GSTR 2004/D3 - Goods and services tax: when does an entity have a decreasing adjustment under Division 132?

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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: when does an entity have a decreasing adjustment under Division 132?

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Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners, as it is not a ruling or advice for the purposes of section 37 of the ***Taxation Administration Act 1953****. The final Ruling will be a public ruling for the purposes of section 37 and may be relied upon by any entity to which it applies.*

What this Ruling is about

1. This Ruling is about Division 132 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). Division 132 applies, in the circumstances set out in the Division, to allow you a decreasing adjustment when you sell a thing.

2. This Ruling explains:

- the circumstances in which you have a decreasing adjustment under Division 132;
- how to calculate the decreasing adjustment using the formula in subsection 132-5(2);
- how subsection 132-5(3) limits the amount of the decreasing adjustment;
- how Division 132 applies to a GST-free supply of a going concern; and
- how Division 132 applies to the sale of a reduced credit acquisition under section 70-25.

3. Division 132 applies to an importation in the same way as to an acquisition. In this Ruling a reference to an 'acquisition' includes a reference to an importation.

4. In this Ruling, in considering whether the supply of a thing is a taxable supply, we assume that the supply is made for consideration and is connected with Australia, and that the supplier is registered or required to be registered.[1]

[1] Paragraphs 9-5(a), (c) and (d).

5. Unless otherwise stated, all legislative references in this Ruling are to the GST Act.

Date of effect

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

7. The final Ruling will be a public ruling for the purposes of section 37 of the *Taxation Administration Act 1953* and may be relied upon, after it is issued, by any entity to which it applies. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and our view of when you can rely on our interpretation of the law in GST public and private rulings.

8. If the final public ruling conflicts with a previous private ruling that you have obtained, the public ruling prevails. However, if you have relied on a private ruling, you are protected in respect of what you have done up to the date of issue of the final public ruling. This means that if you have underpaid an amount of GST, you are not liable for the shortfall prior to the date of issue of the later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

Context

9. Under the GST Act, the supply of a thing is a taxable supply if it satisfies section 9-5. In considering whether a supply is a taxable supply, this Ruling only considers the requirement in paragraph 9-5(b) that the supply be made in the course or furtherance of an enterprise that you carry on.

10. Where your acquisition of a thing is not made solely for a creditable purpose, you are not entitled to a full input tax credit. Where you are entitled to a full input tax credit on your acquisition of a thing, and your subsequent application of the thing is not solely for a creditable purpose, you may have an increasing adjustment.[2] However, in either case if you later make a taxable supply of the thing, you will be liable for GST.

11. Division 132 may allow you a decreasing adjustment in these circumstances. A decreasing adjustment under Division 132 decreases the net amount of GST that you pay in a similar way to an input tax credit. It effectively enables you to recover the input tax credits that you have previously been denied.

[2] Division 129.

12. The application of Division 132 depends, among other things, on the reason for the denial of the full input tax credit, or for the subsequent increasing adjustment. If the reason is that the acquisition or subsequent application of the thing was related to making financial supplies or being of a private or domestic nature, Division 132 may allow you a decreasing adjustment.

13. However, Division 132 will not allow you to effectively recover input tax credits that you have previously been denied on the basis that your acquisition or subsequent application of the thing was for making input taxed supplies other than financial supplies (for example, residential premises).

14. The amount of a decreasing adjustment under Division 132 is calculated by using the following formula, which appears in subsection 132-5(2):

$$\frac{1}{11} \times \text{Price} \times \left[1 - \frac{\text{Adjusted input tax credit}}{\text{Full input tax credit}}\right]$$

Where:

adjusted input tax credit (AITC) is:

(a) the amount of any input tax credit that was attributable to a tax period in respect of the acquisition; minus

(b) the sum of any increasing adjustments, under Subdivision 19-C[3] or Division 129,[4] that were previously attributable to a tax period in respect of the acquisition; plus

(c) the sum of any decreasing adjustments, under Subdivision 19-C or Division 129, that were previously attributable to a tax period in respect of the acquisition.

full input tax credit (FITC) is the amount of the input tax credit to which you would have been entitled for acquiring the thing for the purpose of your enterprise if:

(a) the acquisition had been solely for a creditable purpose; and

(b) in the case where the supply to you was a taxable supply only because of section 72-5[5] or section 84-5[6] – the supply had been a taxable supply under section 9-5.

price is the price of the taxable supply.

[3] Subdivision 19-C is about adjustments for acquisitions.
[4] Division 129 is about changes in the extent of creditable purpose.
[5] Section 72-5 is about taxable supplies to associates without consideration.
[6] Section 84-5 is about intangible supplies from offshore that may be taxable supplies.

15. However, if the amount worked out under subsection 132-5(2) is greater than the difference between the FITC and AITC, subsection 132-5(3) limits the amount of the decreasing adjustment to an amount equal to that difference.

16. In working out the AITC in relation to a thing acquired, subsection 132-5(4) provides that the acquisition or application of the thing is treated as having been for a creditable purpose except to the extent that the acquisition or application relates to the making of financial supplies or is of a private or domestic nature.

17. Section 132-10 provides for a decreasing adjustment under Division 132 to be attributable to the same tax period as the taxable supply to which it relates. If the decreasing adjustment relates to a GST-free supply of a going concern, it is attributable to the tax period to which the adjustment would be attributable if the supply were a taxable supply.

Ruling with explanation

Entitlement to a decreasing adjustment under Division 132

18. To be entitled to a decreasing adjustment under Division 132, you need to have:

- made a taxable supply by way of sale; and
- previously been denied all or part of an input tax credit, or had an increasing adjustment, due to the acquisition or subsequent application of the thing being related to making financial supplies or being of a private or domestic nature. You need to have been otherwise entitled to an input tax credit, at least to some extent, on the acquisition of the thing.[7]

19. You may also have a decreasing adjustment if you make a supply of a thing that would have been a taxable supply had it not been GST-free under Subdivision 38-J.

Taxable supply by way of sale

What is a sale?

20. The technical legal meaning usually given to the term 'sale' is the transfer by mutual consent of the ownership of a thing from one person to another person for a money price.[8] However, in some contexts, as a matter of ordinary non-technical English usage, 'sale' is

[7] Section 11-20.
[8] *Halsbury's Law of England,* 1983, vol.41, 4th edn, Butterworths, London, paragraph 601.

capable of extending to the transfer of property for any valuable consideration – that is, to transfers by way of barter or exchange.[9]

21. We consider that Division 132 is one such context in which it is appropriate to adopt the wider, non-technical interpretation of the term 'sale'.[10] In light of the purpose of Division 132, we are not aware of any reason in principle why a decreasing adjustment should be denied to an entity which receives only non-monetary, yet valuable, consideration for a taxable supply.

22. In our view, the intention behind limiting a Division 132 adjustment to taxable supplies by way of sale of a thing was to exclude taxable supplies consisting of partial or temporary disposals of the thing such as leases. The decreasing adjustment should only be available once the thing is wholly and permanently disposed of. Whether that disposal is for a money price or for other valuable consideration should be immaterial.

23. However, not every disposal is a supply by way of sale. A lease or a gift of a thing is not a supply of the thing by way of sale.

Taxable supply

24. One of the requirements for a sale of a thing to be a taxable supply is that you need to sell the thing in the course or furtherance of the enterprise that you carry on.[11]

25. You acquire and apply a thing for a creditable purpose to the extent that you acquire and apply the thing in carrying on your enterprise.[12] For a thing to be acquired and applied in carrying on an enterprise, the acquisition and application of the thing must be made in the course of the activities that are for the purpose of the enterprise.[13]

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[9] Dictionaries of ordinary English are not entirely consistent on this point. The *Collins Concise Dictionary* (1990) defines 'sell' as 'to dispose of or transfer … to a purchaser in exchange for money **or other consideration**' [emphasis added]. In the *Australian Oxford Dictionary* (1999), the first sense of 'sale' given is 'the exchange of a commodity for money **etc**.' We have emphasised 'etc' in this definition to distinguish from some other dictionaries, which limit the definition of 'sales' to transfers for a money price.

[10] One other context in which we have taken a similar view is in relation to section 38-100, which is about supplies by way of sale, lease or hire of some goods that, though related to an education course, are not GST-free. The Commissioner considers 'sale' in this context to include an act of selling or transferring property for non-monetary consideration (see paragraph 125 of GSTR 2001/1: *supplies that are GST-free for tertiary education courses*).

[11] The term 'enterprise' has the meaning given by section 9-20 and includes activities done in the form of business.

[12] Subsection 11-15(1), subsection 129-50(1) and section 195-1.

[13] This is consistent with the view expressed at paragraph 40 of GSTR 2000/15 which is about determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose.

26. For the sale of a thing to be made in the course or furtherance of your enterprise, the sale of the thing must have a discernible relationship with your enterprise. Whether a discernible relationship exists will depend on the facts and circumstances. The Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998[14] states:

> 'In the course or furtherance' is not defined but is broad enough to cover any supplies made in connection with your enterprise. An act done for the purpose or object of furthering an enterprise, or achieving its goals, is a furtherance of an enterprise although it may not always be in the course of that enterprise. 'In the course or furtherance' does not extend to the supply of private commodities, such as when a car dealer sells his or her own private car. See *Case N43* (1991) 13 NZTC 3361.

27. The requirement for a connection between the supply and the enterprise is also noted in *Case K55* (1988) 10 NZTC 453, where Bathgate DJ said at page 457:

> …it is a question of fact and degree as to whether a supply is in the course or furtherance of a taxable activity carried on by the person concerned. There must obviously be a discernible relationship between the supply and the activity in the form of a nexus for the supply to be in the course or furtherance of the activity…

28. Where you acquire and apply a thing for a creditable purpose but its subsequent application is solely of a private or domestic nature, you may have an increasing adjustment under Division 129. If at the time you sell the thing, your application of it is solely of a private or domestic nature there can be no discernible relationship between the sale of the thing and your enterprise. The sale of the thing is not made in the course or furtherance of your enterprise. It is not a taxable supply and you are not entitled to a decreasing adjustment under Division 132.

Example 1: Application of a private or domestic nature at the time of the sale

29. *Veronica's Fashion House (VFH) is a company which acquired and applied a motor vehicle for a 100% creditable purpose, and claimed a full input tax credit on its acquisition. Three years later there was a 100% change in application of the motor vehicle to a private nature. VFH had an increasing adjustment in the relevant adjustment period under Division 129. There were no further changes in the application of the motor vehicle.*

30. *Subsequently, VFH sells the motor vehicle. At the time of the sale of the motor vehicle, VFH's application of the vehicle was solely private. There is no discernible relationship between the sale of the motor vehicle and the enterprise of VFH. The sale is not made in the course or furtherance of the enterprise carried on by the entity. The*

[14] Paragraph 3.10.

sale is not a taxable supply and therefore VFH is not entitled to a decreasing adjustment on the sale of the motor vehicle.

31. If you have changed the application of the thing from a private or domestic purpose, to a purpose that is partly or solely for a creditable purpose, you may have a decreasing adjustment under Division 129. If at the time you sell the thing, your application of it is partly or solely in carrying on your enterprise, there is a discernible relationship between the sale of the thing and your enterprise. Accordingly, the sale is made in the course or furtherance of the enterprise. It is a taxable supply and you may be entitled to a decreasing adjustment under Division 132.

Example 2: Application for a creditable purpose at the time of sale

32. *Assume that, having applied the motor vehicle solely for private purposes for some time, VFH (from example 1) changes its application to 20% creditable purpose and 80% private. VFH has a decreasing adjustment under Division 129 in the relevant adjustment period. This application of the motor vehicle remains unchanged until VFH sells it. As the motor vehicle is applied partly for a creditable purpose at the time of its sale, there is a discernible relationship between the sale and the enterprise carried on by VFH. The sale is made in the course or furtherance of the enterprise. It is a taxable supply. VFH has a decreasing adjustment under Division 132 on the sale of its motor vehicle.*

33. As explained above, you may not be entitled to a Division 132 decreasing adjustment where you sell a thing and your application of the thing was solely of a private or domestic nature at the time of its sale. This situation is different from where the thing is acquired or subsequently applied to making financial supplies. This is because, in the latter situation, the thing is acquired and at all times applied in carrying on an enterprise. When it is disposed of by way of sale, the sale is a taxable supply.

Input tax credits previously denied

34. The application of Division 132 depends, among other things, on the reason for the denial of the full input tax credit, or for the subsequent increasing adjustment. For Division 132 to apply, that denial must be due to the acquisition or subsequent application of the thing being related to making financial supplies or being of a private or domestic nature. You need to have been otherwise entitled to an input tax credit, at least to some extent, on the acquisition of the thing.

35. You do not have a decreasing adjustment to the extent that you were denied your full input tax credit, or you had an increasing adjustment, for any reason other than because your acquisition or application of the thing was related to making financial supplies or was of a private or domestic nature. For example, you do not have a decreasing adjustment in respect of a thing you acquired before you were registered or required to be registered (unless the thing acquired was a pre-establishment acquisition to which you had an entitlement to an input tax credit under Division 60). Division 132 does not apply on the sale of motor vehicles, trailers or bodies of motor vehicles that you acquired before 23 May 2001.[15] Division 132 also does not apply where you had no entitlement to an input tax credit because your acquisition was not of a taxable supply. Examples of this may arise where you acquired a thing and the supply of the thing to you was:

- made before the start of GST;[16]
- from a supplier that was not registered or required to be registered for GST (unless the thing supplied to you was second-hand goods to which Division 66 applies); or
- either GST-free or was an input taxed supply other than a financial supply (for example, residential premises).

Calculating a decreasing adjustment

36. Where you are entitled to a decreasing adjustment under Division 132, the amount of the decreasing adjustment is calculated using the formula contained in subsection 132-5(2).[17] For the purposes of this Ruling we refer to this formula as the 'decreasing adjustment formula'.

37. The AITC component of the decreasing adjustment formula is the amount of the input tax credit that was attributable to the creditable acquisition, adjusted by any increasing and decreasing adjustments made under Subdivision 19-C and Division 129. If your acquisition or application of the thing was solely private or domestic or solely related to making financial supplies, the amount of AITC will be zero. On the other hand, if the acquisition or application of the thing was partly for a creditable purpose, the AITC amount will have a value greater than zero, which will reduce the amount of the decreasing adjustment accordingly.

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[15] See section 20 of *A New Tax System (Goods and Services Tax) Transition Act 1999*. You do not have a decreasing adjustment arising under Division 132 in respect of motor vehicles, trailers or bodies of motor vehicles acquired before 23 May 2001, because under section 20 you would not have been entitled to an input tax credit on those acquisitions anyway, regardless of the purpose for which you acquired them.

[16] That is, where you acquired a thing before 1 July 2000.

[17] See paragraph 14 of this Ruling.

38. The FITC component is the amount of the input tax credit to which you would have been entitled for acquiring the thing solely for a creditable purpose and includes an acquisition treated under section 72-5 or section 84-5 as a taxable supply. Were the FITC to have a zero value, mathematically it would render the formula inoperable and no decreasing adjustment would be available.[18]

39. Even if it were held that the decreasing adjustment formula is operable where the FITC has a zero value, subsection 132-5(3) would still result in a nil decreasing adjustment.

40. The following example illustrates that an input tax credit entitlement on the acquisition of a thing is necessary for a decreasing adjustment under Division 132.

Example 3: No input tax credit entitlement on acquisition

41. *Janet, a courier contractor, acquired a motorcycle in July 1998 at a cost of $5,000. She used the vehicle 80% for the courier contracting business and 20% privately. In August 2000, Janet registered for GST. In January 2002, she sold the motorcycle for $2,200. Janet accounted for $200 GST on the sale of the motorcycle.*

42. *In trying to apply the decreasing adjustment formula, Janet finds that the FITC and AITC components are zero because there was no input tax credit entitlement at the time of acquisition. The formula is inoperable mathematically and in any case the application of subsection 132-5(3) (which limits the amount of the decreasing adjustment to the difference between the FITC and the AITC – in this case, nil) would result in a nil decreasing adjustment. Janet does not have a decreasing adjustment under Division 132 on the sale of the motorcycle.*

The application of subsection 132-5(3)

43. Where the amount of the decreasing adjustment under subsection 132-5(2) is greater than the difference between the FITC and AITC, subsection 132-5(3) operates to limit the amount of the decreasing adjustment to that difference.

[18] The result of dividing a number by a zero is meaningless. James and James, *Mathematics Dictionary,* 5th edn, Chapman & Hall, New York, 1992, p.133.

Example 4: The application of subsection 132-5(3)

44. *First Bank acquires a building at a cost of $5.5 million (including $500,000 GST) solely for carrying on its enterprise. It is not entitled to an input tax credit on the acquisition because the building is acquired for making financial supplies. Several years later, First Bank sells the building for $11 million in the course of carrying on its enterprise. It accounts for $1 million GST on the sale of the building. The Division 132 decreasing adjustment is initially calculated under subsection 132-5(2) as follows:*

$$\frac{1}{11} \times \$11{,}000{,}00\ 0 \times \left[1 - \frac{0}{\$500{,}000}\right] \quad = \quad \$1{,}000{,}000$$

45. *The amount of $1 million as calculated above is the same as the amount of GST on the sale of the building. However, subsection 132-5(3) limits the decreasing adjustment to the difference between the FITC ($500,000) and the AITC ($0). As a result First Bank has a decreasing adjustment of $500,000, which is the same amount as the GST included in the purchase price of the building.*

The effect of subsection 132-5(4)

46. In working out the AITC, subsection 132-5(4) treats the acquisition or application as having been for a creditable purpose except to the extent that it related to making financial supplies or was of a private or domestic nature. The effect of this rule is that no decreasing adjustment is allowed in so far as you were denied a full input tax credit just because the acquisition was for some *other* non-creditable purpose.

Example 5: The effect of subsection 132-5(4)

47. *XYZ Ltd (XYZ) acquires a building for $2.2 million (including $200,000 GST), for carrying on its enterprise. It intends to apply 60% of the building to making financial supplies and 40% to making other input taxed supplies. XYZ is not entitled to an input tax credit on the acquisition of the building because the acquisition is for making financial supplies and other input taxed supplies. XYZ applies the building as it intends. One year later, XYZ sells the building for $2.2 million in the course or furtherance of its enterprise. The sale is a taxable supply. XYZ is required to account for $200,000 in GST on the sale of the building. XYZ is entitled to a decreasing adjustment under Division 132.*

48. *In working out the AITC for calculating the Division 132 decreasing adjustment, the acquisition and application of the building for making input taxed supplies, other than financial supplies, are treated as having been for a creditable purpose under subsection 132-5(4). No decreasing adjustment under the Division is available to XYZ in so far as it is denied an input tax credit on the acquisition of the building for making input taxed supplies, other than*

financial supplies. XYZ is entitled to the Division 132 decreasing adjustment where it is denied the input tax credit due to the acquisition and application of the building for making financial supplies. In these circumstances, the AITC is $80,000 ($200,000 ´ 40%). The decreasing adjustment is calculated as follows:

$$\frac{1}{11} \times \$2{,}200{,}000 \times \left[1 - \frac{\$80{,}000}{\$200{,}000}\right] = \$120{,}000$$

If not for the application of subsection 132-5(4), the AITC component would be nil and the decreasing adjustment would be $200,000.

Allocating price

49. Where you have acquired things at different times or for different purposes and you later sell those things together as a single taxable supply, you may be entitled to a decreasing adjustment under Division 132 in respect of one or more of those things. Whether Division 132 applies to you in respect of any of the things sold will depend on the reason for the denial of input tax credits on acquisition (or for a subsequent increasing adjustment as the case may be). If you are entitled to a decreasing adjustment under Division 132 in respect of one or more of the things sold, the amount of the adjustment is determined in accordance with the decreasing adjustment formula.

50. To apply the decreasing adjustment formula, you will need to ascertain the 'price' of the taxable supply.[19] Where a number of things are sold together on a global selling price basis, and you and the recipient of the supply have not identified the price of each thing sold, you should use a reasonable method to allocate that price to each relevant thing.[20] However, this allocation process is not necessary where you are entitled to a decreasing adjustment under Division 132 in respect of all the things that form part of the single taxable supply.

Acquisitions taken into account in determining the FITC component

51. As stated in paragraph 38, the FITC component in the decreasing adjustment formula is the amount of the input tax credit to which you would have been entitled for acquiring the thing solely for a creditable purpose. A question arises as to the level of identity required by Division 132 between the thing acquired and the thing subsequently sold.

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[19] Subsection 132-5(2) and section 9-75 (which defines the price of the taxable supply).

[20] See paragraphs 92 to 96 of GSTR 2001/8 for examples of guidance on a reasonable method of allocating price.

52. This question may arise in relation to acquisitions of services necessary to acquire the thing itself. The acquisition of a building, for example, may require the acquisition of valuation, conveyancing and legal services. The acquisition of plant or equipment may depend on the acquisition of transport services in order to move the plant or equipment to where it will be used.

53. The question may also arise where work is done to the thing itself between acquisition and sale. Examples of this may be repair work or improvements to the thing.

Services necessary for the acquisition of the thing

54. In our view, the FITC component does not include input tax credits on the acquisition of services on the basis that they were necessary for the acquisition of the thing itself. An exception to this is where the services supplied to you were integral, ancillary or incidental to the supply of the thing and were treated as forming, with the supply of the thing itself, a single, composite supply to you.[21]

55. Where your acquisition of the thing was separate from your acquisitions of the other services, 'the amount of the input tax credit to which you would have been entitled' is limited by section 11-25 to the amount equal to the amount of the GST payable on the supply of the thing to you. It does not include the amount of GST payable on the supply of other things to you.

Work done to the thing between acquisition and disposal

56. In our view, the FITC component does not include input tax credits on the acquisition of goods or services, such as consumables, repairs, spare parts or other things, where the acquisitions are subsumed into the thing subsequently sold. We consider that an acquisition is subsumed into the thing originally acquired where it replaces a part that existed in the thing as originally acquired, or is intended to maintain the thing in its condition as you originally acquired it. In these circumstances, we consider that the thing sold has the same identity as the thing originally acquired, regardless of these further acquisitions.

57. However, we consider that the FITC component does include input tax credits on a subsequent acquisition in relation to the thing, where the acquisition does more than merely maintain the thing in its condition as you originally acquired it. In these circumstances, we consider that the subsequent acquisitions represent identifiable differences between the thing sold and the thing originally acquired. Because of this, the adjustment available under Division 132 should take account of input tax credits on these acquisitions.

[21] See paragraph 17 of GSTR 2001/8, which is about apportioning the consideration for a supply that includes taxable and non-taxable parts.

Effect on the decreasing adjustment calculation

58. In some cases, whether or not the FITC component takes into account a related acquisition, as described in the preceding paragraphs, will not affect the calculation of the decreasing adjustment under Division 132. An example of this is a thing acquired and applied solely for making financial supplies until its sale as a taxable supply. In such an example, the AITC component will be nil, regardless of whether the related acquisition is taken into account in the FITC component. This is based on our view that, to the extent that an acquisition is related to a thing acquired or applied for making financial supplies, it is itself an acquisition that relates to, or is applied to making financial supplies to that extent.

59. However, even where the AITC is nil, taking an acquisition into account in determining the FITC may affect the amount of the decreasing adjustment. This may be the case, for example, where subsection 132-5(3) applies to limit the amount otherwise determined under the formula. A higher FITC combined with a nil AITC would mitigate the effect of subsection 132-5(3) in these circumstances and allow a higher decreasing adjustment.

Example 6: Effect on decreasing adjustment – transport services acquired as part of a composite supply

60. *Life Assurance Ltd (LA) acquires equipment for its operations, for a total price of $115,500, from ABC Equipment Ltd (ABC). The price includes an amount of $5,500 for transport, which is also provided by ABC as part of a single, composite supply to LA. LA applies the equipment 100% to making financial supplies and as such, is not entitled to an input tax credit on the acquisition of this composite supply. When LA subsequently sells the equipment as a taxable supply for a price of $88,000, it is entitled to a decreasing adjustment under Division 132.*

61. *For calculating the amount of the decreasing adjustment, the AITC component is nil. The FITC component is $10,500 (that is, $^{1}/_{11}$ × $115,500). The decreasing adjustment is calculated as:*

$$\frac{1}{11} \times \$88{,}000 \times \left[1 - \frac{0}{\$10{,}500}\right] \quad = \quad \$8{,}000$$

Example 7: Effect on decreasing adjustment – transport services acquired as a separate supply

62. *LA (from example 6) acquires more equipment from ABC for a price of $110,000, but acquires the necessary transport services from another supplier for a price of $5,500. LA applies the equipment 100% to making financial supplies and has no entitlement to input tax credits on this acquisition. When LA subsequently sells the equipment as a taxable supply for a price of $88,000, it is entitled to a decreasing adjustment under Division 132.*

63. *For calculating the amount of the decreasing adjustment, the AITC component, as in example 6, is nil. This time the FITC component is $10,000 (that is, $^{1}/_{11}$ ´ $110,000), however as shown in the following calculation, the amount of the decreasing adjustment works out to be the same as in example 6:*

$$\frac{1}{11} \times \$88{,}000 \times \left[1 - \frac{0}{\$10{,}000}\right] \quad = \quad \$8{,}000$$

Example 8: Effect on decreasing adjustment of different FITC where AITC is nil

64. *The facts remain as in example 7, except that this time LA sells the equipment for $121,000. The calculation under the formula would be as follows:*

$$\frac{1}{11} \times \$121{,}000 \times \left[1 - \frac{0}{\$10{,}000}\right] \quad = \quad \$11{,}000$$

65. *However, in this example, subsection 132-5(3) applies to limit the decreasing adjustment to the difference between the FITC and the AITC, that is, $10,000.*

66. *Note that, had the sale price of the equipment in example 6 been $121,000, the result of the formula would also have been $11,000. However, with the greater FITC component ($10,500) in that example, the application of subsection 132-5(3) would have resulted in a decreasing adjustment of $10,500.*

Addition after 1 July 2000 to pre-GST acquisition

67. Where, for example, a building is acquired and at a later date, an addition is made to the building, that addition could be expected to be an identifiable part of the building when it is subsequently sold. Where the acquisition of the building occurred before the start of GST and the addition was made after 1 July 2000, we consider that the decreasing adjustment formula applies to the addition to the building in the building that is subsequently sold.

Example 9: Addition after 1 July 2000 to pre-GST acquisition

68. *MNO Company Ltd (MNO) acquires a building in April 2000 for $5,500,000. A year later, MNO adds an extra wing to the building for $1,100,000. Since 1 July 2000, MNO has applied the original building to making financial supplies, and the new wing is also applied in this manner. In April 2002, MNO sells the building as a taxable supply for a price of $7,700,000. The additional wing is a clearly identifiable feature of the building when it is sold. MNO is entitled to a decreasing adjustment under Division 132.*

69. *The AITC component is nil. The FITC component is $100,000 (that is, $^{1}/_{11}$ ´ $1,100,000). There is no entitlement to a decreasing adjustment under Division 132 for the building acquired before the start of GST. The sale price in respect of the additional wing should be allocated on a reasonable basis as explained at paragraph 50, but in a situation of this kind, it is likely that subsection 132-5(3) would operate to limit the amount of the decreasing adjustment to $100,000.*

Sale of a thing that is a GST-free supply of a going concern under Subdivision 38-J

70. Where Division 132 applies to a GST-free supply of a going concern, the meaning of 'price' within the formula for such a supply may be unclear. This is because, in subsection 132-5(2), 'price' is defined as 'the price of the taxable supply'. In our view, the correct approach is to use the actual sale price of the going concern, as stipulated in the contract of sale.

71. Contracts of sale in respect of a GST-free supply of a going concern may contain an indemnity clause under which the recipient indemnifies the supplier to the extent of GST payable in the event that the supply is subsequently found not to be a GST-free supply. The existence of such an indemnity clause does not affect the actual sale price for GST purposes under the contract of sale, unless the indemnity is invoked.

72. To the extent that Division 132 applies to the sale of a thing which is a GST-free supply of a going concern, the thing to which Division 132 can apply is taken to be an individual thing that forms part of the going concern.

73. To calculate a Division 132 decreasing adjustment to which you may be entitled in respect of a GST-free supply of a going concern, you need to determine that part of the sale price of the going concern that relates to each thing sold.

Example 10: The supply of an individual thing forming part of the going concern

74. *Cabot Pty Ltd (Cabot) acquires an aircraft for $385,000 inclusive of GST for its charter enterprise. It claims a full input tax credit of $35,000.*

75. *Cabot later applies the aircraft 90% for creditable purposes and 10% privately. Cabot has an increasing adjustment of $3,500 ($35,000 ´ 10%) under Division 129 in the relevant adjustment period. There are no further changes in the application of the aircraft.*

76. *Five years later, Cabot sells all of the things that were necessarily applied in carrying on its enterprise to Lodge Services as a GST-free supply of a going concern and the aircraft is sold as part of the going concern for a global sale price of $10 million. Cabot*

applies a reasonable basis in apportioning $150,000 of the global sale price to the aircraft.

77. *Cabot is entitled to a decreasing adjustment under Division 132 on the sale of the aircraft. In applying the decreasing adjustment formula, the 'price' of the aircraft is $150,000. Cabot has a decreasing adjustment under Division 132 on the sale of the aircraft as follows:*

$$\frac{1}{11} \times \$150,000 \times \left[1 - \frac{\$35,000 - \$3,500}{\$35,000}\right] = \$1,364$$

Sale of a reduced credit acquisition

78. Division 70 allows a reduced input tax credit on specified acquisitions that relate to making financial supplies. Such acquisitions are referred to as reduced credit acquisitions. To the extent that each reduced credit acquisition relates to making financial supplies, an input tax credit of 75% is currently available.[22] If it were not for Division 70, there would be no entitlement to input tax credits (subject to certain limited exceptions)[23] to the extent that the acquisition relates to making financial supplies.

79. Division 132 can apply where you sell a thing that you acquired as a reduced credit acquisition and the requirements of Division 132 are met. In calculating the amount of a decreasing adjustment under Division 132, subsection 70-25(2) ensures that the definition of the FITC component in paragraph 132-5(2)(a) applies as intended by taking into account the maximum input tax credit to which you could have been entitled rather than a reduced input tax credit.

80. Subsection 70-25(3) alters the decreasing adjustment formula in subsection 132-5(2). In working out the AITC component of the formula, subsection 132-5(4) could be interpreted as requiring that the original acquisition be treated as not having been for a creditable purpose so far as it related to the making of financial supplies. That requirement would normally be the result under subsection 11-15(2). However, under Division 70, reduced credit acquisitions are made for a creditable purpose to the extent that they relate to the making of financial supplies. If subsection 132-5(4) prevented that creditable purpose from being taken into account in working out the AITC, then the Division 132 decreasing adjustment could not take into account your entitlement to a (partial) input tax credit on the reduced credit acquisition. The decreasing adjustment would therefore be overstated.

[22] A New Tax System (Goods and Services Tax) Regulations 1999 regulation 70-5.03.
[23] See subsections 11-15(4), which is about the financial acquisitions threshold and 11-15(5), which is about borrowing to make supplies that are not input taxed.

81. Subsection 70-25(3) prevents this possible anomaly by requiring that, in so far as the original acquisition was a reduced credit acquisition, subsection 132-5(4) still allows it to be treated as having been for a creditable purpose to the extent of the percentage credit reduction that applied at the time. The effect is that your input tax credit on the reduced credit acquisition is included in the AITC calculation along with any Division 11 input tax credits. Example 11 illustrates this effect.

Example 11: Reduced credit acquisition acquired partly for making financial supplies and partly for making taxable supplies

82. *Anchor Bank (which exceeds the 'financial acquisition threshold' under Division 189 and is therefore denied full input tax credits under Division 11) makes a reduced credit acquisition of $110,000, wholly for the purpose of carrying on its enterprise. This acquisition is applied to partly making financial supplies (40%) and partly making taxable supplies (60%). The extent to which Anchor Bank makes the acquisition for a creditable purpose is:*[24]

60% + (40% ´ 75%) = 90%

Thus, Anchor Bank is entitled to an input tax credit of $9,000, that is, 90% of $10,000.[25]

83. *Some years later, Anchor Bank sells the reduced credit acquisition for $99,000 (including GST). The amount of the decreasing adjustment under Division 132 is calculated as follows:*

$$\frac{1}{11} \times \$99{,}000 \times \left[1 - \frac{\$9{,}000}{\$10{,}000}\right] = \$900$$

84. *The sum of the input tax credit and decreasing adjustment Anchor Bank is entitled to is $9,900, that is,$9,000 + $900.*

85. *If it were not for subsection 70-25(3), the extent of creditable purpose calculated under the AITC component of the formula would have been calculated as follows:*

$$\frac{1}{11} \times \$99{,}000 \times \left[1 - \frac{\$6{,}000}{\$10{,}000}\right] = \$3{,}600$$

86. *The sum of the input tax credit and decreasing adjustment Anchor Bank would otherwise have been entitled to is $12,600, that is, $9,000+ $3,600, which would result in a total input tax credit and adjustment greater than the original GST liability on the acquisition by Anchor Bank ($10,000).*

[24] Section 70-20(2).
[25] Section 11-30.

Your comments

87. We invite you to comment on this draft Goods and Services Tax Ruling. Please forward your comments to the contact officer(s) by the due date.

Due date: **23 July 2004**
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Detailed contents list

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Commissioner of Taxation
9 June 2004

Previous drafts:

Not previously issued as a draft

Related Rulings/Determinations:

GSTR 1999/1; GSTR 2000/15; GSTR 2001/1; GSTR 2001/8

Subject references:

- acquisition
- adjusted input tax credit
- application
- barter
- composite supply
- creditable purpose
- decreasing adjustment
- disposal
- domestic and private nature
- financial supplies
- full input tax credit
- gifts
- GST-free supply of a going concern
- increasing adjustment
- input tax credit
- leases
- non-monetary consideration
- price
- reduced credit acquisition
- reduced input tax credits
- sale
- taxable supply

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NO: 2003/13555
ISSN: 1443-5160