# *GSTD 2013/4 - Goods and services tax: where capital assets that diminish in value over time are utilised in making a supply, can the consideration provided by the supplier to acquire those assets be taken into account in determining whether the supply is GST-free under subparagraph 38-250(2)(b)(ii) of A New Tax System (Goods and Services Tax) Act 1999?*

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# Goods and Services Tax Determination

## Goods and services tax: where capital assets that diminish in value over time are utilised in making a supply, can the consideration provided by the supplier to acquire those assets be taken into account in determining whether the supply is GST-free under subparagraph 38-250(2)(b)(ii) of *A New Tax System (Goods and Services Tax) Act 1999*?

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### Ruling

1. Yes. The consideration the supplier provided for acquiring those assets that diminish in value over time can be taken into account in determining whether a supply in that period is GST-free under subparagraph 38-250(2)(b)(ii) of the *A New Tax System (Goods and Services Tax) Act 1999*,[1] to the extent the consideration provided reasonably relates to that supply.

2. To work out the amount of the consideration that can be taken into account, a supplier should apply any reasonable methodology that reflects the proportion of the consideration that relates to each supply made. Consideration for acquisitions cannot be double-counted in determining whether subparagraph 38-250(2)(b)(ii) applies to the various supplies made by the entity.

[1] All legislative references in this Determination are to the *A New Tax System (Goods and Services Tax) Act 1999* unless otherwise stated.

*Example 1 – proportion of capital costs that relates to each supply*

*3. ABC Zoo, an endorsed charity, undertakes a major refurbishment spending $20 million in constructing animal enclosures in its zoo. ABC Zoo reasonably expects that the enclosures will be used for 20 years and will be equally relevant to zoo admissions throughout the expected life of the enclosures. The enclosures are not expected to have any residual value after 20 years.*

*4. In working out the portion of the consideration for acquisitions concerned with construction (the construction cost) to be allocated to the supply of each admission, a methodology would be for ABC Zoo to spread the construction cost of the enclosures equally across 20 years representing the expected life of the enclosures and to allocate $1,000,000 of the construction cost of the enclosure to each year, or $250,000 for a quarterly tax period.*

*5. If it is expected that the number of admissions will be 1,000,000 in a quarterly tax period, the portion of the consideration for the enclosures that is included in the cost of each admission would be $0.25 ($250,000 / 1,000,000).*

*Example 2 – seasonal variations in supplies*

*6. Following on from example 1, if the supplies of admission to the zoo vary on a seasonal basis such that 40% of annual supplies are made in the January to March tax period, and 20% of supplies made in other tax periods, it would instead be appropriate to spread the $1,000,000 annual construction cost such that $400,000 is allocated to supplies in the January to March tax period, and $250,000 in the other periods.*

*Example 3 – allocate the full capital costs in the period or year in which they were incurred*

*7. As distinct from the circumstances in Example 1, ABC Zoo undertakes a regular budgeted capital works program expecting to spend $200,000 per annum on refurbishing animal enclosures. In working out the portion of consideration for acquisitions concerned with refurbishment (capital expenditure) to be allocated to the supply of each admission, instead of spreading the capital expenditure on refurbishments equally across 20 years another reasonable methodology would be to allocate the total capital expenditure of $200,000 to tax periods in the year in which the expenditure is incurred. In such circumstances, this methodology is considered reasonable because the relevant expenditure is fairly regular and consistent from year to year, and thus the annual expenditure reasonably approximates the consideration for acquisitions used in making the supplies of zoo admission in that year.*

**Date of effect**

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

9. The Commissioner will not take compliance action in relation to supplies that were treated as GST-free for tax periods ending on or before 30 June 2013 merely because the full consideration for acquisitions of capital assets was taken into account in the tax period or year in which the capital acquisition was made, in circumstances where this Determination indicates that the consideration should be apportioned in a different way. This is subject to an exception if the Commissioner considers that such an approach was used to deliberately exploit the operation of subparagraph 38-250(2)(b)(ii). This is also subject to there being no double-counting of consideration for acquisition of the relevant capital assets.

**Commissioner of Taxation**
2 October 2013

# Appendix 1 – Explanation

***This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.***

## Background

10. The operation of section 38-250 is considered in detail in sections A and E of Part 3 of the Goods and Services Tax Industry Issues Charities Consultative Committee (which covers these issues) and is a Public Ruling.

11. This Determination expands on the CCCRID by providing the Commissioner's view on whether certain capital costs should be included in calculating the consideration the supplier provided for acquiring the thing supplied.

12. References in this Determination to 'cost' are to consideration for acquisitions.

## Explanation

13. Subparagraph 38-250(2)(b)(ii) provides that a supply (that is not a supply of accommodation) made by an endorsed charitable institution is GST-free if the supply is for consideration that is less than 75% of the consideration the supplier provided, or was liable to provide (the consideration provided), for acquiring the thing supplied.

### *Subparagraph 38-250(2)(b)(ii) is applicable to all types of supplies (other than accommodation)*

14. It is possible to interpret subparagraph 38-250(2)(b)(ii) narrowly such that it only applies where the thing acquired is identical to the thing supplied. This interpretation is suggested by the phrase 'acquiring the thing supplied'. However, the Commissioner has a longstanding view that subparagraph 38-250(2)(b)(ii) can apply to any sort of supply other than accommodation, and that it is not a requirement for the thing acquired to be identical to the thing supplied.

15. Close attention to the structure of subparagraph 38-250(2)(b)(ii) provides some support for the broader construction. Paragraph 38-250(2)(b) is divided into subparagraphs (i) and (ii). Subparagraph (i) applies 'if the supply is a supply of accommodation', whereas subparagraph (ii) applies 'if the supply is not a supply of accommodation'. It therefore appears that subparagraph (ii) was intended to apply to ***all supplies*** other than accommodation. The words of subparagraph (ii) that follow then provide a formula for determining whether such a supply is GST-free. Objectively, it would appear unlikely that the words 'acquiring the thing supplied' used in the formula were intended to modify the scope of the subparagraph set by the phrase 'if the supply is not a supply of accommodation'.

16. Further, the term 'thing' is defined in section 195-1 to mean 'anything that can be supplied or imported'. Accordingly, the use of the word 'thing' does not narrow the application of subparagraph 38-250(2)(b)(ii) to supplies of physical things. In other contexts, the word 'goods' is used in provisions which are intended to be limited to supplies of goods.[2]

[2] See, for example, sections 38-97, 38-185, 38-187, 38-255, 66-5, 78-60 and 79-85

17. The purpose of section 38-250, expressed in the most general terms, is to make non-commercial supplies by charities GST-free.[3] There is nothing in this purpose which would suggest a restriction on the class of supplies to which subsection 38-250(2) applies. A narrower interpretation of subparagraph 38-250(2)(b)(ii) would restrict the operation of the provision substantially and would not include most supplies by charities. However, there is nothing in the legislation or extrinsic materials that evidences an intent that the provision has such narrow scope.

18. The Commissioner acknowledges that the broader view has some difficulties and that the narrower view in some respects is more closely aligned with the text of the provision. Nevertheless, the Commissioner considers that the broader view is arguable and on balance the ATO should retain the broader view.

19. Accordingly, the reference to 'acquiring' in the phrase 'acquiring the thing supplied' in subparagraph 38-250(2)(b)(ii) is interpreted as including acquisitions of things that are on-supplied, the acquisition of those things used up in providing services or manufacture and acquisitions of things that are 'used' in combination in making a supply of something else, for example, admissions to zoos, museums or entertainment venues.

### *Should the consideration for capital assets used in making the supply be taken into account?*

20. The CCCRID states:

> When working out the cost of providing something, a charity should include:
>
> - all direct costs incurred – for example, materials and direct labour, and
> - a reasonable apportionment of indirect costs incurred – for example, marketing, administration, office expenses, electricity, telephone and insurance.

21. The CCCRID says that depreciation of assets cannot be taken into account as it does not involve an actual outlay by the charity. Whilst the CCCRID excludes depreciation, it does not expressly state whether capital costs are excluded altogether, or should be taken into account in another manner (for example, taken into account upfront, rather than being depreciated over time).

22. Once it is accepted that a reasonable portion of indirect costs can be taken into account in determining the consideration the supplier provided for acquiring the thing supplied, there is no reason in principle to exclude capital costs. The consideration paid for acquiring things that are gradually used up over time in making supplies is part of the cost of making the supplies.

23. The things used to make the supply may include acquisitions that are consumed at or about the time they are acquired (such as the animal feed and services of contractors used in making a supply of admission to a zoo) and acquisitions of capital assets (such as buildings, or plant and equipment) that may be used in making supplies over a substantial period of time.

24. The principle that the consideration provided for things used in making a supply is not limited to supplies of admission, but has equal application to other types of supplies, including supplies of services.

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[3] See paragraphs 5.98 and 5.99 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.

25. Where the supplier uses a thing it has acquired to make a supply, 'the consideration the supplier provided' is generally the price paid by the supplier for the thing. Where an asset is used in making multiple supplies, then for each supply the consideration provided for each supply is only a proportion of the consideration paid for the asset. This proportion needs to be determined by reference to the extent the asset is expended or exhausted in making each supply (see further below).

26. Land does not tend to decline in value over time and is not in any sense 'used up' in making the supply. Therefore, in cases where the land is not to any extent the subject matter of the supply, consideration for the acquisition of land cannot be taken into account in applying subparagraph 38-250(2)(b)(ii), other than in relation to the sale of that land. This Determination does not consider in what circumstances it would be appropriate to take into account the consideration for acquisition of land, or a part thereof, in working out whether section 38-250 applies.

### *How should consideration for capital assets used in making the supply be apportioned?*

27. The CCCRID, in the section titled *Non-commercial activities of charities, cost of supply and market value tests*, provides a methodology for working out the 'cost of providing a supply' for purposes of subparagraph 38-250(2)(b)(ii). It states that when applying the cost of supply test, entities can include all direct costs and a reasonable apportionment of indirect costs. However, costs used must be real costs.

28. A reasonable methodology must be adopted to allocate capital costs to the supplies that are made. Where an entity uses a capital asset to make supplies in a period, the methodology must reflect the extent the capital asset is utilised in making the supply. This proportion can be worked out by using any methodology that can reasonably reflect the extent the capital asset is expended or exhausted in making the supply. However, it would not be reasonable to adopt a methodology that results in the same capital costs being taken into account more than once – any methodology should not lead to double-counting.

29. In some cases an appropriate methodology would be to take into account the depreciation amount for the capital asset and spread that depreciation amount across the supplies made in respect of that asset during the tax period. For example, if a capital asset acquired on 1st July has a useful life of ten years with no residual value, the consideration provided in that year for acquiring the asset is 1/10th of the cost of the asset. That cost would then need to be spread over the supplies that the asset is used for in that year. Where a capital asset is only partly used to make supplies, the consideration provided would need to be apportioned further to take into account the proportion of the asset used to make those supplies.

30. In cases where there is a fairly regular and predictable annual budget for capital acquisitions or improvements, there is an alternative approach that can also be reasonable. This is to fully take into account such regular budgeted expenditure in the year it is incurred. This is on the basis that as a regular annual cost of the business it can reasonably be regarded as part of the cost of making supplies in that year. However, this methodology may not be reasonable unless it is applied consistently over time.

# References

*Previous draft:*

GSTD 2013/D3

*Related Rulings/Determinations:*

Charities Consultative Committee Resolved Issues Document
TR 2006/10

*Subject references:*

- charities
- goods and services tax
- GST-free
- nominal consideration

*Legislative references:*

- ANTS(GST)A 1999 38-97
- ANTS(GST)A 1999 38-185
- ANTS(GST)A 1999 38-187
- ANTS(GST)A 1999 38-250
- ANTS(GST)A 1999 38-250(2)
- ANTS(GST)A 1999 38-250(2)(b)
- ANTS(GST)A 1999 38-250(2)(b)(i)
- ANTS(GST)A 1999 38-250(2)(b)(ii)
- ANTS(GST)A 1999 38-255
- ANTS(GST)A 1999 66-5
- ANTS(GST)A 1999 78-60
- ANTS(GST)A 1999 79-85
- ANTS(GST)A 1999 195-1

*Other references:*

- Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998

ATO references

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