TD 2005/35 - Income tax: must an outgoing incurred by a supplier in deriving income from a taxable supply be apportioned when calculating the deduction allowable for the outgoing under section 8-1 of the Income Tax Assessment Act 1997, because some amount of the income relates to GST payable on a taxable supply, and is non-assessable non-exempt income?

Taxation Determination

Income tax: must an outgoing incurred by a supplier in deriving income from a taxable supply be apportioned when calculating the deduction allowable for the outgoing under section 8-1 of the *Income Tax Assessment Act 1997*, because some amount of the income relates to GST payable on a taxable supply, and is non-assessable non-exempt income?

Preamble

The number, subject heading, date of effect and paragraph 1 of this document are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner.*

1. No.

Explanation

2. Paragraph 17-5(a) and section 6-23 of the *Income Tax Assessment Act 1997* (ITAA 1997) together provide that an amount relating to GST payable on a *taxable supply* (as that term is defined in section 195-1 of the *A New Tax System (Goods and Services Tax) Act 1999*) is non-assessable non-exempt income. This means that the income derived from a taxable supply will generally have an assessable income element (the income derived as a result of making the taxable supply excluding the amount relating to GST payable on the taxable supply) and a non-assessable non-exempt income element (the amount relating to GST payable on the taxable supply).

3. In these circumstances, an outgoing that is incurred in gaining or producing income from taxable supplies will be incurred in gaining or producing both assessable income and non-assessable non-exempt income.

4. Subsection 8-1(1) of the ITAA 1997 allows deductions for losses and outgoings to the extent that they are incurred in gaining or producing assessable income or are necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. Paragraph 8-1(2)(c) denies deductions for losses or outgoings to the extent that they are incurred in gaining or producing exempt income or non-assessable non-exempt income.

5. Where an outgoing is not incurred entirely for the purposes specified in subsection 8-1(1), the portion of the outgoing for which a deduction is allowable under section 8-1 is calculated on a basis that is fair and reasonable in the particular circumstances (see paragraph 14 of Taxation Ruling TR 95/33; *Ronpibon Tin NL v. FCT* (1949) 78 CLR 47 at 59).

6. Elements to be taken into account in the calculation of the deductible portion of an outgoing incurred in gaining or producing both assessable and non-assessable non-exempt income are the respective amounts of the outgoing, the non-assessable non-exempt income and the total income (incorporating both the assessable income and the non-assessable non-exempt income).

7. On first consideration of the matters set out in the preceding paragraphs, it might seem that some part of an outgoing incurred in gaining or producing income that includes an amount that is related to GST payable on a taxable supply is not deductible under section 8-1 because the amount of income related to the GST payable is non-assessable non-exempt income. Some calculation would be required to determine the deductible amount of the outgoing in these circumstances.

8. The ITAA 1997 makes specific provision for the effect of GST in calculating deductions. Non-operative material at the foot of section 8-1 indicates: 'For the effect of the GST in working out deductions, see Division 27'.

9. Section 27-20 of the ITAA 1997 applies in this case. It requires that certain elements taken into account in calculating deductions be adjusted for the effect of GST, and provides as follows:

> In calculating an amount that you may be able to deduct:
>
> (a) an element in the calculation that is an amount paid or payable is treated as not including an amount equal to any *input tax credit for an *acquisition related to the amount paid or payable, or any *decreasing adjustment related to that amount; and
>
> (b) an element in the calculation that is an amount received or receivable is treated as not including an amount equal to any *GST payable on a *taxable supply related to the amount received or receivable, or any *increasing adjustment related to that amount.

10. For the purposes of paragraph 27-20(a), a single outgoing is 'an amount paid or payable'. Therefore an amount equal to any input tax credit in relation to the outgoing is not included in calculating the amount of any deduction for the outgoing. Similarly, for the purposes of paragraph 27-20(b), income received or receivable from taxable supplies are 'amounts received or receivable'. Amounts relating to GST payable on taxable supplies are therefore also excluded from the calculation of any amount deductible for the outgoing.

11. Where there are no input tax credit entitlements in relation to an outgoing (for example, for an amount of interest expense), the application of section 27-20 ensures that the fact that part of the income to which the outgoing relates is non-assessable non-exempt income (because it relates to GST payable on taxable supplies) does not cause some part of any deduction allowable for that outgoing to be denied (see Example 1). That is, in calculating deductions for outgoings in these particular circumstances, the operation of section 27-20 overcomes the consequences that otherwise arise when some part of the income received or receivable is non-assessable non-exempt income.

12. When a taxpayer is entitled to input tax credits in relation to an outgoing, the operation of section 27-20 is consistent with the operation of section 27-5 of the ITAA 1997. Section 27-5 denies a deduction to the extent that the loss or outgoing includes an input tax credit entitlement (see Example 2).

13. The principles relating to the application of section 27-20, as outlined in this Taxation Determination, are relevant to both monetary and non-monetary consideration paid or payable or received or receivable. Sections 21 and 21A of the *Income Tax Assessment Act 1936*, as relevant, would apply to the income tax treatment of any non-monetary consideration provided. For the ATO view on the treatment of non-monetary consideration under the GST law, see Goods and Services Tax Ruling GSTR 2001/6.

14. The outcomes that the views in this Taxation Determination provide for are consistent with the underlying policy intent of Divisions 17 and 27 of the ITAA 1997, which together deal with the impact of GST for income tax purposes. Paragraph 3.3 of the Explanatory Memorandum to the A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999, which inserted these Divisions into the law, states:

> [Divisions 17 and 27] put beyond doubt that GST on business inputs is to be excluded from assessable income and expenditure incurred, to the extent of any input tax credit entitlement. The exclusion of GST components from transaction amounts is also consistent with the design principle that GST is not a cost to business.

Example 1

15. *Dianne owns and operates a computer supply store. She borrows funds to purchase a printer for resale, and incurs $20 interest expense on the borrowing. Dianne subsequently sells the printer to Bill for $1,100. The sale of the printer is a taxable supply and $100 of the receipt represents an amount of GST payable. The $100 relating to GST is non-assessable non-exempt income (paragraph 17-5(a) of the ITAA 1997). The interest expense relates to an input taxed supply. No GST is imposed on that supply and as such no input tax credits are available.*

16. *In this case, the outgoing is $20, the non-assessable non-exempt income is $100 and the total income is $1,100. The effect of section 27-20 of the ITAA 1997 is to exclude the non-assessable non-exempt amount relating to GST ($100) (paragraph 27-20(b)) from a calculation of the amount of the outgoing that is deductible under section 8-1.*

17. *Once the non-assessable non-exempt income relating to the amount of GST is excluded as an element of the calculation, there is no basis on which to apportion the deduction for the interest expense under section 8-1 because part of the income derived is not assessable income. As a consequence, any deduction for interest to which Dianne is entitled is not reduced merely because the interest outgoing was to some extent incurred in deriving an amount of income that related to GST payable on a taxable supply and was therefore non-assessable non-exempt income.*

Example 2

18. *Dianne also incurs an expense of $44 on parts that are included in the printer that is sold to Bill. This expense relates to a taxable supply made to Dianne. GST is imposed on that supply and therefore an input tax credit of $4 is available in relation to this outgoing.*

19. *In this case, the outgoing is $44, the non-assessable non-exempt income is $100 and the total income is $1,100. The operation of section 27-20 of the ITAA 1997 in this case is to exclude both an amount equal to the input tax credit for the acquisition ($4) from the outgoing (paragraph 27-20(a)) and the non-assessable non-exempt amount relating to GST ($100) (paragraph 27-20(b)) from a calculation of the amount of the outgoing that is deductible under section 8-1.*

20. *Once the non-assessable non-exempt income relating to the amount of GST is excluded as an element of the calculation, there is no basis on which to apportion the deduction for the interest expense under section 8-1 because part of the income derived is not assessable income. The exclusion of an amount equal to the input tax credit for the acquisition means that Dianne may be able to deduct only $40 of the $44 expense she incurred on the parts. This outcome is identical to that required by section 27-5 (that is, any deduction for a loss or outgoing incurred is denied to the extent that the loss or outgoing includes an amount relating to an input tax credit entitlement). As the input tax credit entitlement in relation to the outgoing is $4, the amount of the deduction denied under section 27-5 is $4 and the maximum deductible amount of the outgoing is $40.*

Date of Effect

21. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation
28 September 2005

Previous draft:

TD 2005/D3

Related Rulings/Determinations:

TR 92/20; TR 95/33; GSTR 2001/6

Subject references:

- business income
- deductions & expenses
- expense apportionment
- GST input tax credits & creditable acquisitions
- GST supply
- input tax credit entitlement
- non-assessable non-exempt income
- taxable supply

Legislative references:

- ANTS(GST)A 1999 195-1
- ITAA 1936 21
- ITAA 1936 21A
- ITAA 1997 6-23
- ITAA 1997 8-1
- ITAA 1997 8-1(1)
- ITAA 1997 8-1(2)(c)
- ITAA 1997 Div 17
- ITAA 1997 17-5(a)
- ITAA 1997 Div 27
- ITAA 1997 27-5
- ITAA 1997 27-20
- ITAA 1997 27-20(a)
- ITAA 1997 27-20(b)
- TAA 1953 Pt IVAAA

Case references:

- Ronpibon Tin NL v. FCT (1949) 78 CLR 47

Other references:

- Explanatory Memorandum to the A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999

ATO references

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