GST and apportionment in complex transactions

by Rashelle Seiden, SC, CTA, Barrister, Ground Floor Wentworth Chambers, and Nayiri Apkarian, FTI, Barrister, Nine Wentworth Chambers

Abstract: For the purposes of the goods and services tax, a transaction which would be regarded, in a practical business sense, as a single supply of goods or services may be comprised of several components, some of which are taxable and some not. Following a commercial approach, Australian courts have resolved the questions of identification and characterisation of supply by examining a transaction/supply from a business and commonsense perspective, paying due deference to the legal realities. Where the supply has "separately identifiable parts" and none are integral, ancillary or incidental, an apportionment exercise will be necessary between the taxable and non-taxable parts of the supply. As with *Luxottica*, an apportionment will be necessary where there is a single supply but one or more parts are taxable, while others are non-taxable. It is likely that the appropriate method of apportionment will be one that is reasonable and supportable in the particular circumstances, having regard to the commercial and legal context in which the transaction occurs.

Introduction

> "The clear thrust of the GST Act, both in its wording and as explained in the EM, is that of a practical business tax imposed with respect to elements of commerce."[1]

The Australian goods and services tax (GST) is a multi-stage, indirect tax, levied on the supplier of "taxable supplies". Broadly, the GST burden is designed to fall on the ultimate consumer and, further, to ensure that tax will be payable only on the value added by each supplier in the chain.[2] In order to avoid "cascading"[3] (the doubling up of GST throughout the supply chain), a supplier may claim credits for acquisitions subject to satisfying certain criteria.[4] And so, the GST is a system of output tax and input credits. Amounts of GST and amounts of input tax credits are set off against each other to produce a "net amount" for a tax period, which is then remitted to the ATO.[5] In this article, this is referred to as the "GST equation". However, not every supply is subject to the output tax or eligible for the input tax credit.

Output side of the equation

On the output tax side of the GST equation sits the seminal concept of "taxable supply". Broadly, pursuant to s 9-5 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GSTA), a "taxable supply" is a "supply" you make for "consideration" *to the extent that* it is not "GST-free" or "input-taxed" as those terms are defined.

"GST-free" supplies include supplies of basic foods, some education courses, as well as some medical, health and care products and services.[6] "Input-taxed" supplies were born of the fact, as noted by Hill J in *HP Mercantile Pty Ltd v FCT*,[7] that the value added in some types of transactions, such as the constant borrowing and lending of money, is not captured by a system comprised of output tax and input credits. The input-taxed supply is not subject to output tax, but the supplier is also not entitled to an input tax credit for tax on any acquisitions to the extent that the acquisition relates to the making of input-taxed supplies. Financial supplies are the quintessential example of input-taxed supplies.

Flowing, therefore, from the definition of taxable supply, comes the necessity to distinguish between taxable supplies and other types of supplies, even where they may be part of the one transaction. However, the difficulty in applying the GSTA does not stop there.

Almost 70 years ago, the High Court of Australia identified that the expression "to the extent that" indicated that an apportionment was contemplated by the legislature.[8] Accordingly, for the purposes of s 9-5, we must discern not only whether there is, by a single deal, a *series* of supplies, some taxable and others not, but we must also consider whether there is a *single* supply with constituent parts which are taxable and not taxable.

The need to dissect the supply into its taxable components or parts is echoed in the provisions that regulate the amount of the output tax levied. Relevantly, the amount of GST on a "taxable supply" is 10% of the "value" of a taxable supply. In turn, "value" is determined by reference to the "consideration" (which has a very broad meaning)[9] for the relevant supply.

Pursuant to s 9-80 GSTA, where the supply (the actual supply) is partly a taxable supply and partly a supply that is GST-free or input-taxed, the value of the part of the actual supply that is a taxable supply is the proportion of the value of the actual supply that the taxable supply represents. Apportionment between the taxable supply and the GST-free or input-taxed supply is required in order to determine the amount of the GST. In other words, even where there is a single supply, it may be comprised of components that are taxable and not taxable.[10]

Accordingly, it might be said that this "practical business tax", reflects the commercial reality that supplies are not always characterised as one thing or another and may be made up of various components. Thus, the identification and characterisation of the supply (s 9-5) and the concept of apportionment (s 9-80) are highly relevant to the output tax side of the equation.

Input side of the equation

It is not simply on the output tax side of the GST equation that apportionment rears its head. It also finds expression on the input side of the GST equation. In order to be entitled to an input tax credit,

the acquisition must be a "creditable acquisition". In turn, in order for an acquisition to be a "creditable acquisition", among other things, the supply of the thing to you must be a "taxable supply".[11] Accordingly, the apportionment issues we must grapple with in relation to "taxable supply" also arise on the input credit side.

For an acquisition to be a "creditable acquisition", it must also be acquired "solely or partly for a creditable purpose".[12] Relevantly, a thing is acquired for a creditable purpose *to the extent that* it is acquired in carrying on your enterprise but not *to the extent* that the acquisition relates to making supplies that would be input-taxed or *to the extent* that the acquisition is of a private or domestic nature.[13] Thus, the GSTA envisages that you may acquire a thing for a purpose that is partly a creditable purpose.[13]

The importance of characterisation

Accordingly, for commercial benefit, as well as legal compliance, it is imperative that a taxpayer correctly characterise its supplies, its acquisitions and the purpose of its acquisitions and dissect these, if necessary, into different components. Yet, despite the Act reflecting the commercial reality that not all supplies fit neatly into one category or another, and our long familiarity with the concept of apportionment, the notion of apportionment under the GSTA poses real challenges for taxpayers, the Commissioner, tribunals and courts. The correct characterisation of the supply in commercial arrangements is not always a straightforward task.

Courts in Australia have adopted a purposive approach to the interpretation of the GSTA, rejecting strict grammatical analysis in favour of consideration not only of the syntax, but also of the "policy and surrounding legislative context" of the relevant provision.[14] The courts view GST as being a "practical business tax".[15]

Australia's superior courts have analysed the character of "supply" not only by using a commonsense approach reflecting the commercial and practical realities of the transaction, but by also paying due regard to the legal context. As mentioned above, the courts have interpreted the GSTA through the prism of the tax being a "practical business tax" having regard to the contractual terms and context of the relevant arrangement.[15]

Apportionment, per se, has not been the subject of many court decisions and none yet have made it to the High Court of Australia. Nevertheless, the High Court of Australia has considered the identity and character of a supply in a number of decisions, which foretells something of what the proper approach to apportionment is. Most relevant to this article are *FCT v Reliance Carpet Co Pty Ltd* (2008) 236 CLR 342 (*Reliance Carpet*), *FCT v Qantas Airways Ltd* (2012) 247 CLR 286 (*Qantas*) and *FCT v MBI Properties Pty Ltd* (2014) 315 ALR 32 (*MBI Properties*).

> *"Australia's superior courts … have interpreted the GSTA through the prism of the tax being a 'practical business tax' …"*

Characterisation of "supply"

Reliance Carpet

In *Reliance Carpet*, the issue before the High Court was whether the taxpayer (vendor) made a "supply for consideration" and, therefore, a "taxable supply" (s 9-5(a)) in respect of a contract for the sale of land that was ultimately terminated, giving rise to the purchaser's deposit being forfeited to the taxpayer.

The Full Federal Court held that the taxpayer had entered into the contract for sale with the purchaser solely for the supply of real property; "nothing more and nothing less".[16] Since that supply did not take place (because the contract was terminated), the taxpayer did not make a "taxable supply" pursuant to s 9-5.

The Commissioner contended that the taxpayer had in fact made a "taxable supply" and the consideration for that supply by the taxpayer was the deposit that was forfeited by the purchaser to the taxpayer on the termination of the contract.

The High Court allowed the appeal after analysing the contract, the general law and statutory provisions of the GSTA, in particular the broad definition of "supply" in s 9-10 GSTA.[17] Notwithstanding that there was no supply of real property, the taxpayer had, nonetheless, made a "supply for consideration" under s 9-5 and, therefore, a "taxable supply".

In more detail, the court held that on execution of the contract, the taxpayer entered into an obligation to do all the things it was bound to do under the contract. These things included maintaining the property, paying all rates, taxes, assessments, fire insurance premiums and other outgoings in respect of the land, and to hold the existing policy of fire insurance for itself and in trust for the purchaser to the extent of their respective interests. In those circumstances, the court held that the taxpayer made a supply pursuant to s 9-10(2)(g) in that it "entered into an obligation to do anything" it was bound to do under the contract.[18]

Moreover, Gleeson CJ, Gummow, Heydon, Crennan and Kiefel JJ held that, on the exchange of contracts, the taxpayer granted the purchaser a contractual right exercisable over or in relation to land, being the right to require conveyance of the land to it on completion of the sale.[18] This constituted a "supply" under para (d) of s 9-10(2) as extended by para (c) of the definition of "real property" in s 195-1 GSTA.[19] Further, the payment of the deposit by the purchaser to the taxpayer was "in connection with" that supply within the meaning of "consideration" in s 9-15(1) GSTA. However, given the nature of the payment by the purchaser (ie security deposit), the deposit could be treated as "consideration" for a "supply" only if and when the deposit was forfeited because of a failure by the purchaser to perform its obligation to complete the relevant contract.[20]

Thus, on the forfeiture of the deposit as a result of the purchaser's failure to perform, the deposit was deemed to be "consideration" for the "supply" made by the taxpayer (being the making of the contract) and the "supply" became a "taxable supply" giving rise to a GST liability.

Reliance Carpet highlights the importance of identifying and characterising the relevant "supply" having regard to the facts, circumstances and a detailed reading of the statutory provisions, including the broad definition of "supply". The relevant supply was not identified merely by reference to the business or commercial

purpose of a transfer of a parcel land. Rather, identification of the relevant supply involved a proper consideration of the rights that arose under the terms of the contract (in this case, a contractual right exercisable over or in relation to the parcel of land) and a consideration of the relevant provisions in the GSTA.

Qantas

The amount in contest in *Qantas* was the GST on fares received from prospective passengers who ultimately failed to take flights for which payment had been made. In accordance with the fare conditions, some fares were forfeited and others were refundable to the customer on application within a specific period. The sum in dispute related to the forfeited fares and those fares, which, although refundable, were never claimed by the customer.

Qantas contended that GST was not payable on the unused fares on the basis that it had ultimately not made a supply to the prospective passenger and the GST remitted to the ATO in respect of those fares should be refunded. In other words: (1) the dealings between the airline and prospective passengers were such that there was no more than one projected "taxable supply" (being the supply of air travel); (2) this supply did not eventuate; and (3) no GST was exigible.[21]

The Full Federal Court found in favour of Qantas and using the language of the Full Federal Court in *Reliance Carpet* held that:[22]

> "… the essence and sole purpose of the transaction … [is the] prospective supply … of air travel … 'nothing more or less' …"

On appeal, Gummow, Hayne, Kiefel and Bell JJ (Heydon J dissenting) allowed the appeal and rejected the "all or nothing" approach of the Full Federal Court.

As with *Reliance Carpet*, their Honours considered the terms of the contract between the airline and the prospective customers, as well as the meaning of "supply" in s 9-10.[23] Applying *Reliance Carpet,* their Honours rejected the airline's contention that the "sole candidate for a taxable supply was the flight".[24]

The airline's conditions of travel did not support the view that Qantas provided an unconditional promise to carry passengers and baggage on a particular flight. Instead, what they supplied was something less than that. This constituted, at least, a promise to use best endeavours to carry the passengers and baggage. This was a "supply" within the meaning of s 9-10 and a "taxable supply" within s 9-5 for which consideration, being the fare, was received.[25]

It can be said that the court, in rejecting an "all or nothing" approach, considered the substance of the transaction more rigorously. The court analysed the contract in the context of the broad definition of supply and the commercial and practical perspective to determine what was actually supplied.

MBI Properties

MBI Properties provides the most recent guidance from the High Court on the issue of characterisation. MBI Properties Pty Ltd (MBI) acquired three apartments in a hotel complex subject to a lease entered into between the vendor and operator of the hotel, MM Ltd. On acquiring the rights of the lessor, MBI Properties became the recipient of a "supply of a going concern" within the meaning of s 135-5 GSTA. One of the issues for determination was whether the taxpayer, as purchaser of the reversionary estate in the leased apartments, made a "supply" to the operator as tenant during the currency of each lease after completion of the purchase. The issue arose in the context of determining whether MBI was subject to an increasing adjustment, on the basis that MBI intended that some or all of the supplies be supplies that are neither taxable nor GST-free. The amount of any increasing adjustment is a question of apportionment (s 135-5(2) GSTA), but the substantive issue for determination was the identification and characterisation of the supplies.

Upholding the appeal, the High Court explained that, in observing the expressed or implied covenant of quiet enjoyment throughout the term of the lease, the lessor is appropriately characterised for the purpose of GST as engaging in an "activity" done "on a regular or continuous basis, in the form of a lease".[26] Such supply is separate from that which occurs at the time of entering into the contract. This meant that MBI acquired an ongoing obligation from the vendor to make an input-taxed supply of residential premises by way of lease to MM Ltd.

Once again, the High Court has demonstrated that, despite the GST being a practical business tax, a rigorous and nuanced approach is called for in order to characterise the supply or supplies, rather than an approach based solely on business common sense.

Apportionment

As mentioned, there are very few cases in Australia to have grappled with the concept of apportionment, but it can be gleaned from our High Court's approach to identification and characterisation of the supply that a practical, commonsense approach, not divorced from the legal context, will be adopted. This is reflected in the seminal case, *FCT v Luxottica Retail Australia Pty Ltd*[27] (*Luxottica*) by the Full Court of the Federal Court.

Luxottica – the "elephant" test

During the period in review, Luxottica, a spectacle frame manufacturer, offered customers of a pair of spectacles a discount on the frames, but not on the lenses.

At issue was the apportionment of the discount offered under the promotion as between the frame and the lenses and the manner in which GST should be calculated in respect of each pair of spectacles purchased under the promotion. Difficulties arose because the supply of frames attracted GST, while the supply of lenses did not.

The Commissioner contended that, when calculating the GST, the discount provided to customers should be deducted from the combined purchase price of the frame and lenses. On the other hand, Luxottica contended that the discount should be deducted from the frame price (a taxable supply) only, giving rise to a lower GST liability than under the Commissioner's approach.

The initial question for determination by the Full Federal Court was whether the sale of a pair of spectacles (comprising a frame with the lenses fitted) was a single supply (as contended by the Commissioner) or two separate supplies being the supply of the frame and a supply of the lenses.[28]

The court held that, although the term "supply" is defined broadly, it nevertheless invited a "common sense, practical approach to characterisation".[29] Ryan, Stone and Jagot JJ agreed with the Administrative Appeals Tribunal (at first instance) that the sale of spectacles was a single supply. This characterisation sat more comfortably with the "practical business tax" approach to GST, which has been adopted by the Federal Court.[30]

In contextualising the approach taken, the court referred to the analogy of a motor vehicle — like a motor vehicle, spectacles are customarily bought as a completed

article and, in such circumstances, are treated as such by the purchaser even though the lens and frame (like tyres and a motor) may be purchased separately.[31]

In his paper delivered to the Australian Bar Association Conference 2017, Conlon QC[32] describes a similar test in relation to the value-added tax (VAT): the "elephant" test. Conlon QC posits that "a single complex supply may be difficult to describe but should be recognisable when one sees it".[33]

Without meaning to detract from the importance of identifying and characterising a particular supply, it must be accepted that a test of general impression is a useful one.

This, however, was not the end of the analysis in *Luxottica*. Satisfied that the supply of the spectacles was a single supply, the court then deliberated on the manner in which the value of the spectacles should be apportioned under s 9-80 as between the GST-free component (the lenses) and the taxable supply (the frames).

The court determined that the equation in s 9-80 contemplates a proportionate approach. However, the court agreed with the tribunal at first instance that the equation in s 9-80 is "impenetrably circular",[34] as it contains two unknowns.[35]

The court ultimately concluded that the element of the equation in s 9-80, the "proportion", must be determined by the decision-maker taking into account the relevant circumstances of the particular case.[36] Moreover, their Honours referred to Hely J's comments in *Kmart Australia Ltd v FCT*[37] where his Honour said (in the context of sales tax) that, where that which is to be valued is one of two elements which form an integrated whole, "apportionment must be undertaken as a matter of practical common sense".[38]

Ultimately, the court in *Luxottica* did not disturb the tribunal's findings in relation to the taxable proportion, for the reason that the question of apportionment in the context of s 9-80 is a question of fact and not of law. Nevertheless, the observations of the court are valuable in that they confirm the relevance of a commonsense and practical approach to GST apportionment.

Saga Holidays – incidental or ancillary

Another case that provides some indication of how apportionment will be dealt with in Australia is *Saga Holidays Ltd v FCT* (*Saga Holidays*).[39]

Saga Holidays involved the supply of a packaged holiday tour called "A Taste of Australia". The tour package was paid for in the United Kingdom and from the tourist's perspective, it was an "all-inclusive" tour. The set price included travel insurance, return economy flights to Australia, transportation within the UK and Australia, a tour guide within Australia, various excursions to be conducted in Australia and, relevantly, accommodation at specified hotels in Australia.

> *"Without meaning to detract from the importance of identifying and characterising a particular supply, it must be accepted that a test of general impression is a useful one."*

In characterising the supply, Stone J focused on the "social and economic" reality of the supply and found that there was a single supply of accommodation and the adjuncts to that supply (such as the use of the furniture and facilities within each room, cleaning and linen services, access to common areas and facilities such as pools, gyms etc) were incidental and ancillary to the accommodation part of the supply. Accordingly, the entire supply was characterised by the dominant supply, being the supply of accommodation and the parts of the supply that were incidental were disregarded for GST purposes. In doing so, no apportionment was required as the entire supply was characterised as the supply of accommodation.

Although this case considered the term "incidental" in the context of a different legislative provision (namely, s 96-5 GSTA and whether the supply was connected to Australia), it provides guidance on how the courts might characterise a supply, ie identifying the components of the supply and characterising it based on the dominant feature or part of the supply.

ATO guidance on apportionment – essential character test

In GSTR 2001/8, the ATO provides guidance to a taxpayer on how to set about characterising the supply for the purposes of apportionment.[40] Specifically, GSTR 2001/8 adopts the nomenclature "mixed supply" and "composite supply" to assist taxpayers in determining whether there is a single supply with separately identifiable parts (a "mixed supply") or a single supply that comprises a dominant part and something that is ancillary or incidental to that part ("composite supply"). These are not terms used in the GSTA. Rather, they are terms that the Commissioner has employed for ease of reference and convenience within the ruling.

Relevantly, the term "mixed supply" is used to describe a supply that has to be separated or unbundled, as it contains separately identifiable taxable and non-taxable parts that should be individually recognised.[41] Goods and services tax is payable on the taxable part of a mixed supply. On the other hand, the term "composite supply" is used to describe a supply that contains a dominant part and includes something that is "integral, ancillary or incidental" to that part, but is nonetheless treated as a single supply.[42] Where a supply is a composite supply, the entire supply is either entirely taxable or entirely non-taxable.[43]

Unsurprisingly, the ATO's view is that the distinction between a "mixed supply" and a "composite supply" is a question of fact and degree, for which a commonsense approach should be adopted.[44]

Where a supply is characterised as a "mixed supply", it is the ATO's view that apportionment of the consideration between the taxable and the non-taxable part must be undertaken as a matter of practical common sense and that the taxpayer may use any "reasonable basis" which is supportable in the particular circumstances.[45]

Referring to the tribunal decision of *Re Food Supplier and FCT* (*Food Supplier*),[46] the GSTR 2001/8 states at para 45A:

> "… [the] promotional items packages with food had intrinsic value and would not be consumed with the food and were mostly unconnected with the food. This was so even when, for example, the main item was a jar of coffee and the promotional item was a mug in which coffee might be served. In these circumstances the Tribunal found that the supply of the promotional items packaged with

> the food items was a mixed supply [at paragraph 5]. In such a case, it could not be said that the food component was the dominant part of the supply and the promotional item was ancillary or incidental to the supply of food."

Accordingly, in *Food Supplier,* the consideration was to be apportioned between the jar of coffee (not taxable) and the free promotional coffee cup (taxable).

Food Supplier is one of the only cases to employ the nomenclature of "mixed supply".

In apportioning a supply between the taxable and non-taxable parts, the Commissioner considers that any reasonable method of apportionment may be used. Applying *Luxottica*, he considers that the apportionment must be supportable by the facts in the particular circumstances and be undertaken as a matter of practical common sense.[47]

Input tax credits

On the input side of the GST equation, apportionment is relevant when determining the extent of a taxpayer's "creditable purpose" which, in turn, informs the taxpayer of their ability to recover the GST paid on inputs.

Rio Tinto

In *Rio Tinto Services Ltd v FCT* (*Rio Tinto*),[48] the taxpayer claimed that it was entitled to input tax credits for the GST paid on acquisitions made in relation to the supply of residential accommodation to workers in a remote region of Australia. At issue here was the characterisation of the purpose of the supply. The Full Court of the Federal Court held that Rio Tinto was not entitled to claim input tax credits by reason of s 11-15(2)(a) GSTA, ie that the acquisition related to making supplies that would be input-taxed.[49] The acquisitions in question all related to the making of the supply of the premises by way of a residential lease (which is an input-taxed supply), even though they may have also related to the broader business purpose of carrying on the enterprise pursuant to s 11-15(1).

The relevant enquiry for the purposes of s 11-15(2)(a) is not simply whether something was acquired in carrying on the enterprise (which, but for the operation of s 11-15(2)(a), would be the relevant enquiry).[50] Instead, the relevant enquiry is:[51]

> "… irrespective of the extent to which the thing had been acquired in carrying on the enterprise, to what extent, if any, did the acquisition relate to making the supplies that would be input taxed. The relationship to focus on in other words, is the relationship between the antecedent acquisitions for which credit is claimed and the subsequent supply for which the credit is, in effect, lost."

The court held that s 11-15(2)(a) therefore requires a precise identification of the relevant acquisition and a factual enquiry into the relationship between the acquisition and the making of supplies that would be input-taxed.[52]

Middleton, Logan and Pagone JJ held that some acquisitions may relate to supplies that are capable of distinct and separate apportionment between an input-taxed supply and a taxable supply. In such cases, it may be possible to bifurcate the creditable purposes between the two.[52] Moreover, their Honours identified that in other acquisitions, it may be that the acquisitions are used indifferently for supplies that are input-taxed and otherwise taxable generally.[53] In that case, a "fair and reasonable" assessment of the extent of the relationship between the two may be necessary.[52]

Ultimately, in *Rio Tinto,* the court held that no apportionment was necessary because all of the acquisitions related to the making of supplies that were input-taxed (provision of residential accommodation).

Practical apportionment

Where, unlike *Rio Tinto,* it is accepted that apportionment is available for an acquisition, it is necessary to determine an appropriate apportionment methodology.

In the event that apportionment of expenditure is necessary, one must consider whether the acquisition can be traced to a distinct supply or supplies or whether the acquisition is fungible and used indifferently for supplies regardless of character (such as general overheads).

ATO guidance on the appropriate apportionment methodology

In GSTR 2006/4, the Commissioner allows the taxpayer to choose its own apportionment method provided it is "fair and reasonable". The apportionment method needs to appropriately reflect the intended or actual use of the acquisitions.[54] Paragraphs 33 to 34 of the ruling provide that:

> "The 'fair and reasonable' principle was used by the High Court in *Ronbipon Tin v. FC of T*,[55] in the context of apportionment of expenditure serving more than one object 'indifferently'. The High Court did not, in that case, apply this principle in relation to the allocation of specific acquisitions wholly to specific ends, or to apportioning items of expenditure 'distinct and severable parts of which' can be identified as being devoted to such specific ends. The Commissioner's view is that the 'fair and reasonable' principle applies equally to the choice of method for allocating and apportioning acquisitions in all circumstances.
>
> Following the principles set out by the High Court, the apportionment method you choose needs to:
>
> - be fair and reasonable;
> - reflect the planned use of that acquisition …; and
> - be appropriately documented in your individual circumstances …"

Guidance from UK and European VAT cases

On the output side of the equation, a number of UK and European cases have considered the characterisation and apportionment of supplies in the context of the VAT rules, among others,[56] *Sea Containers Ltd v Customs and Excise Commissioners* (*Sea Containers*)[57] and *British Airways PLC v Customs and Excise Commissioners* (*British Airways*).[58]

In *Sea Containers,* day train excursions were provided together with fine wine and dining, and the promotional material emphasised the food and wine aspect of the excursion. The question before the court was whether the taxpayer supplied transport or whether it supplied transport and catering. It was held that the proper approach in analysing the supply was to ask whether the catering element was significant in its own right or whether it was merely ancillary to the provision of the transport. In the circumstances (having regard to the prominence of the catering services in the marketing material), the catering service constituted, in its own right, an important element in the supply and was a vital part of what the customer was paying for.

Sea Containers may be contrasted with *British Airways*, where the question was whether the airline was to be taken as making supplies of air transport and of catering services, or a single supply of air transport with the catering services being merely integral or ancillary. It was held that the provision of in-flight catering was, in substance and reality, integral (ancillary or incidental) to the supply of air transportation to customers.

Conlon QC, in his paper to the Australian Bar Association Conference 2017, has very helpfully collected the various approaches

to the characterisation of supply for the purposes of the VAT. These include:

- "principal/ancillary" as exemplified by Case C-349/96, *Card Protection Plan v Customs and Excise Commissioners*,[59] where the subscription paid for a package of benefits for loss or theft of credit cards was ultimately regarded as a principal supply (the aim of the transaction) of insurance, with other elements being ancillary (a means by which to enjoy the principal supply);
- "overarching supply" as exemplified in *College of Estate Management v CCE*,[60] where the written materials provided as part of distance learning packages were treated not as ancillary (subservient, supporting or ministering to) but essential to the overarching supply of education, and so, a single exempt supply;
- "closely linked/economic whole" as exemplified by Case C-41/04, *Levob Verzekeringen BV v Staatssecretairs von Financien*,[61] where the supply of computer software and engineers to install and configure it was part of an economic whole where the service predominated in the aim to acquire fully functioning software; and
- "cause of contract" as exemplified in Case C-111/05 *Aktiebolaget NN v Skatteverket*,[62] where a contract to supply and install fibre-optic cables between Sweden and Denmark was treated as single supply of cable, it being the major element of the contract price, and as the customer ultimately required ownership over the cable, it was treated as a single supply.

It should be noted that, while the cases Conlon QC has collected are illustrative and provide some guidance on apportionment, they were considered within a different legislative context. Importantly, the relevant enquiry under the UK and European rules is primarily whether there is a single supply or multiple supplies. In those jurisdictions, a single supply does not have a taxable and non-taxable part as there is no s 9-80 equivalent. Once it is determined that a transaction is to be treated as a single supply, only a single VAT liability arises. Although, the legislation has created some "carve-outs" for "a concrete and specific aspect of the supply" to attract a different VAT liability, various other legislative provisions may affect the analysis. For instance, in the case of the supply of cables referred to above, a specific legislative provision (place of supply rules) deemed installed goods to be supplied in the place where they were installed and so the transaction was required to be apportioned.

Conlon QC cites the classic example of the French undertakers' case,[63] where the Court of Justice of the European Union rejected a challenge to French domestic VAT legislation which restricted VAT exemption for the (single) supply of funeral services to the element which related to the transfer of the body. Other than by reference to specific legislative provisions, apportionment only applies where a transaction is considered to have multiple supplies.[64] United Kingdom and European VAT cases need to be considered bearing this difference in mind.

> *"… the courts have resolved the questions of identification and characterisation of supply by examining the transaction/supply from a business and commonsense perspective …"*

Finally, on the input side of the equation, the UK position is broadly similar to Australia's position. In the UK, input VAT is deductible to the extent that the cost component is used, or is to be used, for the purposes of taxed transactions. In that regard, the relevant case law refers to "a direct and immediate link" between the cost component and the purpose of the transaction.

Where a cost component is used partly for a taxable purpose and partly for a non-taxable purpose, an apportionment is required. The UK has developed complex methods of apportionment between taxable and exempt outputs. These are known as "the partial exemption rules".

Conclusion

In Australia, the courts have looked at GST through the prism of it being a "practical business tax", but not divorced from the legal context — in particular, the broad definition of "supply". Following a commercial approach, the courts have resolved the questions of identification and characterisation of supply by examining a transaction/supply from a business and commonsense perspective, paying due deference to the legal realities.

Where the supply has "separately identifiable parts" and none are integral, ancillary or incidental, an apportionment exercise will be necessary between the taxable and non-taxable parts of the supply. As with *Luxottica*, an apportionment will be necessary where there is a single supply but one or more parts are taxable, while others are non-taxable.

There is, as yet, little guidance on how such a transaction, once characterised, is to be apportioned between fully and partially taxable components. There is no reason to suspect the same tests and approach to analysis as used in characterisation of supply would not be applied for apportionment. This means that the appropriate method of apportionment will be one that is reasonable and supportable in the particular circumstances, having regard to the commercial and legal context in which the transaction occurs.

Rashelle Seiden, SC, CTA
Barrister
Ground Floor Wentworth Chambers

Nayiri Apkarian, FTI
Barrister
Nine Wentworth Chambers

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References

1 *Sterling Guardian Pty Ltd v FCT* (2005) 220 ALR 550 per Stone J at 563-564.

2 *HP Mercantile Pty Ltd v FCT* (2005) 143 FCR 553 (*HP Mercantile)* at [13].

3 *HP Mercantile* at [10]-[11].

4 Contained in ss 11-5 and 11-15 GSTA.

5 S 7-5 GSTA.

6 S 9-30(1) and Div 38 GSTA.

7 *HP Mercantile* at [16]-[17].

8 *Ronpibon Tin NL v FCT* (1949) 78 CLR 47 at [55]-[56]. In that case, the expression was considered in the context of income tax.

9 The meaning of the term "consideration" is contained in s 9-15 and includes any payment, or any act or forbearance, in connection with a supply of anything or in response to, or for the inducement of, a supply of anything.

10 *FCT v Luxottica Retail Australia Pty Ltd* (2011) 191 FCR 561 (*Luxottica*) at [16].

11 S 11-5(b).

12 S 11-5(a).

13 S 11-15.

14 *HP Mercantile Pty Ltd v FCT* at [66] in *Saga Holidays Ltd v FCT* (2006) 237 ALR 559 at [29].

15 *Sterling Guardian Pty Ltd v FCT* (2005) 220 ALR 550 (*Sterling Guardian*) at 564.

16 *FCT v Reliance Carpet Co Pty Ltd* (2008) 236 CLR 342 at [13].

17 Under s 9-10(1) GSTA, a supply is any form of supply whatsoever. Pursuant to s 9-10(2), a "supply" includes any of the following:

"(a) a supply of goods;

(b) a supply of services;

(c) a provision of advice or information;

(d) a grant, assignment or surrender of real property [defined in s 195: see note 29 below];

(e) a creation, grant, transfer, assignment or surrender of any right;

(f) a financial supply;

(g) an entry into, or release from, an obligation:

(i) to do anything; or

(ii) to refrain from an act; or

(iii) to tolerate an act or situation;

(h) any combination of any 2 or more of the matters referred to in paragraphs (a) to (g)."

18 *Sterling Guardian* at 563.

19 "Real property" is defined in s 195-1 GSTA to include:

"(a) any interest in or right over land; or

(i) a personal right to call for or be granted any interest in or right over land; or

(ii) a licence to occupy land or any other contractual right exercisable over or in relation to land."

20 Section 99-5 GSTA provides that:

"(1) A deposit held as security for the performance of an obligation is not treated as consideration for a supply, unless the deposit:

(a) is forfeited because of a failure to perform the obligation; or

(b) is applied as all or part of the consideration for a supply.

(2) This section has effect despite section 9-15 (which is about consideration)."

21 *FCT v Qantas Airways Ltd* (2012) 247 CLR 286 at [20].

22 Ibid at [11].

23 In particular, ss 9-10(1), 9-10(2)(b), (e), (g)(i) and (h) GSTA.

24 *FCT v Qantas Airways Ltd* (2012) 247 CLR 286 (*Qantas Airways*) at [23].

25 *Qantas Airways* at [33].

26 *FCT v MBI Properties Pty Ltd* (2014) 254 CLR 376 at [36]-[37].

27 *Luxottica*.

28 *Luxottica* at [13].

29 *Luxottica* at [15].

30 *Luxottica* at [13], citing the Administrative Appeals Tribunal at first instances which applied and referred to the "practical business tax" approach in *Sterling Guardian Pty Ltd v FCT* (2005) 220 ALR 550.

31 *Luxottica* at [15].

32 Michael Conlon, QC, Temple Tax Chambers, London EC4Y 9AU.

33 Para 5.5 of the paper delivered by Conlon QC at the Australian Bar Association conference held in London in July 2017.

34 *Luxottica* at [26].

35 The equation in s 9-80(2) contains two unknowns, namely, the "value of the actual supply" and "taxable proportion". It is therefore circular and not solvable. See paras 24-26 of the judgment.

36 *Luxottica* at [37].

37 (2001) 114 FCR 353 at 357.

38 *Luxottica* at [40].

39 *Saga Holidays Ltd v FCT* (2006) 237 ALR 559.

40 Broadly, where a taxpayer has relied on an ATO ruling, the Commissioner must apply the law in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages the taxpayer, in which case the law may be applied in a way that is more favourable to the taxpayer). The taxpayer will also be protected from having to pay any underpaid tax, penalties or interest in respect of matters covered by the ruling if it turns out that it does not correctly state how the relevant provision applies to the taxpayer.

41 Para 16 of GSTR 2001/8.

42 Para 17 of GSTR 2001/8.

43 Para 18A of GSTR 2001/8.

44 Para 20 of GSTR 2001/8.

45 Paras 25 and 26 of GSTR 2001/8.

46 (2007) 66 ATR 938.

47 Para 92 of GSTR 2001/8.

48 *Rio Tinto Services Ltd v FCT* (2015) 235 FCR 159 (*Rio Tinto*).

49 In this case, because of s 40-35(1)(a) GSTA.

50 Assuming that the acquisition is not private or domestic in nature.

51 *Rio Tinto* at [6].

52 *Rio Tinto* at [7].

53 An example would be general business overhead costs.

54 Para 32 of GSTR 2006/4.

55 In the context of the former s 51(1) of the *Income Tax Assessment Act 1936* (Cth).

56 The Commissioner has specifically had regard to some of these in crafting his ruling: para 45C of GSTR 2001/8.

57 [2000] BVC 60.

58 (1990) 5 BVC 97.

59 [1999] STC 270; [2001] STC 174.

60 [2005] STC 1597.

61 [2006] STC 766.

62 [2008] STC 3203.

63 Case C-04/09, *EC Commission v France* [2012] STC 573.

64 The term used in "composite supply". See para 1.6 of the paper delivered by Conlon QC at the 2017 Australian Bar Association Conference.