GSTD 2013/D3 - Goods and services tax: can the consideration the supplier provides for acquiring capital items be included in calculating whether a supply is GST-free under subparagraph 38-250(2)(b)(ii) of the A New Tax System (Goods and Services Tax) Act 1999?

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This document has been finalised by GSTD 2013/4.

There is a Compendium for this document: **GSTD 2013/4EC** .

Draft Goods and Services Tax Determination

Goods and services tax: can the consideration the supplier provides for acquiring capital items be included in calculating whether a supply is GST-free under subparagraph 38-250(2)(b)(ii) of the *A New Tax System (Goods and Services Tax) Act 1999*?

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This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

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Ruling

1. Yes. A portion of the consideration the supplier has provided for acquiring capital items that diminish in value over time can be included when calculating whether a supply in that period is GST-free under subparagraph 38-250(2)(b)(ii) of the *A New Tax System (Goods and Services Tax) Act 1999*,[1] where the capital items are utilised in making the supply.

2. To work out the amount of the consideration that can be included in the calculation, a supplier should apply any reasonable methodology that reflects the proportion of the capital costs that relate to each supply made. Capital costs cannot be double-counted in determining whether subparagraph 38-250(2)(b)(ii) applies to the various supplies made by the entity.

[1] All legislative references in this Determination are to the *A New Tax System (Goods and Services Tax) Act 1999* unless otherwise stated.

Example 1 – proportion of capital costs that relates to each supply

3. ABC Zoo, an endorsed charitable institution, spent $2 million in constructing animal enclosures in its zoo. ABC Zoo reasonably expects that the enclosures will be used for 20 years and will be equally relevant to zoo admissions throughout the expected life of the enclosures. The enclosures are not expected to have any residual value after 20 years.

4. In working out the portion of the construction cost to be allocated to the supply of each admission, a methodology would be for ABC Zoo to spread the capital cost of the enclosures equally across 20 years representing the expected life of the enclosures and to allocate $100,000 of the cost of the enclosure to each year, or $25,000 for a quarterly tax period.

5. If it is expected that the number of admissions is 100,000 in a quarterly tax period, the portion of the consideration for the enclosures that is included in the cost of each admission would be $0.25 ($25,000 / 100,000).

Example 2 – seasonal variations in supplies

6. Following on from example 1, if the supplies of admission to the zoo vary on a seasonal basis such that 40% of annual supplies are made in the January to March tax period, and 20% of supplies made in other tax periods, it would instead be appropriate to spread the $100,000 annual capital cost such that $40,000 is allocated to supplies in the January to March tax period, and $20,000 in the other periods.

Date of effect

7. 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).

8. The Commissioner will not take compliance action to treat as taxable supplies, supplies that were treated as GST-free before the date of this draft Determination because the full capital cost was taken into account in the tax period or year in which the capital acquisition was made.

9. When the final Determination is issued the Commissioner will amend relevant paragraphs of the charities consultative committee resolved issues document to ensure that the document is consistent with the Determination.

Commissioner of Taxation
29 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.

Background

10. The operation of section 38-250 is considered in detail in sections A and E of Part 3 of the charities consultative committee resolved issues document (CCCRID). The CCCRID is published on the ATO website, and is labelled as a public ruling.

11. The CCCRID states that depreciation of assets cannot be taken into account for the purposes of subparagraph 38-250(2)(b)(ii), as it does not involve an actual outlay by the charity. It is silent, however, on whether capital costs are excluded from the calculation under subparagraph 38-250(2)(b)(ii) altogether, or should be taken into account in another manner.

12. This draft Determination expands the CCCRID by providing the Commissioner's view on whether capital costs should be included in calculating the consideration the supplier provided for acquiring the thing supplied.

13. The CCCRID will be amended to ensure consistency with this draft Determination when it is published in final form.

Explanation

14. Subparagraph 38-250(2)(b)(ii) provides that a supply (that is not a supply of accommodation) made by an endorsed charitable institution is GST-free if the supply is for consideration that is less than 75% of the consideration the supplier provided, or was liable to provide (the consideration provided), for acquiring the thing supplied.

Application of subparagraph 38-250(2)(b)(ii) to supplies other than goods

15. It is possible to interpret subparagraph 38-250(2)(b)(ii) narrowly such that it only applies where the thing acquired is identical to the thing supplied. This interpretation is suggested by the phrase 'acquiring the thing supplied'. However, the Commissioner has a longstanding view that subparagraph 38-250(2)(b)(ii) can apply to any sort of supply other than accommodation, and that it is not a requirement for there to be exact identity between the thing acquired and the thing supplied.

16. Close attention to the structure of subparagraph 38-250(2)(b)(ii) provides some support for the broader construction. Paragraph 38-250(2)(b) is divided into subparagraphs (i) and (ii). Subparagraph (i) applies 'if the supply is a supply of accommodation', whereas subparagraph (ii) applies 'if the supply is not a supply of accommodation'. It therefore appears that subparagraph (ii) was intended to apply to ***all supplies*** other than accommodation. The words of subparagraph (ii) that follow then provide a formula for determining whether such a supply is GST-free. Objectively, it would appear unlikely that the words 'acquiring the thing supplied' used in the formula were intended to modify the scope of the subparagraph set by the phrase 'if the supply is not a supply of accommodation'.

17. Further, the term 'thing' is defined in section 195-1 to mean 'anything that can be supplied or imported'. Accordingly, the use of the word 'thing' does not narrow the application of subparagraph 38-250(2)(b)(ii) to supplies of physical things. In other contexts, the word 'goods' is used in provisions which are intended to be limited to supplies of goods. [2]

18. The purpose of section 38-250, expressed in the most general terms, is to make non-commercial supplies by charities GST-free.[3] There is nothing in this purpose which would suggest a restriction on the class of supplies to which subsection 38-250(2) applies. A narrower interpretation of subparagraph 38-250(2)(b)(ii) would restrict the operation of the provision substantially and would not include most supplies by charities. However, there is no evidence in the legislation or other extrinsic materials suggesting such a narrow scope.

19. The Commissioner acknowledges that the broader view has some difficulties and that the narrower view in some respects is more closely in alignment with the text of the provision. Nevertheless, the Commissioner considers that the broader view is arguable and that the better approach is not to disturb this longstanding ATO view.

20. Accordingly, the reference to 'acquiring' in the phrase 'acquiring the thing supplied' in subparagraph 38-250(2)(b)(ii) is interpreted as including acquisitions of things that are on-supplied, the acquisition of those things used up in providing services or manufacture and acquisitions of things that are 'used' in combination in making a supply of something else, for example, admissions to zoos, museums or entertainment venues.

Should the consideration for capital items used in making the supply be taken into account?

21. The CCCRID states:

> When working out the cost of providing something, a charity should include:
>
> - all direct costs incurred – for example, materials and direct labour, and
> - a reasonable apportionment of indirect costs incurred – for example, marketing, administration, office expenses, electricity, telephone and insurance.

22. The CCCRID says that depreciation of assets cannot be taken into account as it does not involve an actual outlay by the charity. Whilst the CCCRID excludes depreciation, it does not expressly state whether capital costs are excluded altogether, or should be taken into account in another manner (for example, taken into account upfront, rather than being depreciated over time).

23. Once it is accepted that a reasonable portion of indirect costs should be taken into account in determining the consideration the supplier provided for acquiring the thing supplied, there is no reason in principle to exclude capital costs. For example, with a zoo admission, the visitor's experience is a combination of the animals, the enclosures, the parks and gardens and other facilities. In making the supply of a zoo admission the entity needs to acquire these and other things. These things are not 'on supplied' to the visitors of the zoo. Rather, they are 'used' by the entity to make a supply of a zoo admission.

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[2] See, for example, sections 38-97, 38-185, 38-187, 38-255, 66-5, 78-60 and 79-85

[3] See paragraphs 5.98 and 5.99 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.

24. The things used to make the supply may include acquisitions that are consumed at or about the time they are acquired (such as animal feed and services of zoo keepers) and acquisitions of capital items (such as buildings, or plant and equipment) that may be used over a substantial period of time.

25. The principle is not limited to supplies of admission, but has equal application to other types of supplies, including supplies of services.

26. Where the supplier uses something it has acquired to make a supply, 'the consideration the supplier provided' is generally the price paid by the supplier for the item. Where such an item is used in making multiple supplies, then for each supply the consideration provided is only a proportion of the price paid. This proportion equals the proportion of the item used to make those supplies.

27. Because land does not tend to decline in value over time and is not in any sense 'used up' in making the supply, the Commissioner considers that consideration for the acquisition of land cannot be taken into account in applying subparagraph 38-255(2)(b)(ii), other than in relation to the sale of that land.

How should consideration for capital items used in making the supply be apportioned?

28. The CCCRID, in the section titled *Non-commercial activities of charities, cost of supply and market value tests*, provides a methodology for working out the 'cost of providing a supply' for purposes of subparagraph 38-250(2)(b)(ii). It states that when applying the cost of supply test, entities can include all direct costs and a reasonable apportionment of indirect costs. However, costs used must be real costs.

29. A reasonable methodology must be adopted to allocate capital costs to the supplies that are made. Where an entity uses a capital item to make supplies in a period, the methodology must reflect the extent the capital item is utilised in making the supply. This proportion can be worked out by using any methodology that can reasonably reflect the extent the capital item is expended in making the supply. However, it would not be reasonable to adopt a methodology that results in the same capital costs being taken into account more than once – any methodology should not lead to double-counting.

30. In some cases an appropriate methodology would be to take into account the depreciation amount for the capital item and spread that depreciation amount across the supplies made in respect of that asset during the tax period. For example, if a capital item acquired on 1st July has a useful life of ten years with no residual value, the consideration provided in that year for acquiring the item is 1/10th of the cost of the item. That cost would then need to be spread over the supplies that the item is used for in that year. Where a capital item is only partly used to make supplies, the consideration provided would need to be apportioned further to take into account the proportion of the item used to make those supplies.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.

Alternative view that disregards consideration provided for the acquisition of capital items where they are not consumed or disposed of in making the supply

31. An alternative view is that subparagraph 38-250(2)(b)(ii) cannot apply to acquisition consideration for capital items that are used in making a supply because the language of subparagraph 38-250(2)(b)(ii) envisages that on making the relevant supply the charity will cease to hold the thing that was acquired.

32. The drafting of subparagraph 38-250(2)(b)(ii) is more obviously applicable to the circumstance where a thing is acquired and that thing is then disposed of by way of supply. Although it is accepted that subparagraph 38-250(2)(b)(ii) can apply to a broader range of supplies, the requirement that there be a supply of a thing acquired might be construed as limiting the types of acquisitions to ones that are either effectively consumed or used up in the process of making the supply, or otherwise subsumed into the thing supplied. This interpretation emphasises the words 'acquiring the thing supplied'. Capital items have enduring use and value after the relevant supply is made, and they are not subsumed into the making of the supply.

33. On this view, consideration for acquiring the thing supplied could include consideration for services that are consumed directly or indirectly in making the supply, as well as goods that are consumed or incorporated into the thing supplied. However, it would not include consideration for things acquired which the entity can still use after the supply has been made.

34. However, in effect capital items are gradually used up in making supplies. On balance the Commissioner considers that the better construction of subparagraph 38-250(2)(b)(ii) is that consideration for all inputs into a supply should be taken into account, but subject where appropriate to a reasonable apportionment.

Appendix 3 – Your comments

35. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

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.

Due date:	**26 June 2013**
Contact officer:	**Grant Murphy**
Email address:	**grant.murphy@ato.gov.au**
Telephone:	**(07) 3213 5707**
Facsimile:	**(07) 3213 5873**
Address:	**Terrica Place, 140 Creek St, Brisbane, QLD, 4000**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

Charities Consultative Committee Resolved Issues Document
TR 2006/10

Subject references:

- charities
- goods and services tax
- GST-free supplies
- nominal consideration

Legislative references:

- ANTS(GST)A 38-97
- ANTS(GST)A 38-185
- ANTS(GST)A 38-187
- ANTS(GST)A 38-250
- ANTS(GST)A 38-250(2)
- ANTS(GST)A 38-250 (2)(b)(i)
- ANTS(GST)A 38-250 (2)(b)(ii)
- ANTS(GST)A 38-255
- ANTS(GST)A 66-5
- ANTS(GST)A 78-60
- ANTS(GST)A 79-85
- ANTS(GST)A 195-1

Other references:

Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998

ATO references

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