



# ***GSTD 2006/5 - Goods and services tax: what are the results for GST purposes of barter exchanges engaging in the arrangement described in Taxpayer Alert TA 2005/4?***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 July 2006*



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## Goods and Services Tax Determination

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Goods and services tax: what are the results for GST purposes of barter exchanges engaging in the arrangement described in Taxpayer Alert TA 2005/4?

### **Preamble**

*This document is a ruling for the purposes of section 105-60 of Schedule 1 to the **Taxation Administration Act 1953**. You can rely on the information presented in this document which provides advice on the operation of the GST system.*

1. A barter exchange does not have an entitlement to input tax credits for acquisitions made by it as part of an arrangement described in Taxpayer Alert TA 2005/4 because:
  - (a) the barter exchange is not carrying on an enterprise;
  - (b) consideration is not provided by the barter exchange in relation to the supply it receives as part of the arrangement;
  - (c) the barter exchange does not make the acquisition for a creditable purpose; or
  - (d) the general anti-avoidance provisions in Division 165 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) may apply to the arrangement.
2. Unless otherwise indicated, all legislative references are to the GST Act.

### **Background and Explanation**

3. Taxpayer Alert TA 2005/4 (Alert) issued on 19 December 2005. It describes arrangements where a barter exchange continually claims GST refunds by ensuring that its acquisitions always exceed its supplies by significant amounts. The Alert indicates that the Commissioner is examining these arrangements.
4. The Alert applies to arrangements that exhibit some or all of the following features:
  - (a) the barter exchange acts as a member with its own trading account to record transactions with its members;
  - (b) the barter exchange debits or credits the account in trade dollars each time it makes an acquisition or supply respectively;

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- (c) the barter exchange acquires goods and services from its members at grossly inflated prices that do not reflect the commercial value of the acquisition. Additionally, acquisitions of services from members, particularly advertising, are disproportionately high relative to the level of activity carried on in the barter exchange;
- (d) the amounts 'paid' by the barter exchange in trade dollars are higher than it would have paid had it paid in Australian dollars on the open market. For example, under a typical agreement, the barter exchange acquires advertising space from a member for 5,500 trade dollars where the market value is \$550;
- (e) acquisitions by the barter exchange in trade dollars create a GST liability for the supplying member. In some instances, the member offsets its liability through additional acquisitions in trade dollars at grossly inflated prices;
- (f) the barter exchange records its acquisitions in trade dollars by debiting its trading account in the records of the exchange. This account becomes increasingly overdrawn, as acquisitions are not limited to the amount of trade dollars in its account. The rules of the exchange stipulate that there is no requirement that the overdrawn amount be repaid by the exchange. This is known as deficit trading. The overdrawn account is recorded as a liability in the accounting records of the exchange and is represented by expenses which are taken into account on the Business Activity Statement (BAS) of the exchange;
- (g) the barter exchange lodges a BAS claiming GST refunds as its acquisitions exceed its supplies;
- (h) in some instances goods and services 'acquired' do not exist or do not take place.

5. This determination explains the Commissioner's reasoning for considering that barter exchanges with these features (as described in paragraph 4 of this Ruling) will not be entitled to input tax credits.

## **No enterprise carried on**

6. The Commissioner will consider whether the barter exchange is carrying on an enterprise.

7. The barter exchange will be conducting an enterprise if its activities are either in the form of a business (paragraph 9-20(a)), or in the form of an adventure or concern in the nature of trade (paragraph 9-20(b)). Accordingly it will be necessary to determine whether, in the arrangement described in the Alert, the barter exchange is carrying on an enterprise at all.<sup>1</sup>

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<sup>1</sup> For guidance as to what constitutes carrying on an enterprise, see Miscellaneous Taxation Ruling MT 2000/1 and Goods and Services Tax Determination GSTD 2000/8.

8. It is a question of fact as to whether the barter exchange is carrying on an enterprise. In the arrangement described in the Alert, the barter exchange makes significant 'acquisitions' in comparison to the sales it makes. The majority of the acquisitions are for advertising space, which is rarely, if ever, utilised. The barter exchange never repays the trade dollar amount overdrawn. There is no evidence of a purpose of profit making, and, in effect, the exchange could continue to operate indefinitely despite its expenditure consistently exceeding its income. The primary, if not sole, purpose underlying the activity of the barter exchange is to generate GST refunds.

9. There is no single test of whether a business or trade is being carried on, however on a weighing of all of the relevant circumstances it is considered that the barter exchange (as described in the Alert) is not carrying on an enterprise within the meaning of section 9-20, as the activity lacks the necessary features inherent in a business, and is also not undertaken in a manner consistent with or similar to ordinary trade.

### **No consideration for supply**

10. Alternatively the Commissioner will consider whether the trade dollars used as the medium of exchange is consideration.

11. For an acquisition to be creditable, consideration must be provided or liable to be provided for the supply (paragraph 11-5(c)). Consideration may be in money, in kind, or in some instances a combination of money and kind.

12. In the arrangement described in the Alert, it is considered that the trade dollars used as the medium of exchange have no commercial or economic value and are not consideration because:

- (a) the commercial value of the trade dollars is nil due to the effect of the exchange's deficit trading;
- (b) the trade dollars have no actual tangible cost to the barter exchange. The trading account of the exchange which is over-drawn, is debited with the trade dollar amount of the acquisition. The rules of the exchange stipulate that the amount does not have to be repaid by the exchange;
- (c) the trade dollars cannot be on-sold or converted to trade dollars in another barter exchange; and
- (d) there is no member entitlement to convert the trade dollars into Australian dollars or redeem them for property at true commercial value.

13. As the barter exchange has not provided nor is liable to provide any consideration for the supply, it has not made a creditable acquisition and is therefore not entitled to input tax credits.

### **Acquisitions not in carrying on enterprise**

14. Alternatively the Commissioner will consider whether the acquisitions of the barter exchange are for a creditable purpose.

15. For an acquisition to be creditable, the acquisition must be solely or partly for a creditable purpose (paragraph 11-5(a)). A taxpayer acquires a thing for a creditable purpose only to the extent that it acquires it in carrying on its enterprise (subsection 11-15(1)).

16. Accordingly, there must be a sufficient connection or nexus between an acquisition and the carrying on of an enterprise for it to be characterised as one made 'in' the carrying on of such an enterprise. Relying on reasoning similar to that of the High Court in its analysis of the nexus requirement in the general deduction provision in the income tax provisions in *Fletcher & Ors v. FCT* (1991) 173 CLR 1 at 18-19, in determining whether a sufficient connection exists it is appropriate to inquire into the subjective intention of a taxpayer in circumstances where acquisitions greatly exceed supplies.

17. In the arrangements described at paragraphs 3 to 4 of this Determination, the acquisitions at inflated prices do not bear the characteristics of rational commercial decisions. Much of what is acquired is not used in the business, and in the instances where advertising space is acquired, it is often not utilised. The significant disproportion between the amount of acquisitions in trade dollars and the amount of sales in each tax period results in large net GST refunds in Australian dollars, and cause both accounting and tax losses to be recorded in the books of account.

18. It is considered that the overall factual context in which the acquisitions are made, particularly the significant disproportion between acquisitions and supplies, indicates that the acquisitions are not sufficiently related to the carrying on of an enterprise by the barter exchange. Rather, they are to be explained by the subjective purpose of obtaining net GST refunds. Accordingly, it is considered that the acquisitions of the barter exchange in trade dollars are not for a creditable purpose.

### **General anti-avoidance provisions apply**

19. Alternatively the Commissioner will consider the application of the general anti-avoidance provisions in Division 165, having regard to all of the facts and circumstances in the particular matter.

20. The application of Division 165, which contains the general anti-avoidance provisions, requires a careful weighing of the individual circumstances of each case. Therefore, in the absence of all relevant information, it is not possible to state definitively whether a particular scheme will attract the application of Division 165.

21. For the Division to apply, the following four elements need to be satisfied:

- (a) one or more of the steps in the arrangement is a 'scheme' as defined in subsection 165-10(2);
- (b) a 'GST benefit', as defined in subsection 165-10(1), arises under the scheme;
- (c) an entity gets a GST benefit from the scheme; and
- (d) it is reasonable to conclude, taking account of the matters in section 165-15, that the dominant purpose or principal effect of entering into or carrying out the scheme was to get a GST benefit.

### **Element 1: scheme**

22. It is considered that all or only some of the elements comprising the arrangements described in paragraphs 3 to 4 of this Determination would constitute a 'scheme' under the broad definition of that term in subsection 165-10(2): see the observations of the High Court in *FCT v. Hart* (2004) 217 CLR 216 at 234-238 and 260-261 in relation to the virtually identical definition of 'scheme' for the purposes of Part IVA of the *Income Tax Assessment Act 1936*.

**Element 2: GST benefit**

23. Further, it is considered that the arrangement constitutes a scheme which would give rise to a GST benefit under paragraph 165-10(1)(b). That is, it is a reasonable expectation that had the barter exchange been unable to make the acquisitions using trade dollars, but rather had to pay for them in Australian dollars, it would not have made these acquisitions at all. Therefore, it could reasonably be expected that the entitlement of the barter exchange to input tax credits was larger than it would be apart from the scheme: see the comments of the High Court in *FCT v. Peabody* (1994) 181 CLR 359 at 385 on the reasonable expectation test in the context of the definition of 'tax benefit' for the purposes of Part IVA of the *Income Tax Assessment Act 1936*.

24. Because of subsection 165-10(3), the barter exchange would be prevented from arguing that a GST benefit would not arise as it would not have entered into any type of transaction had it not used trade dollars: see Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1999 at paragraph 6.335.

**Element 3: entity gets GST benefit**

25. The barter exchange is the entity that gets the GST benefit of the input tax credits described in paragraph 23 of this Determination.

**Element 4: dominant purpose or principal effect**

26. It would also be reasonable to conclude, having regard to the matters set out in subsection 165-15(1), that the sole or dominant purpose of the scheme or part of the scheme, or the principal effect of the scheme or part of the scheme, was for the barter exchange to obtain the GST benefit. In this context the following general observations can be made:

- the manner in which the scheme was entered into or carried out involved the barter exchange making acquisitions, particularly of advertising space, and debiting its own trading account with the trade dollar amount of the acquisitions. This technique leads to the exchange's acquisitions greatly exceeding its supplies with many acquisitions made at inflated prices. There is also indifference as to whether acquisitions are actually received or utilised. These circumstances are facilitated by the fact that the exchange is not required to repay the amount of its overdrawn trading account and are indicative of a purpose of converting trade dollars to Australian dollars in the form of net GST refunds;
- the form of the scheme involves the barter exchange making acquisitions from its members in trade dollars. The substance of the scheme is that the barter exchange makes acquisitions at grossly inflated prices and at no real economic cost to itself, as the consideration is paid by way of debiting its own trading account with the trade dollar value of the acquisition. There is no requirement that this amount ever be repaid. In form, the acquisitions in trade dollars correspond to the value of the acquisitions in Australian dollars. In substance, the trade dollar value assigned to the acquisitions is considerably greater than their Australian dollar commercial value; and
- but for the operation of Division 165, the barter exchange would continue to make acquisitions, mainly advertising space, at commercially unrealistic prices using trade dollars and would be entitled to substantial net GST refunds.

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27. It is therefore open to the Commissioner to exercise his powers under section 165-40 to negate the GST benefit by denying the barter exchange the input tax credits on its acquisitions, including advertising space, at inflated prices.

## Date of Effect

28. This Determination explains our view of the law as it applied from 1 July 2000. You can rely upon this Determination on and from its date of issue for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953*. 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.

29. If this Determination conflicts with a previous private ruling that you have obtained, or a previous public ruling, this public ruling prevails. However, if you have relied on a previous ruling, you are protected in respect of what you have done up to the date of issue of this 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 this later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

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## Commissioner of Taxation

19 July 2006

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

GSTD 2000/8; GSTR 1999/1; MT 2000/1

*Subject references:*

- barter exchange
- consideration
- creditable purpose
- Division 165
- enterprise
- GST benefit
- scheme

*Legislative references:*

- TAA 1953 Sch 1 105-60
- ANTS(GST)A 1999 9-20
- ANTS(GST)A 1999 9-20(a)
- ANTS(GST)A 1999 9-20(b)
- ANTS(GST)A 1999 11-5(a)

- ANTS(GST)A 1999 11-5(c)
- ANTS(GST)A 1999 11-15(1)
- ANTS(GST)A 1999 Div 165
- ANTS(GST)A 1999 165-10(1)
- ANTS(GST)A 1999 165-10(1)(b)
- ANTS(GST)A 1999 165-10(2)
- ANTS(GST)A 1999 165-10(3)
- ANTS(GST)A 1999 165-15
- ANTS(GST)A 1999 165-15(1)
- ANTS(GST)A 1999 165-40
- ITAA 1936 Pt IVA

*Case references:*

- Fletcher & Ors v. FCT (1991) 173 CLR 1
- FCT v. Hart (2004) 217 CLR 216
- FCT v. Peabody (1994) 181 CLR 359

*Other references:*

- Taxpayer Alert TA 2005/4
  - Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1999
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ATO references

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