STB 40 - Outsourcing of Information Technology Services by Government Bodies

Sales Tax Bulletin

Number 40

Outsourcing of Information Technology Services by Government Bodies

---

Valid from 1 July 1999

About this bulletin

This bulletin explains how sales tax applies to the purchase of equipment which is to be used by a government body where that body has either outsourced its information technology (IT) functions, or is in the process of outsourcing those functions.

This bulletin is a public ruling for the purposes of section 77 of the *Sales Tax Assessment Act 1992* and may be relied upon by any person to whom it applies. It replaces any previous private or public rulings if they are inconsistent with the bulletin and is current as at 1 July 1999.

How does the sales tax law affect purchases by government bodies?

The sales tax law provides an exemption from sales tax for goods for use by local councils, government departments and certain other government bodies. This allows these bodies to buy goods for their own use free of sales tax. Where a government body provides its IT services in-house, it can buy IT equipment (e.g. personal computers, mainframes, printers and other associated equipment) free of sales tax. The equipment is owned by the government body and used by officers of the body for its IT functions. To buy the goods free of sales tax, the government body must intend to use the goods for at least as long as the statutory period. The statutory period is the lesser of two years, or the useful life of the goods.

If a government body leases the equipment rather than buying it, it can still obtain the benefit of the sales tax exemption where the equipment is leased for at least as long as the statutory period.

Under certain circumstances, equipment may also be able to be bought free of sales tax by a government body if it is purchased on the understanding that it will be sold to an IT services contractor, who will then lease back the equipment to the government body for a term that is at least as long as the statutory period. You should seek advice from the Tax Office if you use these arrangements.

What about contracts to provide services for government bodies?

Apart from the limited exemption for earth-moving contractors under Item 37 in Schedule 1 to the *Sales Tax (Exemptions and Classifications) Act 1992* (ST(E&C)Act), there is no general exemption for equipment for use by contractors in carrying out contracts to provide services for government bodies, including contracts to provide IT services.

The exemption for government bodies does not extend to persons buying goods which they use in contracts for government bodies. Where property is to pass to a government body under the contract, exemption may apply. See 'Does sales tax exemption under Item 194 have any relevance?' on page 4.

Does exemption apply when IT services are outsourced by government bodies?

As an alternative to providing IT services in-house, some government bodies have outsourced, or are in the process of outsourcing their IT functions. This usually involves a transfer of the body's existing stock of IT equipment to a contractor. The contractor is a separate body and in most cases is a company not entitled to claim sales tax exemption on the purchase of goods.

Under the terms of a typical outsourcing contract, the contractor would be required to buy or lease all the equipment needed to service the government body. The contractor cannot claim sales tax exemption on the equipment because, while it may actually be for use by the government body, the equipment is owned and operated by the contractor. In granting the government body the right or permission to use the equipment, the contractor has applied that equipment to its own use within the meaning of that term in the sales tax law. At that point, the equipment is taxable and the contractor - who is usually not an exempt person - cannot claim a sales tax exemption.

What about the sale to a contractor of a government body's existing stock of computer equipment?

Generally, the sale of a government body's existing stock of computer equipment will not raise any sales tax issues for the contractor. As the existing computer equipment has been used by the government body, it is 'Australian-used goods' and no longer capable of being subject to sales tax.

What about equipment bought by a government body before the outsourcing contract begins?

At some stage - usually no later than the signing of a legally enforceable outsourcing contract - it will become clear that the transfer of ownership in IT equipment will occur on a particular date in the future.

If a government body is intending to purchase IT equipment for its use in the interim period, it will not be able to buy the equipment free of sales tax if the period remaining until the date of transfer is less than the statutory period; that is, if the period remaining is less than two years, or the useful life of the goods.

What if the IT outsourcing contract includes a lease of goods from the contractor to the government body?

Whether an outsourcing contract involves the lease of goods to the government body depends on the terms of the contract and the intention of the parties involved. Some factors that may be relevant in determining whether a lease of goods exists include:

- whether the terms of the contract provide for the lease of goods;
- whether the provision of equipment can be separated from the contract, which may provide generally for the provision of IT services including the provision of equipment;
- whether the parties intend a lease of goods to occur;
- whether the government body is given possession of the IT equipment in return for it making regular payments for use of the equipment;
- whether it is understood between the parties that the IT equipment will be returned to the contractor after the agreed period of possession; and
- whether stamp duty has been or will be paid in relation to a lease of goods.

If there is a lease of goods to the government body, the lessor can buy the equipment that it leases to the government body, free of sales tax providing that the following conditions for an eligible long-term lease are met:

- the term of the lease is at least as long as the statutory period;
- the lessor has been given evidence by the government body, in a form approved by the Commissioner[1] stating that the government body intends to use the goods, during the whole of the statutory period, so as to satisfy an exemption Item; and
- no part of any sales tax borne by the lessor on the goods before the grant of the lease, has been passed on by the lessor to any person.

Some leasing arrangements involve the supply of goods progressively over the term of the lease. Goods that are supplied towards the end of the lease period cannot be purchased free of sales tax by the lessor, if the remaining period is less than the statutory period. The government body cannot give a statement to the lessor in relation to those goods, that it intends to use those goods for the whole of the statutory period.

---

[1] The lessor must obtain a statement from the government body at or before the time it grants the lease. The leasing contract, by itself, does not constitute such a statement by the government body. The lessor must retain the statement for at least five years.

Does sales tax exemption under Item 194 have any relevance?

A contractor providing a service to a government body can buy goods free of sales tax under Item 194 in Schedule 1 to the *Sales Tax (Exemptions and Classifications) Act 1992* where:

- the goods are for use by the contractor for supply to the government body under a contract that is not a contract of sale; and
- property in the goods passes to the government body under the contract; and
- the government body could have bought the goods free of sales tax.

Item 194 usually applies to repair and maintenance contracts where spare parts and materials are supplied under the contract, and property in the spare parts and materials passes to the government body.

Exemption under Item 194 is not available to contractors who enter into an outsourcing contract with a government body. Under a typical outsourcing contract, while the contractor provides goods for the use of the government body, property in the goods does not pass to the government body.

What if the contractor agrees to sell the goods to the government body at the end of the contract?

In granting the government body the right or permission to use the equipment under the contract, the contractor has applied the equipment to its own use. Unless the equipment has been leased to the government body under an eligible long-term lease, the contractor cannot buy the equipment free of sales tax. Because the equipment has been applied to own use by the contractor, it has become Australian-used goods and is no longer assessable goods. If sales tax has been correctly paid on purchase of the equipment by the contractor, there are no grounds for a refund of that sales tax if the equipment is later sold to the government body.

Do you need more information?

If you need more information about how sales tax affects your outsourcing arrangements, please contact the Tax Office:

- by **phone** on our national enquiry number **13 28 66 –** you can ring this number from anywhere in Australia for the cost of a local call;
- **in person** by visiting the enquiry counter at certain Tax Offices – Tax Office addresses are listed in *TaxPack*, and in your White Pages telephone directory;
- by ***A Fax from Tax***, our 24 hour fax information service – simply call **13 28 60** (local call cost) on your phone or fax and follow the voice prompts; or
- at our Internet site, **ATO*assist*** **www.ato.gov.au**

Produced by the Small Business Line of the Australian Taxation Office

NAT2927-7.99