GSTR 2008/D1 - Goods and services tax: registered agricultural managed investment schemes

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Generated on: 5 November 2026, 03:01:48 AM

Draft Goods and Services Tax Ruling

Goods and services tax: registered agricultural managed investment schemes

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Preamble

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way the law applies. It is not a ruling or advice for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953*. You can rely on this publication to provide you with protection from interest and penalties as follows. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

What this Ruling is about

1. This draft Ruling deals with the application of the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act) and the A New Tax System (Goods and Services Tax) Regulations 1999 (the GST Regulations) to agricultural managed investment schemes registered under the *Corporations Act 2001* (the Corporations Act).

2. As a consequence of the release of Taxation Ruling TR 2007/8[1] there is a need to consider the GST implications arising from the views expressed in that ruling about the nature of things done under the schemes covered by that ruling. In particular, this GST Ruling discusses the implications arising from a view that, in the typical registered agricultural managed investment scheme:

- the investor is making an investment on capital account;
- the investor is not carrying on an agricultural business;
- the Responsible Entity (RE) of the scheme is in a trust relationship with the investors as beneficiaries; and
- the RE is carrying on the agricultural business.

TR 2007/8 explains these views in detail and should be read in conjunction with this draft Ruling.

3. For GST purposes these views raise issues in relation to who carries on the agricultural enterprise, the nature of those activities and the nature of the supplies and acquisitions made by the RE and the investor, and their entitlement to input tax credits.

[1] TR 2007/8 Income tax: registered agricultural managed investment schemes.

4. There are a variety of types of managed investment scheme (MIS) that are quite different in legal form, structure and substance from agricultural MIS arrangements. The GST treatment of such arrangements relies on the individual facts and circumstances of each type of arrangement. The views expressed in this draft Ruling are only considered for GST purposes to apply to the particular circumstances of registered agricultural MIS arrangements within the class of entities and schemes covered by this draft Ruling.

Class of entities/scheme

5. This draft Ruling applies to the same entities and schemes set out in TR 2007/8. An explanation of those entities and schemes covered by this draft Ruling (taken from TR 2007/8) is set out in paragraph 10.

Date of effect

6. This draft Ruling represents the preliminary, though considered view of the Tax 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 to supplies and acquisitions made under schemes covered by this draft Ruling begun to be carried out on or after a future commencement date to be specified. Until that time, the Commissioner will not apply the view set out in this draft Ruling to schemes covered by it.

7. The commencement date will depend on whether there is a change in the Tax Office's views on the nature of the agricultural managed investment schemes set out in this Ruling and TR 2007/8 following the outcome of a test case on income tax issues associated with these schemes. Subject of course to the outcome of the test case, the commencement date will be after the resolution of the test case and also after a further transitional period to allow for any information technology, product disclosure, systems and process changes.

8. The final Ruling will be a public ruling for the purposes of section 105-60 of Schedule 1 to 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.

Background

9. The following paragraph is contained in TR 2007/8 and is equally applicable to this GST Ruling.

10. This draft Ruling applies to entities[2] participating as investors[3] in, and responsible entities of, registered agricultural managed investment schemes. These schemes exhibit the first three of the following features, and many of the remaining eleven:

- the scheme is a managed investment scheme (MIS) within the meaning in section 9 of the *Corporations Act 2001* (Corporations Act) involving the conduct of some type of agricultural activity, for example, the growing of agricultural produce for sale, such as standing timber, various sorts of horticultural produce, or the breeding or maintenance of animals, including marine animals, for sale, or for their produce;
- under section 9 of the Corporations Act, a scheme is a MIS where:
  - participants contribute money or money's worth to acquire rights to benefits produced by the scheme (such rights being referred to as 'interests');
  - the contributions are pooled or used in a common enterprise to produce financial benefits or benefits arising from interests in property for the contributors (referred to as 'members' of the MIS); and
  - members do not have day to day control[4] over the operation of the scheme (whether or not they have the right to be consulted or give directions);

[2] In this draft Ruling the term *entity* has the meaning set out in section 184-1 of the GST Act (see also section 960-100 of the *Income Tax Assessment Act 1997* (ITAA 1997)).
[3] Various names are used interchangeably in this draft Ruling to describe the entities participating as investors, for example, participants, members, investors and investor participants.
[4] As to the meaning of the phrase 'day to day control', see *Burton & Ors v. Arcus & Anor* [2006] WASCA 71.

- under Chapter 5C of the Corporations Act the scheme is required to be registered,[5] and there is a Responsible Entity, which under subsection 601FB(1) of Chapter 5C, is '… to operate the scheme and perform the functions conferred on it by the scheme's constitution',[6] and which under section 601FC of Chapter 5C, takes on certain trustee duties and responsibilities, including holding 'scheme property' on trust for the scheme members;
- under the scheme:
  - the investor participants typically enter into contractual arrangements which, on their face, provide for them to have some form of right of access to land or other medium on which the relevant agricultural activity is conducted, which may include rights to the use of certain other assets, and for the provision of various types of services connected with the operation of that activity;
  - amounts charged for things to be done for investors in their first year in the scheme often appear disproportionately high, when compared to amounts charged for the same or similar things to be done in subsequent years;
  - the produce of investors in the scheme is pooled under the control of a manager, for the purposes of sale; and
  - almost invariably, the scheme will be for a fixed duration;

[5] Section 601ED of the Corporations Act sets out when a managed investment scheme must be registered.

[6] Section 601GB of the Corporations Act says that the constitution of a registered scheme must be a document that is 'legally enforceable as between the members and the responsible entity'. Section 601GA of the Corporations Act says that the constitution must 'make adequate provision for' the consideration to be paid to acquire an interest in the scheme (paragraph (1)(a)); and the powers of the responsible entity in relation to dealing with scheme property (paragraph (1)(b)).

- the scheme is designed in terms of the scheme documentation conferring certain rights on the investors, (as described above), to give the appearance of those investors carrying on a business.[7] However, the size of the area of, for example, land allotted to an investor, may be quite small, especially in relation to the overall size of the scheme operations;
- other aspects of the overall design of the scheme look to ensure that the scheme is operated as a whole, rather than as a number of smaller operations, as it makes little commercial or agricultural sense to operate the scheme other than as one operation;
- consistently with the immediately preceding feature, investors are provided with incentives not to operate their interests personally, for example, changes to the operation of the scheme may require agreement from a high percentage of investors, which can constitute a significant practical impediment;
- wide ranging powers of attorney are commonly sought (often irrevocable), so that the investors' personal involvement with the operation of the scheme may be limited simply to the signing of an application form and power of attorney, and the payment of their initial contribution. As a result, investors become bound, for example, by the Constitution of the scheme, and other agreements relevant to the operation of the scheme. Typically, this may mean that in reality, the investors place themselves under the control of an 'agent' for the duration of the scheme;
- there may be restrictions imposed on investors so that, for example, they cannot go on the land to which they ostensibly have access, or take any part in the agricultural operations, without the permission of the manager, in contrast to the position of a business owner or manager in any ordinary sense;
- during the term of the scheme the identity of investors may change without reference to the other investors, and there may be associated agreements under which investors acquire shares or units connected with the conduct of the scheme;

[7] A similar observation was made in *Puzey v. FC of T* [2003] FCAFC 197 by Hill and Carr JJ (French J agreeing), in relation to a sandalwood scheme, similar to the type to which this draft Ruling applies. Their Honours said at [54]: 'In our view the present case is on the borderline. It would be possible as the learned Primary Judge said, to see Mr Puzey as no more than a passive investor, despite agreements he entered into which sought to give him the appearance of a person carrying on a business.'

- calculation of returns payable to investors is not confined solely to, for example, the agricultural activities conducted on their allotment, but done with reference to the results of the operation of the scheme as a whole;[8]
- sometimes the scheme will involve investors being introduced into a 'going concern', for example, where the Responsible Entity has acquired control over an already established business, such as an established orchard or vineyard;
- the most important and ultimate obligation owed to investors does not concern the provision of certain services or access to land, but the investors' entitlement to receive a share of the net proceeds of the sale of the agricultural produce from the scheme as a whole in proportion to the number of interests they hold in the scheme;
- often the key attraction to investors is the expectation that they will be able to deduct all, or a substantial part of, the 'amount of their investment', including any portion represented by borrowed funds.[9]

Nature of the relationship between the RE and investors and role of the RE

11. TR 2007/8 explains in considerable detail the nature of the relationship between the RE and the investor and the role that is played by the RE. The essence of the views expressed in that ruling on those issues is as follows:[10]

- The RE is a trustee holding 'scheme property' on trust for the investors as beneficiaries.[11]
- The RE has all the rights, duties and powers of a trustee to do the things necessary to carry out the scheme and hold the scheme property for the purposes of the scheme, and when it carries out the scheme it does so as a trustee.[12]

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[8] See for example, albeit in the context of a non agricultural scheme, *Australand Corporation (Qld) Pty Ltd v. Johnson & ors* [2007] QSC 13, and the observations of McMurdo J at [40], to the effect that the scheme there involved 'the one business'.

[9] In *Australian Securities & Investments Commission v. GDK Financial Solutions Pty Ltd* [2006] FCA 1415, Finkelstein J said in relation to investors investing in the managed investment scheme in that case (a retirement village scheme), at [4]: 'The key attraction to investors was the expectation that they would be entitled to deduct from their assessable income not only the amount of their investment but also their proportionate share of the loan taken to pay the balance of the purchase price.'

[10] See TR 2007/8, paragraphs 29 to 66.

[11] See in particular paragraphs 8 to 10 and 56 to 66 of TR 2007/8.

[12] See in particular paragraphs 45 to 55 of TR 2007/8.

- 'Scheme property' is the contributions made by the investor and what they are ventured into, and notably includes the pooled produce.[13]
- The RE is carrying on the business of the scheme.[14]

12. It is against that background, and the rationale set out in TR 2007/8, that the following explanation of the GST consequences of the schemes covered by this draft Ruling is made.

Previous Rulings

13. Goods and Services Tax Advice GSTA TPP 001 deals with the question 'Are investors (participants) in an agricultural managed investment scheme required to register for GST?' That advice says that an individual investor is required to be registered for GST if the investor meets the registration threshold and is carrying on an enterprise. It notes that agricultural managed investment schemes are often structured so that investors carry on individual enterprises, but notes that these questions need to be answered on a case by case basis.

14. GSTA TPP 001 is to be withdrawn from the date of effect of the final Ruling.

Legislative context

GST legislation

15. Under section 9-5 of the GST Act, an entity makes a taxable supply if:

(a) the supply is for consideration; and

(b) the supply is made in the course or furtherance of an enterprise that the entity carries on; and

(c) the supply is connected with Australia; and

(d) the entity is registered or required to be registered for GST.

However, the supply is not a taxable supply to the extent that it is GST-free or input taxed.

16. Under subsection 40-5(1) of the GST Act, a financial supply is input taxed. The term financial supply is defined in the GST Regulations.

[13] See in particular paragraphs 45 to 55 of TR 2007/8.
[14] See in particular paragraphs 8 and 66 of TR 2007/8.

17. Subregulation 40-5.09(1) of the GST Regulations provides that the provision, acquisition, or disposal of an interest mentioned under subregulation 40-5.09(3) or 40-5.09(4) of the GST Regulations is a financial supply if:

(a) the provision, acquisition or disposal of that interest is:

- for consideration; and
- in the course or furtherance of an enterprise; and
- connected with Australia, and

(b) the supplier is:

- registered or required to be registered for GST, and
- a financial supply provider in relation to supply of the interest.

18. Item 10 of the table in subregulation 40-5.09(3) of the GST Regulations lists an interest in or under securities. The term 'securities' is defined in the GST Regulations as having the meaning given by subsection 92(1) of the Corporations Act.

19. Something that is a security under the Corporations Act is therefore also a security for the purposes of item 10 of the table in subregulation 40-5.09(3) of the GST Regulations.

20. Section 11-20 of the GST Act provides that an entity is entitled to an input tax credit for any creditable acquisitions that it makes.

21. Under section 11-5 of the GST Act, an entity makes a creditable acquisition if:

(a) the acquisition is solely or partly for a creditable purpose; and

(b) the supply of the thing to the entity is a taxable supply; and

(c) the entity provides, or is liable to provide, consideration for the supply; and

(d) the entity is registered or required to be registered for GST.

22. Section 11-15 of the GST Act provides that an acquisition is for a creditable purpose to the extent that the entity acquires it in carrying on its enterprise. However, an acquisition is not for a creditable purpose to the extent that it relates to making supplies that would be input taxed.[15]

[15] There are exceptions to this exclusion. Refer subsections 11-15(4) and (5) of the GST Act.

Corporations Act 2001

23. Paragraph (c) of subsection 92(1) of the Corporations Act provides that an interest in a managed investment scheme is a security for the purposes of that Act.

24. Section 9 of the Corporations Act defines 'managed investment scheme', as, inter alia:

> a scheme that has the following features:
>
> (i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);
>
> (ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the *members*) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);
>
> (iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions);
>
> …

25. Section 9 also provides that:

> 'interest in a managed investment scheme' means a right to benefits produced by the scheme (whether the right is actual, prospective or contingent and whether it is enforceable or not).

26. Chapter 5C of the Corporations Act deals with the registration, regulation and winding-up of managed investment schemes. The responsible entity of a registered scheme must be a public company that holds an Australian financial services license authorising it to operate a managed investment scheme (section 601FA of the Corporations Act).

27. Under subsection 601FB(1) of the Corporations Act, the responsible entity is required to operate the scheme and perform the functions conferred on it by the scheme's constitution, and that Act. A responsible entity also has power to appoint an agent, or otherwise engage a person to do anything that it is authorised to do in connection with the scheme (subsection 601FB(2) of the Corporations Act).

28. The responsible entity holds scheme property on trust for scheme members (subsection 601FC(2), Corporations Act). The term 'scheme property' is defined by section 9 of the Corporations Act only in relation to a 'registered scheme'. That definition is as follows:

> **scheme property** of a registered scheme means:
>
> (a) contributions of money or money's worth to the scheme; and
>
> (b) money that forms part of the scheme property under the provisions of this Act or the ASIC Act; and

(c) money borrowed or raised by the responsible entity for the purposes of the scheme; and

(d) property acquired directly or indirectly, with, or with the proceeds of, contributions or money referred to in paragraph (a), (b) or (c); and

(e) income and property derived, directly or indirectly, from contributions, money or property referred to in paragraph (a), (b), (c) or (d).

Note 1: Paragraph (a) – if what a member contributes to a scheme is rights over property, the rights in the property that the member retains do not form part of the scheme property.

Note 2: [not presently relevant].

29. Paragraphs 34 to 55 of TR 2007/8 set out a detailed explanation of case law that has considered the meaning of these provisions of the Corporations Act.

Frequently used terms

30. In this draft Ruling:

- 'MIS' includes the term 'scheme' and refers to a managed investment scheme covered by this draft Ruling (see paragraph 10 of this draft Ruling);
- 'RE' means the Responsible Entity of a scheme; and
- 'contributions' means contributions to an MIS as covered by paragraph (a)(i) of the definition of 'managed investment scheme' in section 9 of the Corporations Act.

Ruling

31. The following summarises the GST outcomes that arise in relation to the entities and schemes covered by this draft Ruling.

32. The RE as the trustee of a trust makes an input taxed financial supply to the investor consisting of the supply of the interest in the MIS (or alternatively of an interest in the capital of a trust).

33. Contributions made by an investor to the scheme are considered to include monies paid by the investor as a requirement for participation in the scheme (including monies labelled as 'management fees').

34. All the contributions made by the investor to the RE as the trustee of a trust are the consideration for that input taxed financial supply by the trust. It follows there will be no GST on this supply and no entitlement for any input tax credits by the investor.

35. Any acquisitions made by the RE as trustee of a trust are not for a creditable purpose to the extent they relate to making the input taxed financial supply.[16]

36. The investor will ordinarily not be considered to be carrying on an agricultural enterprise for GST purposes.[17] Rather, on the assumption that the operation of the scheme exhibits the features marking it out as a business,[18] the RE as trustee of a trust (the managed investment scheme), carries on the agricultural enterprise for GST purposes.

37. The RE as trustee of a trust will make supplies of agricultural produce as the trustee of the trust and, similarly, acquisitions for agricultural operations will also be made by the trustee. GST (if any) will be payable on the supply of agricultural products and there will be an entitlement to input tax credits for acquisitions that relate to the making of this supply. Consequently, there will be a need for the RE to register the trust entity, lodge BASs for that entity, pay GST on the taxable supplies of produce that the trust entity makes and claim input tax credits for creditable acquisitions made in carrying on its agricultural enterprise as a trustee.

Explanation (this forms part of the Ruling)

Factors influencing the characterisation of an arrangement for GST purposes

38. In TR 2007/8 the Commissioner takes the view that investor contributions to an agricultural managed investment scheme are more properly characterised according to the substance of the scheme in question when looked at as a whole. As a result of this approach, the Commissioner takes the view that these contributions represent the capital cost of the investor's interest in the scheme and are therefore not deductible under section 8-1 of the ITAA 1997.

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[16] Goods and Services Tax Ruling GSTR 2006/4 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 explains how to apportion the consideration for any acquisition that is only partly for a creditable purpose (GSTR 2006/4). Note also that input tax credits are unavailable only where the 'financial acquisitions threshold' is exceeded (see Division 189 of the GST Act).

[17] The primary view is that the investor is not carrying on a business and therefore an enterprise.

[18] See Miscellaneous Taxation Ruling MT 2006/1 The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number.

39. In analysing a transaction for GST purposes, regard must be given to the true character of the arrangement in which the transaction arises and all the facts and circumstances surrounding it. While the legal form of a transaction is relevant, support for not unduly focussing on the legal interests in transactions involving land can be found in the *Sterling Guardian Pty Ltd v. FC of T* (*Sterling Guardian*),[19] *Saga Holidays Limited v. Commissioner of Taxation* (*Saga Holidays*)[20] and United Kingdom value added tax cases.

40. The practical business approach to GST was confirmed by the Full Federal Court decision in *Saga Holidays*[21] where Stone J, with whom the other members of the Full Court agreed, saw this as part of the context for the interpretation of the GST legislation. Her Honour also regarded the approach of Lord Hoffman in *Beynon and Partners v. Commissioner of Customs and Excise* (*Beynon*)[22] in focussing on the 'social and economic reality' of a transaction as being relevant in an Australian GST context.[23]

41. Where parties to a transaction have reduced their understanding of the transaction to writing, that documentation is the logical starting point in determining the supplies that have been made. However, it is also necessary, in determining whether the documentation captures the nature of a transaction for GST purposes, to examine the surrounding circumstances, including any relevant statutory provisions that govern the arrangement, which together form the total fact situation.

42. In accordance with the above, we consider that the correct approach in determining the GST character of the supplies and acquisitions that arise in relation to agricultural MISs is to examine the total fact situation surrounding the arrangement as a whole, and not just its legal form. We consider that this approach is consistent with the approach taken by the Commissioner in TR 2007/8 in determining the income tax treatment that applies to such arrangements.

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[19] *Sterling Guardian Pty Ltd v. FC of T* [2005] FCA 1166; (2005) 220 ALR 550; (2005); [2005] ALMD 8602; 2005 ATC 4796; (2005) 60 ATR 502 *Sterling Guardian Pty Ltd v. FC of T* (2006) [2006] FCAFC 12; (2006) 149 FCR 255; 228 ALR 712; [2007] ALMD 1419; 2006 ATC 4227; (2006) 62 ATR 119.

[20] *Saga Holidays Limited v. Commissioner of Taxation* [2006] FCAFC 191; 2006 ATC 4841; (2006) 64 ATR 602.

[21] *Saga Holidays Limited v. Commissioner of Taxation* [2006] FCAFC 191 at 29; 2006 ATC 4841; (2006) 64 ATR 602..

[22] *Beynon and Partners v. Commissioner of Customs and Excise* [2005] 1 WLR 86.

[23] *Saga Holidays Limited v. Commissioner of Taxation* [2006] FCAFC 191 at 43; 2006 ATC 4841; (2006) 64 ATR 602.. The Full Federal Court also considered the 'social and economic reality approach' in its decision in *Reliance Carpet Co Pty Limited v. Commissioner of Taxation* [2007] FCAFC 99, from which the Commissioner has sought special leave to appeal to the High Court.

Character of the supply between the RE and the investor

43. It would be common ground that an investor in an agricultural MIS obtains some form of interest in the MIS and such arrangements, if a registered scheme, would be regulated under the Corporations Act.

44. For GST purposes, regulation 40-5.09 of the GST Regulations includes a table of things, the supply of an interest in which is a financial supply. Notable is item 10 'Securities', which is defined in the dictionary at the end of the GST Regulations as having the meaning given by subsection 92(1) of the Corporations Law. Subsection 92(1) of Chapter 1 of the Corporations Act states that securities means among other things 'interests in a managed investment scheme'.[24] An agricultural MIS meets the definition of an MIS in paragraph (a) of section 9 of the Corporations Act and is therefore a security for the purposes of item 10 of the table in subregulation 40-5.09(3) of the GST Regulations.[25]

45. In regulation 40-5.02 'Interest' is defined broadly to mean 'anything that is recognised at law or in equity as property in any form'. Under an agricultural MIS, the RE as the trustee of a trust supplies an interest in a security which is a financial supply if it is for consideration (provided the other requirements of regulation 40-5.09(1) are satisfied).

What is the consideration for the supply to the investor?

46. Consideration for GST purposes is defined in section 195-1 of the GST Act to mean 'any consideration, within the meaning given by section 9-15, in connection with the supply or acquisition'.

47. Section 9-15 expands on the meaning of 'consideration for a supply'. Consideration includes any payment, act or forbearance in connection with, in response to, or for the inducement of, a supply of anything.[26] Consideration may be provided voluntarily, or by someone other than the recipient of the supply.[27]

48. For the purposes of the GST Act it is clear that 'consideration' has a broad meaning.[28]

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[24] Note that legislative references in the GST Regulations refer to the Corporations Law which is now contained in the Corporations Act.

[25] The GST Regulations refer to an interest in a security which is further defined to include an interest in an MIS. Read strictly, this may mean an interest in an interest of an MIS. As a matter of construction this should be read as meaning no more than an interest in an MIS.

[26] Subsection 9-15(1).

[27] Subsection 9-15(2).

[28] See Goods and Services Tax Rulings GSTR 2001/6 Goods and services tax: non-monetary consideration and GSTR 2003/12 Goods and services tax: when consideration is provided and received for various payment instruments and other methods of payment.

49. In a similar fashion to the GST legislation in New Zealand, the nature of the nexus required between supply and consideration is specified in the definition of consideration.[29] A payment will be consideration for a supply if the payment is 'in connection with', 'in response to' or 'for the inducement' of a supply.

50. In determining whether a payment is consideration under subsection 9-15(1), the test is whether there is a sufficient nexus between the supply and the payment made.

51. The meaning given to the term 'in connection with' in *Berry v. FC of T* (1953) 89 CLR 653[30] (*Berry's case*) is similar to that which was described by the New Zealand Court of Appeal in *C of IR v. New Zealand Refining Co. Ltd*,[31] but needs to be applied with regard to the structure of the definition of supply in the GST Act. In *Berry's case*, Kitto J held that 'in connection with' was a broader test than 'for'. At page 659, his Honour commented that consideration will be in connection with property where:

> the receipt of the payment has a substantial relation, in a practical business sense, to that property.

52. In determining whether a sufficient nexus exists between supply and consideration, regard needs to be had to the true character of the transaction. As discussed above, an arrangement between parties will be characterised not merely by the description that parties give to the arrangement, but by looking at all of the transactions entered into and the circumstances in which the transactions are made.[32]

53. The test as to whether there is a sufficient nexus is an objective test. The motive of the supplier and the recipient also may be relevant in determining whether the supply was made for consideration, if a reasonable assessment of the evidence supports that motive.

Contributions as consideration for an interest in a MIS

54. Contributions by investors are often made initially in the form of an application fee. This fee is often subsequently applied as an establishment and/or management fee to acquire for the investor the things set out in section 9 of the Corporations Act namely:

> participants contribute money or money's worth to acquire rights to benefits produced by the scheme (such rights being referred to as 'interests');

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[29] Subsection 2(1) of the *Goods and Services Tax Act 1985* (New Zealand).
[30] In the High Court decision, Kitto J considered the meaning of consideration 'for or in connection with' in the context of former section 84 of the *Income Tax Assessment Act 1936*, a provision which included consideration for or in connection with goodwill in a lease premium.
[31] (1997) 18 NZTC 13,187 at 13,193 - 13,194 per Blanchard J.
[32] *Marac Finance Ltd v. Virtue* (1981) 1 NZLR 586.

55. In TR 2007/8 the Commissioner has expressed the view that for income tax purposes, the contributions by investors in a registered agricultural MIS are the capital cost of the investor's interest in the scheme.

56. For GST purposes, we consider that the contributions by the investors are in connection with, and have a substantial relation to, the supply of the interest in the MIS.

57. In our view, an examination of all the circumstances surrounding the arrangement and of the operation of specific GST provisions, leads to a conclusion that the true character of the contributions by the investors is that it is consideration for the supply of the interest in the MIS (or alternatively of an interest in the capital of a trust). We consider this conclusion may be reached even though the legal form of the documents forming part of the scheme arrangement may give the investor rights to things such as access to land, or the services of a manager.[33]

58. We consider that when viewed objectively, it is the promise of the return from the scheme as a whole that induces the investor to furnish the amounts of consideration required to participate under the scheme.

59. The reality and substance of the schemes in question is that the right to share in these net proceeds is the most important part of the investor's parcel of rights, constituted as their 'interest' in the investment scheme. The investor's contributions can be said on this basis to procure for them this right.

60. It is our view, that there is sufficient nexus between the supply by the RE, as the trustee of the trust, of the interest in the MIS and all of the contributions paid by an investor. The contributions by the investor are therefore consideration for an input taxed financial supply, being an interest in a security that is an interest in the MIS.

61. The conclusion above (that for GST purposes, the investor's contributions are consideration for the supply of an interest in the MIS) is consistent with the view expressed in TR 2007/8, that for income tax purposes, the contributions represent the capital cost of the investor's interest in the scheme.

Financial supply as an interest in a trust

62. The question can arise as to whether there is a further, alternative, argument that the contributions an investor furnishes have the character of consideration for an input taxed financial supply, namely an acquisition of an 'interest in the capital of a trust'.

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[33] It does not matter whether there are separate supplies of such things, as the investor's contributions are not consideration for them. For the reasons stated in paragraphs 56 to 58 the investor's contributions are consideration for the interest in the MIS.

63. TR 2007/8 expresses the view that an investor becomes a beneficiary of a trust when it acquires an interest in a registered MIS. For GST purposes this view relies upon the meaning of 'securities' in item 10 of the table in subregulation 40-5.09(3) of the GST Regulations which includes the capital of a trust.[34]

64. An investor in securing their interest in an MIS may be seen as securing an interest in the capital of a trust, constituted by that scheme. This view of the nature of the consideration could apply not only to the consideration required to be furnished by the investor upon entry into the scheme, but to subsequent amounts of consideration required of the investor under the scheme arrangement.

65. This position is consistent with the view that what induces the investor to furnish consideration is the promise of returns from the operation of the scheme as a whole.

Is the RE carrying on an enterprise?

66. As explained in TR 2007/8 and noted above, it is the Commissioner's view that a trust relationship exists between the investor and the RE and that ruling discusses the nature of this trust. TR 2007/8 also puts forward a view that the agricultural business is carried on by the RE in its capacity as a trustee.[35] For the same reasons it can logically follow for GST purposes that it is the RE who carries on the agricultural enterprise. Under such a view the RE will conduct this enterprise as trustee of an MIS trust entity and will therefore be required to register in this capacity (as trustee of this MIS trust entity) and will remit GST on the trust's supplies of produce (unless special treatment applies such as for GST-free exports).

67. The RE will manage the overall scheme activities, which includes arranging agricultural operations. In relation to the circumstances where the RE is contracting with a manager to establish and cultivate the produce, the RE's activities will be seen to be in its capacity as a trustee.

68. The MIS trust entity, with the RE as trustee, will make all the supplies of the produce to purchasers notwithstanding the terms of the agreements entered into by the investor that provides that the RE will make any supplies of produce as agent for the investor. This follows even though the contractual arrangements relating to the scheme may state that the produce is the property of the investors. The fact remains that the produce is pooled (usually once harvested) and is sold from that pool. The pooled produce is 'scheme property'[36] and is supplied to purchasers by the RE as trustee of the MIS trust.

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[34] Item 10 refers to an interest in or under 'Securities, including: … (d) the capital of a partnership or trust'.
[35] See paragraphs 8 and 66 of TR 2007/8.
[36] And so is held on trust.

69. Broadly, acquisitions made by the RE as trustee in carrying on the agricultural enterprise will be for a creditable purpose, except to the extent the acquisitions relate to the making of input taxed supplies.[37]

70. Examples of acquisitions that relate to the making of input taxed financial supplies (such as the supply of the interest in the MIS to the investor) include acquisitions relating to the issue of a product disclosure statement.

Is the investor carrying on an enterprise?

71. The concept of enterprise for GST purposes is wider than carrying on a business due to the statutory definitions found in the GST Act and may for example include leasing or commencement or termination activities that would not be held for income tax purposes to be carrying on a business.[38]

72. In TR 2007/8 the Commissioner takes the view that investors in schemes to which that (and this) Ruling applies are not considered to be carrying on a business.[39] Rather, the business activities are carried on by the RE (as the investor is merely passive, getting a return from an interest in an MIS). It follows that the investor in such circumstances is also not considered to be carrying on an enterprise for GST purposes (if they do not meet any other enterprise categories in section 9-20 of the GST Act).

73. Having regard to all the facts and circumstances, mere investors in a registered agricultural MIS covered by this draft Ruling are ordinarily[40] not carrying on an enterprise because they are not conducting leasing activities or carrying on a business or entering into an adventure or concern in the nature of trade.[41]

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[37] GSTR 2006/4 explains how to apportion the consideration for any acquisition that is only partly for a creditable purpose. However, the RE would be entitled to full input tax credits for these acquisitions if it does not exceed the financial acquisitions threshold – see paragraph 11-15(4)(b) and Division 189 of the GST Act. If the RE exceeds the financial acquisitions threshold, an entitlement to a reduced input tax credit for certain acquisitions may arise under Division 70 of the GST Regulations.

[38] See section 9-20 of the GST Act.

[39] See paragraphs 11 to 12 and 67 to 100 of TR 2007/8.

[40] The view expressed in TR 2007/8 that in some circumstances the investors may carry out a profit making undertaking, scheme or plan was not the primary view put forward in that ruling. It is only argued in the alternative and subject to the primary view not being sustained. The primary view is that the RE carries on the agricultural business and the investors are not carrying on a business but are merely passive investors.

[41] This draft Ruling does not consider whether an enterprise is carried on by an entity by trading in MIS interests. Refer paragraph (b) of section 11-5 of the GST Act.

74. In Miscellaneous Taxation Ruling MT 2006/1[42] and Goods and Services Tax Determination GSTD 2006/6,[43] the Commissioner has set out his views on an entity carrying on an enterprise. The Commissioner has taken a restricted view on the meaning of the words 'in the form of' which appears in front of 'a business' or 'an adventure or concern in the nature of trade'. Broadly under this view, it is only in very limited circumstances (non-profit entities) that 'in the form of' may expand the meaning of business (which is already a broad concept) and it does not add in any practical sense to the meaning of adventure or concern in the nature of trade.

75. Although these rulings do not deal specifically with an interest an investor has in a MIS, some guidance may be found for GST purposes where the ruling expresses a view that the holding of a passive investment in shares (also an input taxed security) is not considered of itself to be carrying on an enterprise. This issue has arisen where 'mum and dad' investors have shares as individuals, in partnership or through a trust and wish to be registered for GST. Our view is that they are not entitled to register as they are not carrying on an enterprise. This is also the case even where parcels of shares are bought and sold to maintain their investment portfolio. (This is not to be confused with the situation of a share trader that is not a passive investor.)

76. The reasoning in paragraph 75 of this draft Ruling provides context and is relevant to the key point that if the RE as trustee of a trust (the MIS) is carrying on the agricultural enterprise, a mere passive investor in the MIS is not considered to be carrying on the agricultural enterprise. Broadly from the investor's perspective if they are not carrying on an enterprise because they do not fall under one of the categories of the GST definition of enterprise, then they are not entitled to register for GST.[44] It follows that the investor is not entitled to claim any input tax credits in relation to that activity.

77. If an investor is already carrying on an enterprise by way of other activities it is likely that the activity related to the mere holding of their interest in the MIS is outside the scope of their enterprise in the same way a building contractor may hold shares as a private investment that is not part of his or her business. If the enterprise already being carried on is in the agricultural industry it is a question of fact and degree, but in our view it remains likely that the position is the same as that outlined in the building contractor example such that an interest held in a MIS is not part of the particular enterprise being carried on.[45]

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[42] The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number.

[43] Goods and services tax: does MT 2006/1 have equal application to the meaning of 'entity' and 'enterprise' for the purposes of the *A New Tax System (Goods and Services Tax) Act 1999*?

[44] This draft Ruling does not consider the circumstances where an entity may trade in any form of secondary markets in MIS interests.

[45] Note that even if an investor was carrying on an enterprise related to their acquisition of an interest in the MIS, they will not be entitled to an input tax credit for that acquisition. This is because the investor would make an 'acquisition supply' when they make the acquisition of the interest in the MIS (see subregulation 40-5.06(2) of the GST Regulations).

78. It is also our view that even if an investor acquired the interest in the MIS in connection with carrying on its enterprise, the supply of the interest to the investor is an input taxed supply, and therefore an entitlement to an input tax credit would not arise for the investor. This is because the supply to the investor is not a taxable supply.[46] Also, in acquiring the interest in the MIS, the investor would be making an acquisition-supply of that interest.[47] The acquisition-supply would be an input taxed financial supply, and therefore any acquisitions by the investor that relate to that acquisition-supply would not be for a creditable purpose – unless the investor did not exceed the financial acquisitions threshold.[48]

Alternative views

79. TR 2007/8, at paragraphs 168 to 189, recognises that there are alternative views (not supported by the Commissioner) as to the legal effects and taxation treatment of registered agricultural MIS's.

Investors carrying on a business

80. From a GST perspective it has been put forward, and previously accepted by the Tax Office, that depending on the facts and circumstances in individual cases, investors may carry on individual agricultural businesses and therefore be considered as carrying on an enterprise.

81. Under this view it is argued that the consideration furnished by an investor in an agribusiness MIS should be accepted as being for the supply of the things described in the scheme documentation, such as management services, leasing of farm lots, clearing of the land, and supply and planting of seedlings, and it would therefore follow that fees paid to the RE by the investor would be treated as consideration for taxable supplies, under the general provisions of the GST law. Under such an interpretation although these fees are associated with the entry of an investor into the agribusiness MIS, the acquisition of an interest in the scheme can be viewed, having regard to all the relevant facts and circumstances, as an incidental matter. The primary nexus under this view is that consideration relates to the acquisition of services or licences etc, and is not for an interest in a security.

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[46] Refer paragraph (b) of section 11-5 of the GST Act.
[47] Refer paragraphs 22 to 26 of Goods and Services Tax Ruling GSTR 2002/2 Goods and services tax: GST treatment of financial supplies and related supplies and acquisitions.
[48] Section 11-15 of the GST Act.

Investor carrying out an adventure or concern in the nature of trade

82. TR 2007/8, at paragraphs 127 to 138, acknowledges an alternative view that investors in some circumstances may be considered as carrying out for income tax purposes a profit making undertaking, scheme or plan. In GST terms this would be equivalent to an adventure or concern in the nature of trade.

83. Under section 9-20 of the GST Act, an enterprise includes an activity or series of activities done in the form of an adventure or concern in the nature of trade. Therefore, if the investor is considered to be carrying out a profit making undertaking or plan, then for GST purposes, the investor is carrying on an enterprise for the GST. In such circumstances, the investor may be entitled to register for GST purposes.

84. However, even if the investor was registered for the GST, this would not alter the GST character of the supply (of the interest in the MIS) made by the RE as trustee to the investor. This supply would still be an input taxed financial supply, and the investor, in acquiring that input taxed interest in the MIS, would be making an input taxed acquisition-supply.[49]

85. The GST consequences of this are that there would be no GST on the supply of the interest in the MIS; and acquisitions made by the investor in carrying on that enterprise would be for a creditable purpose, except to the extent the acquisitions related to the acquisition of the interest in the MIS (or any other input taxed supplies).

86. We consider the better view is that the RE as trustee of a trust (the MIS) makes a supply to the investor of an interest in the MIS (or alternatively of an interest in the capital of a trust). The consideration for GST purposes is primarily for the acquisition of the interest in the MIS and not for services, etc. The result is that the amounts paid by the investor to the RE have the character of consideration for an input taxed financial supply, being an interest in a security. The investor merely acquires an interest in the MIS, rather than acquiring business inputs.

87. Further, for the reasons set out in the explanation to this draft Ruling, we consider that ordinarily an individual investor would not be carrying on an enterprise in the schemes covered by this draft Ruling.

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[49] See paragraph 9-20(1)(b) of the GST Act and MT 2006/1 at paragraphs 233 to 261 and subregulation 40-5.06(2) of the GST Regulations.

Your comments

88. We invite you to comment on this draft Goods and Services Tax Ruling. Please forward your comments to the contact officer by the due date. (Note: the Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel or relevant Tax officers. The Tax Office may use a version (names and identifying information removed) of the compendium in providing responses to persons providing comments. Please advise if you do not want your comments included in the latter version of the compendium.)

Due date:	**11 April 2008**
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Commissioner of Taxation
27 February 2008

Previous drafts:

Not previously issued as a draft

Related Rulings/Determinations:

GSTR 1999/1; GSTR 2001/6; GSTR 2002/2; GSTR 2003/12; GSTR 2006/4; GSTD 2006/6; MT 2006/1; TR 2007/8

Previous Rulings/Determinations:

GSTA TPP 001

Subject references:

- acquisition
- consideration
- creditable acquisition
- carrying on an enterprise
- financial supplies
- supply

Legislative references:

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NO:	2007/18970
ISSN:	1443-5160
ATOlaw topic:	Goods and Services Tax ~~ General rules and concepts ~~ course or furtherance of enterprise Goods and Services Tax ~~ General rules and concepts ~~ entitlement to input tax credits Goods and Services Tax ~~ Primary production ~~ other