

# ***GSTR 2002/D10 - Goods and Services Tax: Supply of rights for use outside Australia or to a non-resident - subsection 38-190(1), item 4 and subsection 38-190(2)***

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There is an [Erratum notice](#) for this document.  
This document has been finalised.



## **Draft Goods and Services Tax Ruling**

### **Goods and Services Tax: Supply of rights for use outside Australia or to a non-resident – subsection 38-190(1), item 4 and subsection 38-190(2)**

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#### *Preamble*

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners. When officially released it will be a public ruling for the purposes of section 37 of the Taxation Administration Act 1953 and may be relied upon by any person to whom it applies.*

## **What this Ruling is about**

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1. This Ruling examines the operation of item 4 in the table in subsection 38-190(1) of the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act). That subsection sets out supplies of things for consumption outside Australia (other than goods or real property) that are GST-free.
2. In particular, the Ruling examines:
  - how to identify the relevant supply for the purposes of considering transactions involving supplies that may be covered by item 4;
  - what types of supplies are capable of being covered by item 4;
  - the meaning of the expressions ‘supply that is made in relation to rights’ in item 4 and ‘the rights are for use outside Australia’ in paragraph (a) of item 4; and
  - the operation of subsection 38-190(2).
3. The Ruling also briefly discusses the meaning of the expression ‘the supply is to an entity that is not an Australian resident and is outside Australia when the thing supplied is done’ in paragraph (b) of item 4.
4. The Ruling does not otherwise address the operation of the other provisions of section 38-190.
5. While this Ruling outlines the broad principles relating to all kinds of supplies to which item 4 applies, it does not examine in detail how these principles apply to specific types of financial supplies in the context of item 4. Financial supplies for consumption outside

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Australia are dealt with at paragraphs 144 to 170 in Goods and Services Tax Ruling GSTR 2002/2.<sup>1</sup>

6. Unless otherwise stated, all legislative references in this Ruling are to the GST Act and all references to an item number are to an item in the table in subsection 38-190(1).

## Date of effect

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7. This draft Ruling represents the preliminary, though considered, views of the Australian Taxation Office. This draft may not be relied on by taxation officers, taxpayers or practitioners. When the final Ruling is officially released, it will explain our view of the law as it applies from 1 July 2000.

8. The final Ruling will be a public ruling for the purposes of section 37 of the *Taxation Administration Act 1953* and may be relied upon, after it is issued, by any entity to whom 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.

9. If the final public ruling conflicts with a previous private ruling that you have obtained, the public ruling prevails. However, if you have relied on a private ruling, you are protected in respect of what you have done up to the date of issue of the final public ruling. This means that if you have underpaid an amount of GST, you are not liable for the shortfall prior to the later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

## Legislative context

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10. Under section 9-5, you make a taxable supply if:
- (a) you make the supply for consideration; and
  - (b) the supply is made in the course or furtherance of an enterprise that you carry on; and
  - (c) the supply is connected with Australia;<sup>2</sup> and
  - (d) you are registered, or required to be registered.

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

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<sup>1</sup> GSTR 2002/2: GST treatment of financial supplies and related supplies and acquisitions.

<sup>2</sup> Goods and Services Tax Ruling GSTR 2000/31 explains when a supply is connected with Australia under section 9-25.

11. Section 9-25 establishes when a supply is connected with Australia. In the case of supplies of things other than goods or real property, a supply is connected with Australia if the thing is done in Australia or the supply is made through an enterprise that the supplier carries on in Australia.<sup>3</sup>

12. A supply of a right is not connected with Australia unless it is made through an enterprise that the supplier carries on in Australia or the thing is done in Australia. A supply that is not connected with Australia is not a taxable supply under section 9-5.<sup>4</sup>

13. With a supply of a right, the thing that is done is the creation, grant, transfer, assignment or surrender of the right. Whether a right is created, granted, transferred, assigned or surrendered in Australia will depend on how the creation, grant, transfer, assignment or surrender is effected. For example, if the right to use intellectual property is granted by the execution of a written contract, the grant of the right is done in Australia if the contract is executed in Australia. For further detail, see paragraphs 202 to 208 of GSTR 2000/31.

14. A supply is GST-free if it is GST-free under Division 38 or under a provision of another Act.<sup>5</sup>

15. Subdivision 38-E sets out when exports of goods and other supplies for consumption outside Australia are GST-free. The Subdivision comprises:

- section 38-185 – exports of goods;
- section 38-187 – lease or hire of goods for use outside Australia;
- section 38-188 – tooling used by non-residents to manufacture goods for export; and
- section 38-190 – supplies of things, other than goods or real property, for consumption outside Australia.

16. The relevant section for the purposes of this Ruling is section 38-190.

17. The table in subsection 38-190(1) comprises five items which set out supplies of things other than goods or real property that are GST-free.

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<sup>3</sup> Subsection 9-25(5).

<sup>4</sup> However, an intangible supply from offshore that is not connected with Australia may be a taxable supply under Division 84.

<sup>5</sup> Paragraph 9-30(1)(a).

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18. Item 4 appears in the table in subsection 38-190(1) as follows:

<b>Supplies of things, other than goods or real property, for consumption outside Australia</b>		
<b>Item</b>	<b>Topic</b>	<b>These supplies are GST-free<sup>6</sup></b>
4	Rights	<p>a supply that is made in relation to rights if:</p> <p>(a) the rights are for use outside Australia; or</p> <p>(b) the supply is to an entity that is not an Australian resident and is outside Australia when the thing supplied is done.</p>

19. Under subsection 38-190(2), a supply covered by any of items 1 to 5 is *not* GST-free if it is the supply of a right or option to acquire something the supply of which would be connected with Australia and would not be GST-free.

20. As supplies of rights are not dealt with exclusively under item 4, a supply of rights may be GST-free under one of the other items in the table in subsection 38-190(1) if the requirements of that item are satisfied.<sup>7</sup>

## **Ruling**

### **Identifying the relevant supply**

21. While many transactions involve rights being supplied, item 4 only applies to the supply if the essential character or substance of the supply, or of a separately identifiable part of the supply is one of rights. Item 4 does not apply where the supply of rights is merely integral, ancillary or incidental to another dominant part of the supply, the supply being characterised by the dominant part.

22. Determining whether a supply is a single supply, a composite supply that is treated as a supply of a single thing, or a supply comprising separately identifiable parts that retain their own identity,

<sup>6</sup> Except to the extent that they are supplies of goods or real property.

<sup>7</sup> Provided subsection 38-190(2) or subsection 38-190(3) does not operate to negate that GST-free status.

is considered in more detail at paragraphs 49 to 55 and in Goods and Services Tax Ruling GSTR 2001/8.<sup>8</sup>

#### **Supplies that are capable of being covered by item 4**

##### *A supply of goods*

23. A supply of goods is outside the scope of section 38-190 and therefore cannot be covered by item 4.

24. The distinction between a supply of goods and a supply of rights or other things, in the context of supplies of computer software, is discussed at paragraphs 89 to 101.

##### *A supply of real property*

25. A supply of rights which is also a supply of 'real property' as defined in section 195-1 is outside the scope of section 38-190 and therefore cannot be covered by item 4.

##### *What is a right?*

26. For a supply that is made in relation to a right to be covered by item 4, the right must bind the parties in some way. Creation of a mere expectation cannot be a supply that is made in relation to rights under item 4.

27. However, it is not necessary for the right to be a proprietary right.

28. There is further discussion of the meaning of 'right' at paragraphs 63 to 67.

##### *What is 'a supply that is made in relation to rights'?*

29. The expression 'in relation to' in item 4 does not have the effect that item 4 applies to a supply of a service made to facilitate the supply of a right or that is merely associated with the supply of a right. Item 4 only applies to the supply of a right itself. The words 'a supply that is made in relation to rights' mean that all of the types of supplies of rights referred to in paragraph 9-10(2)(e) may be covered by item 4, that is, the creation, grant, transfer, assignment or surrender of a right.

30. Supplies of intellectual property rights are supplies that are made in relation to rights.

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<sup>8</sup> GSTR 2001/8: apportioning the consideration for a supply that includes taxable and non-taxable parts.

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31. We take the view that a supply of 'off-the-shelf' computer software sold embodied in a disk is a supply of goods and therefore excluded from section 38-190. The fact that a sale of 'off-the-shelf' software on disk is accompanied by a 'shrinkwrap licence' - which may deny users the authority to make backup copies, modify, or resell the software or to decompile the code - does not in itself change the character of the supply to a supply that is made in relation to a right.

32. Similarly, where computer software is supplied in intangible form, for example by downloading it from the internet, the inclusion of a 'clickwrap licence' in similar terms to the common form of shrinkwrap licence referred to above will not, in itself, mean that the supply is a supply that is made in relation to rights. In this case, what is supplied is the copyrighted article (that is, the computer program), subject to restrictions on its use. Such a supply is not a supply of goods.

33. Incidental copyright rights, such as the right to copy for downloading purposes, do not change the essential nature of the supply. However, a supply of the right to use the copyright in the program itself for commercial purposes, which allows the licensee to modify, adapt or copy or otherwise do what would ordinarily be the exclusive right of the copyright owner<sup>9</sup>, is a supply that is made in relation to rights.

34. Where a one-off solution is developed by a computer programmer for a client, the correct analysis of the supply will depend on all of the facts and circumstances, including the terms of the contract between the programmer and the client.

35. Supplies of computer software are considered in more detail at paragraphs 89 to 101.

36. Supplies of insurance and capacity in a telecommunications network are also supplies that are made in relation to rights. Refer to paragraphs 102 to 112 for further discussion of these and other supplies, such as membership subscriptions.

## **Supply that is made in relation to rights 'for use outside Australia'**

### *Meaning of 'for use'*

37. The requirement that 'the rights are for use outside Australia' in paragraph (a) of item 4 is an intention test. That is, to be covered by this paragraph, it must be established that the intention is that the rights will be used outside Australia.

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<sup>9</sup> See paragraphs 18 to 20 of Taxation Ruling TR 93/12.

38. The actual use of the rights is not relevant, other than as evidence of the intended use.

39. There is further discussion of the meaning of 'for use' at paragraphs 113 to 128.

***Supply that is made in relation to rights that are partly for use outside Australia***

40. Where rights are for use in and outside Australia an apportionment will be required unless the requirements of paragraph (b) of item 4 are met.

41. Any reasonable method of apportionment may be used.

***A supply is to an entity that is not an Australian resident and is outside Australia when the thing supplied is done***

42. We take the view that the requirement in paragraph (b) of item 4 that the entity, that is not an Australian resident, 'is outside Australia' has the same meaning as 'not in Australia' in items 2 and 3. In particular, this aspect of the provision will be satisfied if the entity is not in Australia in relation to the supply that is made in relation to rights.

43. Apportionment issues do not arise in respect of paragraph (b) of item 4. This is because the supply that is made in relation to a right occurs when the right is created, granted, assigned, transferred or surrendered. The recipient of the supply will be either outside or not outside Australia in relation to the supply at that time.

44. We also take the view that paragraph (b) of item 4 only applies to individuals or companies that are not Australian residents for income tax purposes. Paragraph (b) therefore does not apply to a partnership.

45. The supplies that are capable of being covered by paragraph (b) of item 4 are supplies made to an entity that is not an 'Australian resident', being:

- a company;
- an individual (in a private or business capacity);
- an individual trustee (that is, an individual in the capacity as trustee of a trust, including a superannuation fund); or
- a company that is a trustee (that is, a company in the capacity as trustee of a trust, including a superannuation fund).

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46. For a more detailed discussion of the entities that may be covered by paragraph (b) refer to paragraphs 146 to 159 of this Ruling.

## **Subsection 38-190(2)**

47. If the supply of a right is covered by subsection 38-190(2), neither item 4 nor any other item in the table operates to make the supply GST-free.

48. Subsection 38-190(2) applies to a supply of a right or option to acquire something, by way of creation or grant of the right or option or transfer or assignment of the right or option. It does not apply to a surrender of a right or option to acquire something.

## **Explanations**

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### **Identifying the relevant supply**

49. Where a transaction comprises a bundle of features and acts, you must consider all of the circumstances of the transaction to ascertain its essential character.<sup>10</sup> While many transactions involve rights being supplied, item 4 may only apply to a supply where:

- the essential character or substance of the supply, or the dominant part of a composite supply, is one of rights; or
- the essential character of a separately identifiable part of the supply is one of rights.

Where rights are merely integral, ancillary or incidental to another dominant part of the supply, the supply is characterised by the dominant part.

50. All the circumstances of a supply need to be considered to work out whether the supply is a supply that is made in relation to rights. As explained in GSTR 2001/8, a supply may comprise one or more parts. Where the parts are separately identifiable, distinct or recognisable or have an aim in themselves, you need to consider how the GST Act applies to each part. In GSTR 2001/8, a 'mixed supply' is regarded as a supply that has to be separated or unbundled, as it contains separately identifiable taxable and non-taxable parts that need to be individually recognised. Where a supply comprises parts that are separately identifiable, distinct or recognisable or have an aim in themselves, and one of those parts is a supply that is made in relation

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<sup>10</sup> See GSTR 2001/8: apportioning the consideration for a supply that includes taxable and non-taxable parts.

to rights, item 4 may apply. There may be other parts such as supplies of services to which other items in the table in subsection 38-190(1) may apply.

51. If you make a supply that contains a dominant part and the supply includes something that is integral, ancillary or incidental to that part, then the supply is composite. You treat a composite supply as a supply of a single thing. Where the dominant part of a supply is a supply that is made in relation to rights and the other parts are integral, ancillary or incidental to the supply of rights, the supply is a composite supply and can be treated as a supply of a single thing. Where the supply of rights is integral, ancillary or incidental to another dominant part of the supply, the supply is a composite supply and is treated as a supply of a single thing to which item 4 does not apply.

52. Paragraph 59 of GSTR 2001/8 states the following:

No single factor (by itself) will provide the sole test you use to determine whether a part of a supply is integral, ancillary or incidental to the dominant part of the supply.<sup>11</sup> Having regard to all the circumstances, indicators that a part may be integral, ancillary or incidental include where:

- you would reasonably conclude that it is a means of better enjoying the dominant thing supplied, rather than constituting for customers an aim in itself; or
- it represents a marginal proportion of the total value of the package compared to the dominant part; or
- it is necessary or contributes to the supply as a whole, but cannot be identified as the dominant part of the supply; or
- it contributes to the proper performance of the contract to supply the dominant part.

That is, we consider that a part of a supply will be integral, ancillary or incidental where it is insignificant in value or function, or merely contributes to or complements the use or enjoyment of the dominant part of the supply. It is a question of fact and degree whether a supply is mixed or composite.

53. Rights are created under executory contracts and although the creation of such rights is supported by valuable consideration, the supply may not be characterised as a supply that is made in relation to rights if, for example, those rights contribute to the supply as a whole but cannot be identified as the dominant part of the supply.

54. For example, under an agreement for the sale of goods, a right to the title to the goods may be created in return for consideration. In

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<sup>11</sup> See Lord Hope of Craighead in *Customs and Excise Commissioners v. British Telecommunications plc* [1999] BVC 306 at 314.

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determining whether this is treated as a single supply or as separate supplies of goods and rights, it is useful to apply the indicators set out in GSTR 2001/8. Applying paragraph 59 of GSTR 2001/8, the rights are regarded as integral, ancillary or incidental to the dominant part of the supply. The supply is treated as a single supply of goods.<sup>12</sup>

55. There are cases where it is clear that the parties to a transaction intend to supply rights and other things, such as services, and each of those separately identifiable parts is significant on its own. For example, under a franchising arrangement there may be supplies of rights to use a name and to market certain products, as well as supplies of marketing and administrative services. In this case, the supply is a supply of separately identifiable parts. The rights may be covered by item 4 or other items in the table in subsection 38-190(1). You should also consider whether the services are covered by another item in the table.

## **Supplies that are capable of being covered by item 4**

56. Subsection 38-190(1) applies only to supplies that are not supplies of goods or real property. Item 4 applies only to supplies of rights. To determine whether a supply is capable of coming within the scope of item 4, it is necessary to determine the true character of the supply.

### ***A supply of goods***

57. A supply of goods is outside the scope of subsection 38-190(1) and therefore cannot be covered by item 4.

58. Section 195-1 defines 'goods' as 'any form of tangible personal property'. 'Tangible' connotes a physical existence and has the effect of excluding intangibles. Thus, a supply of goods is a supply of any form of personal property that has a physical existence, but does not include intangible personal property, such as intellectual property rights (for example, copyright).

### ***A supply of real property***

59. A supply of rights which is a supply of 'real property' for GST purposes is outside the scope of section 38-190 and therefore cannot be covered by item 4.

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<sup>12</sup> This approach to rights under executory contracts is consistent with the analysis of a supply of real property under a standard land contract in Goods and Services Tax Ruling GSTR 2000/28. The supply of an equitable interest in the land upon entry into the contract is ancillary to what is the substance of the transaction – the transfer of title and delivery of possession at settlement.

60. 'Real property' is defined in section 195-1 to include:
- (a) any interest in or right over land;
  - (b) a personal right to call for or be granted any interest in or right over land; or
  - (c) a licence to occupy land or any other contractual right exercisable over or in relation to land.

61. This definition of real property for GST purposes has a broad ambit. It extends the meaning of what is real property under the general law. For example, under the general law, 'a licence to occupy land' is a personal right and not real property. However, a licence to occupy land is real property under the section 195-1 definition.

62. If a supply of rights is a supply of real property for GST purposes, then that supply is outside the operation of section 38-190. Therefore, supplies such as leases and licences to occupy property are not capable of being covered by item 4, even if, for example, the lessee/licensee is not an Australian resident and outside Australia when the lease or licence is granted.

### *What is a right?*

63. The word 'right' is not defined for GST purposes and has a very broad meaning under the general law. A 'right' has been defined as 'Generally, a benefit or claim entitling a person to be treated in a certain way'.<sup>13</sup>

64. The creation of expectations among the parties to a transaction does not establish a supply of rights. A supply that does not bind the parties in some way is not a supply that is made in relation to rights.<sup>14</sup>

### *Alternative View*

65. Some commentators have raised whether supplies of rights for GST purposes should be restricted to supplies of proprietary rights.<sup>15</sup> Reference has been made to cases decided in a stamp duty context where personal rights have been held not to be 'property' as defined under the relevant legislation.

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<sup>13</sup> *Australian Legal Dictionary*, Butterworths, 1997.

<sup>14</sup> See further the discussion at paragraphs 33 to 35 of Goods and Services Tax Ruling GSTR 2000/11 (grants of financial assistance) and at paragraphs 37 to 41 of Goods and Services Tax Ruling GSTR 2001/4 (GST consequences of court orders and out-of-court settlements).

<sup>15</sup> See R Cordara QC and P Gallagher, 'Supply of Rights and Rights to a Supply', VAT Monitor July/August 2001 pp 161-175, and C James and P Stacey, 'The Limits of Supply', (2002) 2 AGSTJ 41.

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66. In our view, there is no basis for limiting the operation of item 4 to supplies of proprietary rights. The stamp duty cases were decided in the context of provisions containing specific references to property and against the background of conveyance duty applying generally to instruments transferring interests in property.

67. For instance, under the general law certain licences (such as grocer, tavern and fishing licences) have been held to involve merely personal rights.<sup>16</sup> Supplies of these types of licences in our view would involve supplies of rights for the purposes of item 4.

### *What is ‘a supply that is made in relation to rights’?*

68. The meaning of the phrase ‘in relation to’ and similar phrases has been considered by the courts in a large number of cases across a wide range of legislation. While the courts have said that the words are of wide import, they have also made it clear that the context determines the scope of such phrases.

69. In *Hatfield v. Health Insurance Commission*<sup>17</sup> Davies J stated:

Expressions such as “relating to”, “in relation to”, “in connection with” and “in respect of” are commonly found in legislation but invariably raise problems of statutory interpretation. They are terms that fluctuate in operation from statute to statute... The terms may have a very wide operation but do not usually carry the widest possible ambit, for they are subject to the context in which they are used, to words with which they are associated and to the object or purpose of the statutory provision in which they appear.<sup>18</sup>

70. This passage was approved by the Full Federal Court in *Burswood Management Ltd v. Attorney-General*.<sup>19</sup>

71. The phrase ‘supply that is made in relation to’ in item 4 takes its meaning from its context in the GST Act. Subsection 9-10(2) of the GST Act sets out the meaning of ‘supply’ inclusively by providing examples of different kinds of supplies. A supply of goods or services is simply described as such in paragraphs 9-10(2)(a) and (b).

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<sup>16</sup> For example, in *Jack v. Smail* [1905] 2 CLR 684 it was held that a grocer’s licence conferred a personal right to carry on a business of a grocer at specified premises. In *Burns Philp Trustee Company Ltd v. Ironside Investments Pty Ltd* [1984] 2 Qd R 16 Shepherdson J held that a tavern licence was a personal right to the holder of such a licence. In *Pyke v. Duncan* [1989] VR 149 Nathan J held that licences under the Victorian *Fisheries Act* were personal in nature.

<sup>17</sup> (1987) 15 FCR 487.

<sup>18</sup> (1987) 15 FCR 487.

<sup>19</sup> (1990) 23 FCR 144.

72. However, it is recognised that supplies involving real property and rights may be made in different ways. Under paragraph (e) of subsection 9-10(2)(e), a supply includes ‘a creation, grant, transfer, assignment or surrender of any right’.

73. The structure of the definition of the term ‘eligible industrial property right’ in subsection 3(1) of the *Export Market Development Grants Act 1974* bears some similarity to the expression ‘supply that is made **in relation to** rights’ in item 4:

‘Eligible industrial property rights’ means rights **in relation to** inventions or trade marks, or copyright in relation to works, designs and other things...(emphasis added)

74. This definition was considered by the Full Federal Court in *Australian Trade Commission v. Disktravel*.<sup>20</sup> Kiefel J, with whom Mansfield J concurred, stated:

In my view, there is a reason for the separate description of rights relating to inventions and trade marks and copyright in relation to works and the words were most likely deliberately chosen by those drafting the definition of eligible [industrial property] rights because they most accurately reflected the rights spoken of.

The rights which exist “in relation to” inventions and trade marks are those provided for in the *Patents Act 1990* (Cth) and the *Trade Marks Act 1995* (Cth). Rights follow from a grant of a patent or the registration of a trade mark. In each case they are rights of monopoly of use and, with respect to inventions, of exploitation and rights to authorise others to do so (see s13 Patents Act; s20 Trade Marks Act).<sup>21</sup>

75. Just as the expression ‘in relation to’ was used in that context to encapsulate those *rights in relation to* inventions and trade marks identified in the patents and trade marks legislation, so too in our view it is used in item 4 to encapsulate the *supplies in relation to* rights identified in paragraph 9-10 (2)(e).

76. This interpretation of ‘supply that is made in relation to rights’ is also consistent with the apparent policy of section 38-190. The heading to section 38-190 supports the view that it is concerned with supplies of things other than goods or real property for consumption outside Australia.

77. Under paragraph (a) of item 4 a supply involving rights as described in paragraph 9-10(2)(e) may be GST-free whether supplied to a resident or non-resident, provided that the rights are for use outside Australia. In our view, this is consistent with the purpose of section 38-190.

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<sup>20</sup> (1999) 91 FCR 374.

<sup>21</sup> (1999) 91 FCR 374, at 402.

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78. However, a supply of services associated with the rights supply may be consumed in Australia where it is made to a resident or to a non-resident that is conducting a business in Australia. To extend the application of item 4 to associated services would result in many such services being GST-free even where those services are for consumption in Australia. In our view, this is contrary to the purpose of section 38-190.

79. Applying item 4 to associated services would also be inconsistent with the treatment of services associated with other kinds of supplies, such as the supply of goods for use outside Australia. There is nothing in the Act or extrinsic material to suggest that services that are associated with any thing that is supplied for use outside Australia, but are in fact consumed in Australia, should as a matter of policy be GST-free.<sup>22</sup>

80. Additionally, in Column 2 of subsection 38-190(1), the topic is 'Rights'.<sup>23</sup> This reference to rights alone supports the view that item 4 is about all the ways that a supply involving rights may be made under paragraph 9-10(2)(e) and does not extend to other supplies, such as services, that are performed to facilitate the supply of rights.

81. The heading to the Explanatory Memorandum on item 4<sup>24</sup> also supports the view that item 4 is restricted to the supply of rights themselves.

82. Accordingly, we consider that the phrase 'a supply that is made in relation to rights' means a supply of the right itself by way of the creation, grant, transfer or assignment of the right or a supply by way of the surrender of a right. It does not cover a supply of a service provided to facilitate the supply of the right or that is merely associated with the supply of the right.

83. We consider that a supply of legal services or other services associated with the supply of a right is not 'a supply that is made in relation to rights' within the meaning of that phrase as it is used in item 4. A supply of services may be GST-free under one of the other items in subsection 38-190(1).

## *Alternative View*

84. There is an alternative view that a service provided to facilitate the supply of a right or that is associated with the supply of a right comes within the meaning of the phrase 'a supply that is made in relation to rights'. For example, a lawyer may draft an agreement for

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<sup>22</sup> There are specific exemptions such as certain transport services in section 38-355.

<sup>23</sup> Under section 182, this column forms part of the Act and is an operative provision.

<sup>24</sup> A New Tax System (Goods and Services Tax) Bill 1998. House of Representatives Explanatory Memorandum.

the grant of an intellectual property right to another entity or provide services in registering a patent or trademark.

85. The argument in support of this view is that the words ‘in relation to’ must give the phrase ‘supply that is made in relation to rights’ a broader meaning than ‘supply of rights’, which the drafter would have chosen had it been intended to limit the meaning of the phrase to supplies of rights. While superficially appealing, this view fails to have regard to the context and purpose of the legislation. Additionally, the alternative phrase ‘supply of rights’ would not be intelligible if paragraph 9-10(2)(e) of the definition of ‘supply’ were to be read in the place of ‘supply’ in the phrase.

86. To interpret ‘in relation to’ in a way that makes services associated with the supply of a right GST-free would also create an anomaly in respect of the operation of subsection 38-190(2). The broad interpretation of ‘in relation to’ would make associated services GST-free, but subsection (2) has no application to supplies of services. Consequently, the supply of the right may be taxable, while the supply of associated services may be GST-free. In our view, it is unlikely that Parliament would have intended such an anomaly to arise and an interpretation which avoids it is to be preferred.

### ***Some examples of characterising supplies made in relation to rights and other supplies***

#### *Intellectual property*

87. Intellectual property is a generic term describing a variety of rights to control or profit from ideas and information. Intellectual property can be divided into four main areas:

- forms of expression – these intellectual property rights prevent others from copying the forms in which ideas are expressed and are protected by the *Copyright Act 1968* (Cth), *Designs Act 1906* (Cth) or *Circuits Layouts Act 1989* (Cth);
- scientific advances – these are intellectual property rights to exploit inventions, protected by the *Patents Act 1990* (Cth), and to exploit new varieties of plants, protected by the *Plant Breeders Rights Act 1994* (Cth);
- reputation – these intellectual property rights preserve and exploit the value of commercial and professional reputation, which can be protected by remedies for the tort of passing off, or by the *Trade Marks Act 1995* (Cth); and

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- confidential information – these intellectual property rights prevent the publication or misuse of government, personal or trade secrets and can be protected by equitable remedies for breach of confidence.

88. Supplies of intellectual property rights are supplies that are made in relation to rights for the purposes of item 4.

## *Computer software*

89. Computer software is a specific example of intellectual property. Computer software can be described as ‘computer programs consisting of encoded instructions designed to cause a computer to perform a particular task or to produce a particular result’.<sup>25</sup> A computer program is, in substance, knowledge or information, that is, it is intellectual property. However, the carrying medium for a computer program, for example, a disk, is tangible property.<sup>26</sup>

90. A supply of computer software may involve only a grant of rights (for example, rights to copy programs) or an assignment of rights (for example, assignment of the copyright in a program) or it may also include a supply of goods, such as a disk.

91. The nature of computer software and various transactions involving computer software is examined in some depth for income tax purposes in Taxation Ruling TR 93/12.<sup>27</sup>

92. The approach taken in TR 93/12 is consistent with the decision of the United Kingdom (UK) Court of Appeal in *St Albans City and District Council v. International Computers Ltd.*<sup>28</sup> In that case Sir Iain Glidewell referred to a decision of the Supreme Court of New South Wales (NSW), *Toby Constructions Products Pty Ltd v. Computa Bar (Sales) Pty Ltd.*<sup>29</sup> In that case, Rogers J held that hardware and software sold as a package were goods for the purposes of the New South Wales *Sale of Goods Act*. Rogers J said<sup>30</sup>:

At the end of the day what weighs with me is that the system, software included, whilst representing the fruits of much research and work, was in the current jargon off the shelf, in a sense mass produced.

93. Where ‘off-the-shelf’ computer software is supplied embodied in a carrying medium such as a disk, this is a supply of goods. The whole of the purchase price of the disk is treated as proceeds from the

<sup>25</sup> See paragraph 10 of TR 93/12.

<sup>26</sup> See paragraph 11 of TR 93/12.

<sup>27</sup> Taxation Ruling TR 93/12 Income tax: computer software.

<sup>28</sup> [1996] 4 All ER 481.

<sup>29</sup> [1983] 2 NSWLR 48.

<sup>30</sup> [1983] 2 NSWLR 48, at 51.

sale of goods, notwithstanding that there may be an ancillary supply of a licence to use the program.<sup>31</sup>

94. A sale of 'off-the-shelf' software on disk will commonly be accompanied by a 'shrinkwrap licence'. The licence commonly denies users the authority to make backup copies, modify, or resell the software or to decompile the code. The essential nature of the transaction is a supply of the copyrighted article, on disk, albeit subject to restrictions and disclaimers, rather than a supply of a *right to use* the article. It is no more a supply of a right to use the program than the supply of a book is a supply of a right to use the material in the book. The inclusion of a shrinkwrap licence of this kind does not change the character of the supply to a supply of a right.

95. Where computer software is supplied in intangible form, for example by downloading it from the internet, the inclusion of a 'clickwrap' licence in similar terms to the common form of shrinkwrap licence referred to above will not, in itself, mean that the supply is a supply of rights. In this case, what is supplied is the copyrighted article (that is, the computer program), subject to restrictions on its use. Such a supply is not a supply of goods as there is no tangible property supplied. Nor is it a supply of a right – it is simply a supply of the copyrighted article by electronic means.

96. If the essential nature of the transaction is the supply of the copyrighted article, subject to restrictions on its use, the fact that a 'licence' relating to the supply of the software is couched in terms of a licence 'to use' the software will not in itself mean that the substance of the supply is a supply of a right to use the software. Where, as will usually be the case with off-the-shelf or standard software, the essential nature of the transaction is the supply of the computer program subject to restrictions on its use, the substance of the supply is not a supply of a right. Similarly, incidental copyright rights, such as the right to copy for downloading purposes, do not change the essential nature of the supply.

97. A supply of rights in relation to the copyright in the program itself, which allows the licensee to modify, adapt or copy or otherwise do, for commercial purposes, what would ordinarily be the exclusive right of the copyright owner<sup>32</sup>, is a supply that is made in relation to rights.

98. Where a one-off solution is developed by a computer programmer for a client, the correct analysis of the supply will depend on all the facts and circumstances, including the terms of the contract between programmer and client. For example, a one-off program may

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<sup>31</sup> See paragraphs 33 and 34 of TR 93/12.

<sup>32</sup> See paragraphs 18 to 20 of TR 93/12.

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be developed as a solution to a particular information technology problem at great expense over a period of months.

99. Where, under the terms of the agreement, copyright in the program will vest upon its creation in the client, whether the program is delivered to the client electronically or on disk, the supply is a supply of services. There is no right supplied in these circumstances.

100. If the programmer contracts to develop a solution and make it available for the client, on terms that copyright in the program, once developed and accepted by the client, will be assigned to the client, the supply will be a mixed supply, comprising the development and a supply of the program and assignment of copyright in the program. Assignment of the copyright is the supply of a right, but supply of the program is not. The supply of the program is not a supply of goods even if it is delivered in tangible form on a disk.

101. Apportionment of the consideration between the development and supply of the program, and the assignment of the copyright, may be required in such cases. The program may be highly customised to the client's requirements, such that it is unlikely to be suitable for other commercial exploitation. It may therefore be unlikely that the client will wish to do things which would otherwise breach copyright, or that there would be significant commercial value to the programmer in retaining copyright. In that case, it is to be expected that little or no consideration would be apportioned to the assignment of the copyright.

## *Insurance*

102. The general law recognises that what an insured obtains under a contract of insurance is a chose in action.<sup>33</sup> Where, under the contract of insurance, the insurer agrees to compensate the insured for the loss that the insured may sustain through the happening of the event upon which the insurer's liability may arise, this chose in action is a right to be indemnified if the insured event occurs. There is a supply by way of a creation of a right when the contract of insurance is entered into.

103. A contract of life insurance and many contracts of accident insurance are not contracts of indemnity as they provide for the payment of a specified sum upon the occurrence of an event such as death or accident. What the insured obtains is a chose in action that is a right to receive a certain sum upon the occurrence of the event. There is a supply by way of a creation of a right when the contract of insurance is entered into.

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<sup>33</sup> See *Re Moore* (1878) 8 Ch. D. 519 at 520.

104. There are examples of a supplies of insurance at paragraphs 124 to 126 and 165 to 167.

*Supply of capacity in an international telecommunication network*

105. Telecommunication carriers (telcos) arrange telecommunication networks for clients' exclusive use. These networks have various names such as leased lines, international private circuits, indefeasible rights to use (IRUs), and global networks. To establish these networks, telcos acquire the right to access capacity in various telecommunication cables throughout the world and supply capacity to their clients.

106. In *Overseas Telecommunications Commission (Australia) v. FCT*<sup>34</sup> Lockhart J of the Federal Court of Australia had to decide whether, under the relevant IRU agreement, Overseas Telecommunications Commission (OTC) granted a right to use a cable to another party (STA) or whether there was an undertaking by OTC to provide telecommunication services to STA. This question would determine whether OTC was entitled to income tax deductions for investment allowance purposes. Lockhart J held the effect of the relevant IRU agreement was that OTC granted a right to STA. This was the substance of the transaction.

107. This case supports our view that the supply of capacity in an international telecommunication network is a supply of a right.

*Membership subscriptions*

108. Supplies of membership subscriptions can be difficult to characterise as there may be elements of services, rights or goods provided by the supplier. The principles outlined in GSTR 2001/8 are relevant in analysing a supply to determine whether it comprises separately identifiable parts that should be treated as supplies in their own right.

109. In characterising supplies of membership subscriptions it is necessary to determine what in substance and reality is supplied in return for the subscription payment. The characterisation of the supply does not depend on what an individual member subjectively paid the subscription for.<sup>35</sup>

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<sup>34</sup> 89 ATC 5200; (1989) 20 ATR 1482.

<sup>35</sup> See *Commissioners of Customs and Excise v. The Automobile Association* (1974) 1 BVC 8 and *British Railways Board v. Customs and Excise Commissioners* (1977) 1 BVC 116.

***Example 1 – a professional membership subscription supplied to a non-resident***

110. *An Australian organisation supplies a professional membership subscription to a non-resident. The entity provides its members with:*

- *promotion of the interests of the profession of its members to the general public;*
- *advancing the knowledge of its members by sponsoring seminars or conferences;*
- *access to members-only information;*
- *library service including technical references or information;*
- *periodic journals or magazines;*
- *discounts on registration fees for conferences or seminars in Australia; and*
- *the right to use post-nominals demonstrating membership of the entity.*

111. *The supply is characterised as a supply of services. Although there are incidental components of goods and rights, the dominant part of the composite supply is the supply of services. This is the supply for consideration.*<sup>36</sup>

112. There may be situations where the supply for consideration in respect of membership subscriptions is the supply of a right, or a combination of a supply of a right and a supply of services that are to be treated as separately identifiable parts of the supply. It will be a case of weighing up what is supplied in each case to determine the supply for which the subscription amount is consideration.

**Supply that is made in relation to rights ‘for use outside Australia’*****Meaning of ‘for use’***

113. A supply that is made in relation to rights is GST-free under paragraph (a) of item 4 ‘if the rights are for use outside Australia’.<sup>37</sup>

114. Support for the view that a test of whether something is for use in a particular way is about the intended use can be found in sales tax

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<sup>36</sup> Although item 4 does not apply in this situation, item 2 or item 3 may apply if the non-resident is not in Australia when the thing supplied is done and the other conditions of item 2 or item 3 are met.

<sup>37</sup> Provided subsection 38-190(2) does not operate to negate the GST-free status of the supply.

cases including the High Court decision in *Deputy Commissioner of Taxation v. Stewart and Another (Stewart's case)*.<sup>38</sup> One of the questions the High Court had to decide was whether machines were 'goods for use...., and not for sale in that case, by... a benevolent institution',<sup>39</sup> when they were supplied to public benevolent institutions.

115. Deane J's explanation of the requirement that the goods be 'for use' by a public benevolent institution makes it clear that what is relevant is projected use. His Honour explained that<sup>40</sup>:

...the question whether particular goods satisfy the description of being goods for use by a public benevolent institution will ordinarily fall to be answered by identifying the relevant projected use of the goods and by ascertaining whether that use answers the description of a use of the goods by a public benevolent institution.<sup>41</sup>

116. Brennan J made the following comment about what the 'for use' test entailed:

As the question whether goods were for use by a benevolent institution is likely to arise for determination after the institution has begun to use them, evidence of the actual use to which the goods have been put will be relevant and admissible.<sup>42</sup>

117. In the United Kingdom VAT Tribunal decision, *IDS Aircraft Ltd*<sup>43</sup>, the Tribunal had to decide whether the lease of an aircraft was 'for use' outside any European Union country throughout the period of the lease and therefore zero-rated.<sup>44</sup>

118. In deciding whether the dry leasing of the aircraft was made 'for use' outside any country of the EU 'throughout the period' of the dry leasing, the Tribunal judge stated:

What I have to determine in this case is whether the company let the Cessna on hire under the dry lease for use outside the EU throughout the period of the hiring. This in my judgment means that I am required to consider the intended purpose of the hiring. That dry lease was agreed by telephone without documentation and without any express agreement or term as to where it should be used or not used. The Cessna has a range well beyond the Channel Islands. On any objective basis it must have appeared likely to people in the aircraft chartering business that the Cessna would be used by

<sup>38</sup> (1984) 154 CLR 385; (1984) 84 ATC 4146; (1984) 15 ATR 387.

<sup>39</sup> Item 81(1) in the First Schedule to the *Sales Tax (Exemptions and Classifications) Act 1935*.

<sup>40</sup> *Stewart's case* (1984) 154 CLR 385 at 401-2; (1984) 84 ATC 4146 at 4155; (1984) 15 ATR 387 at 398.

<sup>41</sup> Taxation Ruling TR 2002/1 is also consistent with this analysis.

<sup>42</sup> *Stewart's case* (1984) 154 CLR 385 at 397-8; (1984) 84 ATC 4146 at 4153; (1984) 15 ATR 387 at 395-6.

<sup>43</sup> [1995] BVC 1126.

<sup>44</sup> Item 2 Grp 9 of Schedule 5, *Value Added Tax Act 1983* (UK).

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Beauport for a significant period of the hiring in flights to and from, or over, countries of the EU. It is for the company to satisfy me that its appeal is justified. It has not satisfied me that on the balance of probabilities the charter was entered into for use only in the Channel Islands or elsewhere outside the EU.<sup>45</sup>

119. Accordingly, it is the intended use of the rights at the time they are created, granted, transferred, assigned or surrendered that determines whether the rights are ‘for use outside Australia’ and therefore the extent to which the supply is GST-free. The GST status of the supply as taxable or GST-free is not affected by the actual use of the rights, other than as potential evidence of the intended use.<sup>46</sup>

120. There is authority to the effect that the intended use of a thing can encompass the intended on-supply of that thing. In *Shell-Mex and BP Ltd v. Clayton*<sup>47</sup> it was held by the UK Court of Appeal that oil was ‘intended for the use of’ the appellant notwithstanding that the appellant received the oil for the purpose of sale and distribution.

121. This case was cited with approval by the High Court in *Max Factor & Co v. FC of T*<sup>48</sup> (*Max Factor*) where it was held that the word ‘use’ is to be understood in its ordinary meaning of purpose served or object or end and is not restricted to any notion of actual physical use. In *Max Factor* a manufacturer of cosmetics was held to be applying goods to its own use (for the purposes of the relevant sales tax provision) in giving goods away in the course of its business.

122. The intended use of a right also encompasses the situation where the recipient does not actually exploit the right. For example, a patent may be acquired by an entity in the course of its enterprise to prevent other entities from exploiting that right. In these circumstances, the right is for use where it prevents other entities from exploiting the right.

123. A supply of insurance is for use where coverage of the risk is located. The insured has a right to be indemnified or a right to payment of a specified sum if the insured event occurs. The fact that a claim may be made in a particular place following the occurrence of an event, or that a claim must be made on the insurer in a particular place, does not mean that the right is for use in that place. In addition, the fact that no claim may be made on an insurance policy does not affect where the rights under the insurance policy are for use.

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<sup>45</sup> [1995] BVC 1126 at 1132.

<sup>46</sup> *Stewart’s case* (1984) 154 CLR 385; (1984) 84 ATC 4146; (1984) 15 ATR 387 per Brennan J at 397-8; 4153; 395-6.

<sup>47</sup> [1955] 3 All ER 102.

<sup>48</sup> (1971) 124 CLR 353.

***Example 2 – supply of public liability insurance to a resident company whose employees are working overseas***

124. *An insurance company in Australia supplies public liability insurance to an Australian resident company to protect it against liability claims arising as a result of any negligence by its employees while they are working overseas. The relevant contract is made by the parties in Australia.*

125. *The contract of insurance gives the insured party a right to be indemnified if the insured event occurs. The right to be indemnified is for use where the insured event or coverage of the risk is located.*

126. *As the risk that is covered by the insurance policy is outside Australia, the right is for use outside Australia. The supply is GST-free under paragraph (a) of item 4.*

127. The extent to which rights are actually used outside Australia may prove to be different from the intended use. This may happen if there is a change in circumstances which was not foreseen when the judgment about the intended use was made, that is, when the rights were created, granted, transferred, assigned or surrendered.

128. A large variation that is not explicable by an unforeseen change in circumstances may, however, be evidence that the assessment of the intended use was not reasonable. This is an example of where actual use may be relevant as evidence of the intention when the supply was made.<sup>49</sup>

***Supply that is made in relation to rights that are partly for use outside Australia***

129. A supply that is made in relation to rights is GST-free under paragraph (a) of item 4 *to the extent* that the rights were intended, at the time they were created, granted, transferred, assigned or surrendered, to be used outside Australia.<sup>50</sup>

130. You work out the GST payable on a supply that is made in relation to rights that are partly for use outside Australia by apportioning the consideration between the part of the supply that is made in relation to rights for use in Australia and the part that is made in relation to rights for use outside Australia. Apportionment of the consideration for a supply that includes taxable and non-taxable

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<sup>49</sup> *Stewart's case* (1984) 154 CLR 385; (1984) 84 ATC 4146; (1984) 15 ATR 387., per Brennan J at 397-8; 4153; 395-6.

<sup>50</sup> Section 9-5.

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parts<sup>51</sup> is discussed in Goods and Services Tax Ruling GSTR 2001/8.<sup>52</sup>

131. You may use any reasonable method of apportioning the consideration to work out the extent to which the supply is GST-free under paragraph (a) of item 4.

### *Reasonable method of apportionment*

132. What is a reasonable method of apportioning the consideration for a supply to reflect the extent to which rights are for use outside Australia depends on the nature of the supply and all the surrounding circumstances. In some cases, this may be evident to the supplier of the rights from the contract that the supplier has entered into.

133. However, in many cases it is the recipient of the supply who will have the best information available to it to determine the extent to which the rights are for use outside Australia. It is expected that, in these circumstances, the supplier will consult with the recipient to obtain that information or to be satisfied that the recipient has made a genuine attempt to determine the extent to which the rights are for use outside Australia.

134. Factors that may be relevant to forming a judgment as to the extent of intended use of rights for the purposes of paragraph (a) of item 4 include:

- expectations of the recipient, based on reasonable grounds, as to the likely use of the right over the period for which the right is granted, or if the right has been granted for an unspecified period, the expectations of the recipient as to the likely use over the anticipated period of use;
- economic, social, cultural and political conditions - the nature of the right itself, for example, the language of a written work or its relevance to a particular culture, may influence where the right will be used;
- past revenue, royalty or profitability patterns evident from the use of similar rights - this may come from industry statistics or from past experience in the recipient's business; and
- projected use of the right in and outside Australia based on market research.

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<sup>51</sup> A part of a supply that is GST-free is a 'non-taxable part' for the purposes of GSTR 2001/8 (see paragraph 32).

<sup>52</sup> See paragraph 25 of GSTR 2001/8.

***Example 3 – supply of worldwide copyright***

135. *An Australian resident musician assigns worldwide copyright in music to an Australia resident record company. The relevant contract is signed by the parties in Australia.*

136. *The supply of copyright is not a supply of goods or real property for GST purposes.*

137. *The supply of copyright will be GST-free under paragraph (a) of item 4 to the extent that the supply of rights is for use outside Australia. A reasonable basis of apportionment should be used. A reasonable basis may be the proportion of total projected sales or profits that is expected to be generated outside Australia.*

***Attribution of GST***

138. The basic attribution rules are set out in Division 29. If you account for GST on a cash basis you attribute GST on a taxable supply to the tax period in which you receive consideration for the supply to the extent that the consideration is received in that tax period. If you do not account for GST on a cash basis, you attribute all the GST payable on a taxable supply to the earlier of the tax period in which:

- any of the consideration for the supply is received; or
- an invoice for the supply is issued.

***Where there is a periodic or progressive supply or acquisition, can Division 156 be used to attribute based on actual use?***

139. Division 156 provides a special rule where you do not account for GST on a cash basis and a supply is made for a period or on a progressive basis. Under Division 156, where a supply is made for a period or on a progressive basis and the consideration is provided on a progressive or periodic basis, the GST payable and input tax credits are attributed as if each periodic component were a separate supply/acquisition. An example is where rights are granted for a period in return for the payment of periodic royalties.

140. Division 156 does not treat the supply as if it were a series of separate supplies. Rather, it simply allows the GST on the supply to be attributed as if there were separate supplies. Where a right is supplied for a period and is partly for use outside Australia, you apportion the consideration for the supply to its GST-free part, based on the extent to which the right is intended, when the supply is made, to be used outside Australia. This means that the apportionment will be the same for each component of a progressive or periodic supply covered by Division 156.

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141. Similarly, if you account for GST on a cash basis, you attribute GST progressively as you receive the consideration. This means that the apportionment will be the same for each tax period to which you attribute the GST payable as you receive the consideration.

142. An example of a supply that is partly taxable is the supply of a right assigned in Australia to another Australian entity to exploit copyright on a worldwide basis for 10 years. Based on the expected use of the copyright in Australia and outside Australia, the royalty payments are for a partly taxable and partly GST-free supply. The supplier needs to determine, at the time of making the assignment, where the right is to be used to determine the taxable portion of the supply. As the royalty payments are for a supply for a period, the amount of GST to be remitted by the supplier in each tax period is based on the intended use at the time the supply is made. Division 156 cannot be used to apportion based on the actual use in each tax period.

### ***No adjustment under Division 19 where actual use differs from intended use***

143. Division 19 outlines how adjustments arise through adjustment events. Subsection 19-10(1) states:

An adjustment event is any event which has the effect of:

- (a) cancelling a supply or acquisition; or
- (b) changing the consideration for a supply or acquisition;  
or
- (c) causing a supply or acquisition to become, or stop being, a taxable supply or creditable acquisition.

144. The extent to which a supply of a right is GST-free under paragraph (a) of item 4 is a question of apportionment based on the extent of intended use of the right outside Australia. There is no adjustment event under paragraph 19-10(1)(c) where the actual use differs from the intended use as nothing has occurred to cause the supply to become or stop being a taxable supply.

145. A change in use of a supply of rights does not cause the supply to become or stop being a taxable supply for the purposes of Division 19. While adjustments to input tax credits for changes in use are accounted for under Division 129, there are no corresponding adjustments, under Division 129 or any other provisions, to the GST payable where the intended use of rights in relation to paragraph (a) of item 4 and actual use of the rights differ.

**A supply is to an entity that is not an Australian resident and is outside Australia when the thing supplied is done**

146. The condition in paragraph (b) of item 4 is that the supply that is made in relation to rights 'is to an entity that is not an Australian resident and is outside Australia when the thing supplied is done'. This condition is an alternative to paragraph (a) of item 4.

147. The expression used in paragraph (b) of item 4 'the supply is to an entity that is not an Australian resident and is outside Australia when the thing supplied is done' has the same meaning as 'a supply that is made to a non-resident who is not in Australia when the thing supplied is done' as used in item 2. This is reinforced by the topic heading for item 2 where the term 'outside Australia' is used.

148. The meanings of 'not an Australian resident' and 'not in Australia' when the thing supplied is done are discussed in more detail in Draft Goods and Services Tax Ruling GSTR 2002/D8.

***Australian resident***

149. For paragraph (b) of item 4 to apply to a supply, the supply must be made to 'an entity that is not an Australian resident'. 'Entity' is defined in subsection 184-1(1) and includes things not ordinarily regarded as entities, such as a partnership, a trust and a superannuation fund.

150. 'Australian resident' is also defined in section 195-1 as a person who is a resident of Australia for the purposes of the *Income Tax Assessment Act 1936* ('ITAA 1936'). A resident of Australia is defined in subsection 6(1) of the ITAA 1936 and covers persons that are either individuals or companies.

151. The expression 'not an Australian resident' in paragraph (b) of item 4 means, therefore, either an individual who, or a company that, is not a resident of Australia as defined in the ITAA 1936.

152. A supply made to a non-resident individual or corporate trustee may be covered by item 4. A trustee is treated as an entity.<sup>53</sup> The trustee is the entity that makes supplies and acquisitions on behalf of the trust.

153. Other definitions specific to resident trust estates and resident superannuation funds in the ITAA 1936 are not relevant for the purposes of item 4. This is because these other definitions are not imported into the section 195-1 definition of 'Australian resident'.

154. A partnership is not a separate legal entity and is not an individual. Additionally, the definition of partnership in

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<sup>53</sup> Subsection 184-1(2).

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section 195-1<sup>54</sup> excludes a company. Under section 184-5, an acquisition made by a partner of a partnership in his or her capacity as a partner is taken to be an acquisition made by the partnership itself. A partner can be an individual or a company, and, therefore, meets the definition of a non-resident. However, for GST purposes, a supply is made to the partnership, which is not a non-resident for the purposes of item 4. Paragraph (b) of item 4 therefore cannot apply to a supply made to a partnership.

155. However, paragraph (b) of item 4 may apply if the partner acquires a supply in a different capacity from that of a partner in a partnership, for example, as a private individual.

156. Accordingly, paragraph (b) of item 4 only applies to individuals or companies that are not Australian residents for income tax purposes. Paragraph (b) does not apply to a partnership.

157. Therefore, the supplies capable of being covered by paragraph (b) of item 4 are supplies made to an entity that is not an 'Australian resident', being:

- a company;
- an individual (in a private or business capacity);
- an individual trustee (that is, an individual in the capacity as trustee of a trust, including a superannuation fund); or
- a company that is a trustee (that is, a company in the capacity of trustee of a trust, including a superannuation fund).

### *Alternative view*

158. The definition of non-resident can be more widely interpreted to mean any entity that is not an Australian resident, rather than restricting the meaning to an entity that is an individual or a company. This would mean that all entities listed in section 184-1, other than Australian resident individuals or companies, are covered by the term 'not an Australian resident' as used in item 4.

159. Applying this broader interpretation would mean, for example, that all 'domestic' partnerships would be treated as not Australian residents as such partnerships are not Australian residents as defined under the ITAA 1936. We consider it is unlikely that Parliament would have intended to extend the benefit of paragraph (b) of item 4 to partnerships of Australian resident individuals or companies while

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<sup>54</sup> Section 195-1 adopts the meaning of 'partnership' given by section 995-1 of the *Income Tax Assessment Act 1997*.

denying its benefit to Australian resident individuals or companies not in partnership.

***Outside Australia in relation to the supply***

160. It is possible for an entity to manifest its presence both inside and outside Australia. It is necessary to consider whether the presence outside Australia is in relation to the supply.

161. At paragraph 68 of GSTR 2000/31, we state that ‘the pre-condition that the recipient is not in Australia at the relevant time requires that neither the recipient, nor a representative acting on behalf of the recipient if the recipient is a company, is in Australia *in relation to the supply*’. Similarly, the requirement in paragraph (b) of item 4 that the non-resident is ‘outside Australia’ will be satisfied if the non-resident is outside Australia in relation to the supply. GST-free status will not be denied where the non-resident is in Australia for other purposes, but outside Australia in relation to the supply.

162. Conversely, paragraph (b) will not be satisfied where the non-resident is not outside Australia in relation to the supply, even though it may be outside Australia for other purposes.<sup>55</sup>

163. Apportionment issues do not arise in respect of paragraph (b) of item 4. This is because the supply made in relation to a right occurs when the right is created, granted, assigned, transferred or surrendered. The recipient of the supply will be either outside or not outside Australia in relation to the supply at that time.

***Example 4 - public liability insurance policy issued to non-resident in Australia***

164. *An Australian resident insurer supplies product liability insurance to a non-resident company to protect it against liability claims arising in respect of use of its product in Australia. The non-resident company has a branch in Australia and it is through that branch that the policy negotiations are concluded and the proposal is signed. As the risk that is covered by the insurance policy would arise in Australia, the supply is not for use outside Australia. The supply is not GST-free under paragraph (a) of item 4. Nor is it GST-free under paragraph (b), as the non-resident insured is in Australia in relation to the supply.*

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<sup>55</sup> The meaning of ‘not in Australia in relation to the supply’ is discussed in detail in Draft Goods and Services Tax Ruling GSTR 2002/D8.

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## ***Example 5 - life insurance policy issued to non-resident not in Australia***

165. *Explorer Corporation (the insured), a non-resident entity, insures the life of its senior mining engineer who consults with the corporation's clients in various countries including Australia. Explorer Corporation is the beneficiary under the life insurance contract. The life policy is issued in Australia by Rapid Life (the insurer), an Australian resident life insurance company. The supply is the interest in life insurance constituted by the rights under the contract of life insurance.*

166. *The supply of the interest is connected with Australia because it satisfies both paragraphs 9-25(5)(a) and 9-25(5)(b). The thing supplied is done in Australia and the supply is made through an enterprise Rapid Life carries on in Australia.*

167. *The supply is GST-free under paragraph (b) of item 4 of subsection 38-190(1). Explorer Corporation is not an Australian resident and does not carry on business in Australia. It is outside Australia when the policy is issued. Explorer Corporation is therefore not in Australia in relation to the supply. It is the presence or otherwise in Australia of the entity to which the life insurance policy is issued (the insured) rather than that of the person whose life is insured (the senior mining engineer) which is relevant.*

## **Subsection 38-190(2)**

168. Subsection 38-190(2) is designed to ensure that the supply of a right or option is not GST-free if the right or option can be redeemed for the supply of something else, the supply of which would be a taxable supply.

169. Without subsection 38-190(2), the supply of a thing that is connected with Australia, and not otherwise GST-free, could occur without GST being payable, if all of the consideration were to be provided for the granting of a right or option to acquire the thing, notwithstanding that when the thing itself is supplied it may be consumed in Australia.

170. If there is a supply of a right or option to acquire *a supply that would be GST-free*, subsection 38-190(2) does not negate the GST-free status of the supply of the right or option accorded by one of the items in the table in subsection 38-190(1). This includes a case where the underlying supply is itself GST-free under one of the items in the table in subsection 38-190(1).

171. Subsection 38-190(2) was amended by the *Indirect Tax Legislation Amendment Act 2000* to make it clear that the subsection

does not apply where the supply underlying the right would be GST-free. That is, where the right is redeemed for a GST-free supply.

172. The example given in the Explanatory Memorandum to the Bill<sup>56</sup> for that Act is of a supply of a right where the underlying supply is a financial supply to a non-resident that is GST-free. It was recognised that to treat the supply of the right as not being GST-free, when the underlying supply would be GST-free, would have been inconsistent.

173. Where a transaction involves a supply of a right or option to acquire something, the supplier will usually enter into an obligation to supply the thing if the right or option is exercised. The fact that the transaction also involves an entry into an obligation does not in itself preclude the operation of subsection 38-190(2) if there is a relevant supply of a right or option to acquire something.

#### ***Example 6 – right or option to acquire equipment***

174. *An Australian company grants an option to acquire equipment in Australia to a non-resident company that is not in Australia when the grant occurs. There are within the one contract both the creation of the contractual right to acquire the equipment and the entry into the contractual obligation to supply the equipment (if the option is exercised). The supply of the option is the substance of the supply. Subsection 38-190(2) ensures that the supply of the right to acquire the equipment is excluded from GST-free status under any of the items in the table of subsection 38-190(1), as the supply of the equipment would be connected with Australia and would not be GST-free.*

175. Subsection 38-190(2) uses the composite expression ‘supply of a right or option to acquire something’. In our view, in interpreting that expression, it is not appropriate to read paragraph 9-10(2)(e) of the definition of ‘supply’ in the place of ‘supply’; the phrase would not be intelligible if that approach were to be taken. Accordingly, we take the view that the expression takes its ordinary meaning. As such, it is apt to cover a supply of a right or option to acquire something by way of grant or creation of the right or option or transfer or assignment of the right or option, but does not extend to a surrender of a right or option to acquire something.

## **Detailed contents list**

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176. Below is a detailed contents list for this draft Ruling:

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<sup>56</sup> Indirect Tax Legislation Amendment Bill 2000 Explanatory Memorandum at paragraph 3.28.

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## **Your comments**

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177. If you wish to comment on this draft Ruling, please send your comments by 7 February 2003 to:

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## Commissioner of Taxation

18 December 2002

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*Previous draft:*

Not previously released in draft form

*Related Rulings/Determinations:*

GSTR 1999/1; GSTR 2000/11;  
GSTR 2000/28; GSTR 2000/31;  
GSTR 2001/4; GSTR 2001/8;  
GSTR 2002/2; GSTR 2002/D8;  
TR 93/12; TR 2002/1

*Subject references:*

- adjustment
- apportionment
- attribution
- copyright
- for use
- goods
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- insurance
- intellectual property
- international telecommunications
- network
- membership subscriptions
- non-resident
- not in Australia
- outside Australia
- real property
- rights
- software
- supply that is made in relation to rights

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- ANTS(GST)A 1999 9-10(2)(a)
- ANTS(GST)A 1999 9-10(2)(b)
- ANTS(GST)A 1999 9-10(2)(e)
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