


***GSTR 1999/D8 - Goods and Services Tax:
determining the extent of creditable purpose for
claiming input tax credits and for making
adjustments for changes in extent of creditable
purpose***

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There is an Erratum notice for this document.
This document has been finalised.



Draft Goods and Services Tax Ruling

Goods and Services Tax: determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose

| Contents | Para |
|--|------|
| What this Ruling is about | 1 |
| Date of effect | 8 |
| Background | 9 |
| Ruling | 13 |
| Explanations (this forms part of the Ruling) | 24 |
| Definitions | 112 |
| Your comments | 127 |
| Detailed contents list | 128 |

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 taxation officers, taxpayers and practitioners, as it is not a ruling or advice in terms of section 37 of the **Taxation Administration Act 1953**. When officially released it will be a public ruling for the purposes of section 37 and may be relied upon by any person to whom it applies.*

What this Ruling is about

1. This Ruling explains the Commissioner's view on the meaning of 'creditable purpose' in Divisions 11, 15 and 129 of *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act'). Unless otherwise stated, all legislative references in this Ruling are to this Act.
2. Certain terms used in this Ruling are defined or explained in the Definitions section of the Ruling. These terms, when first mentioned elsewhere in the body of this Ruling, will appear in **bold** type.
3. The Ruling also explains several possible methodologies for determining the extent of creditable purpose. These methodologies will be useful for the correct calculation of **input tax credits** in respect of acquisitions and importations, and also for calculating any later **adjustments** for change in extent of creditable purpose.
4. Under proposed amendments to the GST Act, the Commissioner may determine ways in which to work out the extent to which a creditable acquisition or creditable importation is for a creditable purpose.¹ This draft Ruling is not a determination under those provisions. It seeks to explain the Commissioner's view on the

¹ *A New Tax System (Indirect Tax and Consequential Amendments) Bill No 2, Schedule 1 sections 3A and 3B* – as at 17 December 1999, this Bill is awaiting Royal Assent.

GSTR 1999/D8

operation of the law, in the absence of such a determination. Your views will be taken into account in finalising this Ruling and in formulating any determinations ultimately made by the Commissioner relating to the extent of creditable purpose generally, and in specific situations such as the use of motor vehicles.

5. This Ruling applies to all entities registered for the Goods and Services Tax ('GST') or required to be registered that make claims for input tax credits.

6. The 'extent of creditable purpose' is one of the several criteria used in determining eligibility for input tax credits for acquisitions and importations. This Ruling does not consider the other requirements of sections 11-5 and 15-5 for eligibility for input tax credits.

7. This Ruling does not cover the situation where input tax credits need to be apportioned because your annual turnover of **financial supplies** exceeds the **financial supplies threshold** and you also make **taxable supplies** or **GST-free supplies**. Apportionment of input tax credits relating to financial supplies exceeding the financial supplies threshold will be dealt with in a publication specifically covering financial supplies. Nevertheless, the general principles discussed in this Ruling will have relevance to all acquisitions and importations, including those used to make financial supplies.

Date of effect

8. This Ruling, when finalised, will apply on and from 8 July 1999 (the date of Royal Assent to the GST legislation).

Background

9. If you are registered or required to be registered, GST is payable by you on the taxable supplies that you make. However, you may be entitled to input tax credits for the GST included in the price of things you acquire for your enterprise and for the GST paid on importations.

10. When you first claim an input tax credit for an acquisition or importation, the amount of credit you are entitled to depends on how your planned use of the acquisition or importation in your enterprise compares to the total use. This is the extent of your creditable purpose. The amount of your entitlement to an input tax credit is reduced if the thing is only partly for a creditable purpose. For example, if you acquire a computer which you plan to use 60% in your enterprise for a creditable purpose, you are entitled to claim 60%

of the full input tax credit. The extent of your creditable purpose is 60%.

11. However, because your actual use may vary from your intended use over time, you may have to make an **adjustment** to make sure you have not claimed too much or too little input tax credit. This means you need to work out the extent to which you actually used the acquisition or importation for a creditable purpose.

12. Your **net amount** is the difference between the GST payable by you and your input tax credits. This amount must be paid to, or refunded by, the Commissioner.² Adjustments are either increasing or decreasing. An increasing adjustment increases your net amount for the tax period, while a decreasing adjustment decreases your net amount for the tax period. You include these amounts on your **GST return**.

Ruling

13. In order to claim the correct amount of input tax credits, you will need to adopt an appropriate basis for determining the extent of creditable purpose for your acquisitions and importations. (See paragraph 63.)

14. Where the extent to which an acquisition or importation is subsequently applied for a creditable purpose differs from the planned extent, you need an appropriate basis for calculating the extent of that change of use. (See paragraph 64.)

15. Where the extent of creditable purpose is and remains at 100% of the total purpose, no apportionment is necessary. (See paragraphs 24 to 29.)

16. Where the extent of creditable purpose is less than 100%, you need to apportion the total purpose between that which is creditable and that which is not. (See paragraphs 24 to 29.)

17. Where the extent of creditable purpose is and remains at zero, you are not entitled to any input tax credits. (See paragraphs 24 to 29.)

18. The apportionment method you choose should use information regarding the actual application of the expenditure where it is possible to do so. If this is not possible or practicable, you should use some other fair and reasonable basis. (See paragraph 68.)

² Subsection 33-5(1) and section 35-5. (Note: if the net amount is a refund it may be offset against other amounts payable to the Commissioner.)

GSTR 1999/D8

19. Where practicable, you should use a direct apportionment method. If this is not practicable, we will accept an indirect method. (See paragraph 71.)
20. You make an acquisition or importation ‘in carrying on your enterprise’ if it is made in the course of conducting your enterprise, including during the commencement or termination of that enterprise. (See paragraphs 38 to 43.)
21. When Miscellaneous Taxes Ruling MT 1999/D1 is finalised, the parts of it that explain the definition of ‘enterprise’ under section 38 of the *A New Tax System (Australian Business Number) Act 1999* (‘ABN Act’) will reflect the Commissioner’s interpretation of the definition of ‘enterprise’ under section 9-20 of the GST Act. (See paragraph 44.)
22. The views expressed by the Courts and by the Commissioner in Taxation Rulings, in relation to the words ‘private or domestic’ in subsection 51(1) of the *Income Tax Assessment Act 1936* (‘ITAA 1936’) and section 8-1 of the *Income Tax Assessment Act 1997* (‘ITAA 1997’), are relevant for determining the meaning of those words in paragraphs 11-15(2)(b), 15-10(2)(b) and 129-50(2)(b). (See paragraph 62.)
23. If you make a **creditable acquisition** or **creditable importation**, you must keep records that show and explain all transactions and other acts you engage in that are relevant to that acquisition or importation. This includes records of your calculation of your input tax credits and net amount. (See paragraphs 110 and 111.)

Explanations (this forms part of the Ruling)

Entitlement to input tax credits for acquisitions and importations

24. You are entitled to input tax credits in respect of any ‘creditable acquisition’ or ‘creditable importation’ that you make.³
25. One of the requirements for an acquisition or importation to be creditable, is that it be made solely or partly for a ‘creditable purpose’.⁴
26. The meaning of ‘creditable purpose’ is stated in the same terms for both acquisitions and importations in the GST Act. It requires you to consider both of the following conditions:⁵

³ Sections 11-20 and 15-15.

⁴ Sections 11-5 and 15-5.

⁵ Sections 11-15 and 15-10.

- (i) you acquire a thing or import goods for a creditable purpose to the extent you do so in carrying on your enterprise;
- (ii) you do not acquire a thing or import goods for a creditable purpose to the extent that:
 - (a) the acquisition or importation relates to making supplies that would be input taxed;⁶ or
 - (b) the acquisition or importation is of a private or domestic nature.

27. However, an acquisition or importation can still be fully creditable if the only non-creditable use is the making of financial supplies not exceeding the financial supplies threshold.

Acquisitions and importations that are only partly creditable

28. Your entitlement to an input tax credit is reduced if the acquisition or importation is partly creditable.⁷ An acquisition or importation is partly creditable if it is made only partly for a creditable purpose.⁸ In addition, an acquisition (but not an importation) is partly creditable if you provide, or are liable to provide, only part of the consideration for the acquisition.⁹

29. When an acquisition or importation is partly creditable because it is only partly for a creditable purpose, the amount of input tax credit to which you are entitled depends on the extent of creditable purpose expressed as a percentage of the total purpose of the acquisition or importation.¹⁰

Calculating input tax credits

30. Formulae are specified in the GST Act for the calculation of input tax credits for acquisitions and importations. A different formula is specified for importations, as the extent to which consideration is provided is not relevant for importations. The formulae are:¹¹

For acquisitions:

⁶ Excluding financial supplies made through an enterprise or part of an enterprise carried on outside Australia: subsection 11-15(3).

⁷ Sections 11-25 and 15-20.

⁸ Sections 11-30 and 15-25. The *A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999* proposes to repeal these sections and insert similar provisions in sections 11-15 and 15-10. As at 17 December 1999, this Bill is awaiting Royal Assent.

⁹ Paragraph 11-30(1)(b).

¹⁰ Subsections 11-30(3) and 15-25(3).

¹¹ Subsections 11-30(3) and 15-25(3).

GSTR 1999/D8

Full input tax credit x Extent of creditable purpose x Extent of consideration

For importations:

Full input tax credit x Extent of creditable purpose

31. The extent of creditable purpose is expressed as a percentage of the total purpose. Therefore, in order to claim the correct amount of input tax credits, you need to be able to determine the extent to which acquisitions and importations are made for a creditable purpose.

When extent of creditable purpose changes after acquisition or importation

32. After an acquisition or importation is made, the extent to which it is actually applied for a creditable purpose may be different from the planned use. This means that the original input tax credit claimed may have been too much or not enough.

33. In these situations, under the GST Act, adjustments may be required in subsequent tax periods called **adjustment periods**.¹² Any adjustments will affect the net amount payable to or refundable by the Commissioner. The number of adjustment periods you have for an acquisition or importation depends on the GST-exclusive value of consideration for it. We explain this in the table below:¹³

| GST-exclusive value of consideration for the acquisition or importation | Number of adjustment periods |
|--|-------------------------------------|
| \$1,000 or less | None |
| \$1,001 to \$5,000 | Two |
| \$5,001 to \$499,999 | Five |
| \$500,000 or more | Ten |

34. The formula for calculating the adjustment requires you to calculate your actual application for a creditable purpose as a percentage of total application. If this is the first adjustment you are making for the acquisition or importation, you calculate your change in extent of creditable purpose by comparing your actual application

¹² Division 129 of the GST Act provides for adjustments for change in extent of creditable purpose. We will explain the operation of this Division in another publication.

¹³ Sections 129-10(2) and 129-20(3). The adjustment periods in the table above are for acquisitions and importations that do not relate to business finance. Acquisitions relating to business finance relate solely or partly to making financial supplies and are not solely or partly of a private or domestic nature: see section 129-10.

with your planned use at the time you claimed original input tax credit. However, if you have previously made an adjustment for the changed use of the acquisition or importation, you calculate the subsequent change by comparing the actual application with the former application used when making that previous adjustment. Therefore, you need to calculate your actual application for creditable purposes. You calculate the adjustment as follows:

$$\text{Full input tax credit} \quad \times \quad \text{Change in extent of creditable purpose}$$

Whether the adjustment is increasing or decreasing depends on whether the extent of creditable purpose has increased or decreased.

35. The actual application is measured from the time of acquisition up until the end of each adjustment period. This means that the calculation of creditable purpose is a cumulative one, starting at the point of acquisition and ending at the end of the relevant adjustment period.

36. However, you do not have an adjustment under Division 129 for acquisitions or importations to which the proposed Division 130 applies.¹⁴ The proposed Division 130 relates to goods acquired or imported solely for a creditable purpose which are later applied solely to private or domestic use.

When do you need to calculate the extent of creditable purpose?

37. You need to calculate the extent of creditable purpose if your acquisitions or importations are:

- (i) only partly in carrying on your enterprise;
- (ii) partly used to make **input taxed supplies**; or
- (iii) partly of a private or domestic nature.

Acquisitions and importations made partly 'in carrying on your enterprise'

When is an acquisition or importation made in 'carrying on your enterprise'?

38. You acquire a thing for a creditable purpose to the extent that you acquire it in carrying on your enterprise. There must therefore be a connection between the acquisition and the enterprise, such that you

¹⁴ New Division 130 is proposed to be included in *A New Tax System (Indirect Taxes and Consequential Amendments) Bill No 2 (1999)*. As at 17 December 1999, this Bill is awaiting Royal Assent.

GSTR 1999/D8

can be said to have made the acquisition ‘in carrying on your enterprise’.

39. An acquisition is made ‘in carrying on your enterprise’ once it is established that you made the acquisition or importation in the course of the activity or series of activities that constitute your enterprise.

40. Acquisitions or importations may not be directly linked to the making of any supplies, e.g., ASIC compliance costs or the costs of maintaining a register of shareholders. These may still be creditable acquisitions, provided you made them in the carrying on your enterprise. However, if the enterprise makes input taxed supplies as well as taxable supplies or GST-free supplies, you still need to apportion the input tax credits on these types of acquisitions and importations.

41. The test for determining whether you have made an acquisition in carrying on your enterprise is broader than the test for income tax deductibility. Under section 195-1, ‘carrying on’ is defined to include the commencement or termination of your enterprise. For example, in some circumstances the cost of a feasibility study may not be deductible for income tax purposes, while acquisitions for the same study conducted in the course of an enterprise could be creditable acquisitions under the GST Act.

42. Under the GST law, unlike under income tax law, there is no distinction between acquisitions of a capital or revenue nature. For this reason, input tax credits may be available in respect of an acquisition for which no income tax deduction would be allowable. In addition, services for managing your tax affairs, the cost of which is only made deductible for income tax purposes by a specific provision can be creditable acquisitions.¹⁵

43. Whether you are carrying on an enterprise is a question of fact. Carrying on an enterprise includes those things you do in actually managing or conducting that enterprise.

What is an ‘enterprise’?

44. ‘Enterprise’ is defined in the GST Act.¹⁶ The same definition appears in the ABN Act,¹⁷ and has been considered in a Draft Miscellaneous Taxes Ruling MT 1999/D1. When officially released, this Ruling will state the Commissioner’s view on the meaning of the term ‘enterprise’ in the ABN Act. When MT 1999/D1 is finalised, the parts of it that explain the definition of ‘enterprise’ under section 38 of

¹⁵ Section 25-5 of the ITAA1997.

¹⁶ Section 9-20.

¹⁷ Section 38.

the ABN Act will reflect the Commissioner's view of the definition 'enterprise' under section 9-20 of the GST Act.

45. 'Enterprise' is broadly defined in the GST Act and includes activities where you are engaged in a business. Charitable and religious organisations, government bodies and trusts are also considered to be carrying on an enterprise. There are several exclusions including activities of employees and activities done as a private hobby. You can obtain further guidance from MT 1999/D1 when we finalise it.

Partly in carrying on your enterprise

46. An example of an acquisition that is partly creditable because it is used only partly in an enterprise is where an employee also engages in an enterprise (e.g., a consultancy), and his or her acquisitions are used in both the enterprise and for the purposes of his or her employment.

Acquisitions or importations used partly to make input taxed supplies

47. Acquisitions or importations may be partly creditable because you use them partly to make input taxed supplies. Input taxed supplies are listed in Division 40 of the GST Act, and include:

- (i) financial supplies;
- (ii) residential rent (including some supplies of commercial residential premises);
- (iii) sales of **residential premises** including supplies by way of long term lease;
- (iv) precious metals; and
- (v) school tuckshops and canteens (supplies of food only).

Financial supplies

48. If your annual turnover of financial supplies exceeds the financial supplies threshold and you also make taxable or GST-free supplies, this Ruling does not cover the apportionment of your input tax credits. This issue will be the subject of another publication specifically covering financial supplies. (See comments made in paragraph 7.)

49. If your annual turnover of financial supplies does not exceed this threshold, and all your other supplies are taxable or GST-free, your acquisitions can still be fully creditable. However, if:

- (i) your annual turnover of financial supplies does not exceed this threshold; and
- (ii) you make other input taxed supplies, or acquisitions of a private or domestic nature,

you still need to apportion your input tax credits to the extent that you use your acquisitions or importations in making those other input taxed supplies or they are of a private or domestic nature.

Supplies of residential rent

50. A supply of residential premises by way of lease, hire or licence (including by way of renewal or extension) is input taxed. Such supplies are input taxed to the extent that the premises are to be used predominantly for residential accommodation. A supply of residential premises by way of **long term lease** is treated the same way as a sale of residential premises. (See paragraphs 52 and 53.)

51. The supply of commercial accommodation is a taxable supply, but is input taxed as a supply of residential rent where the supplier chooses that Division 87 of the GST Act does not apply. Division 87 deals with the valuation of the supply of long-term accommodation which is commercial accommodation in commercial residential premises.

Supplies of residential premises

52. The supply of residential premises by way of sale or long term lease is input taxed to the extent that the premises are residential premises to be used predominantly for residential accommodation.

53. However, the supply of residential premises is not input taxed to the extent the premises are commercial residential premises or **new residential premises**.

Supplies of precious metals

54. We do not cover input taxed supplies of precious metals in this Ruling. It is the subject of further industry consultation.

School tuckshops and canteens

55. The supply of food by a non-profit body through a school tuckshop or canteen is input taxed if:

- (i) the shop only supplies food; and

- (ii) the non-profit body chooses to have all its supplies of food through the shop treated as input taxed.

56. If a tuckshop does not or cannot elect to be input taxed, its supplies are taxable or GST-free, in which case it can claim input tax credits in full.

57. Consequently, school tuckshops and canteens make either:

- (i) taxable or GST-free supplies; or
- (ii) input taxed supplies,

and do not need to apportion input tax credits.

Where the acquisition or importation is of a private or domestic nature

58. An acquisition is partly creditable if it is partly of a 'private or domestic nature'.

59. The question of whether an acquisition or importation is of a 'private or domestic nature' depends on the circumstances of each case.

What is meant by 'private or domestic nature'?

60. The words 'private or domestic nature' are used in the ITAA 1936 and the ITAA 1997.¹⁸ In these sections, the words are part of what is referred to as the negative limb of the test for deductibility for income tax. The positive limb of section 8-1 and subsection 51(1) requires the expenditure to be incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. There has been debate under current income tax law whether the positive and negative limbs of section 8-1 and section 51(1) are mutually exclusive. One view is that the positive limb and this part of the negative limb are simply stating the same test in different words, that is, if something has been incurred in gaining assessable income, it cannot be private or domestic and vice versa. This view finds support in the fact that the many cases on the business/personal borderline in income tax sometimes concentrate on the positive and sometimes on the negative limb, without suggesting that they are dealing with different principles. Even cases that suggest some potential overlap consider that it is rare for an item of expenditure to satisfy the positive limb, and yet be considered to be of a 'private or domestic nature'. (*FCT v. Hatchett* (1971) 125 CLR 494, contrast with *FCT v. Forsyth* (1981) 148 CLR 203 and *John v. FCT* (1989) 166 CLR 417.)

¹⁸ Sections 51(1) and 8-1 respectively.

61. In income tax law, the Courts have considered the deductibility of various expenses that generally have a private or domestic nature. These include:

- (i) travel expenses to and from work;
- (ii) expenses for the necessities of life (such as food, clothing and shelter);
- (iii) self education;
- (iv) child care fees; and
- (v) home office expenses such as rent, interest, electricity, etc.

The Courts usually decided these cases on their particular facts with no general principle stating that expenditure of a particular type is always private or domestic.

62. The Commissioner views the words ‘private or domestic nature’ in the GST Act as having essentially the same meaning as in the ITAA 1936 and ITAA 1997. The meaning of ‘creditable purpose’ in sections 11-15 and 15-10 can be seen as having positive and negative limbs, similar to section 8-1 of the ITAA 1997 and section 51(1) of the ITAA 1936. The positive limb refers to the requirement that the acquisition or importation be made in ‘carrying on your enterprise’, while the negative limb excludes items of a private or domestic nature.¹⁹ We consider that the preferable view is that, as is probably the case under income tax law, there is no difference between the two tests in the enterprise/private borderline. Even if this is not correct, it would under the GST also be rare for an acquisition or importation to satisfy the positive limb and also be of a private or domestic nature. In either event, the Commissioner treats the body of income tax case law in the area of ‘private or domestic’ as establishing the principles applicable to the GST, unless some specific provision of the GST Act indicates a contrary outcome in a particular case.

Apportioning input tax credits

Apportionment at the time of acquisition or importation

63. For the purpose of claiming input tax credits, you need to know or estimate the extent to which the acquisition or importation is for a creditable purpose. At the time of acquisition, it is your *planned* use of the thing acquired or imported that is relevant to work out your input tax credit. In these circumstances, you may be able make a reasonable estimate of the planned use of the acquisition or importation. You may base this estimate on records you already have

¹⁹ As well as acquisitions and importations that relate to making supplies that would be input taxed.

available, or on your previous experience. However, in some circumstances, such as initial acquisitions in a new enterprise, you may not have any records or experience on which to base the estimate of planned use. The methods explained below (see paragraphs 75 to 109) may help you determine your planned use.

Apportionment in cases of subsequent changes in the extent of creditable purpose

64. After making an acquisition or importation, the extent to which you actually apply it for a creditable purpose may differ from the extent to which you intended or planned to use it. In this case, you may need to make an adjustment for change in the extent of creditable use. The methods explained below may help you determine your actual use.

65. In determining your actual usage, you may measure the use over a certain period (e.g., a log book for a car). The period you choose to measure should be representative of the total usage of the thing acquired.

General principles of apportionment

66. The phrase, 'to the extent' appears in sections 11-15 and 15-10 which explain the meaning of 'creditable purpose'. The same phrase is to be found in section 8-1 of the ITAA 1997 and subsection 51(1) of the ITAA 1936. Under income tax law, the phrase 'to the extent' has been found to require an apportionment to be made in order to determine what part of a loss or outgoing is deductible. The Commissioner views the phrase 'to the extent' in the GST Act as incorporating the same apportionment concepts as under income tax law unless the contrary intention is expressed.

67. The issue of apportionment has been the subject of considerable income tax case law. The essential principles underlying that case law emerged from the High Court decision of *Ronpibon Tin NL v FCT* (1949)78 CLR 47; 4 AITR 236 ('Ronpibon Tin') where Latham CJ, Rich, Dixon, McTiernan and Webb JJ, said at CLR 59, AITR 247:

'It is perhaps desirable to remark that there are at least two kinds of items of expenditure that require apportionment. One kind consists in undivided items of expenditure in respect of things or services of which distinct and severable parts are devoted to gaining or producing assessable income and distinct and severable parts to some other cause. In such cases it may be possible to divide the expenditure in accordance with the applications which have been made of the things or services.

The other kind of apportionable items consist in those involving a single outlay or charge which serves both objects indifferently. Of this, directors' fees may be an example. With the latter kind there must be some fair and reasonable assessment of the extent of the relation of the outlay to assessable income. It is an indiscriminate sum apportionable, but hardly capable of arithmetical or rateable division, because it is common to both objects.'

The result in that case was that the Court rejected an arbitrary method under which the Commissioner disallowed a fixed percentage of expenses as relating to investment income and the case was referred back for apportionment in accordance with the principles quoted above.

68. The relevant principle established by *Ronpibon Tin* is to apportion on the basis of information regarding the actual application of the expenditure where it is possible to do so. That is, where 'distinct and several parts' are devoted to different purposes, apportion on the basis of those purposes. Other items which involve an expenditure that is dedicated to different purposes need to be apportioned on some 'fair and reasonable basis'.

Methodologies for apportioning input tax credits

69. Where the extent of creditable purpose is less than 100%, you require a method of apportioning between creditable and non-creditable purpose. The method should use actual information regarding the purpose of the acquisition or importation where possible as this accords with the basic principles explained above. If this is not possible for practical reasons, or the acquisition or importation relates to both creditable and non-creditable purposes, you should adopt some other 'fair and reasonable' basis.

70. The most appropriate method depends on the circumstances of each case. In choosing a method to measure the use of an acquisition, the matters you should consider include:

- (i) the nature of the acquisition and the ways of directly measuring its use, and
- (ii) the value of the acquisition and the cost of directly measuring its use.

71. We prefer direct methods (see paragraphs 76 to 90) as they accord with the principles explained above. Therefore, if a direct method is available you should use it, unless you have a good reason not to (for example, when you consider that an indirect method would be more accurate or that the cost of measuring the use of the acquisition is disproportionate to the cost of the acquisition itself).

72. Of the indirect methods, we prefer the input based as it is more likely to reflect the principles outlined above. Where an input based method is not available, an output based method may produce a fair and reasonable estimate.

73. The use to which you put the item may also affect the choice of method. For example, where you could use a thing for private purposes as well as for making input taxed supplies, a different measurement method might be appropriate, depending on the type of use. An output based (indirect) method would not be appropriate for determining the private use to which a thing is put, as output bears no relationship to private use.

74. A combination of different methods might be required for the various acquisitions or importations made by an entity. For example, an entity might be carrying on different businesses or making supplies in different sectors, or there might be several kinds of businesses within a GST group.²⁰

Types of methods

75. Apportionment methodologies can be broadly categorised as being either *direct* or *indirect*. Direct methods usually give the most accurate measure of the extent of creditable purpose and are, therefore, preferred.

Direct methods

76. These methods use variables that are a direct measure of the use of the acquisition or importation. Variables that are inherent to, or directly connected with, the acquisition or type of acquisition usually give a fair reflection of the use of the thing.

77. The variables are a direct link between the acquisition or importation and the use to which it is put. Some examples of these variables are:

- (i) distance, for example, kilometres travelled by a motor vehicle;
- (ii) time, for example, computer time spent on various activities;
- (iii) transactions, for example, numbers of transactions of particular types; and
- (iv) area, for example, floor area.

²⁰ GST Groups are covered by Division 48 and the proposed new Divisions 149 under *A New Tax System (Indirect Taxes and Consequential Amendments) Bill No 2 (1999)*. As at 17 December 1999, this Bill is awaiting Royal Assent.

GSTR 1999/D8

78. The method then simply expresses the relevant use as a percentage of total use.

Example

79. Kent is commencing to operate a business as a freelance journalist from his home. He registers for GST, and purchases a computer system for \$5,500 (including GST). Kent deals with many clients by e-mail, uses his computer and Internet connection to research topics for his articles, and has his business records on computer. Kent also uses his computer for private purposes. When he bought the computer, he estimated that he would use it for 30 hours per week for business and 10 hours for private purposes. As the expected business use is 75% (30 hours out of 40), Kent can claim an input tax credit of \$375 ($75\% \times 1/11 \times \$5,500$) based on this reasonable estimate of business use. However, he needs to keep a record to measure the actual use of the computer. The record could be a diary kept for a representative period such as a month. If the actual use varies from the estimated use, Kent needs to make an adjustment in the relevant adjustment period. He will have two adjustment periods since the GST exclusive value of the computer is \$5,000 (see paragraph 33).

Example

80. Toby owns a small store selling posters, comics, etc. The premises from which he runs the business also includes a flat, where Toby lives. The total area of the premises is 60 square metres, with 40 square metres relating to the flat and 20 square metres relating to the shop. Toby incurs the following expenditure in relation to the premises in the March tax period (all prices include GST):

| | |
|--|-------|
| Electricity | \$450 |
| Telephone (one line which serves both shop and flat) | \$580 |
| Insurance (covering entire premises) | \$330 |

81. Toby must apportion the input tax credits on those expenses that relate to both the shop and the flat (as he cannot claim input tax credits for acquisitions of a private or domestic nature).

82. **Electricity** – as this is a variable expense, floor area would not be an appropriate means by which to apportion as it bears no relation to the amount of energy actually used. Toby could use the number of hours worked in the shop to estimate the amount of electricity related to business usage. Based on business hours compared to non-business hours, and the nature of the appliances used, Toby makes a reasonable

estimate that 40% of electricity costs are attributable to his business activities.

$$\$450 \times 1/11 \times 40\% = \$16.36$$

83. **Telephone** - Toby uses the same telephone for business and private purposes. As this is also a variable expense, floor area would not seem to be an appropriate basis for apportioning the input tax credit on the telephone expense. Toby makes a reasonable estimate based on information on the account (which is partially itemised) and past experience that 75% of calls are business related.²¹ Toby can therefore apportion the input tax credit on the telephone expense as follows :

$$\$580 \times 1/11 \times 75\% = \$39.54$$

84. **Insurance** - this is a fixed occupation expense. A floor area basis would be appropriate to apportion this expense, as it reasonably reflects the portion of the insurance cost relating to the shop area.

$$\$330 \times 1/11 \times 20/60 = \$10.00$$

Apportioning input tax credits on cars

85. Car expenses fall into two broad categories – initial purchase costs and ongoing running costs. An entitlement to input tax credits arises to the extent that these costs are for a creditable purpose. If you also use a car you acquire and use in your enterprise partly for a non-creditable purpose, you need to apportion the input tax credits on the acquisition of the car and on car running expenses. You need to work out the percentage you use the car for a creditable purpose in your enterprise. To do this you could keep a record of kilometres travelled for the purposes of your enterprise compared to total distance travelled by the car for all purposes. For example, if you already keep a log book for claiming deductions for car expenses for income tax purposes, you could also use this for apportioning your input tax credits under GST.

86. If you purchase a motor vehicle for a creditable purpose and have previously used a log book, you can use this method for apportioning the input tax credit associated with the purchase. Alternatively, if you have other records that show the distance travelled for the purpose of your enterprise and the total distance travelled by the car for all purposes, you can use those records.

87. However, you cannot rely on the business percentage established by a log book for a replacement vehicle or an additional vehicle if you intend that the business percentage will be different. In

²¹ He could also have used some other basis, for example a log of calls kept for a representative period.

GSTR 1999/D8

these circumstances, you should make a reasonable estimate of the creditable use based upon all relevant matters – such as expected variations in patterns of use of the vehicle and odometer records – and claim the input tax credit on this estimate. If you claim input tax credits based on a reasonable estimate, and that estimate later proves to be too high or too low, you should make an adjustment.

Example

88. Joanne is a real estate agent who is registered for GST. On 1 August 2002 she purchases a car for \$33,000 (including GST) to replace her existing car. Joanne had kept a log book to substantiate the percentage that she used the existing car for business during the 2001-2002 year. The log book showed she used the car 60% for business. As Joanne expects that the pattern of usage will be the same for the replacement car, she can apportion the input tax credit on that basis. Accordingly she claims an input tax credit of \$1,800 (60% x 1/11 x \$33,000). However, she needs to keep a record to measure the actual use of the car, e.g., by keeping a log book for a representative period. If the actual use varies from the estimated use, Joanne needs to make an adjustment in the relevant adjustment period. She will have five adjustment periods since the GST exclusive value of the car is \$30,000. (See paragraph 33.)

89. While log books clearly provide the best evidence of the extent of creditable purpose, the Commissioner takes the view that there may be other methods that provide a fair and reasonable estimate of the extent of creditable purpose.

90. Input tax credits on the acquisition of new motor vehicles are to be phased in over the first two years of the operation of the GST.²² For the year ending 30 June 2001, no input tax credits are allowed, and for the year ending 30 June 2002 the entitlement to input tax credits is reduced by 50%.²³

Indirect methods

91. The indirect methods attempt to estimate the usage of acquisitions and importations for creditable purposes. Indirect methods use variables that are not directly identifiable with the use of the particular acquisition. For this reason, they may not give an accurate measure of the creditable use of the acquisition or

²² Section 20 of the *A New Tax System (Goods and Services Tax Transition) Act 1999* ('the Transition Act').

²³ There are exceptions to the phasing-in rules for cars held as trading stock, second hand cars, cars that would have been sales tax exempt and replacement vehicles acquired by insurers to settle a claim: section 20(4).

importation. However, they may provide a reasonable basis for the purpose of apportioning input tax credits.

92. Indirect methods may be appropriate in circumstances such as where there are overhead expenses or a large number of small acquisitions or importations and it is not cost effective to try to measure the use to which each separate acquisition or importation is put.

93. Indirect methods may be of limited use for acquisitions or importations of substantial value compared with the total acquisitions. To include these relatively large acquisitions or importations in the indirect method calculation, may achieve a result that does not accurately reflect the use of all acquisitions or importations.

94. You need to make adjustments for change in extent of creditable purpose over a number of adjustment periods. While it is possible to employ an indirect method to track the extent of creditable purpose for an acquisition over time, this would require you to calculate the relevant variables on a cumulative basis from the time of acquisition through to the end of each adjustment period.

95. There are two common types of indirect methods, input based and output based.

96. **Input based methods:** these methods employ measures of some inputs to estimate the use of other inputs. However, they are only useful where you have already allocated input tax credits for some acquisitions or importations on a direct basis to making taxable or GST-free supplies or to making input taxed supplies. The proportion of acquisitions already allocated on a direct basis should be sufficient to give some reliability to the calculation. You can use the proportion applied to making taxable or GST-free supplies out of the total allocated directly to apportion input tax credits in respect of those acquisitions with a mixed purpose, or where direct allocation was not possible. Some examples of input based methods are:

- (i) the cost of acquisitions used to make taxable or GST-free supplies relative to the total costs of all acquisitions; or
- (ii) input tax attributable to acquisitions used to make taxable or GST-free supplies relative to total input tax.

These method provide the most accurate results where the percentage of unallocated acquisitions relating to making taxable supplies is similar to the proportion of direct costs already directly allocated to making taxable supplies.

GSTR 1999/D8*Example*

97. Georgina owns a two storey building and is registered for GST. She rents out the ground floor to a business (a taxable supply) and the top floor as residential premises (an input taxed supply). Some of the costs of her enterprise are overheads which she cannot directly allocate to making either taxable supplies or input taxed supplies. Georgina can directly allocate her other costs to making either taxable supplies or input taxed supplies. She could use an input based method as follows:

| INPUTS | | | |
|---|---|---------------------------|-----|
| Acquisitions - making taxable supplies | A | | 300 |
| Acquisitions - making input taxed supplies | B | | 200 |
| Acquisitions - overheads | C | | 100 |
| | | | |
| Extent of creditable purpose | = | $\frac{A}{A + B}$ | |
| | = | $\frac{300}{(300 + 200)}$ | |
| Extent of creditable purpose (expressed as a percentage) | = | 60% | |

Georgina applies the extent of creditable purpose of 60% to the overheads of \$100 and claims input tax credits on \$60 of overheads as well as on the acquisitions for making taxable supplies of \$300.

98. **Output based methods:** these utilise measures of output to estimate use of acquisitions or importations. For example:

- (i) total value of taxable and GST-free supplies as a percentage of total supplies; and
- (ii) net profit (or gross profit) from taxable and GST-free supplies as a percentage of total net profit (or gross profit).

Example

99. Roger makes input taxed supplies and taxable supplies from his enterprise. Some of his costs are overheads which he cannot directly allocate to making either taxable supplies or input taxed supplies. Roger may need to use an output based method as follows:

| INPUTS | | | |
|---|--|---|---------------------------------|
| Overheads | | | 1,000 |
| OUTPUTS | | | |
| Taxable supplies | | D | 2,000 |
| Input taxed supplies | | E | 3,000 |
| TOTAL | | F | 5,000 |
| Extent of creditable purpose | | = | $\frac{D}{F}$ |
| | | = | $\frac{2,000}{(3,000 + 2,000)}$ |
| Extent of creditable purpose (expressed as a percentage) | | = | 40% |

Roger applies the extent of creditable purpose of 40% to the overheads of \$1,000 and claims input tax credits on \$400 of overheads as well as on any creditable acquisitions directly used in making taxable supplies.

Example - comparing input and output based methods

100. Daniel is a carpenter who makes supplies of building services (taxable supplies). He also owns a number of residential rental properties (input taxed supplies).

101. Daniel has kept separate records of materials that he acquired to make taxable supplies and also expenses that he incurred in making input taxed supplies. However, he has various overhead expenses for his office that he is not able to directly allocate to specific supplies. He has also kept a separate record of the total income from each activity.

102. Daniel's total supplies and acquisitions are as follows:

| | Taxable supplies \$ | Input taxed supplies \$ | Total \$ |
|-----------------|---------------------------|-------------------------------|-------------|
| Sales | 70,000 | 40,000 | 110,000 |
| Direct expenses | 35,000 | 15,000 | 50,000 |
| Gross profit | 35,000 | 25,000 | 60,000 |
| Overheads | | | 11,000 |
| Net Profit | | | 49,000 |

GSTR 1999/D8

103. Daniel is able to allocate input tax credits on direct costs according to his record of their usage to make taxable or input tax supplies. However, as there is no direct basis of allocating the input tax credits on the overhead expenses, he needs to adopt some indirect basis. The possibilities are:

- (i) an input based method: based on the costs of inputs solely used for making taxable and input taxed supplies (called direct costs); or
- (ii) an output based method: based on the value of the taxable supplies and input taxed supplies.

104. **Input based method:** this method assumes that the overheads are consumed (for a creditable purpose) in the same proportion as the direct costs of making taxable supplies bears to the total direct costs. Therefore, Daniel should include only direct costs in the calculation. This calculation requires that the extent of creditable purpose and the extent of non-creditable purpose, as percentages, should add up to 100%.

105. Before Daniel uses this method, the amount of the direct costs already allocated should be sufficient so as to give some reliability to the calculation.

106. If Daniel uses all direct costs, he works out the extent of creditable purpose for overhead expenses as follows:

$$\begin{array}{r}
 \text{direct cost of making taxable supplies} \\
 \text{total direct costs} \\
 = \qquad \qquad \qquad \underline{35,000} \\
 \qquad \qquad \qquad 50,000 \\
 = \qquad \qquad \qquad 70\%
 \end{array}$$

107. **Output based method:** this method gives a reasonably reliable result when overheads are used (for a creditable purpose) in the same proportion that the revenue derived from taxable supplies bears to total revenue. This calculation requires that the extent of creditable purpose and the extent of non-creditable purpose, as percentages, should add up to 100%.

108. Applying the output based method using revenue gives the following percentage of creditable purpose:

$$\begin{array}{r}
 \text{revenue from taxable supplies} \\
 \text{total revenue} \\
 = \qquad \qquad \qquad \underline{70,000} \\
 \qquad \qquad \qquad 110,000 \\
 = \qquad \qquad \qquad 63.64\%
 \end{array}$$

109. Both the input and output based methods work on the assumption that measures of input and output are an adequate estimate of the use of mixed use inputs for the making of various supplies. You must take care when using these methods, to take into account any part of the 'input' or 'output' measure used that is not reflective of the use of inputs, for example, the inclusion of an unusual supply or acquisition of a capital item of substantial value.

Record keeping – general requirements

110. If you make a creditable acquisition or creditable importation you must keep records that show and explain all transactions and other acts you engage in that are relevant to that acquisition or importation. You must retain those records for at least 5 years after the completion of the transaction or acts to which they relate. The records must be such as to enable your liability under the GST Act to be readily ascertained.²⁴

111. It follows that you should retain records relating to the calculation and apportionment of input tax credits, and how you arrived at your net amount. Records you normally keep may be sufficient to satisfy these requirements. Where this is not the case, you may need to keep additional records.

Definitions

Adjustments

112. Adjustments are changes you need to make on your Business Activity Statement ('BAS') to increase or decrease your net amount payable or refundable for a tax period. The changes may be needed to:

- (i) increase or decrease the GST payable on supplies you made because something happened so that the amount of GST payable by you included on a previous BAS is no longer correct; or
- (ii) increase or decrease the input tax credits for acquisitions or importations because something happened so that the amount of input tax credits you claimed for an acquisition or importation on a previous BAS is no longer correct.²⁵

²⁴ Section 70 of the *Taxation Administration Act 1953*.

²⁵ Section 195-1.

Adjustment period

113. An adjustment period²⁶ for an acquisition or importation is a tax period applying to you that:

- (a) starts at least 12 months after the end of the tax period to which the acquisition or importation is attributable (or would be attributable if it were a creditable acquisition or creditable importation); and
- (b) ends:
 - (i) on 30 June in any year; or
 - (ii) if none of the tax periods applying to you in a particular year ends on 30 June ends closer to 30 June than any of the other tax periods applying to you in that year.

In addition, a tax period provided for under section 27-40 is an adjustment period for the acquisition or importation.²⁷

Creditable acquisition

114. A creditable acquisition is an acquisition you use in your enterprise. You are entitled to an input tax credit for these acquisitions. You make a creditable acquisition if:

- (a) you acquire anything solely or partly for a creditable purpose; and
- (b) the supply of the thing to you is a taxable supply; and
- (c) you provide, or are liable to provide, consideration for the supply; and
- (d) you are registered or required to be registered.²⁸

Creditable importation

115. Creditable importation relates to goods you import to use in your enterprise. You are entitled to an input tax credit for these importations. You make a creditable importation if:

- (a) you import goods solely or partly for a creditable purpose; and
- (b) the importation is a taxable importation; and
- (c) you are registered or required to be registered.²⁹

²⁶ Section 129-20.

²⁷ Section 27-40 deals with concluding tax periods.

²⁸ Section 11-5.

Financial supplies

116. Financial supplies are supplies that are interests in financial products as set out in section 40-5³⁰ of the GST Act and in regulation 40-13 of the A New Tax System (Goods and Services Tax) Regulations 1999. Examples include maintaining and operating cheque and savings accounts for account holders; lending, including maintaining and discharging loans and mortgages; life insurance contracts; conversion of foreign currency; futures contracts; commodity derivatives; options; and shares or debentures.

Financial supplies threshold

117. Financial supplies threshold³¹ is the lesser of:

- (i) \$50,000 (or such other amount specified in the regulations); or
- (ii) 5% of your annual turnover (treating supplies that are input taxed as part of your annual turnover).

GST return

118. GST return is the approved form (it is a section of the BAS) on which you must account for GST and some other taxes. You account for GST on this form by using it to work out your net amount for the tax period.³²

GST-free supply

119. GST-free supply means a supply that is GST-free under Division 38. That Division provides that exports and supplies of certain things such as food, health, education, child care, religious services and farm land are GST-free. If a supply is GST-free, you do not charge GST on the supply, but you are entitled to input tax credits for things acquired or imported to make the supply.

²⁹ Section 15-5.

³⁰ The *A New Tax System (Indirect Tax and Consequential Amendments) Bill No 2 1999* proposes to amend subsection 40-5(2). As at 17 December 1999, this Bill is awaiting Royal Assent. Regulations pursuant to subsection 40-5(2) are still to be gazetted.

³¹ The term 'financial supplies threshold' is not defined in the GST Act, but it is a convenient way of describing the conditions in subsections 11-30(2) and 15-25(2).

³² Section 31-15.

Input tax credit

120. Input tax credit is the credit you are entitled to for the GST included in the price you pay for an acquisition or the GST paid on an importation, if it is for use in your enterprise. The entitlement arises under section 11-20 (about creditable acquisitions) or section 15-15 (about creditable importations).

Input taxed supplies

121. Input taxed supplies means supplies that are input taxed under Division 40. That Division sets out the supplies that are input taxed. They are financial supplies (section 40-5), residential rent (section 40-35), residential premises (section 40-65), certain supplies of precious metals (section 40-100) and school tuckshops and canteens (section 40-130). If a supply is input taxed you do not include GST in the price of the supply, but you are not entitled to input tax credits for anything acquired or imported to make the supply.

Long-term lease

122. Long-term lease means a supply by way of lease, hire or licence (including a renewal or extension of a lease, hire or licence) for at least 50 years if:

- (a) at the time of the lease, hire or licence, or the renewal or extension of the lease, hire or licence, it was reasonable to expect that it would continue for at least 50 years; and
- (b) unless the supplier is an Australian government agency - the terms of the lease, hire or licence, or the renewal or extension of the lease, hire or licence, as they apply to the recipient are substantially the same as those under which the supplier held the premises.³³

Net amount

123. Net amount is the difference between your total GST payable and your total input tax credits for a tax period.³⁴ It can be increased or decreased by adjustments arising in the same tax period. You include your net amount for a tax period on your BAS.

³³ Section 195-1.

³⁴ Section 17-5.

New residential premises

124. New residential premises means residential premises that have not previously been sold as residential premises and have not previously been the subject of a long-term lease.³⁵

Residential premises

125. Residential premises means land or a building occupied or intended to be occupied as a residence, and includes a floating home.³⁶

Taxable supply

126. Taxable supply has the meaning given by sections 9-5 (the basic definition), 78-30 (about taxable supplies relating to insurance claims), 84-5 (about intangible supplies from offshore) and 105-5 (about supplies by creditors in satisfaction of debts). Section 9-5 provides that:

- (i) you make a taxable supply if:
 - (a) you make the supply for consideration; and
 - (b) the supply is made in the course or furtherance of an enterprise that you carry on; and
 - (c) the supply is connected with Australia; and
 - (d) you are registered, or required to be registered; and
- (ii) the supply is not a taxable supply to the extent that it is GST-free or input taxed.

Your comments

127. If you wish to comment on this draft Ruling, please send your comments promptly by **18 February 2000** to:

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Facsimile (07) 3853 4882
Email simon.jukes@ato.gov.au

³⁵ Section 195-1. The *A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999* proposes to amend this definition. As at 17 December 1999, this Bill is awaiting Royal Assent.

³⁶ Section 195-1. The *A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999* proposes to amend this definition. As at 17 December 1999, this Bill is awaiting Royal Assent.

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Detailed contents list

128. Below is a detailed contents list for this Draft Ruling:

| | Paragraph |
|---|------------------|
| What this Ruling is about | 1 |
| Date of effect | 8 |
| Background | 9 |
| Ruling | 13 |
| Explanations (this forms part of this Ruling) | 24 |
| Entitlement to input tax credits for acquisitions and importations | 24 |
| Acquisitions and importations that are only partly creditable | 28 |
| Calculating input tax credits | 30 |
| When extent of creditable purpose changes after acquisition or importation | 32 |
| When will you need to calculate the extent of creditable purpose? | 37 |
| <i>Acquisitions and importations made partly 'in carrying on your enterprise'</i> | 38 |
| <i>When is an acquisition or importation made in 'carrying on your enterprise'?</i> | 38 |
| <i>What is an 'enterprise'?</i> | 44 |
| <i>Partly in carrying on your enterprise</i> | 46 |
| <i>Acquisitions or importations used partly to make input taxed supplies</i> | 47 |
| <i>Financial supplies</i> | 48 |
| <i>Supplies of residential rent</i> | 50 |
| <i>Supplies of residential premises</i> | 52 |
| <i>Supplies of precious metals</i> | 54 |
| <i>School tuckshops and canteens</i> | 55 |
| <i>Where the acquisition or importation is of a private or domestic nature</i> | 58 |
| <i>What is meant by 'private or domestic'?</i> | 60 |
| Apportioning input tax credits | 63 |
| <i>Apportionment at the same time of acquisition or importation</i> | 63 |
| <i>Apportionment in cases of subsequent changes in the extent of creditable purpose</i> | 64 |
| <i>General principles of apportionment</i> | 66 |
| Methodologies for apportioning input tax credits | 69 |

| | |
|---|------------|
| Types of methods | 75 |
| <i>Direct methods</i> | 76 |
| <i>Example</i> | 79 |
| <i>Example</i> | 80 |
| <i>Apportioning input tax credits on cars</i> | 85 |
| <i>Example</i> | 88 |
| <i>Indirect methods</i> | 91 |
| <i>Example</i> | 97 |
| <i>Example</i> | 99 |
| <i>Example</i> | 100 |
| Record keeping – general requirements | 110 |
| Definitions | 112 |
| Adjustments | 112 |
| Adjustment period | 113 |
| Creditable acquisition | 114 |
| Creditable importation | 115 |
| Financial supplies | 116 |
| Financial supplies threshold | 117 |
| GST return | 118 |
| GST-free supply | 119 |
| Input tax credit | 120 |
| Input taxed supplies | 121 |
| Long-term lease | 122 |
| Net amount | 123 |
| New residential premises | 124 |
| Residential premises | 125 |
| Taxable supply | 126 |
| Your comments | 127 |

Commissioner of Taxation

 22 December 1999

| | |
|--|---------------------------------|
| <i>Previous draft:</i> | - carrying on your enterprise |
| Not previously issued in draft form | - creditable acquisition |
| | - creditable importation |
| <i>Related Rulings/Determinations:</i> | - creditable purpose |
| | - enterprise |
| <i>Subject references:</i> | - extent of creditable purpose. |
| - acquisition | - financial supplies |
| - activity statement | - GST |
| - adjustment period | - GST-free |
| - adjustments | - GST-free supplies |
| - Business Activity Statement | - GST return |

GSTR 1999/D8

- importation
 - input tax credits
 - input taxed supplies
 - input taxed
 - long term lease
 - net amount
 - partly creditable
 - private or domestic nature
 - record keeping
 - supplies of residential premises
 - taxable supplies
 - taxable supply
- ANTS(GST)A 1999 27-40
 - ANTS(GST)A 1999 31-15
 - ANTS(GST)A 1999 33-5(1)
 - ANTS(GST)A 1999 35-5
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 - ANTS(GST)A 1999 40-65
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 - ANTS(GST)A 1999 40-130
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 - ANTS(GST)A 1999 84-5
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ATO references:

NO 99/17932-5

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