


GSTD 2007/D3 - Goods and services tax: what are the results for GST purposes of a charitable institution engaging with an associated endorsed charitable institution in an arrangement described in Taxpayer Alert TA 2007/1?

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This document has been finalised.



Draft Goods and Services Tax Determination

Goods and services tax: what are the results for GST purposes of a charitable institution engaging with an associated endorsed charitable institution in an arrangement described in Taxpayer Alert TA 2007/1?

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.

1. The arrangement described in Taxpayer Alert TA 2007/1 may not result in supplies of accommodation being treated as GST-free because:
 - (a) the consideration for the supply of accommodation to the residents is not less than 75% of the cost to the supplier of providing the accommodation; or
 - (b) the general anti-avoidance provisions in Division 165 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)¹ may apply to the arrangement.

Background and explanation

2. Taxpayer Alert TA 2007/1 (Alert) issued on 6 March 2007. It describes an arrangement designed to gain entitlement to input tax credits by treating otherwise input taxed supplies of residential accommodation as GST-free. These arrangements involve charitable institutions leasing land and buildings to associated endorsed charitable institutions in an attempt to increase the cost of making supplies of accommodation to residents and thereby satisfying the concession in section 38-250. The Alert indicates that the Commissioner is examining these arrangements.

¹ Unless otherwise indicated, all legislative references are to the GST Act.

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3. The Alert applies to arrangements that exhibit some or all of the following features:
- (a) Entity A, a charitable institution, owns land and buildings from which it makes or could make supplies of residential accommodation;
 - (b) supplies of residential accommodation by Entity A would be input taxed² as they are made for consideration that is:
 - 75% or more of the GST inclusive market value of the supply;³ and/or
 - 75% or more of the cost to Entity A of providing the accommodation;⁴
 - (c) Entity A enters into a lease⁵ to supply the land and buildings to Entity B, an associated endorsed charitable institution;
 - (d) the lease payments from Entity B to Entity A are recorded as book entries and no actual payments are made;⁶
 - (e) Entity B then provides the accommodation to residents;
 - (f) the lease payments recorded from Entity B to Entity A serve to increase the cost to Entity B of providing the accommodation, so that the consideration received by Entity B falls below 75% of the cost to Entity B of providing the accommodation; and
 - (g) Entity B treats the supplies of accommodation to residents as GST-free and claims input tax credits.
4. This determination explains the Commissioner's reasoning for considering that supplies made under arrangements with these features (as described in paragraph 3 of this Determination) may not be GST-free.

Legislative context

5. Section 38-250 provides that, among other things, a supply of accommodation by an endorsed charitable institution, an endorsed trustee for a charitable fund, a gift-deductible entity or a government school is GST-free if:
- the supply is for consideration that is less than 75% of the GST inclusive market value of the supply;⁷ or
 - the supply is for consideration that is less than 75% of the cost to the supplier of providing the accommodation.⁸

² Section 40-35.

³ Subparagraph 38-250(1)(b)(i).

⁴ Subparagraph 38-250(2)(b)(i).

⁵ In this context the supply may be by way of lease, hire or licence.

⁶ Note, the view explained in Goods and Services Tax Determination GSTD 2004/4 Goods and services tax: can consideration for a supply be provided or received without transferring money (such as where the parties only make book entries recording their agreement that the supply is paid for)? (GSTD 2004/4) does not generally apply in the current context. GSTD 2004/4 addresses the meaning of 'consideration' rather than 'cost'.

⁷ Subparagraph 38-250(1)(b)(i).

⁸ Subparagraph 38-250(2)(b)(i).

Cost to the supplier

6. When calculating the cost of providing something for the purposes of section 38-250 of the GST Act an organisation 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.⁹

7. 'Incurred' in the context of calculating the cost of providing something for the purposes of section 38-250 is not defined in the GST Act and therefore takes its ordinary meaning.

8. Similarly in an income tax context there is no statutory definition, or an exhaustive judicial meaning, of the term 'incurred'. However some guidance is available from judicial decisions.¹⁰ It is generally accepted that a loss or outgoing is incurred when the taxpayer concerned becomes 'definitively committed' to the expenditure. This will typically be when a present legal obligation to make the expenditure comes into existence, even though the liability may be defeasible by others or the amount of the liability cannot be precisely ascertained (provided it is capable of reasonable estimation). Whether a taxpayer has a presently existing liability which definitively commits the taxpayer to incur expenditure, depends on the facts and circumstances, including the legal arrangements under which the liability is claimed to arise.

9. No money need actually be outlaid for a cost to be 'incurred', so long as there is a presently existing liability.

Cost to the supplier of providing the accommodation***Where Entity B is a company***

10. The supply of land and buildings by Entity A to Entity B may be made either by establishing or utilising a pre-existing arrangement. Where Entity B is a company, judicial decisions provide guidance as to whether the acquisition of the land and buildings by way of lease by Entity B can be included in calculating the cost of making supplies by Entity B.

11. In *Case S28 85 ATC 273*, management fees were calculated and recorded in the associated companies' respective accounting records and no actual payments were made.

12. In finding that the expenditure had been incurred, the No. 3 Board of Review found the following:

There certainly was no payment but that lack is of no real significance. Where a separate legal entity accepts a liability by recording it in its books of account, and shows the other party as a creditor, it seems to me it has to be regarded as 'definitively committed' and the expenditure is incurred in the sense required by sec 51(1). (*Federal Commissioner of Taxation v. James Flood Pty Ltd* (1953) 88 CLR 492 at p 506.)

⁹ Charities Consultative Committee Resolved Issues Document, Non-Commercial Activities of Charities, Part 3 – Cost of Supply and Market Value Tests. This document can be downloaded from our website www.ato.gov.au. See also Goods and Services Tax Rulings 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 and GSTR 2007/D1 Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?

¹⁰ See Taxation Ruling TR 97/7 Income tax: section 8-1 – meaning of 'incurred' – timing of deductions.

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13. As such, it is possible for a company that is a separate legal entity to have a presently existing liability and be 'definitively committed' to that liability when it records it as a book entry, even if no actual payment is made.

14. In this arrangement the payments from Entity B to Entity A for the supply of land and buildings by way of lease are recorded as book entries and no actual payments are made.

15. Where Entity B is a company, it will be considered to have incurred costs of acquiring the land and buildings by way of lease from Entity A, if an objective analysis of the facts shows that it is definitively committed to those costs. This is because Entity B has a presently existing liability when it records the other party as a creditor in its books of account, even though no actual payments are made. Where Entity B is definitively committed to the costs, they can be included for the purpose of subparagraph 38-250(2)(b)(i), in the cost to Entity B of providing the accommodation.

16. Whether Entity B is definitively committed to the costs recorded in the accounts is a question of objectively analysing the available evidence to determine whether the parties intend Entity B to be subjected to the liability concerned. If, objectively, the parties never intend the liability to be met by Entity B, the Commissioner would not accept that the amount is a cost to Entity B. Relevant evidence would include, for example, whether Entity B has been invested with the means to meet the liability owed to Entity A.

17. If the consideration paid by the residents to Entity B is less than 75% of the cost, as described above, to the supplier (Entity B) of providing the accommodation, the supplies are GST-free and Entity B can claim input tax credits for the GST paid on acquisitions relating to the supplies. This will be the case unless, as discussed below, Division 165 applies.

Where Entity B is a non-profit sub-entity

18. If Entity A is an endorsed charitable institution¹¹ it may make a choice to establish Entity B as a non-profit sub-entity under Division 63. A non-profit sub-entity is treated as a separate entity for GST purposes only, and is not a separate legal entity. In the context of these specific arrangements, doubt may exist as to the validity of the leasing arrangement, and if accepted further doubt may exist as to whether, unless evidenced by the actual transfer of monies, costs can be 'incurred' by the particular non-profit sub-entity under this arrangement.

19. As no actual payment is made in this specific arrangement, if Entity B does not have a presently existing pecuniary liability the acquisition of the land and buildings by way of lease by Entity B may not be considered to be included in the cost to Entity B of providing the accommodation for the purpose of subparagraph 38-250(2)(b)(i).¹² Consequently, the consideration for the accommodation paid by residents may not be less than 75% of the cost to the supplier (Entity B) of providing the accommodation, and the supply may not be GST-free.

20. If the supply of accommodation by Entity B is not GST-free it will be input taxed, and Entity B will not be entitled to claim input tax credits on acquisitions to the extent that they relate to the supply.

¹¹ See subsection 63-5(3), which explains that a charitable institution cannot choose to establish non-profit sub-entities unless it is endorsed. See also section 195-1, which defines an endorsed charitable institution to mean a charitable institution that is endorsed under subsection 176-1(1).

¹² This does not impact on the choice by a non-profit sub-entity to account on a non-cash basis for supplies and acquisitions as part of their ordinary business operations.

Division 165 – anti-avoidance

21. Alternatively, the Commissioner will consider the application of the general anti-avoidance provisions in Division 165 to both forms of the arrangements as described above.

22. The application of Division 165 was considered by the Administrative Appeals Tribunal in *VCE v. Federal Commissioner of Taxation* 2006 ATC 187, the first decision to examine the use of these provisions. Additionally, the Commissioner has set out his views on the application of Division 165 to specific arrangements and these are discussed in a number of public rulings and determinations.¹³

23. 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.

24. 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

25. It is considered that all or only some of the elements comprising the arrangements described in paragraph 3 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 *Federal Commissioner of Taxation 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* and the decision of Deputy President Forgie of the Administrative Appeals Tribunal in the *VCE v. Federal Commissioner of Taxation* 2006 ATC 187 that specifically dealt with a scheme in the context of the application of Division 165.

¹³ See:

- GSTR 2004/3 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/2: Avoidance of GST on the sale of new residential premises;
- GSTR 2005/3 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/9 – exploitation of the second-hand goods provisions to obtain input tax credits;
- GSTR 2005/4 Goods and services tax: arrangements of the kind described in Taxpayer Alerts TA 2004/6 and TA 2004/7: use of the Grouping or Margin Scheme provisions of the GST Act to avoid or reduce the Goods and Services Tax on the sale of new residential premises;
- GSTR 2005/5 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/8: use of the Going Concern provisions and the Margin Scheme to avoid or reduce the Goods and Services Tax on the sale of new residential premises, and;
- 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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26. The scheme in the arrangements may be concisely described as one involving the interposition of Entity B between Entity A and its supplies of residential accommodation to residents, effected by way of the lease of the land and buildings to Entity B.

Element 2: GST benefit

27. 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, had Entity A not entered into the lease of the land and buildings with Entity B, it would have continued, as before, to make input taxed supplies of residential accommodation directly to residents. Entity B would not have made GST-free supplies of residential accommodation and claimed input tax credits in respect of these supplies. Therefore, because of its entitlement to input tax credits arising from the GST-free supplies of residential accommodation, it could reasonably be expected that a larger amount would be payable to Entity B under the provisions of the GST Act (apart from Division 165) than would have been but for the scheme: see the comments of the High Court in *Federal Commissioner of Taxation 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*.

Element 3: entity gets GST benefit

28. Entity B gets the GST benefit of the input tax credits described in paragraph 27 of this Determination.

Element 4: dominant purpose or principal effect

29. 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 Entity B 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 involves Entity A leasing the land and buildings from which it made input taxed supplies of residential accommodation to Entity B, which subsequently makes supplies of residential accommodation GST-free pursuant to subsection 38-250 of the GST Act. The lease payments made by Entity B to Entity A serve to increase the cost to Entity B of providing the accommodation and are sufficient in amount to make the consideration payable by residents to Entity B fall below 75% of its total cost of providing the accommodation, thus ensuring that it satisfies the pre-conditions for GST-free treatment set out in subsection 38-250;

- the form of the scheme involves Entity A leasing the land and buildings from which it makes supplies of residential accommodation to Entity B which then makes supplies of residential accommodation instead. The particular form of the scheme produces a GST benefit. In commercial and economic substance, the scheme produces no change. The same economic group, which includes Entity A and Entity B, continues to hold the land and buildings and make the same supplies of residential accommodation, on the same terms, to the same residents. The lease payments are merely recorded as book entries and no actual payments are made by Entity B to Entity A; and
- but for the operation of Division 165, Entity B would continue to supply GST-free accommodation to residents and would be entitled to input tax credits on its acquisitions in respect of the accommodation.

30. It is therefore open to the Commissioner to exercise his powers under section 165-40 to negate the GST benefit by denying Entity B the input tax credits on its acquisitions in respect of the accommodation.

Date of effect

31. This draft Determination represents the preliminary, though considered view of the Australian Taxation Office. When the final Determination is officially released, it will explain our view of the law as it applies both before and after its date of issue.

32. The final Determination 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.

Your comments

33. We invite you to comment on this draft Goods and Service Tax Determination. 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.)

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Related Rulings/Determinations:

TR 97/7; GSTR 1999/1; GSTR 2004/3;
GSTR 2005/3; GSTR 2005/4; GSTR 2005/5;
GSTR 2006/4; GSTD 2006/5; GSTD 2004/4

Subject references:

- Division 165
- endorsed charitable institution
- GST benefit
- GST-free supply
- input taxed supply
- residential accommodation
- scheme

Legislative references:

- ITAA 1936 Pt IVA
- ANTS(GST)A 1999 38-250
- ANTS(GST)A 1999 38-250(1)(b)(i)
- ANTS(GST)A 1999 38-250(2)(b)(i)
- ANTS(GST)A 1999 40-35
- ANTS(GST)A 1999 Div 63
- ANTS(GST)A 1999 63-5(3)
- 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 165-15
- ANTS(GST)A 1999 165-15(1)

- ANTS(GST)A 1999 165-40

- ANTS(GST)A 1999 176-1(1)

- ANTS(GST)A 1999 195-1

- TAA 1953 Sch 1 105-60

Case references:

- Case S28 85 ATC 273
- Federal Commissioner of Taxation v. Hart (2004) 217 CLR 216; (2004) 2004 ATC 4599; (2004) 55 ATR 712
- Federal Commissioner of Taxation v. James Flood Pty Ltd 88 CLR 492; (1953) ALR 903; (1953) 10 ATD 240
- Federal Commissioner of Taxation v. Peabody (1994) 181 CLR 359; (1994) 94 ATC 4663; (1994) 28 ATR 344
- VCE v. Federal Commissioner of Taxation 2006 ATC 187; 63 ATR 1249

Other references:

- Taxpayer Alert TA 2004/6
- Taxpayer Alert TA 2004/7
- Taxpayer Alert TA 2004/8
- Taxpayer Alert TA 2004/9
- Taxpayer Alert TA 2007/1
- Charities Consultative Committee Resolved Issues Document, Non-Commercial Activities of Charities

ATO references

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