GSTR 2004/8 - Goods and services tax: when does an entity have a decreasing adjustment under Division 132?

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Generated on: 20 November 2026, 03:48:00 AM

Goods and Services Tax Ruling

Goods and services tax: when does an entity have a decreasing adjustment under Division 132?

Contents Para

What this Ruling is about 1
Date of effect 7
Context 9
Ruling with explanation 18
Detailed contents list 102

Preamble

This document is a ruling for the purposes of section 37 of the ***Taxation Administration Act 1953****. You can rely on the information presented in this document which provides advice on the operation of the GST system.*

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

What this Ruling is about

1. This Ruling is about Division 132 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). It applies to all entities that:

- make a taxable supply by way of sale; and
- were not entitled to a full input tax credit on the acquisition or later application of the thing because the acquisition or application related to making financial supplies or was of a private or domestic nature.

2. Division 132 applies to allow you a decreasing adjustment when you sell a thing in the circumstances set out in the Division. A decreasing adjustment under Division 132 effectively enables you to recover the input tax credits that you have previously been denied.

3. This Ruling explains:

- the circumstances in which you have a decreasing adjustment under Division 132;
- how to calculate the decreasing adjustment using the formula in subsection 132-5(2);
- how subsection 132-5(3) limits the amount of the decreasing adjustment;
- how Division 132 applies to a GST-free supply of a going concern; and
- how Division 132 applies to the sale of a reduced credit acquisition under section 70-25.

4. Division 132 applies to an importation in the same way as to an acquisition. In this Ruling a reference to an 'acquisition' includes a reference to an importation.

5. In this Ruling, when considering whether the supply of a thing is a taxable supply, we have assumed that the supply is made for consideration and is connected with Australia, and that the supplier is registered or required to be registered.[1]

6. Unless otherwise stated, all legislative references in this Ruling are to the GST Act.

Date of effect

7. This Ruling explains our view of the law as it applied from 1 July 2000. You can rely upon this Ruling on and from its date of issue for the purposes of section 37 of the *Taxation Administration Act 1953*. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and our view of when you can rely on our interpretation of the law in GST public and private rulings.

8. If this Ruling conflicts with a previous private ruling that you have obtained, this 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 this public ruling. This means that if you have underpaid an amount of GST, you are not liable for the shortfall prior to the date of issue of this later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

Note: The Addendum to this Ruling that issued on 13 September 2006 applies on and from 13 December 2004 (the date of commencement of Division 131) except for the amendments at:

- items 1(b) and 4 of this Addendum, which apply on and from 29 June 2005; and
- items 2 and 6 of this Addendum, which apply on and from the date of issue of GSTR 2006/4.

You can rely on this Addendum, for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953* [formerly section 37], from its date of issue.

Context

9. Under the GST Act, the supply of a thing is a taxable supply if it satisfies section 9-5. In considering whether a supply is a taxable supply, this Ruling only considers the requirement in paragraph 9-5(b)

[1] Paragraphs 9-5(a), (c) and (d).

that the supply be made in the course or furtherance of an enterprise that you carry on.

10. If your acquisition of a thing is not made solely for a creditable purpose, you are not entitled to a full input tax credit. If you are entitled to a full input tax credit on your acquisition of a thing, and your subsequent application of the thing is not solely for a creditable purpose, you may have an increasing adjustment.[2] In either case if you later make a taxable supply of the thing, GST will be applied to the full value of the supply. However, Division 132 may give you a decreasing adjustment.

11. Division 132 allows a decreasing adjustment if the input tax credits were denied because the acquisition or subsequent application[3] of the thing was solely or partly related to making financial supplies or was of a private or domestic nature.

12. Division 132 in effect treats the original acquisition as related, in part at least, to the later sale of the thing acquired. For example, if a thing is acquired and applied solely for making financial supplies with all input tax credits denied, and is subsequently sold for half the original acquisition price,[4] Division 132 effectively gives you half the original input tax credit. It gives you a decreasing adjustment[5] to effectively recover the input tax credits previously denied.

13. However, Division 132 will not allow you to effectively recover input tax credits that you have previously been denied on the basis that your acquisition or subsequent application of the thing was for making input taxed supplies other than financial supplies (for example, supplies of residential premises that are covered by section 40-35 or 40-65).

14. The amount of a decreasing adjustment under Division 132 is calculated by using the following formula, which appears in subsection 132-5(2):

$$\frac{1}{11} \times \text{Price} \times \left[1 - \frac{\text{Adjusted input tax credit}}{\text{Full input tax credit}}\right]$$

Where:

adjusted input tax credit (AITC) is:

(a) the amount of any input tax credit that was attributable to a tax period in respect of the acquisition; minus

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[2] Division 129.

[3] For the purposes of the GST Act, 'apply', in relation to a thing acquired or imported, is defined by section 129-55 to include:

(a) supply the thing;
(b) consume, dispose of or destroy the thing; and
(c) allow another entity to consume, dispose of or destroy the thing.

In this Ruling we also use the term in this extended sense.

[4] Disregarding any possible application of Division 129.

[5] A decreasing adjustment decreases the net amount of GST that you pay in a similar way to an input tax credit.

(b) the sum of:

(i) any increasing adjustments, under Subdivision 19-C[6] or Division 129[7], that were previously attributable to a tax period in respect of the acquisition or importation; and

(ii) any increasing adjustment under Division 131[7A] that has been previously, is or will be attributable to a tax period in respect of the acquisition or importation; plus

(c) the sum of any decreasing adjustments, under Subdivision 19-C or Division 129, that were previously attributable to a tax period in respect of the acquisition.

full input tax credit (FITC) is the amount of the input tax credit to which you would have been entitled for acquiring the thing for the purpose of your enterprise if:

(a) the acquisition had been solely for a creditable purpose; and

(b) in the case where the supply to you was a taxable supply because of section 72-5[8] or section 84-5[9] – the supply had been or is a taxable supply under section 9-5.

price is the price of the taxable supply.

15. However, if the amount worked out under subsection 132-5(2) is greater than the difference between the FITC and AITC, subsection 132-5(3) limits the amount of the decreasing adjustment to an amount equal to that difference.

16. In working out the AITC in relation to a thing acquired, the acquisition or application of the thing is treated under subsection 132-5(4) as having been for a creditable purpose except to the extent that the acquisition or application relates to the making of financial supplies or is of a private or domestic nature.

17. Section 132-10 provides for a decreasing adjustment under Division 132 to be attributable to the same tax period as the taxable supply to which it relates. If the decreasing adjustment relates to a GST-free supply of a going concern, it is attributable to the tax period to which the adjustment would be attributable if the supply were a taxable supply.

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[6] Subdivision 19-C is about adjustments for acquisitions.
[7] Division 129 is about changes in the extent of creditable purpose.
[7A] Division 131 is about annual apportionment of creditable purpose.
[8] Section 72-5 is about taxable supplies to associates without consideration.
[9] Section 84-5 is about intangible supplies from offshore that may be taxable supplies.

Ruling with explanation

Entitlement to a decreasing adjustment under Division 132

18. To be entitled to a decreasing adjustment under Division 132, you need to have:

- made a taxable supply by way of sale; and
- previously been denied all or part of an input tax credit, or had an increasing adjustment, due to the acquisition or subsequent application of the thing being related to making financial supplies or being of a private or domestic nature. You need to have been entitled to an input tax credit, at least to some extent, on the acquisition of the thing if it were not for those matters.[10]

19. You may also have a decreasing adjustment if you make a supply by way of sale of a thing that would have been a taxable supply had it not been GST-free under Subdivision 38-J.

Taxable supply by way of sale

What is a sale?

20. The technical legal meaning usually given to the term 'sale' is the transfer by mutual consent of the ownership of a thing from one person to another person for a money price.[11] However, in some contexts, as a matter of ordinary non-technical English usage, 'sale' is capable of extending to the transfer of property for any valuable consideration – that is, to transfers by way of barter or exchange.[12]

21. We consider that Division 132 is one such context in which it is appropriate to adopt the wider, non-technical interpretation of the term 'sale'.[13] In light of the purpose of Division 132, we are not aware of any reason in principle why a decreasing adjustment should be denied to an entity which receives only non-monetary, yet valuable, consideration for a taxable supply.

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[10] Section 11-20.

[11] *Halsbury's Law of England,* 1983, vol. 41, 4th edn, Butterworths, London, paragraph 601.

[12] Dictionaries of ordinary English are not entirely consistent on this point. *The Collins Concise Dictionary* 1990, Harper Collins, New York, defines 'sell' as 'to dispose of or transfer … to a purchaser in exchange for money **or other consideration**' [emphasis added]. In *The Australian Oxford Dictionary* 1999, Oxford University Press, Melbourne, the first sense of 'sale' given is 'the exchange of a commodity for money **etc**.' We have emphasised 'etc' in this definition to distinguish from some other dictionaries, which limit the definition of 'sales' to transfers for a money price.

[13] One other context in which we have taken a similar view is in relation to section 38-100, which is about supplies by way of sale, lease or hire of some goods that, though related to an education course, are not GST-free. The Commissioner considers 'sale' in this context to include an act of selling or transferring property for non-monetary consideration (see paragraph 125 of Goods and Services Tax Ruling GSTR 2001/1, *Goods and services tax: supplies that are GST-free for tertiary education courses*).

22. In our view, the intention behind limiting a Division 132 adjustment to taxable supplies by way of sale of a thing was to exclude taxable supplies consisting of partial or temporary disposals of the thing such as the grant of a lease over the thing. The decreasing adjustment should only be available once the thing is wholly and permanently disposed of. Whether that disposal is for a money price, as opposed to some other kind of valuable consideration, should be immaterial.

23. Not every disposal is a supply by way of sale. For example, a gift of a thing is not a supply by way of sale because there is no consideration for a gift.

24. Also, the grant of a lease of a particular asset, even a long-term lease, is not a supply by way of sale because the lessor retains legal title and a reversionary interest in the asset. The legal and beneficial interest in the asset is not wholly and permanently disposed of by the lessor.

25. However, if the lessee of a lease assigns the whole of its leasehold interest, the lessee wholly or permanently disposes of its interest in the asset. The assignment of the whole of the leasehold interest by the lessee for consideration is a supply by way of sale for the purposes of Division 132.[14]

Taxable supply

26. One of the requirements for a sale of a thing to be a taxable supply is that you need to sell the thing in the course or furtherance of the enterprise that you carry on.[15]

27. You acquire or apply a thing for a creditable purpose to the extent that you acquire or apply the thing in carrying on your enterprise.[16] For a thing to be acquired or applied in carrying on an enterprise, the acquisition or application of the thing must be made in the course of the activities that constitute the enterprise.[17]

[14] This view is similar to the view we have taken in relation to section 40-65 in paragraph 18 of Goods and Services Tax Ruling GSTR 2003/3, *Goods and services tax: when is a sale of real property a sale of new residential premises?* We consider that for the application of section 40-65 to residential premises, 'sale' and 'sold' refer to the transfer of the full and complete ownership of land, that is, the maximum interest that the Crown has alienated – whether it is freehold or leasehold.

[15] The term 'enterprise' has the meaning given by section 9-20 and includes activities done in the form of business.

[16] Subsection 11-15(1), subsection 129-50(1) and section 195-1.

[17] This is consistent with the view expressed at paragraph 55 of GSTR 2006/4 which is about determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose.

28. For the sale of a thing to be made in the course or furtherance of your enterprise, the sale of the thing must have a connection with your enterprise. Whether a connection between the sale of the thing and your enterprise exists will depend on the facts and circumstances. The Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998[18] states:

> 'In the course or furtherance' is not defined but is broad enough to cover any supplies made in connection with your enterprise. An act done for the purpose or object of furthering an enterprise, or achieving its goals, is a furtherance of an enterprise although it may not always be in the course of that enterprise. 'In the course or furtherance' does not extend to the supply of private commodities, such as when a car dealer sells his or her own private car. See *Case N43* (1991) 13 NZTC 3361.

29. Given the broad meaning of 'in the course or furtherance', a sale of a thing is capable of being made in the course or furtherance of an enterprise regardless of the extent to which it has a connection with the enterprise, so long as it has some connection. The GST Act does not require that the thing must be applied primarily or principally in carrying on the enterprise for the supply of the thing to be in the course or furtherance of an enterprise. Accordingly, a connection between the sale of the thing and your enterprise exists even if, at the time of its sale, the thing is applied in carrying on the enterprise to a minor or secondary extent.[19]

30. Each of the following characteristics of a thing indicates strongly that the sale of the thing has a connection with your enterprise:

- at the time of sale it formed part of the assets of your enterprise (for example, it is trading stock or a depreciable asset for income tax purposes);
- at the time of sale it was applied[20] in carrying on your enterprise to at least some extent; and
- it is sold as a transaction of your enterprise.

31. Factors that tend to indicate that a sale is a transaction of the enterprise include the following:[21]

- the sale is made from enterprise premises;
- payment is accepted using enterprise facilities such as a cash register or a credit card facility;

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[18] Paragraph 3.10.

[19] This view is consistent with the view expressed in paragraph 42 of GSTR 2003/6 which is about transfers of enterprise assets as a result of property distributions under the *Family Law Act 1975* or in similar circumstances. We consider that a supply is not made in the 'course or furtherance of' an enterprise if the overriding essential character of the supply is private.

[20] See the extended meaning of supply in section 129-55.

[21] *James Conlin T/A Cottage Art & Frames* (Unreported VAT Tribunal decision 17550 12/02/200*2)*.

- the proceeds of sale are deposited into an enterprise bank account; and
- enterprise book accounts are used to record the transaction.

The list in this paragraph is not exhaustive or conclusive. All the facts and circumstances must be considered and balanced.

32. If you acquire a thing solely for a creditable purpose you are entitled to a full input tax credit on the acquisition.[22] The thing forms part of the assets of your enterprise. If your subsequent application of the thing is solely or partly of a private or domestic nature you may have one or more increasing adjustments under Division 129. If at the time you sell the thing, your application of it is solely of a private or domestic nature, the thing does not form part of the assets of your enterprise, and the thing is not sold as an enterprise transaction, then there can be no connection between the sale of the thing and your enterprise. The sale of the thing is not made in the course or furtherance of your enterprise. It is not a taxable supply and you are not entitled to a decreasing adjustment under Division 132.

Example 1: application of a private or domestic nature at the time of the sale

33. *Veronica's Fashion House (VFH) is a private company which acquired and applied a car 100% for a creditable purpose and claimed a full input tax credit on its acquisition. The car forms part of the assets of VFH's enterprise. VFH claims a depreciation deduction on the car for income tax purposes. Three years later, VFH changes its application of the car to a 100% private nature by allowing a shareholder to use the car wholly for private purposes. The car has been removed from the assets of VFH's enterprise. VFH does not claim a depreciation deduction on the car for income tax purposes. (As the car was not used by an employee or an associate of an employee, there are no fringe benefits tax implications.) VFH had increasing adjustments in the relevant adjustment periods under Division 129. There were no further changes in the application of the car.*

34. *Later, VFH sells the car. At the time of the sale, VFH's application of the car was solely private. The car was never recommitted to the enterprise. It does not form part of the assets of VFH's enterprise and the sale is not an enterprise transaction. There is therefore no connection between the sale of the car and the enterprise of VFH. The sale is not made in the course or furtherance of the enterprise carried on by the entity. It is not a taxable supply and therefore VFH is not entitled to a decreasing adjustment under Division 132 on the sale.*

[22] Subject to Division 130, which is about goods that are applied solely to private or domestic use.

35. The following example shows that if you have changed the application of a thing from a private or domestic purpose to a purpose that is partly or solely creditable, you may have decreasing adjustments under Divisions 129 and 132. If at the time you sell the thing, there is a connection between the sale and your enterprise, in terms of paragraphs 28 to 30, the sale is made in the course or furtherance of the enterprise. It is a taxable supply and you may be entitled to a decreasing adjustment under Division 132.

Example 2: application for a creditable purpose at the time of sale

36. *Assume that, having applied the car solely for private purposes for some time, VFH (from Example 1) changes its application to 20% creditable purpose and 80% private. VFH reintroduces the car to its enterprise and proportionately claims a depreciation deduction on the car under income tax law. VFH may have decreasing adjustments under Division 129 in the relevant adjustment periods. Assume that this application of the car remains unchanged until VFH sells it. As the car is applied partly for a creditable purpose and forms part of the assets of VFH's enterprise at the time of its sale, there is a connection between the sale and the enterprise carried on by VFH. The sale is made in the course or furtherance of the enterprise. It is a taxable supply. VFH has a decreasing adjustment under Division 132 on the sale.*

37. For the reasons explained above, you may not be entitled to a Division 132 decreasing adjustment if you sell a thing and your application of the thing was solely of a private or domestic nature at the time of its sale as there may be no connection between the sale and the enterprise. This result is different from the result where the thing is acquired or subsequently applied to making financial supplies. This is because, in the latter case, the thing is applied in carrying on your enterprise when it is sold. The sale is connected with your enterprise and a Division 132 adjustment may therefore be available.

Input tax credits previously denied

38. The application of Division 132 depends, among other things, on the reason for the denial of the full input tax credit, or for the subsequent increasing adjustment. For Division 132 to apply, that denial must be due to the acquisition or subsequent application of the thing being related to making financial supplies or being of a private or domestic nature. You need to have been entitled, apart from those matters, to an input tax credit, at least to some extent, on the acquisition of the thing. This entails that at least some GST must have been payable on the supply of the thing to you.

39. You do not have a decreasing adjustment to the extent that you were denied your full input tax credit, or you had an increasing adjustment, for any reason other than because your acquisition or application of the thing was related to making financial supplies or was of a private or domestic nature. For example, you do not have a decreasing adjustment if you:

- acquired a thing before you were registered or required to be registered; or
- sell motor vehicles, trailers or bodies of motor vehicles that you acquired before 23 May 2001.[23]

40. Division 132 also does not apply if you had no entitlement to an input tax credit because the supply of the thing to you was not a taxable supply. Examples of this may arise where you acquired a thing and the supply of the thing to you was:

- made before the start of GST;[24]
- from a supplier that was not registered or required to be registered for GST (unless the thing supplied to you was second-hand goods to which Division 66 applies); or
- either GST-free or was an input taxed supply other than a financial supply (for example, residential premises covered by section 40-35 or 40-65).

Calculating a decreasing adjustment

41. If you are entitled to a decreasing adjustment under Division 132, the amount of the decreasing adjustment is calculated using the formula contained in subsection 132-5(2).[25] In this Ruling we refer to this formula as the 'decreasing adjustment formula'.

[23] See section 20 of the *A New Tax System (Goods and Services Tax) Transition Act 1999*. You do not have a decreasing adjustment arising under Division 132 in respect of motor vehicles, trailers or bodies of motor vehicles acquired before 23 May 2001, because under section 20 you would not have been entitled to an input tax credit on those acquisitions anyway, regardless of the purpose for which you acquired them.

[24] That is, if you acquired a thing before 1 July 2000. Subsection 7(2) of the A *New Tax System (Goods and Services Tax) Transition Act 1999* provides that an entitlement to an input tax credit only arises on an acquisition or importation to the extent that it is made on or after 1 July 2000.

[25] See paragraph 14 of this Ruling.

42. The AITC component of the decreasing adjustment formula is the amount of the input tax credit that was attributable to the acquisition, adjusted by any increasing and decreasing adjustments made under Subdivision 19-C and Division 129 and any increasing adjustment under Division 131[25A] that has been previously, is or will be attributable to a tax period in respect of the acquisition. If your acquisition or application of the thing was solely private or domestic or solely related to making financial supplies, the amount of AITC will be nil. On the other hand, if the acquisition or application of the thing was partly for a creditable purpose, the AITC amount will have a value greater than nil, which will reduce the amount of the decreasing adjustment available under Division 132.

43. The FITC component is the amount of the input tax credit to which you would have been entitled for acquiring the thing solely for a creditable purpose. (For this purpose, if the supply to you was treated as a taxable supply because of section 72-5 or section 84-5, it is treated as a taxable supply under section 9-5).[26] If the FITC has a nil value, mathematically the formula is inoperable and no decreasing adjustment is available.[27]

44. Even if it were held that the decreasing adjustment formula is operable where the FITC has a nil value, subsection 132-5(3) would still ensure a nil decreasing adjustment.

45. The following example illustrates that an input tax credit entitlement on the acquisition of a thing is necessary for a decreasing adjustment under Division 132.

Example 3: no input tax credit entitlement on acquisition

46. *Janet, a courier contractor, acquired a motorcycle in July 1998 at a cost of $5,000. She used the vehicle 80% for the courier contracting business and 20% privately. In August 2000, Janet registered for GST. In January 2002, she sold the motorcycle for $2,200. Janet accounted for $200 GST on the sale of the motorcycle.*

[25A] You may make an annual apportionment election under Division 131 if you satisfy the eligibility requirements, which are set out in section 131-5 and are explained in the Fact Sheet *GST and annual private apportionment* (which can be accessed at www.ato.gov.au).

[26] Paragraph (b) of the definition of 'full input tax credit' in subsection 132-5(2).

[27] The result of dividing a number by a zero is meaningless. James and James, *Mathematics Dictionary,* 5th edn, Chapman & Hall, New York, 1992, p.133.

47. *In trying to apply the decreasing adjustment formula, Janet finds that the FITC and AITC components are nil because there was no input tax credit entitlement at the time of acquisition. The formula is inoperable mathematically and in any case the application of subsection 132-5(3) (which limits the amount of the decreasing adjustment to the difference between the FITC and the AITC – in this case, nil) would result in a nil decreasing adjustment. Janet does not have a decreasing adjustment under Division 132 on the sale of the motorcycle.*

Example 3A: Annual apportionment election in place

47A. *Following from Example 3, assume Janet has quarterly tax periods. Janet acquires another motorcycle on 15 December 2004 for $5,500 (including $500 GST).*

47B. *Janet has a Division 131 annual apportionment election in place and claims the full input tax credit of $500 in the tax period in which the motorcycle is acquired, that is, the tax period ending 31 December 2004.*

47C. *Janet's use of the motorcycle is 80% for her courier contracting business and 20% private. Under Division 131 Janet is required to make an increasing adjustment of $100 ($500 - ($500 × 80%)) to account for her private use of the motorcycle. Janet needs to make the increasing adjustment in her Business Activity Statement (BAS) that covers the last day on which her income tax return is due or she may choose to make the adjustment in a BAS for an earlier tax period. As Janet is required to lodge her income tax return for the 2004-05 income year by 31 October 2005, she needs to account for the increasing adjustment in a BAS for a tax period ending no later than 31 December 2005.*

47D. *On 15 June 2005 Janet sells the motorcycle for $4,400. As the motorcycle is sold in the course or furtherance of Janet's enterprise, the sale is a taxable supply. Janet accounts for the GST payable of $400 ($^1/_{11}$ of $4,400) in the tax period ending 30 June 2005. At the same time Janet is also entitled to a decreasing adjustment under Division 132.*

47E. *In calculating the decreasing adjustment under Division 132, Janet is required to work out the adjusted input tax credit (AITC) amount. The AITC is the amount of any input tax credit that was attributable to a tax period in respect of the motorcycle (that is $500) less the increasing adjustment of $100, which she is required to make under Division 131. The AITC is therefore $400 ($500 - $100). The amount of the decreasing adjustment calculated under subsection 132-5(2) is as follows:*

$$\frac{1}{11}\times\$4{,}400\times\left[1-\left(\frac{\$400}{\$500}\right)\right] \quad = \quad \$80$$

The application of subsection 132-5(3)

48. If the amount of the decreasing adjustment under subsection 132-5(2) is greater than the difference between the FITC and AITC, subsection 132-5(3) limits the amount of the decreasing adjustment to that difference.

Example 4: the application of subsection 132-5(3)

49. *First Bank acquires a building at a cost of $5.5 million (including $500,000 GST) solely for carrying on its enterprise. It is not entitled to an input tax credit on the acquisition because the building is acquired for making financial supplies. Several years later, First Bank sells the building for $11 million in the course of carrying on its enterprise. It accounts for $1 million GST on the sale of the building. The Division 132 decreasing adjustment is initially calculated under subsection 132-5(2) as follows:*

$$\frac{1}{11} \times \$11{,}000{,}000 \times \left[1 - \frac{0}{\$500{,}000}\right] \quad = \quad \$1{,}000{,}000$$

50. *The amount of $1 million as calculated above is the same as the amount of GST on the sale of the building. However, subsection 132-5(3) limits the decreasing adjustment to the difference between the FITC ($500,000) and the AITC ($0). As a result First Bank has a decreasing adjustment of $500,000, which is the same amount as the amount of GST included in the GST-inclusive price that First Bank paid for its purchase of the building.*

The effect of subsection 132-5(4)

51. In working out the AITC, subsection 132-5(4) treats the acquisition or application as having been for a creditable purpose except to the extent that it related to making financial supplies or was of a private or domestic nature. The effect of this rule is that no decreasing adjustment is allowed in so far as you were denied a full input tax credit just because the acquisition was for some other non-creditable purpose.

Example 5: the effect of subsection 132-5(4)

52. *XYZ Ltd (XYZ) acquires a building for $2.2 million (including $200,000 GST), for carrying on its enterprise. It intends to apply 60% of the building to making financial supplies and 40% to making other input taxed supplies. XYZ is not entitled to an input tax credit on the acquisition of the building because the acquisition is for making financial supplies and other input taxed supplies. XYZ applies the building as it intends. One year later, XYZ sells the building for $2.2 million in the course or furtherance of its enterprise. The sale is a taxable supply. XYZ is required to account for $200,000 in GST on*

the sale of the building. XYZ is entitled to a decreasing adjustment under Division 132.

53. *In working out the AITC for calculating the Division 132 decreasing adjustment, the acquisition and application of the building for making input taxed supplies, other than financial supplies, are treated as having been for a creditable purpose under subsection 132-5(4). No decreasing adjustment under the Division is available to XYZ in so far as it is denied an input tax credit on the acquisition of the building for making input taxed supplies, other than financial supplies. XYZ is entitled to the Division 132 decreasing adjustment if it is denied the input tax credit due to the acquisition and application of the building for making financial supplies. In these circumstances, the AITC is $80,000 ($200,000 × 40%). The decreasing adjustment is calculated as follows:*

$$\frac{1}{11} \times \$2{,}200{,}000 \times \left[1 - \frac{\$80{,}000}{\$200{,}000}\right] \quad = \quad \$120{,}000$$

If not for the application of subsection 132-5(4), the AITC component would have been nil and the decreasing adjustment would have been $200,000.

Allocating price

54. If you have acquired things at different times or for different purposes and you later sell those things together as a single taxable supply, you may be entitled to a decreasing adjustment under Division 132 in respect of one or more of those things. Whether Division 132 applies to you in respect of any of the things sold will depend on the reason for the denial of input tax credits on acquisition (or for a subsequent increasing adjustment as the case may be). If you are entitled to a decreasing adjustment under Division 132 in respect of one or more of the things sold, the amount of the adjustment is determined in accordance with the decreasing adjustment formula.

55. To apply the decreasing adjustment formula, you will need to ascertain the 'price' of the taxable supply.[28] If a number of things are sold together on a global selling price basis, and you and the recipient of the supply have not identified the price of each thing sold, you should use a reasonable method to allocate that price to each relevant thing.[29] However, this allocation process is not necessary if you are entitled to a decreasing adjustment under Division 132 in respect of all the things that form part of the single taxable supply.

[28] Subsection 132-5(2) and section 9-75 (which defines the price of the taxable supply).
[29] See paragraphs 92 to 96 of GSTR 2001/8 for examples of guidance on a reasonable method of allocating price.

Acquisitions taken into account in determining the FITC component

56. As stated in paragraph 43, the FITC component in the decreasing adjustment formula is the amount of the input tax credit to which you would have been entitled for acquiring the thing solely for a creditable purpose. A question arises as to the level of identity required by Division 132 between the thing acquired and the thing subsequently sold.

57. This question may arise in relation to acquisitions of services necessary to acquire the thing itself. The acquisition of a building, for example, may require the acquisition of valuation, conveyancing and legal services. The acquisition of plant or equipment may depend on the acquisition of transport services in order to move the plant or equipment to where it will be used.

58. The question may also arise if work is done to the thing itself between acquisition and sale. Examples of this may be repair work or improvements to the thing.

Services necessary for the acquisition of the thing

59. In our view, the FITC component does not include input tax credits on the acquisition of services on the basis that they were necessary for the acquisition of the thing itself. An exception to this is if the services supplied to you were integral, ancillary or incidental to the supply of the thing and were treated as forming, with the supply of the thing itself, a single, composite supply to you.[30]

60. If your acquisition of the thing was separate from your acquisitions of the other services, 'the amount of the input tax credit to which you would have been entitled' is limited by section 11-25 to the amount equal to the amount of the GST payable on the supply of the thing to you. The FITC component does not include the amount of GST payable on the supply of the other things to you.

Work done to the thing between acquisition and disposal

61. In our view, the FITC component does not include input tax credits on the acquisition of goods or services, such as consumables, repairs, spare parts or other things, if the acquisitions are subsumed into the thing subsequently sold. We consider that an acquisition is subsumed into the thing originally acquired if it replaces a part that existed in the thing as originally acquired, or is intended to maintain the thing in its condition as you originally acquired it. In these circumstances, we consider that the thing sold has the same identity as the thing originally acquired, regardless of these further acquisitions.

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[30] See paragraph 17 of GSTR 2001/8, which is about apportioning the consideration for a supply that includes taxable and non-taxable parts.

62. However, we consider that the FITC component does include input tax credits on a subsequent acquisition in relation to the thing, if the acquisition does more than merely maintain the thing in its condition as you originally acquired it. In these circumstances, we consider that the subsequent acquisitions represent identifiable differences between the thing sold and the thing originally acquired. For example, an addition of a wing to a building changes the character, functionality or structure of the building. Because of this, the adjustment available under Division 132 should take account of input tax credits on these acquisitions.

63. The difference between maintaining a thing in its original condition and doing more than merely maintaining it is the same as the distinction made for income tax purposes between revenue and capital expenditure and repairs and improvements.

64. You can rely on income tax guidelines laid down by the courts for distinguishing between revenue and capital outgoings for you to determine what acquisitions of goods or services that are included in work done to the thing that are to be taken into account in the FITC component. The guidelines indicate that capital expenditure is incurred in establishing, replacing or enlarging the profit yielding structure whereas revenue expenditure is incurred as a working or operating expense. For further discussion see Taxation Ruling TR 97/23, *Income tax: deductions for repairs*.

65. In respect of repairs or improvements, the word 'repairs' ordinarily means the remedying or making good of defects in, damage to, or deterioration of, property to be repaired (being defects, damage or deterioration in a mechanical and physical sense) and contemplates the continued existence of the property. Repairs, broadly speaking, restore the efficiency of function of the property without changing its character.

66. Improvements, on the other hand, provide a greater efficiency of function in the property – usually in some existing function. They involve bringing a thing or structure into a more valuable or desirable form, state or condition than a mere repair would do.[31]

Effect on the decreasing adjustment calculation

67. In some cases, whether or not the FITC component takes into account a related acquisition, as described in the preceding paragraphs, will not affect the operation of the decreasing adjustment formula. An example of this is a thing acquired and applied solely for making financial supplies until its sale as a taxable supply. In such an example, the AITC component will be nil, regardless of whether the related acquisition is taken into account in the FITC component. This is based on our view that, to the extent that an acquisition is related to a thing acquired or applied for making financial supplies, it is itself an

[31] See Taxation Ruling TR 97/23, *Income tax: deductions for repairs*.

acquisition that relates to, or is applied to making financial supplies to that extent.

68. However, even if the AITC is nil, taking an acquisition into account in determining the FITC may affect the amount of the decreasing adjustment. This may be the case if subsection 132-5(3) limits the amount otherwise determined under the formula. A higher FITC combined with a nil AITC would mitigate the effect of subsection 132-5(3) in these circumstances and allow a higher decreasing adjustment.

Example 6: effect on decreasing adjustment – transport services acquired as part of a composite supply

69. *Life Assurance Ltd (LA) acquires equipment for its operations, for a total price of $115,500, from ABC Equipment Ltd (ABC). The price includes an amount of $5,500 for transport, which is also provided by ABC as part of a single, composite supply to LA. LA applies the equipment 100% to making financial supplies and as such, is not entitled to an input tax credit on the acquisition of this composite supply. When LA subsequently sells the equipment as a taxable supply for a price of $88,000, it is entitled to a decreasing adjustment under Division 132.*

70. *For calculating the amount of the decreasing adjustment, the AITC component is nil. The FITC component is $10,500 (that is, $^1/_{11} \times \$115,500$). The decreasing adjustment is calculated as:*

$$\frac{1}{11} \times \$88,000 \times \left[1 - \frac{0}{\$10,500}\right] \quad = \quad \$8,000$$

Example 7: effect on decreasing adjustment – transport services acquired as a separate supply

71. *LA (from Example 6) acquires more equipment from ABC for a price of $110,000, but acquires the necessary transport services from another supplier for a price of $5,500. LA applies the equipment 100% to making financial supplies and has no entitlement to input tax credits on this acquisition. When LA subsequently sells the equipment as a taxable supply for a price of $88,000, it is entitled to a decreasing adjustment under Division 132.*

72. *For calculating the amount of the decreasing adjustment, the AITC component, as in Example 6, is nil. This time the FITC component is $10,000 (that is, $^1/_{11} \times \$110,000$), however as shown in the following calculation, the amount of the decreasing adjustment works out to be the same as in Example 6:*

$$\frac{1}{11} \times \$88,000 \times \left[1 - \frac{0}{\$10,000}\right] \quad = \quad \$8,000$$

Example 8: effect on decreasing adjustment of different FITC if AITC is nil

73. *The facts remain as in Example 7, except that this time LA sells the equipment for $121,000. The calculation under the formula would be as follows:*

$$\frac{1}{11} \times \$121{,}000 \times \left[1 - \frac{0}{\$10{,}000}\right] \quad = \quad \$11{,}000$$

74. *However, in this example, subsection 132-5(3) applies to limit the decreasing adjustment to the difference between the FITC and the AITC, that is, $10,000.*

75. *Note that, had the sale price of the equipment in Example 6 been $121,000, the result of the formula would also have been $11,000. However, with the greater FITC component ($10,500) in that example, the application of subsection 132-5(3) would have resulted in a decreasing adjustment of $10,500.*

Example 9: effect on decreasing adjustment – subsequent acquisition subsumed into the thing sold

76. *Zenit Credit Union (Zenit) acquires a building for a total price of $3.3 million. The supplier pays GST of $300,000. Zenit applies the building solely to making financial supplies. It is not entitled to an input tax credit on the acquisition of the building. Five years later, the building's original paintwork has deteriorated. To restore the building's paintwork to its original condition, Zenit has it repainted for $22,000 (including $2,000 GST). Zenit is not entitled to an input tax credit on the acquisition of the painting services as this acquisition relates to making financial supplies. Zenit later sells the building as a taxable supply for a price of $5.5 million. While Zenit is entitled to a decreasing adjustment under Division 132, the FITC component in the decreasing adjustment formula does not take account of the acquisition of the painting services. These were subsumed into the building. The building sold is the same thing as the building acquired.*

77. *For calculating the amount of the decreasing adjustment, the AITC component is nil. The FITC component is $300,000. The decreasing adjustment is calculated as follows:*

$$\frac{1}{11} \times \$5{,}500{,}000 \times \left[1 - \frac{0}{\$300{,}000}\right] \quad = \quad \$500{,}000$$

78. *However, subsection 132-5(3) applies to limit the decreasing adjustment to the difference between the FITC and the AITC, that is, $300,000.*

Example 10: effect on decreasing adjustment – subsequent acquisition with identifiable difference between the thing sold and the thing acquired

79. *The facts remain as in Example 9, except that Zenit commissions a building firm to carry out an extensive modification of the interior and exterior of the building instead of having it repainted. The building is not merely repaired or restored; the functionality and quality of the building is significantly enhanced compared with its original condition. Zenit pays the building firm $2.2 million for the modifications. The building firm pays GST of $200,000. Zenit is not entitled to any input tax credit on the acquisition of the modification as this acquisition relates to making financial supplies. Zenit later sells the building as a taxable supply for a price of $7.7 million. Zenit is entitled to a decreasing adjustment under Division 132. The FITC component in the decreasing adjustment formula takes into account the acquisition of the modification of the building. This is because the building sold is identifiably different from the building originally acquired.*

80. *For calculating the amount of the decreasing adjustment, the AITC component is nil. The FITC component is $500,000, that is, $300,000 + $200,000. The decreasing adjustment is calculated as follows:*

$$\frac{1}{11} \times \$7{,}700{,}000 \times \left[1 - \frac{0}{\$500{,}000}\right] \quad = \quad \$700{,}000$$

81. *However, subsection 132-5(3) applies to limit the decreasing adjustment to the difference between the FITC and the AITC, that is $500,000.*

Addition after 1 July 2000 to pre-GST acquisition

82. If, for example, a building is acquired and at a later date, an addition is made to the building, that addition could be expected to be an identifiable part of the building when it is subsequently sold. If the acquisition of the building occurred before the start of GST and the addition was made after 1 July 2000, we consider that the decreasing adjustment applies to the addition to the building (but not to the building as originally acquired).

Example 11: addition after 1 July 2000 to pre-GST acquisition

83. *MNO Company Ltd (MNO) acquires a building in April 2000 for $5,500,000. A year later, MNO adds an extra wing to the building for $1,100,000. Since 1 July 2000, MNO has applied the original building to making financial supplies, and the new wing is also applied in this manner. In April 2002, MNO sells the building as a taxable supply for a price of $7,700,000. The additional wing is a clearly*

identifiable feature of the building when it is sold. MNO is entitled to a decreasing adjustment under Division 132.

84. *The AITC component is nil. The FITC component is $100,000 (that is, $^{1}/_{11} \times$ $1,100,000). There is no entitlement to a decreasing adjustment under Division 132 for the building acquired before the start of GST. The sale price in respect of the additional wing should be allocated on a reasonable basis as explained at paragraph 55, but in a situation of this kind, it is likely that subsection 132-5(3) would operate to limit the amount of the decreasing adjustment to $100,000.*

Sale of a thing that is a GST-free supply of a going concern under Subdivision 38-J

85. If Division 132 applies to a GST-free supply of a going concern, the meaning of 'price' within the formula for such a supply may be unclear. This is because, in subsection 132-5(2), 'price' is defined as 'the price of the taxable supply'. In our view, the correct approach is to take the price to be the actual amount of the consideration for the going concern, as determined in the contract of sale.

86. Contracts of sale in respect of a GST-free supply of a going concern may contain an indemnity clause under which the recipient indemnifies the supplier to the extent of GST payable in the event that the supply is subsequently found not to be a GST-free supply. The existence of such an indemnity clause does not affect the actual sale price for GST purposes under the contract of sale, unless the indemnity is invoked.

87. To the extent that Division 132 applies to the sale of a thing which is a GST-free supply of a going concern, the thing to which Division 132 can apply is taken to be an individual thing that forms part of the going concern.

88. To calculate a Division 132 decreasing adjustment to which you may be entitled in respect of a GST-free supply of a going concern, you need to determine that part of the sale price of the going concern that relates to each thing sold.

Example 12: the supply of an individual thing forming part of the going concern

89. *On 1 July 2000 Cabot Pty Ltd (Cabot) acquired an aircraft for $385,000 inclusive of GST solely for its charter enterprise. It claimed a full input tax credit of $35,000.*

90. *For the first two years after acquisition, Cabot's application of the aircraft has been 100% for a creditable purpose. However, for each of the next 4 years after the end of the first adjustment period under Division 129, Cabot applied the aircraft 90% for a creditable purpose and 10% privately. As a result, Cabot has had total increasing adjustments under Division 129 by the end of the fifth and*

final adjustment period of $2,333 (ignoring cents).[32] *Cabot has had no other adjustments in respect of the aircraft.*

91. *Cabot later sells all of the things that were necessarily applied in carrying on its enterprise to Lodge Services as a GST-free supply of a going concern and the aircraft is sold as part of the going concern for a global sale price of $10 million. Cabot, on a reasonable basis, apportions $150,000 of the global sale price to the aircraft.*

92. *Cabot is entitled to a decreasing adjustment under Division 132 on the sale of the aircraft. In applying the decreasing adjustment formula, the 'price' of the aircraft is $150,000. Cabot has a decreasing adjustment under Division 132 on the sale of the aircraft as follows:*

$$\frac{1}{11} \times \$150{,}000 \times \left[1 - \frac{\$35{,}000 - \$2{,}333}{\$35{,}000}\right] \quad = \quad \$909$$

Sale of a reduced credit acquisition

93. Division 70 allows a reduced input tax credit on specified acquisitions that relate to making financial supplies. Such acquisitions are referred to as reduced credit acquisitions. To the extent that each reduced credit acquisition relates to making financial supplies, an input tax credit of 75% is currently available.[33] If it were not for Division 70, there would be no entitlement to input tax credits (subject to certain limited exceptions)[34] to the extent that the acquisition relates to making financial supplies.

94. Division 132 can apply if you sell a thing that you acquired as a reduced credit acquisition and the requirements of Division 132 are met. In calculating the amount of a decreasing adjustment under Division 132, subsection 70-25(2) ensures that the definition of the FITC component in paragraph 132-5(2)(a) applies as intended by taking into account the maximum input tax credit to which you could have been entitled rather than the reduced input tax credit.

95. Subsection 70-25(3) alters the decreasing adjustment formula in subsection 132-5(2). In working out the AITC component of the formula, subsection 132-5(4) could be interpreted as requiring that the original acquisition be treated as not having been for a creditable purpose so far as it related to the making of financial supplies. That requirement would normally be the result under subsection 11-15(2). However, under Division 70, reduced credit acquisitions are made for a creditable purpose to the extent that they relate to the making of financial supplies. If subsection 132-5(4) prevented that creditable purpose from being taken into account in working out the AITC, then the Division 132 decreasing adjustment could not take into account

[32] The calculation of the increasing adjustments is based on section 129-40.
[33] A New Tax System (Goods and Services Tax) Regulations 1999 regulation 70-5.03.
[34] See subsection 11-15(4), which is about the financial acquisitions threshold, and subsection 11-15(5), which is about borrowing to make supplies that are not input taxed.

your entitlement to a (partial) input tax credit on the reduced credit acquisition. The decreasing adjustment would therefore be too great.

96. Subsection 70-25(3) prevents this possible anomaly by requiring that, in so far as the original acquisition was a reduced credit acquisition, subsection 132-5(4) still allows it to be treated as having been for a creditable purpose to the extent of the percentage credit reduction that applied at the time. The effect is that your input tax credit on the reduced credit acquisition is included in the AITC calculation along with any Division 11 input tax credits. Example 13 illustrates this effect.

Example 13: reduced credit acquisition acquired partly for making financial supplies and partly for making taxable supplies

97. *Anchor Bank (which exceeds the 'financial acquisition threshold' under Division 189 and is therefore denied full input tax credits under Division 11) makes a reduced credit acquisition of $110,000, wholly for the purpose of carrying on its enterprise. This acquisition is applied partly to making financial supplies (40%) and partly to making taxable supplies (60%). The extent to which Anchor Bank makes the acquisition for a creditable purpose is:*[35]

60% + (40% × 75%) = 90%

Thus, Anchor Bank is entitled to an input tax credit of $9,000, that is, 90% of $10,000.[36]

98. *Some years later, Anchor Bank sells the reduced credit acquisition for $99,000 (including GST). The amount of the decreasing adjustment under Division 132 is calculated as follows:*

$$\frac{1}{11} \times \$99{,}000 \times \left[1 - \frac{\$9{,}000}{\$10{,}000}\right] = \$900$$

99. *The sum of the input tax credit and decreasing adjustment Anchor Bank is entitled to is $9,900, that is,$9,000 + $900.*

100. *If it were not for subsection 70-25(3), the extent of creditable purpose calculated under the AITC component of the formula would have been calculated as follows:*

$$\frac{1}{11} \times \$99{,}000 \times \left[1 - \frac{\$6{,}000}{\$10{,}000}\right] = \$3{,}600$$

[35] Section 70-20(2).
[36] Section 11-30.

101. *The sum of the input tax credit and decreasing adjustment Anchor Bank would otherwise have been entitled to is $12,600, that is, $9,000 + $3,600, which would have resulted in a total input tax credit and adjustment greater than the original GST liability on the acquisition by Anchor Bank ($10,000). Subsection 70-25(3) prevents this anomaly from arising.*

Detailed contents list

102. Below is a detailed contents list for this Goods and Services Tax Ruling:

	Paragraph
What this Ruling is about	**1**
Date of effect	**7**
Context	**9**
Ruling with explanation	**18**
Entitlement to a decreasing adjustment under Division 132	18
Taxable supply by way of sale	20
What is a sale?	20
Taxable supply	26
Example 1: application of a private or domestic nature at the time of the sale	33
Example 2: application for a creditable purpose at the time of sale	36
Input tax credits previously denied	38
Calculating a decreasing adjustment	41
Example 3: no input tax credit entitlement on acquisition	46
The application of subsection 132-5(3)	48
Example 4: the application of subsection 132-5(3)	49
The effect of subsection 132-5(4)	51
Example 5: the effect of subsection 132-5(4)	52
Allocating price	54
Acquisitions taken into account in determining the FITC component	56
Services necessary for the acquisition of the thing	59
Work done to the thing between acquisition and disposal	61
Effect on the decreasing adjustment calculation	67

Example 6: effect on decreasing adjustment – transport services acquired as part of a composite supply 69

Example 7: effect on decreasing adjustment – transport services acquired as a separate supply 71

Example 8: effect on decreasing adjustment of different FITC if AITC is nil 73

Example 9: effect on decreasing adjustment – subsequent acquisition subsumed into the thing sold 76

Example 10: effect on decreasing adjustment – subsequent acquisition with identifiable difference between the thing sold and the thing acquired 79

Addition after 1 July 2000 to pre-GST acquisition 82

Example 11: addition after 1 July 2000 to pre-GST acquisition 83

Sale of a thing that is a GST-free supply of a going concern under Subdivision 38-J 85

Example 12: the supply of an individual thing forming part of the going concern 89

Sale of a reduced credit acquisition 93

Example 13: reduced credit acquisition acquired partly for making financial supplies and partly for making taxable supplies 97

Detailed contents list **102**

Commissioner of Taxation
24 November 2004

Previous draft:
GSTR 2004/D3

Related Rulings/Determinations:
GSTR 1999/1; GSTR 2001/1; GSTR 2001/8; GSTR 2003/3; GSTR 2003/6; GSTR 2006/4; TR 97/23

Subject references:
- acquisition
- adjusted input tax credit
- application
- barter
- composite supply
- creditable purpose
- decreasing adjustment
- disposal
- domestic and private nature
- financial supplies
- full input tax credit
- gifts
- GST-free supply of a going concern
- improvements
- increasing adjustment
- input tax credit
- leases
- non-monetary consideration
- price
- reduced credit acquisition
- reduced input tax credits
- repairs
- sale
- taxable supply

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ATO references
NO: 2003/13555
ISSN: 1443-5160