GSTD 2001/2 - Goods and services tax: is the sale of goods by a lessor on expiry of a lease agreement a separate supply to the lease of the goods?

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Goods and Services Tax Determination

Goods and services tax: is the sale of goods by a lessor on expiry of a lease agreement a separate supply to the lease of the goods?

Preamble

*This document was published prior to 1 July 2010 and was a public ruling for the purposes of former section 37 of the **Taxation Administration Act 1953** and former section 105-60 of Schedule 1 to the **Taxation Administration Act 1953**.*

*From 1 July 2010, this document is taken to be a public ruling under Division 358 of Schedule 1 to the **Taxation Administration Act 1953**.*

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you - provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

*[**Note:** This is a consolidated version of this document. Refer to the Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

Date of Effect

This Determination applies both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Note: Changes made to the Determination by Addenda that issued on 31 October 2012 and 2 October 2013 have been incorporated into this version of the Determination. Refer to each Addendum to see how that Addendum amends this Determination.

1. Yes. The sale of the goods by the lessor is a separate supply to the supply by way of lease. This is the case whether the lessor sells the goods to the lessee or to a third party.

2. Lease agreements provide for the lessee to use goods, for example, a motor vehicle, for the term of the lease for consideration in the form of periodic payments. Lease agreements usually specify the residual value of the goods, and that the lessee is liable for any shortfall between this residual value and the amount for which the goods are sold. Such a provision in a lease agreement is commonly called a guaranteed lease residual or a guaranteed residual value clause. Some lease

agreements also provide that the lessee is entitled to any surplus if the residual value is less than the net amount for which the goods are sold.

3. Lease agreements also include a provision that, on termination of the lease, either the lessee return the goods to the lessor or that the lessee has no right or obligation to purchase the goods. Where the lessee has the right or obligation to purchase the goods on termination of the lease, the agreement would be a hire purchase agreement rather than a lease agreement. In the absence of an obligation or right to purchase in the agreement, it is nevertheless common practice for the lessee to acquire the goods on expiry of the lease for an amount equal to the residual value. Where the lessee does acquire the previously leased goods, they are not acquired under the terms or conditions of the lease agreement, but under a separate or collateral agreement that is separately negotiated between the parties.

4. The supply of the goods by way of lease may be GST-free under the GST transitional rules.[1] The sale of the goods by the lessor is a separate supply to the lease of the goods and is not identified in the lease agreement. Therefore the sale of the goods on or after 1 July 2000 will not be a GST-free supply under the transitional rules.

5. Where the sale of the goods to the lessee or a third party is a taxable supply, GST payable by the lessor is 1/11th of the consideration.

6. On expiry of the lease a lessee may be liable for, or entitled to, the difference between the sale proceeds and the residual value of the goods. This will alter only the amount of consideration for the supply by way of lease, not the consideration for the supply by way of sale.

Sale proceeds less than the residual value

7. Where the goods are sold to a third party on expiry of the lease and the lessee is required to make a shortfall payment because the sale proceeds are less than the residual value, an adjustment event arises for the lessor in relation to the supply of the goods by way of lease.[2] This adjustment event gives rise to an increasing adjustment where the supply is a taxable supply.[3] The lessor will be required to issue an adjustment note to the lessee.[4] Similarly there is an adjustment event for the lessee. Where the acquisition is a creditable acquisition a decreasing adjustment arises.[5]

8. Where the supply by way of lease is a GST-free supply, an adjustment will not arise and the shortfall payment will not be subject to GST.

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[1] A supply under a lease agreement containing a review opportunity that arises on or after the relevant date will not be GST-free from the date the opportunity arises. See Goods and Services Tax Ruling GSTR 2000/16 'Goods and services tax: transitional arrangements – GST-free supplies under existing agreements' for further explanation on the application of section 13 of the *A New Tax System (Goods and Services Tax Transition) Act 1999* (the Transition Act).

[2] Paragraph 19-10(2)(b) of the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act). See Goods and Services Tax Ruling GSTR 2000/19 'Goods and services tax: making adjustments under Division 19 for adjustment events' for further information.

[3] Section 19-50 of the GST Act.

[4] Subsection 29-75(1) of the GST Act and Goods and Services Tax Ruling GSTR 2013/2 'Goods and services tax: adjustment notes'.

[5] Section 19-85 of the GST Act.

Sale proceeds exceed the residual value

9. Where the sale proceeds exceed the residual value and the lessor pays the difference to the lessee, an adjustment event arises for the lessor in relation to the supply of goods by way of lease. This adjustment event gives rise to a decreasing adjustment where the supply is a taxable supply.[6] The lessor will be required to issue an adjustment note to the lessee. There is an adjustment event for the lessee. Where the acquisition of the leased goods by the lessee is a creditable acquisition, an increasing adjustment arises.[7]

10. Where the supply by way of lease is a GST-free supply, an adjustment will not arise.

Agreements spanning 1 July 2000

11. If the supply by way of lease spans 1 July 2000, section 12 of the Transition Act will apply[8]. In these circumstances, where the supply is a taxable supply and the lessee is required to make a shortfall payment under a guaranteed lease residual clause, this amount is apportioned for the period spanning 1 July 2000 to determine the correct GST payable for the supply by way of lease.

12. Similarly, where the lessor makes a surplus payment to the lessee and the supply by way of lease is a taxable supply, the decreasing adjustment will need to take into account the proportion of the supply that was not subject to GST because it was made before 1 July 2000.

Examples

13. In the following examples, all the parties are registered for GST from 1 July 2000.

Example 1 – Sale of goods to the lessee

14. *In November 1996, Tanya entered into a lease agreement with Finance Co. to lease a motor vehicle for 4 years to use 100% for her business. The lease agreement provides for consideration in the form of monthly lease payments. It also provides for a residual value of $5,000.00. It does not provide for an opportunity to review the consideration, and it does not specify that the motor vehicle will be supplied to Tanya on termination of the lease.*

15. *As the GST transitional rules apply to the agreement the supply identified in the agreement, i.e., the supply by way of lease, is GST-free.*

16. *In November 2000, the lease agreement expires. Tanya accepts an offer under a separate agreement from Finance Co. by which she can acquire the vehicle in consideration for a payment of $5,500.00. She continues to use the vehicle for 100% business use and the purchase of the vehicle is a creditable acquisition. Finance Co. has made a taxable supply of the motor vehicle to Tanya, and GST of $500.00 (1/11th of the $5,500.00) is payable by Finance Co. Tanya is entitled to an input tax credit of $500.00 (1/11th of the $5,500.00).*

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[6] Section 19-55 of the GST Act.

[7] Section 19-80 of the GST Act.

[8] See Goods and Services Tax Ruling GSTR 2000/7 'Goods and services tax: transitional arrangements – supplies, including supplies of rights, made before 1 July 2000 and the extent to which such supplies are taken to be made on or after 1 July 2000', paragraph 27.

Example 2 – Adjustments where goods are sold for less than the residual value

17. *Same lease agreement as in Example 1. On expiry of the lease in November 2000, Tanya returns the motor vehicle to Finance Co. The terms of the lease agreement provide for Finance Co. to sell the motor vehicle by private sale. Finance Co. sells the motor vehicle to a third party for $3,300.00. Finance Co. has made a taxable supply and GST payable is $300.00 (1/11th of $3,300.00).*

18. *Under the terms of the lease agreement, Tanya is required to pay any shortfall between the net sale proceeds of the vehicle and the residual value.*

19. *The shortfall payment of $2,000.00 gives rise to an adjustment event for Tanya and Finance Co. because of the change to the consideration for the supply by way of lease of the motor vehicle.*

20. *In this example, the lease agreement does not contain a review opportunity. Accordingly, the supply by way of lease is GST-free, an adjustment will not arise and GST does not apply to the shortfall payment. However, if the lease agreement did have a review opportunity, GST will apply to the shortfall payment of $2,000.00 but only to the extent that the shortfall payment relates to the supply made from the latter of 1 July 2000 or the date of the review opportunity.*

Example 3 – Adjustments where goods are sold for more than the residual value

21. *Craig entered into a motor vehicle lease agreement in August 2000 with Finance Co. The agreement requires Craig to pay $500.00 per month for 3 years and guarantee the residual value of $6,000.00 on expiry of the lease. The agreement also allows Finance Co. to take GST into account in calculating the net sale proceeds. Craig uses the vehicle for 100% business use.*

22. *On expiry of the lease, Craig returns the vehicle to Finance Co. which sells the motor vehicle to a third party for $11,000.00. Under the lease agreement Finance Co. refunds the excess, after deducting GST (ignoring selling costs), of $4,000.00 to Craig.*

23. *The transitional rules do not apply and Finance Co. has made a taxable supply of the motor vehicle to the third party. GST of $1,000.00 (1/11th of $11,000.00) is payable on this supply.*

24. *However, the payment of $4,000.00 to Craig is connected with the supply by way of lease of the motor vehicle, therefore an adjustment event will arise for both Craig and Finance Co. as the consideration for that supply has changed.*

25. *The GST on the supply of the lease of the vehicle by Finance Co. has decreased because of the adjustment event and Finance Co. will have a decreasing adjustment to its net amount. Craig's entitlement to input tax credits for the acquisition by way of lease has also decreased so he will have an increasing adjustment to his net amount. The previously attributed GST amount for the supply of the lease is $1,636.36 ($500.00 x 36 =$18,000.00 x 1/11)*[9]*. The corrected GST amount for this supply is $1,272.73 ($18,000.00 - $4,000.00 =$14,000.00 x 1/11)*[10]*. Finance Co. has a decreasing adjustment of $363.63.*[11] *Similarly Craig has a previously attributed input tax credit amount of $1,636.36, a corrected input tax credit amount of $1,272.73 and an increasing adjustment of $363.63.*[12] *Finance Co. is required to give Craig an adjustment note.*[13]

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[9] Section 19-45 of the GST Act and Goods and Services Tax Ruling GSTR 2000/19 'Goods and services tax: making adjustments under Division 19 for adjustment events', paragraphs 81 – 83.
[10] Section 19-40 of the GST Act and GSTR 2000/19, paragraphs 76 – 80.
[11] Section 19-55 of the GST Act and GSTR 2000/19 paragraphs 84 – 87.
[12] Sections 19-70, 19-75 and 19-80 of the GST Act, and GSTR 2000/19 paragraphs 92 – 96, 97 – 99 and 100 – 103 respectively.
[13] Subsection 29-75(1) of the GST Act and Goods and Services Tax Ruling GSTR 2013/2.

Example 4 – Sale of goods for less than the residual value, lease spans 1 July 2000, supply is not GST-free under transitional rules

26. *On 1 August 1999, Geoff entered into a lease agreement with Finance Co. to lease a motor vehicle for 3 years to use 100% for his business. The lease agreement provides for consideration in the form of 36 monthly lease payments of $500.00 plus GST payable by Finance Co. Therefore the monthly lease payments for the supply made from 1 July 2000 will be $550.00. It also provides for a residual value of $6,000.00, that sale proceeds are net of any GST payable by Finance Co. on the sale of the vehicle and that Finance Co. can recoup from Geoff the GST payable on any shortfall payment.*

27. *On 31 July 2002, the lease agreement expires. Geoff returns the vehicle to Finance Co. and the vehicle is sold to a third party for $4,400.00. GST is payable by Finance Co. on the sale to the third party, i.e., $400.00. Under the lease Geoff is required to make a shortfall payment of $2,000.00. The shortfall payment gives rise to an adjustment event for Geoff and Finance Co. because of the change to the consideration for the supply by way of lease of the motor vehicle.*

28. *As the supply by way of lease agreement is a taxable supply from 1 July 2000, the GST on the supply of the lease of the vehicle by Finance Co. has increased because of the adjustment event and Finance Co. will have an increasing adjustment to its net amount. Geoff's entitlement to the input tax credit for the acquisition by way of lease has increased so he will have a decreasing adjustment to his net amount.*

29. *The GST payable by Finance Co. before receiving the shortfall payment is $550.00 x 1/11 x 25 months = $1,250.00.*[14] *This is the previously attributed GST amount for the supply by way of lease. As GST is only payable on the supply made on or after 1 July 2000, the corrected GST amount for this supply should be calculated by apportioning the shortfall payment over the total period of the lease.*

Shortfall payment	*$2,000.00*
Pre 1 July 2000 component – 335 days	*$611.31*
Post 30 June 2000 component - 761 days	*$1,388.69*

30. *Therefore the amount of the shortfall payment that applies to the period 1 July 2000 to 31 July 2002 is $1,388.69 ($2,000.00 x 761/1096). However, as Geoff has agreed to pay the GST on any shortfall, the post 1 July 2000 component is increased by 10%, i.e., $1,527.56. Geoff will be required to make a total shortfall payment of $2,138.87 ($1,527.56 + $611.31). Finance Co. will have a corrected GST amount of $1,388.87 (($550.00 x 25) + $1,527.56) x 1/11). Therefore Finance Co. will have an increasing adjustment of $138.87.*

Previously attributed GST amount	*Shortfall payment subject to GST*	*GST payable on shortfall = increasing adjustment*	*Corrected GST amount*
$1,250.00	*$1,388.69*	*$138.87*	*$1,388.87* *($1,250.00 + $138.87)*

[14] Where a lease agreement does not provide for an increase in the lease payments from 1 July 2000 to take into account GST and the supply by way of lease is not GST-free the formula in Goods and Services Tax Bulletin GSTB 2000/4 should be used.

31. *Similarly Geoff has a previously attributed input tax credit amount of $1,250.00, a corrected input tax credit amount of $1388.87 and a decreasing adjustment of $138.87. Finance Co. is required to give Geoff an adjustment note.*[15]

Commissioner of Taxation
14 March 2001

Previously released:

Previously released as Draft GSTD 2000/D6

Related Rulings/Determinations:

TR 2006/10; GSTR 2013/2; GSTR 2000/7; GSTR 2000/16; GSTR 2000/19; GSTB 2000/4

Subject references:

- agreements spanning 1 July 2000
- financial leases
- goods & services tax
- GST consideration
- GST free
- GST supply
- GST transitional issues
- lease & hire expenses
- lease & hire income
- lease residual
- special transitional rules
- taxable supply
- taxation determinations

Legislative references:

- ANTS(GSTT) A99 12
- ANTS(GSTT) A99 13
- ANTS(GST) A99 19-10(2)(b)
- ANTS(GST) A99 19-40
- ANTS(GST) A99 19-45
- ANTS(GST) A99 19-50
- ANTS(GST) A99 19-55
- ANTS(GST) A99 19-70
- ANTS(GST) A99 19-75
- ANTS(GST) A99 19-80
- ANTS(GST) A99 19-85
- ANTS(GST) A99 29-75(1)
- TAA 1953 Sch 1 Div 358

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[15] Subsection 29-75(1) of the GST Act and Goods and Services Tax Ruling GSTR 2013/2.