GSTD 2014/D4 - Goods and services tax: is the supply of brokerage services that facilitates the sale or purchase of financial products on overseas securities or futures exchanges, a GST-free supply under paragraph (a) of item 4 in the table in subsection 38-190(1) of the A New Tax System (Goods and Services Tax) Act 1999 (GST Act)?

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There is a Compendium for this document: **GSTD 2015/1EC** .

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Draft Goods and Services Tax Determination

Goods and services tax: is the supply of brokerage services that facilitates the sale or purchase of financial products on overseas securities or futures exchanges, a GST-free supply under paragraph (a) of item 4 in the table in subsection 38-190(1) of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)?

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Ruling

1. Yes. The supply of brokerage services that facilitates the sale or purchase of financial products on overseas securities or futures exchanges is a GST-free supply under paragraph (a) of item 4 in the table in subsection 38-190(1) of the GST Act (Item 4).

2. For the purposes of this draft Determination:

- The broker supplies services to clients that facilitate the sale or purchase of financial products on overseas securities or futures exchanges.
- The terms 'sale or purchase' and 'traded' includes equivalent dealings in financial products that require brokerage services, such as opening, closing-out, cash settling, or exercising a right in relation to a financial product.
- Financial products are tradable rights having a financial character and include shares, debt instruments, options, warrants, derivatives, futures contracts, exchange traded funds, and interests in unit trusts. They do not include products involving supplies of goods or real property.

Example 1

3. *Fantastic Brokerage carries on an enterprise in Australia and supplies brokerage services to an Australian resident client who is purchasing shares on an overseas securities exchange.*

4. *The brokerage services supplied by Fantastic Brokerage are a supply made in relation to rights as they facilitate a dealing in the rights that constitute the share. As the shares are purchased on an overseas securities exchange, the rights in the shares are for use where the exchange is located.*

5. *Therefore, the supply of brokerage services by Fantastic Brokerage is a supply that is made in relation to rights that are for use outside Australia. Accordingly, the supply of brokerage services is GST-free under Item 4.*

Example 2

6. *Norved Single Origin Beans (Norved) is an Australian coffee roaster who buys its green coffee beans at the prevailing world price. It uses deliverable Arabica coffee bean futures that are traded on an overseas futures exchange to hedge its exposure to the world coffee price. Norved uses Helpful Hedger Co to provide brokerage services to facilitate opening and closing-out of its futures positions.*

7. *Norved decides that coffee prices are likely to rise, so it buys (long position) a coffee beans futures contract to lock in a particular price. Entry into the futures contract involves a supply in relation to rights for the purposes of Item 4. Norved may request that Helpful Hedger closes-out the open position on the overseas exchange near the expiry date. Alternatively, Norved will hold the contract until expiry, at which time the overseas futures exchange will match Norved to a specific seller to complete a sale of goods. As the use of the rights is on the overseas futures exchange, the rights in the futures contract are for use outside Australia.*

8. *Therefore, the brokerage services provided by Helpful Hedger Co to facilitate opening or closing the futures contract position is a supply in relation to rights that is GST-free under Item 4.*

Date of effect

9. 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).

Commissioner of Taxation
29 October 2014

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. This draft Determination sets out the Commissioner's views regarding how Item 4 applies to specific brokerage services. The application of Item 4 is considered more broadly in Goods and Services Tax Ruling GSTR 2003/8.

Supplies in relation to rights that are for use outside Australia

11. Item 4 relevantly provides that 'a supply that is made in relation to rights' is GST-free 'if… the rights are for use outside Australia'. Paragraph (b) of Item 4 is not considered in this draft Determination. Subsection 38-190(2) of the GST Act will not apply as brokerage services are a supply of a service not a supply of a right or an option to acquire something.

12. GSTR 2003/8 explains[1] that a supply of a thing is a 'supply that is made in relation to rights' if it fits within one of three categories. Category 3 refers to services directly connected with rights. If a dealing or exercise in a particular financial product on an overseas securities or futures exchange (overseas exchange) is one of rights, then the brokerage services that facilitate that dealing or exercise are directly connected to those rights.[2]

Are the specified financial products rights or a bundle of rights?

13. To establish if brokerage services relating to a particular financial product is a supply in relation to rights, it needs to be determined if the essential character or substance of a dealing in a financial product is one of rights.[3] This will be satisfied if a supply of the financial product can be characterised as a supply of rights (Category 1) or a supply of a thing where the value is exclusively or almost exclusively a bundle of rights (Category 2).[4] The rights must be more than incidental, for example rights in an executory contract may contribute to the supply but cannot be identified as the dominant part of the supply.[5]

14. Due to the financial character of financial products that are listed on overseas securities and futures exchanges, any dealings in those products are considered to be in rights. The following examples illustrate this:

- A share will give rise to contractual rights and obligations between the shareholder and the company.
- Debt instruments give rise to a chose in action against the debtor for repayment of the principal and other rights to periodic payments. For example bonds, debentures, floating rate notes, exchange traded notes.

[1] At paragraph 27A onwards.
[2] In the same way as brokerage services in relation to the sale of shares at paragraph 79A of GSTR 2003/8.
[3] Paragraphs 69 and 78 of GSTR 2003/8.
[4] See paragraphs 64 and 73 of GSTR 2003/8.
[5] Paragraph 70 of GSTR 2003/8.

- Listed options and warrants and other derivatives where a right can be exercised that results in delivery of another financial product. For example, put and call options over shares, options over futures.
- Non-deliverable cash settled derivatives are an exchange of rights and obligations. For example, futures contracts over share price indexes or interest rates and listed contracts for difference.
- Exchange-traded funds that utilise a company or trust structure.[6]

Futures

15. Deliverable commodity futures contracts are an agreement to buy or sell the underlying goods. The commercial or business purpose of the futures market, discerned objectively,[7] is trading in the contracts themselves[8]. It is considered in the context of Item 4, that the essential character of a deliverable commodity futures contract, at the time that brokerage services are provided in opening or closing the position, is in the rights (to make or take delivery of the underlying goods) in the contract. This is the case even if the client intends to hold the contract until delivery is required.[9]

Are the rights for use outside of Australia?

16. The remaining requirement to establish that a supply of brokerage services will be GST-free under Item 4, is to determine if the rights in the financial products are for use outside Australia. It is the intended use of those rights that is relevant to determine where the rights are for use.[10]

Brokerage services when purchasing a financial product

17. Given the varied nature of financial products, a client may intend to use the rights for various purposes, such as trading or reselling the financial product, exercising the rights in the financial product, or holding the product as an investment.

18. When financial products are acquired with the intention of reselling them on an overseas exchange, or the essential character of the product is to exercise a right (for example options and warrants) on an overseas exchange, the rights are for use outside Australia.

19. When financial products are acquired without the client having any immediate intention to exercise or resell them, other factors may be relevant. In considering the nature of the rights in the financial products and the surrounding circumstances, the jurisdiction where the relevant rights would be exercised or enforced, combined with the product being listed on an overseas securities or futures exchange, are relevant factors for determining if the rights are for use outside Australia.[11]

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[6] *CPT Custodian Pty Ltd v. Commissioner of State Revenue* [2005] HCA 53 at 39 where units in a unit trust were described as 'discrete bundles of rights'.
[7] *ATS Pacific Pty Ltd v. Commissioner of Taxation* [2014] FCAFC 33 at 29.
[8] *Sydney Futures Exchange Limited v. Australian Stock Exchange Limited* [1995] 128 ALR 417 at 470.
[9] If an entity holds a futures contract until expiry the subsequent supply of goods will be a separate supply between that entity and the relevant counterparty. This separation is supported by Items 7 and 8 in the table in Regulation 40-5.12 of the *A New Tax System (Goods and Services Tax) Regulations 1999*.
[10] Paragraph 108A of GSTR 2003/8.
[11] Such an approach is generally consistent with the common law rules for determining where such intangible assets are located, see for example paragraph 105 of TR 2008/9.

20. It is accepted that a broker may face the following practical difficulties in determining the use of the financial product to which the brokerage services relate:

- Brokerage services may involve high volume transactions with minimal client interaction; therefore the ability to obtain specific information about a client's intended use for a specific transaction is limited.
- Financial products listed on overseas exchanges may be subject to materially different legal systems and regulatory frameworks. This makes it difficult for a broker to characterise the rights and their use for each specific product.

21. When a client buys a financial product on an overseas exchange the location of the overseas exchange determines where the rights in the financial product are for use. Therefore, a supply of brokerage services to purchase a financial product on an overseas securities or futures exchange is GST-free.[12]

Brokerage services when selling the financial product

22. When a client is acquiring brokerage services to sell a financial product on an overseas exchange, the rights will be for use by the subsequent purchaser, not the broker's client.[13] It is accepted that it is generally not possible for the broker to identify the purchaser and their use of the financial product.

23. When a client sells a financial product on an overseas exchange, the new purchaser will be considered to have acquired the rights in the financial product for use outside Australia.[14] Therefore, the supply of brokerage services to sell a financial product on an overseas securities or futures exchange is GST-free.

[12] Where products are unlisted or over the counter products that are not bought and sold on an exchange, the location of the exchange is not a relevant factor and this draft Determination doesn't apply.

[13] This is consistent with *Travelex Ltd v. Commissioner of Taxation* [2010] HCA 33 at 35, where the seller of the currency was required to look to the purchaser's intention to spend the currency in Fiji, rather than how the seller had used the rights prior to selling them. Where the nature of the product is that it no longer exists once sold or closed-out by the seller, the rights are for use at the exchange where the transaction occurred.

[14] This is consistent with the practical application of Item 2 in the table in subsection 38-190(1) to exchange-traded financial products in paragraph 168 of GSTR 2002/2.

Appendix 2 – Your comments

24. 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.

25. 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:	**28 November 2014**
Contact officer:	**John Gill**
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Telephone:	**(03) 9215 3742**
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; TR 2008/9; GSTR 2003/8; GSTR 2002/2

Subject references:

- financial Instruments
- goods and services tax
- GST financial supplies
- GST free
- rights for use outside Australia

Legislative references:

- ANTS(GST)A 1999 38-190(1)
- ANTS(GST)A 1999 38-190(2)
- ANTS(GST)R 1999 40-5.12

Case references:

- Travelex Ltd v. Commissioner of Taxation (2010) 241 CLR 510; [2010] HCA 33; 2010 ATC 20-214; (2010) 76 ATR 329
- CPT Custodian Pty Ltd v. Commissioner of State Revenue (2005) 224 CLR 98; [2005] HCA 53; 2005 ATC 4925; (2005) 60 ATR 371
- ATS Pacific Pty Ltd v. Commissioner of Taxation [2014] FCAFC 33; 2014 ATC 20-449
- Sydney Futures Exchange Limited v. Australian Stock Exchange Limited [1995] FCA 1106; [1995] 128 ALR 417

ATO references

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