D2 - Goods and services tax: what are second-hand goods and when are they acquired for the purposes of sale or exchange (but not manufacture) in the ordinary course of business under Division 66 of the A New Tax System (Goods and Services Tax) Act 1999 (GST Act)?*

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Draft Goods and Services Tax Determination

Goods and services tax: what are second-hand goods and when are they acquired for the purposes of sale or exchange (but not manufacture) in the ordinary course of business under Division 66 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)?

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Ruling

1. For the purposes of Division 66 of the GST Act, 'goods' are any form of tangible personal property. Fixtures are not goods, as they are part of the real property to which they are affixed. Determining whether an item is a fixture requires consideration of the degree and object of annexation of the item to land.

2. For the purposes of Division 66 of the GST Act, the term 'second-hand' takes its ordinary meaning. Considering whether goods are second-hand requires a commonsense approach. Goods are 'second-hand' if they have been 'previously used', or are 'not new'. Goods do not become second-hand simply because they were sold by a manufacturer or a distributor before being retailed.

3. Subsection 66-5(1) and paragraph 66-40(1)(a) of the GST Act will be satisfied where an entity that acquires second-hand goods is in the business of **buying and selling** second-hand goods, and the goods are acquired for the purposes of being sold or exchanged in the ordinary course of that business.

4. Also, an entity that carries on a business involving the **leasing and selling** of second-hand goods will satisfy subsection 66-5(1) of the GST Act where:

a. the entity acquired the second-hand goods in the ordinary course of its business;

b. the contractual arrangements under which the second-hand goods were acquired and leased, contemplate that the entity will lease the goods back to the vendor for a defined term and then sell the goods at conclusion of the lease term; and

c. the contractual arrangements provide that the proceeds from selling the second-hand goods will be compared with the residual value agreed upon commencement of the arrangements, in order to determine the extent of any indemnity payable by the lessee, or, entitlement of the lessee to participate in profits from the sale of the goods.[1]

5. Second-hand goods are not acquired for the purposes of sale or exchange in the ordinary course of business simply because there is an intention that the goods will ultimately be sold after they are no longer required.

Example 1

6. *Integrity Co is registered for GST and carries on the business of selling second-hand boats. It acquired a previously used boat from an entity that was not registered, nor required to be registered for GST. Upon its acquisition, the boat became part of the trading stock of Integrity Co. The boat is a second-hand good as it was previously used by the vendor before Integrity Co acquired it. Integrity Co acquired the boat for the purposes of sale or exchange in the ordinary course of its business and satisfies subsection 66-5(1) of the GST Act.*

7. *Integrity Co would have acquired the boat for the purposes of sale or exchange in the ordinary course of business within the meaning of paragraph 66-40(1)(a) of the GST Act, if it carried on the business of selling second-hand boat parts and acquired the boat in order for parts of the boat to become its trading stock.*

Example 2

8. *Fleet Co is registered for GST and purchases, leases, manages and sells second-hand motor vehicles in the ordinary course of its business. Fleet Co acquired a previously used motor vehicle from an entity that was not registered, nor required to be registered for GST. The contractual arrangements under which Fleet Co acquired the motor vehicle required it to lease the vehicle back to the vendor for a fixed term and provided that Fleet Co would take possession of the vehicle at the end of that term and then sell it.*

[1] Even if subsection 66-5(1) of the GST Act is satisfied, entitlement to an input tax credit will only arise if the other requirements of Divisions 11 and 66 are met. Goods and Services Tax Determination *GSTD 2012/6: when an entity makes a taxable supply of second-hand goods by way of lease before making a taxable supply of the goods by way of sale (or exchange), are both taxable supplies taken into account to quantify and attribute input tax credits under Subdivision 66-A of the A New Tax System (Goods and Services) Tax Act 1999?*, explains how input tax credits are quantified and attributed where second-hand goods that are acquired for the purposes of sale or exchange in the ordinary course of business are leased before being sold.

9. *The contractual arrangements under which Fleet Co acquired and leased the motor vehicle also contemplated that the lessee would indemnify Fleet Co, or, become entitled to share in any of its profit from sale of the vehicle. The amount of the indemnity or profit-share depended on the extent to which Fleet Co's sale proceeds for the vehicle differed from the vehicle's residual value. The residual value was calculated and agreed by Fleet Co and the lessee upon acquisition of the vehicle.*

10. *The motor vehicle acquired by Fleet Co is a second-hand good acquired for the purposes of sale or exchange in the ordinary course of business and subsection 66-5(1) of the GST Act is satisfied.*

11. *If the business of Fleet Co was such that second-hand motor vehicles were not sold until returns from leasing ceased being commercially viable, or the terms on which Fleet Co acquired and leased the vehicle did not contemplate that Fleet Co would subsequently sell the vehicle, subsection 66-5(1) of the GST Act would not be satisfied.*

Date of effect

12. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

13. When the final Determination is issued, it is proposed that paragraphs 33 to 41 and 43 to 45F of Goods and Services Tax Ruling GSTR 2005/3 be withdrawn, as the Commissioner's view on what second-hand goods are and when they are acquired for the purposes of sale or exchange in the ordinary course of business under Division 66 will be contained in the final Determination.

Commissioner of Taxation
15 May 2013

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

All legislative references in this Explanation are to the GST Act unless otherwise stated.

Division 66

14. Division 11 contains the basic rules about whether an acquisition is a 'creditable acquisition'. Under section 11-20, an entity is entitled to an input tax credit for any creditable acquisition they make provided the entity satisfies section 11-5. Paragraph 11-5(b) requires that the supply of the thing to the entity is a 'taxable supply' within the meaning of section 9-5.

15. The sale by an unregistered entity of second-hand goods to a GST registered entity is not a taxable supply under section 9-5. As it is not a taxable supply, the acquisition of the second-hand goods by the registered entity is not a creditable acquisition under section 11-5.

16. However, if subsection 66-5(1) is satisfied and the requirements of section 11-5 are otherwise met, the acquisition of second-hand goods by a registered entity will be a creditable acquisition.

17. Subsection 66-5(1) is satisfied if second-hand goods are acquired for the purposes of sale or exchange (but not manufacture) in the ordinary course of business. However, subsection 66-5(1) does not apply if any of the exceptions in subsection 66-5(2) apply.

18. Subsection 66-40(1) deals with acquisitions of second-hand goods that are divided for re-supply. If satisfied, subsection 66-40(1) enables application of a global accounting method to reduce the GST payable when parts of the divided second-hand goods are later supplied.[2] However, subsection 66-40(1) does not apply if an entity makes a single supply of the entirety of the second-hand goods, or if any of the exceptions in subsection 66-40(2) apply.

19. To satisfy subsection 66-40(1), the requirement in paragraph 66-40(1)(a) must be met. Paragraph 66-40(1)(a) requires that second-hand goods are acquired for the purposes of sale or exchange (but not manufacture) in the ordinary course of business.

20. It follows that to be entitled to an input tax credit in accordance with Division 66, there must be an acquisition of 'goods' that are 'second-hand', and the goods must also have been acquired 'for the purposes of the purposes of sale or exchange (but not for manufacture) in the ordinary course of business'.

Meaning of 'goods'

21. Section 195-1 defines 'goods' to mean any form of tangible personal property. Therefore, real property and intangible property are not covered by the definition. Furthermore, fixtures are not goods as they are part of the real property to which they are affixed.

[2] See sections 66-45 and 66-50 of the GST Act.

22. Determining whether an item is a fixture requires consideration of whether it is annexed to the land with the intention of remaining in position permanently or indefinitely or only for some temporary purpose.[3] This requires that the degree and object of annexation be taken into account as well as all other relevant surrounding circumstances.[4]

23. Further, an item may be a fixture even though its annexation is generally by its own weight where, for example, it is placed on the land for integration into a factory system. Even though an item may be able to be removed relatively easily, it will be a fixture if, having regard to all the circumstances mentioned above, the intention is that it should remain permanently or indefinitely on land.[5]

Meaning of 'second-hand' goods

24. Section 195-1 provides that second-hand goods do not include:

a. precious metal;

b. goods to the extent that they consist of gold, silver, platinum, or any other substance which, if it were of the required fineness, would be precious metal; or

c. animal or plants.

25. As the meaning of 'second-hand goods' provided by section 195-1 is not exhaustive, the term takes its ordinary meaning. The ordinary meaning of 'second-hand', depending on its context, contemplates previous use or previous ownership, or both.[6]

26. The expression 'second-hand goods' is similarly defined in the corresponding provisions of the New Zealand GST legislation. The meaning of 'second-hand goods' was discussed in the New Zealand Court of Appeal case of *LR McLean and Company Limited & Ors v. Commissioner of Inland Revenue* [1994] 3 NZLR 33 (*McLean*). Richardson J commented at page 34:

> In ordinary usage the expression refers to goods which have been used, although depending on the context it may apply to goods which are no longer new or even in some contexts goods which have simply been previously owned.

27. Further, McKay J, with whom Gault J agreed, said:

> Although the term can be used of goods that have previously been owned, even if not used, prior ownership does not always have the effect of making goods 'second-hand'.

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[3] *Australian Provincial Assurance Co Limited v. Coroneo* (1938) 38 SR (NSW) 700 at 712 and *Commissioner of State Revenue v. Uniqema Pty Ltd* [2004] VSCA 82 at paragraph [47].

[4] The relevant surrounding circumstances may include State or Territory legislation that modifies the common law regarding fixtures in respect of particular items.

[5] *National Dairies WA Ltd v. Commissioner of State Revenue* [2001] WASCA 112.

[6] Goods and Services Tax Ruling GSTR 2000/8 *Goods and Services Tax: special credit for sales tax paid on stock*, discusses the meaning of second-hand goods at paragraphs 57 to 76 inclusive.

28. This view is consistent with the views of Barber DJ in the New Zealand Taxation Review Authority *Case 1* (1991) 15 TRNZ 617, cited with approval in *McLean's* case, where at page 623 Barber DJ said:

> I consider that there is quite some commonsense flexibility in ascertaining whether a good is still new or has become second hand. I do not regard second ownership as necessarily rendering an item second hand. Many goods pass from manufacturer to wholesaler to retailer to customer or consumer (with other levels of distributors sometimes involved) and yet are not regarded as second hand at the consumer purchase level, even though the item has been used as stock-in-trade at the various distribution levels. The good is not usually regarded as second hand until it has been used for its intrinsic purpose.

29. Consistent with the view in Goods and Services Tax Ruling GSTR 2000/8, *Goods and Services Tax: special credit for sales tax paid on stock*, we consider that second-hand in the context of Division 66 also means 'previously used' or 'not new'. As noted by Barber DJ, usually goods are considered second-hand if they have been used for their intrinsic purpose. Although goods used for another purpose can also be second-hand, goods would not be regarded as second-hand merely because they have been sold by a manufacturer or a distributor before being retailed.

Acquired 'for the purposes of sale or exchange (but not for manufacture) in the ordinary course of business'

30. Subsection 66-5(1) and paragraph 66-40(1)(a) require that second-hand goods are acquired for the purposes of sale or exchange (but not manufacture) in the ordinary course of business.

31. Subsection 66-5(1) and paragraph 66-40(1)(a) will be satisfied where an entity that acquires second-hand goods is in the business of buying and selling second-hand goods, and the goods are acquired for the purposes of being sold or exchanged in the ordinary course of that business.

32. Where an entity carries on a business involving the leasing and selling of second-hand goods, the decisions in *LeasePlan Australia Limited v. Commissioner of Taxation (LeasePlan)*,[7] and *Case* 6/2012[8] are relevant to determining whether second-hand goods are acquired for the purposes of sale or exchange (but not manufacture) in the ordinary course of business.

33. In *LeasePlan* an entity purchased, leased, managed and sold second-hand vehicles in the ordinary course of its business. The entity acquired second-hand vehicles from some of its employees. The contractual arrangements under which the acquisitions were made provided that the entity would lease the vehicles back to the employees, and then sell them at conclusion of the lease.

34. Those contractual arrangements also contemplated that the lessees would indemnify the entity, or, become entitled to share in any profit from the entity's sale of the vehicles.[9] The amount of the indemnity or profit-share depended on the extent to which the sale proceeds differed from a vehicle's residual value. The residual value was calculated and agreed at inception of the sale and lease-back arrangements.[10]

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[7] [2009] FCA 1309.
[8] [2012] AATA 407.
[9] [2009] FCA 1309 at paragraphs [33] and [34].
[10] [2009] FCA 1309 at paragraph [29].

35. The Federal Court accepted that the terms of the contractual arrangements that encompassed these features, and, evidence that an integral aspect of the entity's business involved monitoring potential sale proceeds for the second-hand vehicles that were leased, demonstrated that the entity acquired the vehicles for a purpose of sale in the ordinary course of business, thereby satisfying subsection 66-5(1).[11]

36. Following *LeasePlan,* GSTR 2005/3 was amended by the insertion of the statement that '[t]he Commissioner accepts that lessors that regularly purchase second-hand motor vehicles from unregistered lessees on lease terms that provide for a period of leasing, followed by sale, are entitled to input tax credits on the acquisition of the vehicles under Division 66*'.*[12]

37. In *Case* 6/2012, an entity acquired and then leased second-hand aircraft to numerous lessees continuously throughout a seventeen year period, after which time the aircraft were sold.[13]

38. On the facts before the Administrative Appeals Tribunal, the terms on which the aircraft were acquired did not require the entity to sell the aircraft at the end of a lease. Neither did those terms oblige a lessee to indemnify the entity, or, entitle a lessee to share in any profit, should the entity's sale proceeds for an aircraft differ from a pre-determined residual value.[14]

39. Additionally, the Tribunal found that:

a. there was no evidence to demonstrate that the entity regularly bought and sold second-hand aircraft;[15]

b. the entity held the aircraft for much of their useful lives;[16] and

c. the aircraft were not sold until returns from leasing ceased being commercially viable.[17]

40. These findings led the Tribunal to conclude that the entity did not acquire the second-hand aircraft for the purposes of sale or exchange in the ordinary course of business.[18]

41. We accept the decision in *LeasePlan* that a sole or dominant purpose test does not apply under subsection 66-5(1), but note the concern that the Tribunal had with this construction of subsection 66-5(1) in *Case* 6/2012.[19]

42. The decisions in *LeasePlan* and *Case* 6/2012 illustrate that applying subsection 66-5(1) and paragraph 66-40(1)(a) requires consideration of the circumstances surrounding the acquisition of second-hand goods. Where second-hand goods are acquired for a purpose of leasing, particular focus on the specific terms concerning the acquisition and leasing of the goods, as well as of terms going to any obligation or entitlement of a lessee in consequence of a sale of the goods, is necessary in determining whether subsection 66-5(1) of the GST Act is satisfied. Where all the factors mentioned in paragraphs 38 and 39 are present, an acquisition of second-hand goods does not satisfy subsection 66-5(1).

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[11] [2009] FCA 1309 at paragraphs [46] and [48].
[12] Paragraph 45B of GSTR 2005/3.
[13] [2012] AATA 407 at paragraph [61].
[14] [2012] AATA 407 at paragraph [61].
[15] [2012] AATA 407 at paragraph [61].
[16] [2012] AATA 407 at paragraph [56].
[17] [2012] AATA 407 at paragraph [73].
[18] [2012] AATA 407 at paragraphs [62] and [73].
[19] [2012] AATA 407 at paragraphs [46] to [49].

43. Conversely, we accept that subsection 66-5(1) is satisfied where:

a. an entity acquired second-hand goods in the ordinary course of its business;

b. the contractual arrangements under which the second-hand goods were acquired and leased contemplate that the entity will lease the goods back to the vendor for a defined term and then sell the goods at conclusion of the lease term; and

c. the contractual arrangements provide that proceeds from selling the second-hand goods will be compared with a residual value agreed upon commencement of the arrangements, in order to determine the extent of any indemnity payable by the lessee, or, entitlement of the lessee to participate in profits from the sale of the goods.[20]

44. However, this does not mean that entities are entitled to input tax credits in accordance with Division 66 in all cases where there is an intention that second-hand goods that have been acquired will ultimately be sold.

45. An entity that purchases second-hand goods for use in its enterprise and sells those goods after they are no longer required is not entitled to input tax credits under Division 66.

46. For instance, a tradesperson may purchase a second-hand vehicle (from an unregistered entity) for use in their enterprise but also with a view to selling it at some time in the future. In these circumstances, we are of the view that it would not be accurate to characterise the tradesperson as purchasing the motor vehicle for the purpose of sale or exchange. On these facts, the purpose is to use the vehicle in the enterprise of the tradesperson.

[20] Even if subsection 66-5(1) of the GST Act is satisfied, entitlement to an input tax credit will only arise if the other requirements of Divisions 11 and 66 are met. Goods and Services Tax Determination *GSTD 2012/6: when an entity makes a taxable supply of second-hand goods by way of lease before making a taxable supply of the goods by way of sale (or exchange), are both taxable supplies taken into account to quantify and attribute input tax credits under Subdivision 66-A of the A New Tax System (Goods and Services) Tax Act 1999?*, explains how input tax credits are quantified and attributed where second-hand goods that are acquired for the purposes of sale or exchange in the ordinary course of business are leased before being sold.

Appendix 2 – Your comments

47. You are invited to comment on this draft Determination, including the proposed date of effect for the final Determination, and the proposed partial withdrawal of GSTR 2005/3. Please forward your comments to the contact officer by the due date.

48. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- be published on the ATO website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

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References

Previous draft:

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Related Rulings/Determinations:

TR 2006/10; GSTR 2000/8; GSTR 2005/3; GSTD 2012/6;

Subject references:

- goods and services tax
- GST second hand goods
- input tax credits

Legislative references:

- ANTS(GST)A99 9-5
- ANTS(GST)A99 Div 11
- ANTS(GST)A99 11-5
- ANTS(GST)A99 11-5(b)
- ANTS(GST)A99 11-20
- ANTS(GST)A99 66-5(1)
- ANTS(GST)A99 66-5(2)
- ANTS(GST)A99 66-40(1)
- ANTS(GST)A99 66-40(1)(a)
- ANTS(GST)A99 66-40(2)
- ANTS(GST)A99 66-55
- ANTS(GST)A99 66-50
- ANTS(GST)A99 195-1

Case references:

- Australian Provincial Assurance Co Limited v. Coroneo (1938) 38 SR (NSW) 700
- Case 6/2012 [2012] AATA 407
- Commissioner of State Revenue v. Uniqema Pty Ltd [2004] VSCA 82
- LeasePlan Australia Limited v. Commissioner of Taxation [2009] FCA 1309
- LR McLean and Company Limited & Ors v. Commissioner of Inland Revenue [1994] 3 NZLR 33
- National Dairies WA Ltd v. Commissioner of State Revenue [2001] WASCA 112
- New Zealand Taxation Review Authority Case 1 (1991) 15 TRNZ 617

ATO references

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