JOINT SUBMISSION BY

The Taxation Institute, CPA Australia,
The Institute of Chartered Accountants in Australia,
the Institute of Public Accountants and Taxpayers Australia

Draft Goods and Services Tax Ruling Addendum GSTR 2001/8DA

Goods and services tax: apportioning the consideration for a supply that includes taxable and non-taxable parts

Due Date: 25 November 2011

The Professional Bodies welcome the opportunity to comment on Draft Goods and Services Tax Ruling Addendum GSTR 2001/8DA (***Draft Addendum***). Please note that references below to the ***Draft Ruling*** are to *Goods and Services Tax Ruling GSTR 2001/8 Goods and Services Tax: apportioning the consideration for a supply that includes taxable and non-taxable parts* in the form that it would take if the Draft Addendum were to be finalised. We refer to the Draft Ruling and not to the Draft Addendum specifically as many of the comments below relate to continued deficiencies in the Draft Ruling that are not addressed by the Draft Addendum, or to internal inconsistencies that would arise in the Draft Ruling if the Draft Addendum were to be finalised in its current form.

References to the ***GST Act*** are to the *A New Tax System (Goods and Services Tax) Act* 1999.

References to ***Luxottica*** are to the Full Federal Court decision of *Commissioner of Taxation v Luxottica Retail Australia Pty Ltd* [2011] FCAFC 20.

Mixed Supply

In the Draft Ruling, the Commissioner makes the comment at proposed paragraph 45B that the United Kingdom and European VAT law have "no equivalent of Australia's mixed supply and section 9-80". But what is "Australia's mixed supply"? The term "mixed supply" has been coined by the Commissioner in GSTR 2001/8 and does not appear in the GST Act. Though it is sometimes referred to, the concept does not appear to have any foundation in the relevant domestic or international case law[1].

[1] In *Food Supplier v Commissioner of Taxation* [2007] AATA 1550 at [5], Downes J stated, "*Some GST cases dealing with packaged items involve the question whether a supply is a "composite supply" or a "mixed supply". In a composite supply, items which are integral, ancillary or incidental to the main item may be treated for GST purposes in the same way as the main item. An example might be a paper serviette supplied with food. In a composite supply, where the main item is GST-free (usually when it is food), no GST will be payable. A mixed supply, on the other hand, is a supply of separate items together.*" However, these cases are not identified and no reference is made to the legislative basis of the "mixed supply" concept. Presumably, the views of the Commissioner as expressed in the Draft Ruling were put forward in that matter and accepted by the Tribunal. As stated in [6], the composite/mixed supply analysis was not the central issue in that case. In contrast, at paragraph 29 of *Luxottica Retail Australia Pty Limited and Commissioner of Taxation* [2010] AATA 22, the Tribunal acknowledges that the term "mixed supply" is not referenced in the legislation.

In the legislative context, the concept may be implied by s. 9-10 (in particular s. 9-10(2)(h)which refers to "any combination of any 2 or more of the matters referred to in paragraphs (a) to (g)", s.9-5 (in particular, the words "[h]owever, the supply is not a *taxable supply to the extent that it is *GST-free or *input taxed") and s. 9-80 of the GST Act (which refers to supplies that have taxable components and GST-free or input taxed components). However, s. 9-80 is a valuation rule, not a supply characterisation rule. It applies to single supplies with taxable and GST-free or input taxed components and may well modify what the treatment of those supplies would be in other jurisdictions in the absence of such a provision (e.g. the UK and European VAT regimes), but it is not determinative of what supplies will fall within that category, nor does it give rise to that category. The characterisation of single, composite supplies, mixed supplies and multiple supplies must be carried out at the outset in accordance with s.9-10 (the meaning of supply) in order to determine whether s. 9-80 will apply.

If, in the Commissioner's view, s. 9-80 provides the legislative basis for the "mixed supply" concept, this should be stated in the Draft Ruling in the definitions included in paragraphs 16 and 43. If there is some other legislative basis on which the term is founded, this should be described accordingly. For the purposes of this submission, we assume that the term "mixed supply" is a term used by the Commissioner for convenience to describe a single supply made up of components that are not incidental, integral or ancillary (i.e. comprising a single, composite supply) where those components would, if recognised separately, attract different treatment under the GST Act.

Absence of Multiple Supplies Analysis

There are two separate and distinct questions that taxpayers must address when they supply more than one thing in a single transaction:

1. Does the transaction comprise of a single supply or multiple supplies?; and
2. If it is a single supply, is it a single, composite supply or a single, mixed supply?

The Draft Ruling is fundamentally lacking in its failure to provide any meaningful guidance to taxpayers in respect of the first, threshold question: When is the giving or doing of multiple things amalgamated into the making of a single supply? While ss. 9-5, 9-10 and. 9-80 of the GST Act suggest that a single supply can be broken down into its various components, it is a matter of logic and common sense that it must first be determined whether a relevant transaction consists of a single supply or multiple supplies before it can be established whether s. 9-80 will apply.

In some cases, the answer might be straightforward. A supply of ground floor commercial premises with a non-commercial residential dwelling on the first floor would, for example, be taken to be a "mixed supply", in the sense that it is a single supply of one land title with various components that attract different GST treatment. But there are more difficult examples that arise frequently for taxpayers. For example, do the following represent one single supply (mixed or composite) or multiple supplies? These are a sample of many examples that arise for taxpayers on a day to day basis:

- the supply of a bundle of electrical items sold together;

- the supply of pasta, pasta sauce, parmesan cheese and a cookbook, or other grocery combinations, sold together at a discount (where each is also sold separately);
- the supply of software with associated rights to customer support; and
- the supply of a meal comprising a sandwich, a piece of fruit and a bottle of water or a soft drink.

Knowing whether the sale of these individual items are amalgamated into a single supply is important for taxpayers, particularly in circumstances where one item would be sold on a GST-free basis and another would be taxable and, especially where discounts and promotional free goods are also involved. What are the considerations that one takes into account; e.g. the packaging of the items, the marketing, whether there is a single time or point of sale? This analysis is important, because it will determine whether the value of each of the items can be determined under s. 9-75 of the GST Act, or whether it is necessary to apply s. 9-80 of the GST Act and the apportionment methodologies set out in the Draft Ruling.

For this reason, it is odd that the guidelines in the Draft Ruling seem to suggest that the only relevant analysis in relation to bundles of items sold together (such as the ones listed above) is the differentiation between single, composite supplies and mixed supplies. In other words, the Draft Ruling seems to imply that if one component is not "integral, ancillary or incidental[2]" to the other, it is, by default, a single, mixed supply. We submit that this is a misguided approach. It would be nonsensical to suggest that the sales of these items can never constitute separate supplies in their own right. Taxpayers must, and do, begin the process with an analysis of whether there is a single supply or multiple supplies – so much is evident from the case law, including the issues determined in *Luxottica*[3].

If it is the case that the Draft Ruling is only intended to apply after a number of things supplied together have already been characterised as a single supply or a multiple supply (as is the suggestion in the title of the ruling, which presupposes "a supply"), then we make the following suggestions:

1. The Draft Ruling should be amended so that this proposition is clearly stated at the outset, together with an explanation of the Commissioner's views about the mixed supply concept and the legislative basis for it.
2. The Draft Ruling ought not to imply that where a number of things are supplied together, and no one part is incidental, integral or ancillary to the other, that there is by default a mixed supply, as the multiple supplies scenario must at least be contemplated.
3. The UK case law referred to in the Draft Ruling is removed, as the cases go to the question of whether there is a single supply or multiple supplies, not to whether there is a single, composite supply or a single, mixed supply (discussed further below).
4. The Commissioner must set out in another ruling how taxpayers should determine whether they are making a single supply with multiple components or multiple supplies.

[2]See paragraph 19 of Draft Ruling.

Case Law and Multiple Supplies

It is highly confusing for taxpayers that the cases referred to by the Commissioner have been applied in order to answer the question as to whether the supply is a single, composite supply or a single, mixed supply, where in fact they specifically answer the question as to whether there is a single supply or multiple supplies. For example (this list is not exhaustive):

- The Draft Ruling refers to paragraph 15 of *Luxottica,* stating that the Full Federal Court found that "while 'supply' is widely defined it 'invites a practical, commonsense approach to characterisation'." This may be true, but the Full Federal Court was not differentiating between a single, composite supply and a single, mixed supply. Their Honours were differentiating between a single supply and multiple supplies. This is evidenced clearly by the heading at page 5 of the judgment, "***One supply or two supplies?***"Further, paragraph 13 states, "An initial question is **whether the sale of spectacles** (comprising a frame with the lenses fitted) **is a single supply** (as the Commissioner contends) **or two supplies**, being a supply of the frame and a supply of the lenses" (emphasis added).
- In *British Airways plc v Customs and Excise Commissioners* [1990] STC 643 (referred to at paragraphs 48 and 50 of the Draft Ruling) , the relevant question is specifically and repeatedly expressed as "**whether British Airways makes one supply**, namely transportation with in-flight catering as an integral part of it, **or two supplies**, namely transportation and catering" (at 648);
- In *Sea Containers Services Ltd v Customs and Excise Commissioners* [2000] STC 82 (***Sea Containers***) (referred to at paragraphs 45C and 46 of the Draft Ruling), Keane J states that the "appeal raises once again the familiar problem of **whether services and goods supplied are to be treated as one composite supply or as two or more separate supplies** for the purposes of the value added tax (VAT) legislation" (at 83).
- In *Customs and Excise Commissioners v British Telecommunications plc* [1999] 1 WLR 1376, (referred to at paragraphs 57 and 59 of the Draft Ruling), Lord Slynn of Hadley described the issue in question as **whether the supply of the car and the provision of the transport are separate supplies for VAT purposes**, or whether there is one supply of a delivered car" (at 1378).
- In *Customs and Excise Commissioners v Wellington Private Hospital Ltd* [1997] STC 445 (referred to at paragraph 51 of the Draft Ruling),Millet LJ summarised the approach to the issue by stating that, "In determining **whether what would otherwise be two supplies should be regarded as a single supply** the court has to ask itself whether one element is an 'integral part' of the other, or is 'ancillary' or 'incidental' to the other..." (at 462).

It is inappropriate for the Draft Ruling to, first, use these cases to support a principle that they do not stand for (i.e. whether a supply is a single, composite supply or a single, mixed supply) and, second, to the extent that international case law is helpful and relevant, fail to use them to support the proposition that they do stand for, which is whether numerous items supplied together constitute one single supply or multiple supplies. In differentiating between single and multiple supplies, the taxpayer should be able to draw on the principles that have emerged from these cases and should not be instructed in the Draft

Ruling to instead use those principles to draw a different and inconsistent outcome. That is, the Draft Ruling is incorrect in suggesting that an analysis that results in a finding of *multiple supplies* in the UK and European VAT context could or should be applied analogously to give rise to a *single mixed supply* in the Australian context. Clearly, these outcomes are contradictory.

For example, in *Sea Containers*, the "transport" and "fine dining" associated with a day excursion were taken to constitute two separate supplies. At paragraphs 45C and 46 of the Draft Ruling, the Commissioner uses the case as an example of a single supply comprising of separately identifiable parts. Is it the Commissioner's view, then, that in the Australian context, these would be taken to constitute a single mixed, supply? If so, what is the legislative basis for making this distinction in the Australian context? Does this not fundamentally subvert the actual outcome of that case, which was an express determination that the transaction comprised of not one supply but two supplies? This is a confusing and counter-intuitive approach.

For completeness, we note that if the Draft Ruling is to include authorities from the UK and the European VAT regimes, these should be updated in order to reflect the evolution of the case law over the last ten years, in the same way that the Australian case law has been updated. This is a necessary part of making a full and accurate representation of where the law stands in those jurisdictions. We submit that the Commissioner should, at a minimum, consider making some reference to the following cases:

- *Aktiebolaget NN v Skatteverket* [2007] All ER (D) 478
- *Beynon and Partners v Customs and Excise Commissioners* [2005] STC 55
- *C&E Commissioners v FDR Ltd* [2000] EWCA Civ 216
- *College of Estate Management v C&E Commissioners* [2005] All ER (D) 219
- *De Montfort University Students' Union v The Commissioners of Customs and Excise* MAN/2002/0523
- *Levob Verzekeringen BV and another v Staatssecretaris van Financien* (Case 41/04) [2005] All ER (D) 328
- *Faaborg-Gelting Linie A/S v Finanzamt Flensburg* (Case C-231/94) [1996] STC 774
- *Talacre Beach Caravan Sales Ltd v C&E Commissioners* (Case C-251/05) [2006] ECR I-6269

We note that this list is not exhaustive. Further, if the Commissioner considers that the analysis devoted to the international authorities is already too lengthy or lengthy enough, it may be appropriate to substitute some of the earlier cases with these or other more recent authorities.

Section 9-80 of the GST Act

The Draft Ruling fails to acknowledge the full implication of the Full Federal Court's decision in Luxottica in respect of the formula set out in s. 9-80(2) of the GST Act. Paragraph 30 of the Draft Ruling states:

> "*In the case of a mixed supply that has non taxable parts that are GST free or input taxed**, the value of the taxable supply is determined in accordance with the formula in section 9-80**. To determine the value of the taxable supply it is necessary to calculate the taxable proportion, that*

is, the proportion of the value of the actual supply that the taxable supply represents." (Emphasis added.)

Similar comments are made at paragraph 81C.

At the outset, we suggest that the words "the value of the taxable supply is determined" should read "the value of the taxable part of the supply is determined", since the apportionment exercise is carried out in respect of components of a single supply (this is also the case in respect of proposed paragraph 30A).

More importantly, we consider it misleading and unhelpful to suggest to taxpayers that the value of the taxable supply must still be determined in accordance with the formula in section 9-80(2). The Full Federal Court has now confirmed the view already held by taxpayers and their advisors who have had occasion to apply section 9-80 prior to the Luxottica case being heard – the formula is circular and does not work. In this regard, Ryan, Stone and Jagot JJ stated the following at paragraph 26 of *Luxottica*:

"*Stripping away the verbiage in the Act, this restatement shows that, even after applying the definition of taxable proportion, there remain two unknowns: v and k. This leads one back to the basic problem:* ***one cannot solve an equation in two unknowns. It follows that the formula in s 9-80(2) cannot be made to work. It justifies the Tribunal's reference to it as "impenetrably circular"***."(Emphasis added.)

Their Honours also stated at paragraph 30:

"*As noted above the object of s 9-80 is tolerably clear. It is also not in contention that the GST payable in respect of an actual supply is calculated with reference to the value of that supply. However,* ***that value cannot be determined by application of the formula in s 9-80(2). Similarly, the value of the taxable part of the actual supply is, pursuant to s 9-80(1), a proportion of the value of the actual supply***." (Emphasis added.)

These comments in respect of 9-80(1) at [30], while not discussed here at length, are illustrated by the unhelpful and nonsensical formula provided at paragraph 81B of the Draft Ruling, which essentially states that "the value of the taxable supply = the value of the taxable supply".

The findings of the Full Federal Court in respect of the formula in s. 9-80(2) are unequivocal and proposed paragraphs 30 and 81C should be amended in order to accurately reflect them. It is not sufficient that the Draft Ruling includes an outline of what the Court said in that regard – it only creates more confusion that the Draft Ruling states that the formula must be applied, followed by the Full Federal's Court's explanation of why it cannot be applied.

We agree with the comments set out in proposed paragraph 30A as to how the taxable proportion of a "mixed supply" should be calculated and consider these to be sufficient in the absence of a comprehensible formula in s. 9-80(2).

We submit that the Commissioner must give more thoughtful consideration to the ongoing application of s. 9-80 of the GST Act and the outcomes in *Luxottica*, including how those outcomes may have been different if the court had **not** identified sound commercial reasons for the arrangement. Arguably, if the arrangement in *Luxottica* had not been commercial and was, instead, contrived in order to minimise the GST payable to the Commissioner, there would have been nothing in s. 9-80 to preclude this outcome. Instead, the anti-avoidance provisions at Div 165 of the GST Act would have operated in order to deny the taxpayer the GST benefit. This is consistent with the Tribunal's view, accepted by the Full Federal Court, that:

> "*The case law also establishes that as a general rule, and **absent tax avoidance or sham** (and there is no suggestion of any such elements in this case) the courts will generally accept that the price contractually agreed between the parties will be determinative of the value for taxation purposes.*" [4] (Emphasis added.)

It was on the basis of the "commerciality" of the apportionment that it was considered appropriate by the courts, not the direct application of s. 9-80 (though the purpose of s. 9-80 was considered and taken into account).

Arguably, Div 165 is the appropriate test going forward until the requisite legislative amendments are made to restore the efficacy of s. 9-80. This approach would give effect to the Full Federal Court's views in *Luxottica* and, indeed, the Commissioner's view in proposed paragraph 30A, that where the pricing methodology applied is commercially appropriate and is not applied in a particular way with the sole or dominant purpose of achieving a GST benefit, it would be inappropriate for the Commissioner to interfere with the commercial decisions made by the taxpayer.

Food Supplier and 'Conditionality'

We disagree with the comments at paragraphs 65, 65A, 66 and 81O of the Draft Ruling and invite the Commissioner to reconsider the ongoing relevance of the comments made in *Food Supplier v Commissioner of Taxation* [2007] AATA 1550 in light of the Full Federal Court decision in *Luxottica*. Even accepting the Commissioner's comments at 81X to 81Z and 89 (based on the findings of fact in *Food Supplier*), it does not follow that a supplier can *never* provide something to a purchaser that is free. To the extent that this generalisation arises out of *Food Supplier*, it cannot withstand the test outlined in *Luxottica*.

It may well be that a decision to provide an item for 'free' in circumstances that would fall squarely within the test of commerciality outlined in *Luxottica*. For example, where a jar of coffee is sold for $10 without a mug, but as part of a promotional exercise, is sold for $10 with a 'free' mug, there is no provision of the GST Act that would preclude the supplier from giving the mug away as a 'gift' as a marketing or goodwill building technique, if that commercial driver could be demonstrated by the facts.

[4] See paragraph 30 of *Luxottica Retail Australia Pty Limited and Commissioner of Taxation* [2010] AATA 22.

We note particularly the references to 'conditionality' in paragraph 66 of the Draft Ruling. The Commissioner must concede and acknowledge in the Draft Ruling that the conditionality argument failed in Luxottica. In the Administrative Appeals Tribunal (***AAT***) decision, *Luxottica Retail Australia Pty Limited and Commissioner of Taxation* [2010] AATA 22, the Tribunal found the following:

> *"41. We also consider that the conditionality issue does not undermine the reasonableness of the calculation of the taxable proportion in this way.*
>
> *42. Mr Wigney argued, and strenuously, that the conditionality issue brings about the result for which the Commissioner contends but he did not explain why this conclusion follows, and we do not accept that it is so. Mr Wigney was not able to demonstrate why or on what basis the conditionality issue has this effect. There was never any suggestion that the conditionality issue resulted in some form of (presumably) non-monetary consideration. During the course of the hearing mention was made of "loss leading". Assume by way of example that a store has an excess of clocks of a certain make. It advertises that it will sell those clocks at a substantial discount (compared to its previously advertised price) to anyone who will purchase other goods costing not less than $100. We can see no reason why, absent tax avoidance or sham, the price for the other goods and also the price for the clock is not for GST purposes the discounted price for the clock and the list prices for the other items purchased."*

We consider that this reasoning can be applied whether the transaction involves a discount or an item being given to a purchaser for "free". If a supplier had an excess supply of clocks, for example, and sees a net benefit from a "goodwill" perspective in rewarding customers for their purchasers by giving away a clock for free, absent tax avoidance or a sham, there is nothing to "undermine the reasonableness" of the supplier's commercial decision.

This conclusion was acknowledged at [41] of the Full Federal Court decision in *Luxottica*. It was not set aside and it is apparent from the outcome in *Luxottica* that the Commissioner's appeal failed on this point. To the extent that there is any inconsistency between the decision in *Food Supplier* and the decision of the Full Federal Court in *Luxottica*, preference should be given to the reasoning in *Luxottica*. On this basis, we submit that paragraphs 64 to 69 of the Draft Ruling should be deleted.