

2011

EXPOSURE DRAFT

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GST TREATMENT OF APPROPRIATIONS

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EXPLANATORY MEMORANDUM

(Circulated by the authority of the  
Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP)

# Chapter 1

## GST treatment of appropriations

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### Outline of chapter

1.1 Schedule # to this Bill amends the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) to restore the policy intent that the non-commercial activities of government related entities (GREs) not be subject to the Goods and Services Tax (GST).

1.2 All legislative references in this chapter are to the GST Act unless otherwise stated.

### Context of amendments

1.3 Currently under paragraph 9-15(3)(c) of the GST Act, a payment made by a GRE to another GRE is not the provision of consideration if the payment is specifically covered by an appropriation under an Australian law.

1.4 This exclusion of certain types of payments from the definition of consideration is intended to give effect to the policy that payments under an appropriation to fund the non-commercial activities of government be excluded from GST.

1.5 The Full Federal Court of Australia in *TT-Line Co Pty Ltd v FCT* [2009] FCAFC 178 (TT-Line) considered the application of paragraph 9-15(3)(c). In considering when a payment will be ‘specifically covered by an appropriation’ in the context of paragraph 9-15(3)(c), the Court held that the minimum level of specificity required for paragraph 9-15(3)(c) to apply is that the payment is made pursuant to an appropriation the terms of which specify the GRE by name or GREs generically. Therefore, paragraph 9-15(3)(c) will only apply to a payment, where, under the terms of the appropriation, the payment can only be made to a GRE. The exception will not apply where, under the terms of the appropriation, the payment can be made to a GRE or a non-GRE.

1.6 The Court’s decision shows that the provision does not operate widely enough to give effect to the policy intent that the non-commercial activities of GREs be excluded from the GST system where those activities are funded by payments that, under the terms of the relevant appropriation, can be made to a GRE or non-GRE. As the law currently stands, the provision only covers payments pursuant to an appropriation the terms of which specify the GRE by name or GREs generically.

1.7 The amendment contained in Schedule # to this Bill is intended to restore the policy intent that the non-commercial activities of GREs are not subject to GST, following the Court’s decision in TT-Line.

**Summary of new law**

1.8 The amendment will ensure that non-commercial activities of GREs will not be subject to GST. This is achieved by deeming a payment from one GRE to another GRE, that is covered by an appropriation, and is not for a supply which is commercial in nature to not be consideration for the purposes of section 9-15.

**Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
<p>The exception in paragraph 9-15(3)(c) ensures that a payment made from one GRE to another GRE, pursuant to an appropriation under an Australian law is excluded from the definition of consideration in section 9-15 where it is not for a supply which is commercial in nature.</p> <p>The exception operates even where the terms of the appropriation do not confine payments to a particular GRE, or GREs otherwise generically specified.</p>	<p>The exception in paragraph 9-15(3)(c) operates only in relation to payments made pursuant to an appropriation the terms of which specify the GRE by name or GREs generically.</p>

**Detailed explanation of new law**

1.9 This measure ensures that the non-commercial activities of GREs will be not subject to GST. This will be achieved by deeming payments which meet certain criteria to not be the provision of consideration.

1.10 A payment will not be the provision of consideration if:

- the payment is made by a GRE to another GRE; and
- the payment is covered by an appropriation under an Australian law; and
- the payment is not made for a supply which is commercial in nature.

1.11 Where the elements of paragraph 9-15(3)(c) are satisfied, there will be differential treatment between payments made to a GRE and non-GRE. This outcome is intended and accords with the policy intent of paragraph 9-15(3)(c).

*Whether the payment is made by a GRE to another GRE*

1.12 Subparagraph 9-15(3)(c)(i) requires that the payment be made by a GRE to another GRE. GRE is defined in section 195-1 of the GST Act. [*Schedule #, item 1, subparagraph 9-15(3)(c)(i)*]

*Whether the payment is covered by an appropriation under an Australian law*

1.13 Subparagraph 9-15(3)(c)(ii) requires that the payment is covered by an appropriation under an Australian law. This will be the case where the payment is made pursuant to an appropriation. [*Schedule #, item 1, subparagraph 9-15(3)(c)(ii)*]

1.14 The entity receiving the payment does not need to be specified within the terms of the appropriation, either by name, or generically in order for subparagraph 9-15(3)(c)(ii) to be satisfied. Subparagraph 9-15(3)(c)(ii) can be satisfied where the terms of the appropriation state the purpose for which funds can be appropriated, rather than the entities to which the funds can be appropriated.

1.15 The payment will not need to be ‘specifically covered’ by an appropriation under an Australian law. The term ‘specifically’, which appears in the current law, will be removed from paragraph 9-15(3)(c). This is to clarify that the exception should operate more widely than it currently does.

1.16 Furthermore, the exception is not prevented from operating where the terms of the appropriation under which the payment is made do not confine the payment to GREs, either by name, or generically. That the terms of the appropriation allow for payments to be made to both GREs and non-GREs has no bearing on whether subparagraph 9-15(3)(c)(ii) is satisfied.

*Whether the payment is for a supply that is commercial in nature*

1.17 Subparagraph 9-15(3)(c)(iii) is intended to ensure that the payment in question is not for a supply which is commercial in nature. This is intended to give effect to the policy intent that a payment for a supply which is commercial in nature, even if it is a payment covered by an appropriation and made by one GRE to another, does not fall within the exception set out in paragraph 9-15(3)(c). [*Schedule #, item 1, subparagraph 9-15(3)(c)(iii)*]

1.18 The ability for payments to be made to both GREs and non-GREs under the terms of an appropriation under an Australian law does not in itself indicate that the supply is commercial in nature. Note 1

to paragraph 9-15(3)(c) illustrates a payment that is not for a supply which is commercial in nature, whereas Note 2 illustrates a payment for a supply which is commercial in nature.

1.19 Subparagraph 9-15(3)(c)(iii) can be satisfied if the payment is not for a supply which is commercial in nature, even if the GRE receiving the payment engages in commercial activity as part of its broader operations. The terms on which a particular supply is made will be indicative of whether or not that supply is commercial in nature.

1.20 A supply is considered to be commercial in nature where the price charged goes beyond recovering the cost of making the supply.

1.21 In this context, the concept of ‘cost’ means the actual costs of making the supply. It does not include concepts of cost which are measured based on opportunity cost or forgone revenue.

### **Example 1.1**

A Territory Department of Education (the Department) has funding arrangements with government and non-government schools. Funding payments are made pursuant to an appropriation under that Territory’s law, the terms of which allow for payments to be made to both government and non-government schools. Schools receiving funding, both government and non-government schools, commit to achieving certain education outcomes as part of the funding arrangements.

A payment is made by the Department to a Government school to fund its general operations pursuant to an appropriation under that Territory’s law. The appropriation law states the total amount of money that may be appropriated for both government and non-government schools. The Department determines how much funding ought to be allocated to each school based on objective criteria and funding arrangements are entered into between the Department and both government and non-government schools. The objective criteria by which the amount of funding is determined are based on the costs that will be incurred by the school in meeting the education outcomes that it has undertaken to meet.

This payment is a payment from one GRE (the Department of Education) to another GRE (the government school), which satisfies subparagraph 9-15(3)(c)(i). The payment is covered by the appropriation as the terms of the appropriation support the payment to the government school. As a result, the condition set out in subparagraph 9-15(3)(c)(ii) is satisfied, notwithstanding that the terms of the appropriation allow funds to be made to both GREs and non-GREs.

A payment by the Department under such a funding arrangement to a government school is a payment that is not for a supply which is commercial in nature, which means that subparagraph 9-15(3)(c)(iii) is satisfied. The amount of the payment under the funding arrangement is designed only to meet the costs of delivering the education outcomes that the school has undertaken to meet. The payment does not go

beyond recovering the costs of making the supply. The potential for payments to be made to GREs and non-GREs under the terms of the appropriation does not make the supply commercial in nature.

As paragraph 9-15(3)(c) is satisfied, the payment is not the provision of consideration for the purposes of section 9-15.

### **Example 1.2**

A Commonwealth Department (the Department) seeks to acquire valuation services for use in the course of carrying out its functions. It commences a tender process for obtaining a supplier of the valuation services.

The tender process is open to participation from any entity, GRE or non-GRE, meeting the terms and conditions for the tender process. Participating firms must lodge their tender response within the specified timeframe.

Once the tender process has closed, the Department conducts an evaluation of submitted tenders and then awards a contract to a tendering firm on the basis of the price submitted, as well as their legal, commercial, technical and financial abilities. The payment that the Department is obliged to make under the resulting contract with the successful tenderer is paid pursuant to an appropriation under Commonwealth law. In this case, the payment covers the cost of making the supply and a margin.

If the successful tenderer is a GRE (the GRE supplier), the payment by the Department to the GRE supplier will be:

- a payment from one GRE to another; and
- a payment that is covered by an appropriation under an Australian law; and
- a payment that is for a supply which is commercial in nature.

The payment is for a supply which is commercial in nature as the price charged goes beyond recovering the cost of making the supply. The price incorporates a margin which is in excess of the cost of making the supply.

The payment will not satisfy subparagraph 9-15(3)(c)(iii) as the payment is for a supply which is commercial in nature. Therefore, it will not satisfy the exception in paragraph 9-15(3)(c). The payment is not excluded from being the provision of consideration for the purposes of section 9-15.

### **Example 1.3**

Two Commonwealth Departments enter into a memorandum of understanding (MOU). A section of the MOU sets out business administration services that one Department (the GRE supplier) will provide to the other, and the terms on which the services will be

provided. The Department acquiring the services did not establish a tender process for finding a supplier for the services.

The funds which are paid under the MOU are appropriated under Commonwealth law. The payment that the Department acquiring the business administration services makes is set at the cost of providing the services.

The payment by the Department to the GRE supplier will be:

- a payment from one GRE to another (from the Department to the GRE supplier); and
- a payment that is covered by an appropriation under an Australian law; and
- a payment that is not for a supply which is commercial in nature.

The payment is not for a supply that is commercial in nature as the price charged under the MOU does not go beyond recovery of the costs of the GRE supplier in supplying the business administration services.

The payment will satisfy subparagraph 9-15(3)(c)(iii) as the payment is not for a supply which is commercial in nature. Therefore, it will satisfy the exception in paragraph 9-15(3)(c). The payment is excluded from being the provision of consideration for the purposes of section 9-15.

#### **Example 1.4**

A State GRE (the GRE supplier) is engaged in the provision of transportation services to the general public for a fare that reflects the market price for comparable services. It competes with other transportation providers in the conduct of its business and the transportation services are mainly aimed at transporting passengers to and from the State.

The State Government has a policy of subsidising the fares for pensioners who are resident in that State (eligible customers). The State Department of Transport (the Department) has established a program to deliver this policy objective. All suppliers in the market are required to hold a licence, and a condition of having a licence is participation in the program. Under the program, an eligible customer pays only half of the fare to the GRE supplier at the end of their transport journey. The GRE supplier then reports the subsidised transport journey to the Department, which then pays an amount equivalent to half of the fare to the GRE supplier. Payments under the program are made pursuant to an appropriation under a State Act.

The payments are for the purpose specified in the terms of the appropriation, which also do not confine payments to a particular entity or a class of entities.

The sum of the amount of the subsidy and the subsidised fare is equal to the fare that the GRE supplier would charge in the absence of the

subsidy. This is an amount which is greater than the cost of supplying the transportation services.

Where the GRE supplier charges the subsidised fare to the passenger, and claims the amount of the subsidy from the Department, the payment of the subsidy to the GRE supplier will be a:

- payment from one GRE to another (from the Department to the GRE supplier); and
- payment that is covered by an appropriation under an Australian law; and
- payment that is for a supply which is commercial in nature.

The supply from the GRE supplier to the Department to supply transportation services at the reduced fare is commercial in nature as the price charged goes beyond recovering the cost of making the supply. The price factors in a return above the cost of the making of the supply.

The payment will not satisfy subparagraph 9-15(3)(c)(iii) as the payment is for a supply which is commercial in nature. Therefore, it will not satisfy the exception in paragraph 9-15(3)(c). The payment is not excluded from being the provision of consideration for the purposes of section 9-15.

### **Example 1.5**

A State GRE (the GRE supplier) is engaged in the provision of transportation services to the general public for fares that are set at a rate below the market value. The fares charged do not cover the costs of supplying the transportation services.

The State Department of Transport (the Department) has a funding arrangement with the GRE supplier whereby the GRE supplier undertakes to supply transportation services to the general public for the reduced fares. The funding payment is calculated as the shortfall (if any) between the cost of providing the transportation services and the farebox revenue.

The payment by the Department to the GRE supplier will be:

- a payment from one GRE to another (from the Department to the GRE supplier); and
- a payment that is covered by an appropriation under an Australian law; and
- a payment that is not for a supply which is commercial in nature.

The relevant supply for the purposes of subparagraph 9-15(3)(c)(iii) is the service of supplying transportation services to the general public at the reduced fare. The payment is not for a supply which is commercial in nature as the payment is designed to meet the cost of providing the



transportation services that are not covered by farebox revenue. The price charged for the supply does not go beyond recovering the costs of making the supply.

The payment will satisfy subparagraph 9-15(3)(c)(iii) as the payment is not for a supply which is commercial in nature. Therefore, it will satisfy the exception in paragraph 9-15(3)(c). The payment is excluded from being the provision of consideration for the purposes of section 9-15.

## Application and transitional provisions

1.22 The amendments made by this schedule apply, and are taken to have applied, in relation to payments made on or after 1 July 2012.  
*[Schedule #, item 6]*

## Consequential amendments

1.23 Broadly, Division 72 sets out particular rules for taxable supplies between associates without consideration, or for inadequate consideration. It also sets out rules for acquisitions without consideration.

1.24 Division 72 has the potential to operate where paragraph 9-15(3)(c) does, for example because a payment for a supply is deemed to not be the provision of consideration for the supply, with the result that there is a supply between associates which is without consideration. These consequential amendments will clarify how Division 72 interacts with paragraph 9-15(3)(c).

1.25 Section 72-95 of the GST Act is being amended to ensure that Division 72 will not apply to anything covered by paragraph 9-15(3)(c).  
*[Schedule #, item 2, subsection 72-95(1); item 3, subsection 72-95(2)]*

1.26 Section 72-100 of the GST Act is being amended to ensure that Division 72 will not apply to anything covered by paragraph 9-15(3)(c).  
*[Schedule #, item 4, subsection 72-100(1); item 5, subsection 72-100(2)]*