CONSIDERATION RECONSIDERED

1 OVERVIEW

There is now a growing body of jurisprudence on the meaning of "consideration" under the Australian GST law. Particular challenges have emerged both in characterising a transaction and in placing a value on it. This paper will examine the legislative framework within which the concept of consideration plays an integral part, including the nexus between supply and consideration, and then considers the two most important practical issues which have emerged: the allocation of consideration by the parties, and the characterisation of certain payments as third party payments.

Much attention is often directed towards the meaning of "supply" under the GST law, and deservedly so. But "consideration" is not some distant cousin. The two concepts are inextricably linked and are deserving of equal attention.

2 THE LEGISLATIVE FRAMEWORK

2.1 A tax on consumption but not a consumption tax

"Broadly speaking, the GST is a tax on private consumption in Australia" which "taxes the consumption of most goods, services and anything else in Australia, including things that are imported".[1] However, as the Full Court of the Federal Court observed in *Sterling Guardian*:

> "In economic terms it may be correct to call the GST a consumption tax, because the effective burden falls on the ultimate consumer. But as a matter of legal analysis what is taxed, that is to say what generates the tax liability (and the obligations of recording and reporting), is not a consumption tax but a particular form of transaction, namely supply . . ."[2]

The taxing of private consumption in Australia is generally achieved by:

- imposing tax on supplies made by entities registered for GST; but
- allowing those entities to offset the GST they are liable to pay on supplies they make against input tax credits for the GST that was included in the price they paid for their business inputs.[3]

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[1] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998, Executive Summary, at 6

[2] *Sterling Guardian Pty Ltd v Federal Commissioner of Taxation* (2006) 149 FCR 255 at 258, approved by the High Court in *Federal Commissioner of Taxation v Reliance Carpet Co Pty Ltd* (2008) 236 CLR 342 at 346

[3] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998, Executive Summary, at 6

In this way GST is effectively a tax on 'final' private consumption in Australia.[4] But it may be more accurate to say that GST is a tax on final private consumption *expenditure*, or its non-monetary equivalent, since it will be apparent that without consideration there will be no tax.

The general scheme of the Australian GST has been described by Hill J in *ACP Publishing Pty Ltd v Commissioner of Taxation*:

> The GST is, in essence, the tax known in most countries as value added tax, a name which, perhaps, best describes the essence of the tax. The characteristics of a value added tax were aptly described by the European Court of Justice in *Dansk Denkavit ApS v Skatteministeriet* [1994] 2 CMLR 377 at 394-5 as being that it 'applies generally to transactions relating to goods or services; it is proportional to the price of those goods or services; it is charged at each stage of the production and distribution process; and finally it is imposed on the added value of goods and services, since the tax payable on a transaction is calculated after deducting the tax paid on the previous transaction.
>
> These characteristics are displayed in the Australian legislation by the tax ('output tax') being levied, in effect, upon substantially all supplies (referred to in the GST Act as 'taxable supplies') being generally, although not exclusively, supplies of goods or services made by a registered person, or person required to be registered, for consideration . . . and the deduction referred to in *Dansk* (popularly known as an 'input tax credit') being given to a registered person, or person required to be registered, who makes a creditable acquisition, as that expression is defined.[5]

In *HP Mercantile Pty Limited v Commissioner of Taxation*[6], his Honour (with whom Stone J and Allsop J agreed) elaborated as follows:

> The genius of a system of value added taxation, of which the GST is an example, is that while tax is generally payable at each stage of commercial dealings ('supplies') with goods, services or other 'things', there is allowed to an entity which acquires those goods, services or other things as a result of a taxable supply made to it, a credit for the tax borne by that entity by reference to the output tax payable as a result of the taxable supply. That credit, known as an input tax credit, will be available, generally speaking, so long as the acquirer and the supply to it (assuming it was a 'taxable supply') satisfied certain conditions, the most important of which, for present purposes, is that the acquirer make the acquisition in the course of carrying on an enterprise and thus, not as a consumer. The system of input tax credits thus ensures that while GST is a multi-stage tax, there will ordinarily be no cascading of tax. It ensures also that the tax will be payable, by each supplier in a chain, only upon the value added by that supplier.[7]

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[4] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998, Executive Summary, at 6

[5] [2005] FCAFC 57 at [2]-[3]

[6] [2005] FCAFC 126

[7] [2005] FCAFC 126 at [13]

In this legislative framework, consideration serves two broad purposes. First, when furnished by a private consumer (or entity unable to claim an input tax credit) it is the measure of consumption. Second, when furnished by an intermediate trader entitled to claim an input tax credit, it is a measure of that trader's credit entitlement and, when offset against GST payable, forms part of the measure of the value added by the intermediate trader.

2.2 The legislative provisions

Within the basic rules in Chapter 2 of the GST Act, are the central provisions in Part 2-1. "GST is payable on taxable supplies and taxable importations",[8] while "entitlements to input tax credits arise on creditable acquisitions and creditable importations."[9] "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 may be altered to take account of adjustments)."[10]

Part 2-2 of the GST Act is also within the basic rules and is headed "Supplies and acquisitions". This Part contains only Division 9, entitled "Taxable supplies", and Division 11, entitled "Creditable acquisitions".[11] Relevantly, you make a "taxable supply" if "you make the supply for consideration".[12]

A supply in turn "is any form of supply whatsoever."[13] The Explanatory Memorandum states that this definition "is defined broadly and is intended to encompass supplies as widely as possible."[14] The ordinary meaning of the term "supply" is then expanded by the statute to include, among other things, rights, obligations, information and financial supplies.[15]

A supply "does not include a supply of money unless the money is provided as consideration for a supply that is a supply of money."[16] This provision is designed to ensure that the payment of money as consideration for goods, services, rights or other things, is not itself a supply or acquisition unless, for example, it forms part of a foreign exchange transaction.[17]

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[8] GST Act, s 7-1(1)

[9] GST Act, s 7-1(2)

[10] GST Act, s 7-5

[11] The headings to Parts and Divisions form part of the Act: GST Act, s 182-1(1)

[12] GST Act, s 9-5(a)

[13] GST Act, s 9-10(1)

[14] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998, paragraph 3.6

[15] GST Act, s9-10(2)

[16] GST Act, s 9-10(4)

[17] See, for example, *Travelex Ltd v Federal Commissioner of Taxation* (2010) 241 CLR 510

The expression "consideration" is defined expansively in section 9-15 to include:

(a) any payment, or any act or forbearance, in connection with a supply of anything; and

(b) any payment, or any act or forbearance, in response to or for the inducement of a supply of anything.[18]

It does not matter whether the payment, act or forbearance was voluntary, or whether it was by the recipient of the supply.[19] Nor does it matter whether the payment, act or forbearance was in compliance with a court or tribunal order, or in compliance with a settlement relating to proceedings before a court or tribunal.[20]

The recently enacted section 9-17, applicable from 1 July 2012, provides four specific exclusions to the definition of "consideration".[21] First, if a right or option to acquire a thing is granted, then the consideration for the supply of the thing on the exercise of the right or option is limited to any additional consideration provided. If there is no additional consideration, then there is no consideration for the supply.[22] Second, making a gift to a non-profit body is not the provision of consideration.[23] Third, a payment made by a government related entity to another government related entity is not the provision of consideration if the payment is covered by an appropriation under an Australian law (or is made under a specified intergovernmental health agreement), and satisfies the "non-commercial" test.[24] Fourth, a payment is not consideration if the payment is made by a government related entity to another government related entity and the payment is of a kind specified in the regulations.[25]

The relevant entity must pay the GST payable on any taxable supply that it makes.[26] The amount of GST on a taxable supply is 10% of the "value" of the taxable supply,[27] where the value of the taxable supply equals 10/11ths of the "price".[28] "Price" in turn is the sum of (a) so far as the consideration for the supply is consideration expressed as an amount of money – the amount (without any discount for the amount of GST (if any) payable on the supply); and (b) so far as the consideration is not consideration

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[18] GST Act, s9-15(1)

[19] GST Act, s9-15(2)

[20] GST Act, s9-15(2A)

[21] See GST Act, s9-15(3) (now repealed) for tax periods before 1 July 2012

[22] GST Act, s9-17(1)

[23] GST Act, s9-17(2)

[24] GST Act, s9-17(3); see also *TT-Line Company Pty Ltd v Commissioner of Taxation* [2009] FCAFC 178 (decided under the former s9-15(3)(c))

[25] GST Act, s9-17(4)

[26] GST Act, s 9-40

[27] GST Act, s 9-70

[28] GST Act, s 9-75(1)

expressed as an amount of money – the GST inclusive market value of that consideration.[29]

Turning then to inputs, or acquisitions, Division 11 of Part 2-2 of the GST Act is headed "Creditable acquisitions". You make a creditable acquisition if, relevantly, "you provide, or are liable to provide, consideration for the supply".[30]

An entity is entitled to an input tax credit for any creditable acquisition that it makes.[31] An acquisition is "any form of acquisition whatsoever."[32] As with "supply", the Explanatory Memorandum to the GST Act states that this definition "is defined broadly and is intended to encompass acquisitions as widely as possible."[33]

The amount of the input tax credit for a creditable acquisition is an amount equal to the GST payable on the supply of the thing acquired. However, the amount of the input tax credit is reduced if the acquisition is only partly creditable,[34] such as where you make the acquisition only partly for a creditable purpose, or you provide, or are liable to provide, only part of the consideration for the acquisition.[35]

3 THE NEXUS BETWEEN SUPPLY AND CONSIDERATION

3.1 Supply "for" consideration – the technical view

It is necessary to identify both "supply" and "consideration", and then identify a relevant connection between them. But how strong must that connection be? And what does the expression "for" tell us?

These issues were recently canvassed in a stamp duty context before Pagone J in the *Lend Lease Development* case.[36] The primary task was to identify "the consideration (if any) for the dutiable transaction".[37] His Honour stated:

> The fundamental enquiry in each case was what had been received as consideration "for" the dutiable transaction. That inquiry required an evaluation of the nexus between the consideration and the transfer. It will not be sufficient that there be some connection between consideration and transfer to conclude that one

[29] GST Act, s 9-75(1)

[30] GST Act, s 11-5(c)

[31] GST Act, s 11-20

[32] GST Act, s 11-10(1)

[33] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998, paragraph 3.21

[34] GST Act, s 11-25

[35] GST Act, s 11-30(1)

[36] *Lend Lease Development Pty Ltd v Commissioner of State Revenue* [2012] VSC 108

[37] *Duties Act 2000* (Vic), section 20(1)(a)

> is "for" the other. The legislative policy evident in s20(1) is to require a particular connection between transfer and consideration for duty to be imposed. It has not adopted as the required connection that the consideration be "in respect of", "in connection with" or "in relation to" the transfer which may be thought to require something less than when the connection required by providing that the consideration must be "for" the transfer. Even when the connection required may be that something be "in respect of" (or like expression) something else, the nexus between the two would need to be material and based upon rational and discernible links.[38]

Absent other considerations, the expression "for" will require a stronger connection than, say, the expression "in respect of". Neverthless, the context within which the expression "for" is used in section 9-5(a) of the GST Act may tell us a different story.

The expression "consideration" in section 9-15(1) includes any payment, act or forbearance "in connection with", "in response to" or "for the inducement of" a supply of anything. It would seem incongruous that the strength of the nexus in section 9-5(a) should be different to that in section 9-15(1). The better view would be that the expression "for" in section 9-5(a), in the context in which it appears, should be read as importing those connecting expressions appearing in section 9-15(1). As Pagone J observed above, this still requires the nexus "to be material and based upon rational and discernible links". In *Travelex*, French CJ and Hayne J stated:

> It may readily be accepted that "in relation to" is a phrase that can be used in a variety of contexts, in which the degree of connection that must be shown between the two subject matters joined by the expression may differ. . . It may also be accepted that "the subject matter of the enquiry, the legislative history, and the facts of the case" are all matters that will bear upon the judgment of what relationship must be shown in order to conclude that there is a supply "in relation to" rights.[39]

As an aside, the phrase "in connection with" may well be responsible for the "practical business test" which has permeated the GST jurisprudence. The test derives from the judgment of Kitto J in *Berry's* case,[40] which concerned a provision which included in a taxpayer's assessable income a "premium" defined to be "any consideration in the nature of a premium, fine or foregift payable to any person for or in connection with the grant or assignment by him of a lease . . ." His Honour considered that the words "in connection with" in that provision were satisfied if there was a "substantial relation, in a practical business sense" between the payment on the one hand, and the grant or assignment of the lease, on the other hand.[41]

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[38] *Lend Lease Development Pty Ltd v Commissioner of State Revenue* [2012] VSC 108 at [12] (footnotes omitted)

[39] *Travelex v Commissioner of Taxation* [2010] HCA 33 at [25] per French CJ and Hayne J, citing *HP Mercantile Pty Ltd v Commissioner of Taxation* [2005] FCAFC 126; (2005) 143 FCR 553 at [35] per Hill J

[40] *Berry v Federal Commissioner of Taxation* (1953) 89 CLR 653; [1953] HCA 70

[41] *Berry v Federal Commissioner of Taxation* (1953) 89 CLR 653 at 659; [1953] HCA 70, referred to in *TT-Line Company Pty Ltd v Commissioner of Taxation* [2009] FCAFC 178 at [43] per Edmonds J

3.2 Supply "for" consideration – the practical view

The definition of "supply" is so wide that there is a veritable universe of supplies. In a practical sense it is often necessary to look first to consideration to narrow down the universe. That is, once you have identified the consideration you begin to identify which supply it might be attached to. This was alluded to in argument before the Full Court of the Federal Court in *Qantas*:

> PERRAM J: In the Act, consideration is always logically linked to supply. So once you've identified the consideration, which is for something, once you've identified that in the facts, that must necessarily link to a supply, possibly more than one supply . . . So there's always a unity between consideration on the one hand and supplies on the other. And it may be that you can get to the same place, starting in two different locations. You may be able to work out the consideration by identifying the supplies or you may be able to work out the supplies by identifying the consideration. It may be wrapped up in that way.[42]

And later:

> PERRAM J: . . . there could be dozens of supplies in any particular transaction. Of that pool of supplies, only a few may be called to section 9-10 and turn out to be taxable supplies.[43]

Earlier, in *Reliance Carpets*, the High Court appeared to approach the task in much the same way. First, by noting that there were many supplies but only one taxable supply:

> The composite expression "a taxable supply" is of critical importance for the creation of a liability to GST. In the facts and circumstances of a given case there may be disclosed consecutive acts each of which answers the statutory description of "supply", but upon examination it may appear that there is no more than one "taxable supply".[44]

And second, by focusing on consideration as a starting point for analysis:

> Had the taxpayer made a taxable supply, ie a "supply for consideration"?
>
> First, as to the consideration. The payment of the deposit by the purchaser to the taxpayer was "in connection with" a supply by the taxpayer, within the meaning of the definition of "consideration" in s9-15(1)(a) of the Act. That connection is readily seen from the circumstance that, with the receipt of the written notice of the exercise of the option by the purchaser . . . the payment of the deposit obliged the

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[42] *Qantas Airways Ltd v Commissioner of Taxation*, Full Court Transcript, page 60.

[43] *Qantas Airways Ltd v Commissioner of Taxation*, Full Court Transcript, page 61

[44] *Commissioner of Taxation v Reliance Carpet Co Pty Ltd* (2008) 236 CLR 342 at 346; [2008] HCA 22, per Gleeson CJ, Gummow, Heydon, Crennan and Kiefel JJ

> parties to enter into the mutual legal relations with the executory obligations and rights laid out in the Contract.[45]

Nevertheless, even if approached in this way, the proposition that in every case there is consideration there is a supply is erroneous.[46] The decision of *Qantas* in the Full Court of the Federal Court may well illustrate this. In considering a pre-payment for a flight which was not taken, the Court found it relevant to ask what the purpose of the payment was for:

> Here, the transaction does not even comprise numerous aspects. It merely comprises the provision of domestic air travel by Qantas. That is the substance and reality of the transaction, and, as the Tribunal correctly found, that is what (the purpose) the passenger pays his or her fare for.[47]

3.3 Whose perspective - supplier or recipient?

According to the Full Court of the Federal Court, the terms of section 9-5 show that whether or not there is a taxable supply for the purposes of the provision is to be determined from the perspective of the entity making the supply.[48] One wonders, with respect, why should that be so? One might equally say that whether or not there is a taxable supply for the purposes of the provision is to be determined from the perspective of the entity furnishing the consideration. As discussed above, it is relevant to ask what a payment is made for.

In circumstances where you have two parties to a transaction, a supplier and a recipient, it is not clear to me why the purpose of either one of them should govern whether or not there is a taxable supply. The enquiry must surely be an objective one having regard to the perspectives of both supplier and recipient, and all other relevant circumstances.

4 CONSIDERATION ALLOCATED BY THE PARTIES

4.1 The Act takes transactions as it finds them

In *Magna Alloys & Research Pty Ltd v FC of T*[49], Deane and Fisher JJ stated, in the context of the general deduction provision in section 51(1) of the *Income Tax Assessment Act* 1936:

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[45] *Commissioner of Taxation v Reliance Carpet Co Pty Ltd* (2008) 236 CLR 342 at 353-354; [2008] HCA 22, per Gleeson CJ, Gummow, Heydon, Crennan and Kiefel JJ

[46] *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84 at [68] per Kenny and Dodds-Streeton JJ

[47] *Qantas Airways Ltd v Commissioner of Taxation* [2011] FCAFC 113 at [57] per Edmonds and Perram JJ (Stone J agreeing)

[48] *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84 at [59] per Kenny and Dodds-Streeton JJ

[49] (1980) 80 ATC 4542

> It is no part of the function of the Act or of those who administer it to dictate to taxpayers in what business they shall engage or how to run their business profitably or economically. 'The Act must operate upon the result of a taxpayer's activities as it finds them'(per Williams J. in *Tweddle v FC of T* (1942) 7 ATD 186 at 190; see also *Ronpibon Tin NL and Tongkah Compound NL v FC of T* 78 CLR at 56-7; *Cecil Bros Pty Ltd v FC of T* (1962-1964) 111 CLR 430 at 434, 441; *Commissioner of Inland Revenue v Europa Oil (NZ) Ltd* (No 1) [1971] AC 760 at 772; *FC of T v South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645 at 653-4).[50]

The principle that the Act takes transactions as it finds them had been accepted in sales tax,[51] and echoes of that principle can be found in the decision of the Full Court of the Federal Court in *Luxottica*, discussed below.[52] The principle is also accepted by the Commissioner.[53]

4.2 It is a matter for the parties to the contract

The Administrative Appeals Tribunal in *Luxottica* observed that the case law establishes that as a general rule, and absent tax avoidance or sham, the courts will generally accept the price contractually agreed between the parties to be determinative of the value for taxation purposes.[54]

The facts in *Luxottica* were not in dispute. Luxottica ran various promotions. Under these promotions, spectacle frames were offered at a discount from the normal selling price, but on condition that the customers acquired not only the frames but also lenses for those frames. There was no discount offered for the lenses. The discount offered for the frames was sometimes a percentage of up to 50% off the normal selling price of the frames and sometimes a specific monetary amount.

It was found that a supply of spectacles is a single supply comprising two components, being the frame and a pair of lenses. What was in issue between the parties was the apportionment of the discount in circumstances in which the supply of the frames was taxable while the supply of the lenses was GST-free.

While the facts were not in dispute, the following further findings of the Tribunal are of significance: (a) there were sound commercial reasons for the discounting of frames; (b)

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[50] (1980) 80 ATC 4542 at 4557

[51] *Re Estee Lauder Pty Ltd and Commissioner of Taxation* [1988] FCA 167 at [26] per Burchett J

[52] 'How a promotion is structured is a matter for the commercial judgment of the seller': *Commissioner of Taxation v Luxottica Retail Australia Pty Ltd* [2011] FCAFC 20 at [39] per Ryan, Stone and Jagot JJ

[53] GSTR 2006/9, Goods and services tax: supplies, paragraph 112 and proposition 10: "it is necessary to analyse the transaction that occurs, not a transaction that might have occurred"

[54] *Luxottica Retail Australia Pty Ltd v Commissioner of Taxation* [2010] AATA 22 at [30] per Block, Deputy President, and Frost, Senior Member, citing *Lex Services plc v Commissioners of Customs and Excise* [2003] UKHL 67; [2004] STC 73 at [18]

there was no commercial imperative for the discounting of lenses; and (c) there was nothing contrived or artificial about the pricing methodology adopted in the promotional arrangements.[55]

The Full Court found that the Tribunal had made a considered decision as to the value of the taxable supply based on findings of fact that it was entitled to make. Any error made by the Tribunal in determining the value would be an error of fact, and as such would not give rise to a question of law enlivening the jurisdiction of the Court.[56]

5 THIRD PARTY CONSIDERATION

The Act tells us that it does not matter whether the payment, act or forbearance was by the recipient of the supply.[57] Thus, consideration for a supply can include third party consideration. The problems caused by multiple parties in any given transaction are well known: "It is I think no coincidence that many of the cases which have caused difficulty in the VAT field, causing resolution by the higher courts, have concerned situations involving three parties."[58]

Multiple party transactions do not take some generic form. That is why two leading House of Lords authorities involving three parties are only superficially alike. In *Redrow*,[59] there were three separate bilateral contracts between the three parties, but only one of them was liable to pay the consideration and accordingly there was only one taxable supply. In *Plantiflor*,[60] by contrast, the three parties entered into two separate but related bilateral contracts. Neither involved third party consideration. Each transaction must therefore be analysed by reference to the bilateral arrangements which exist within it.

The English cases take us only so far. In *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)*,[61] discussed further below, the Commissioner in his written submissions argued that the primary judge was misled by *Redrow*. The Full Court of the Federal Court rejected this submission:

> Plainly enough, the issue under consideration in *Redrow* arose in different circumstances from the present and was decided under different (though not dissimilar) taxation legislation. The primary judge quite properly referred to the approach in *Redrow*, but made it very clear that she was not treating it as

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[55] *Luxottica Retail Australia Pty Ltd v Commissioner of Taxation* [2010] AATA 22 at [40] per Block, Deputy President, and Frost, Senior Member

[56] *Commissioner of Taxation v Luxottica Retail Australia Pty Ltd* [2011] FCAFC 20 at [42] per Ryan, Stone and Jagot JJ

[57] GST Act, s9-15(2)

[58] *Customs and Excise Commissioners v Reed Personnel Services Ltd* [1995] STC 588 at 595 per Laws J

[59] *Customs and Excise Comrs v Redrow Group plc* [1999] 1 WLR 408

[60] *Commissioners of Customs and Excise v Plantiflor Ltd* [2002] UKHL 33

[61] *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84

> necessarily governing the case before her. As her Honour herself acknowledged (at [41]), "[u]ltimately, we are driven back to the words of the GST Act". Her Honour reasoned to a conclusion by reference to the provisions of the GST Act, as she was required to do.[62]

But the words of the Act don't always lend themselves to easy answers.

5.1 A tale of two subsidies

An illustration of the difficulties referred to above can be found in two leading Australian cases involving payment of government subsidies for transport services.

TT-Line

In *TT-Line Company Pty Ltd v Commissioner of Taxation*,[63] a rebate was paid by the Commonwealth to a ferry passenger in connection with a supply of transport services by a ferry operator (TT-Line) to the passenger (Mr Egan), but paid by way of reimbursement by the Commonwealth to the ferry operator. The question was whether the amount received by the ferry operator from the Commonwealth was consideration within the meaning of s 9-15(1) of the GST Act for the supply of those transport services. The Full Court of the Federal Court held that it was consideration. Edmonds J, with whom Perram J agreed, stated:

> The payment by the Commonwealth to the appellant in respect of the appellant's supply of the transport services to Mr Egan needs to be understood for what it is: reimbursement of the rebate the appellant provided Mr Egan at the time he purchased his ticket. The consideration for the supply of the transport services to Mr Egan included not only what he paid, but the amount of the rebate he was granted by the appellant, which rebate was paid by the Commonwealth to the appellant by way of reimbursement.[64]

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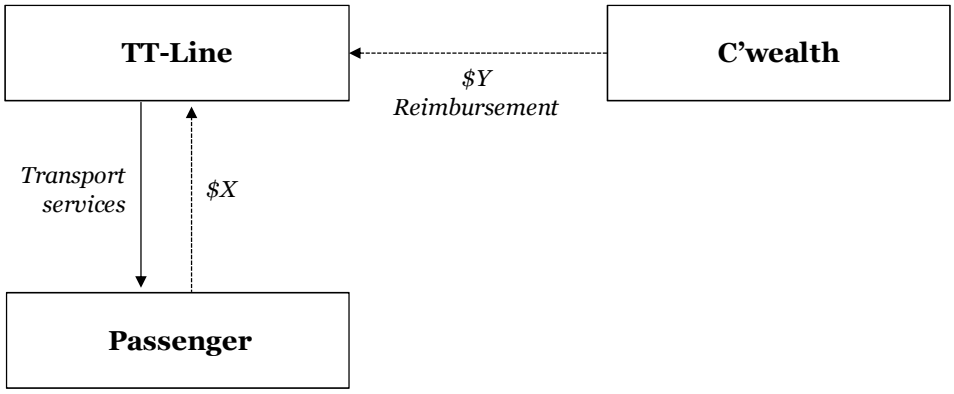
[62] *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84 at [62] per Kenny and Dodds-Streeton JJ

[63] *TT-Line Company Pty Ltd v Commissioner of Taxation* [2009] FCAFC 178

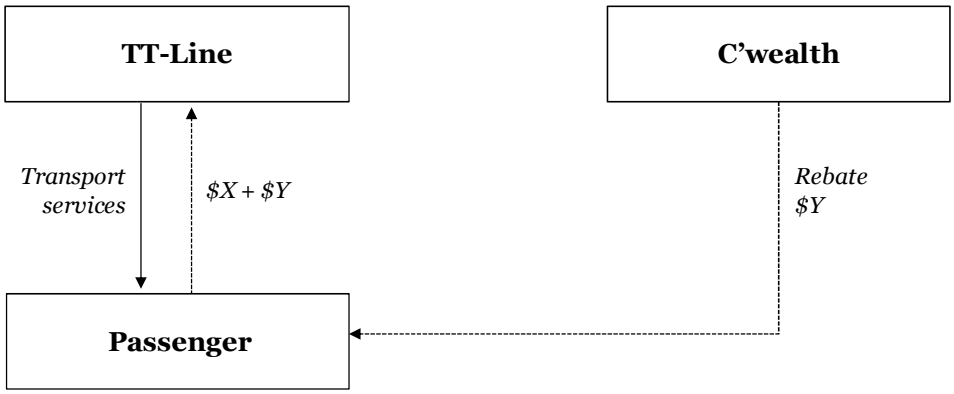
[64] *TT-Line Company Pty Ltd v Commissioner of Taxation* [2009] FCAFC 178 at [50]; see also Emmett J at [18]

This can be illustrated diagrammatically as follows:

TT-Line – 'Actual' Flow



TT-Line – 'GST' Flow



Although often thought of as a "third party" consideration case, *TT-Line* actually involved a Commonwealth subsidy provided direct to Mr Egan, but paid by way of reimbursement to TT-Line. That is, the consideration furnished by Mr Egan was furnished wholly by Mr Egan and not by a third party.

Department of Transport

In *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)*,[65] the Victorian Department of Transport (DOT) subsidised travel for a disabled passenger. The Commissioner's case was that the DOT was not entitled to input tax credits in respect of payments made by the DOT to taxi-cab operators because there were no

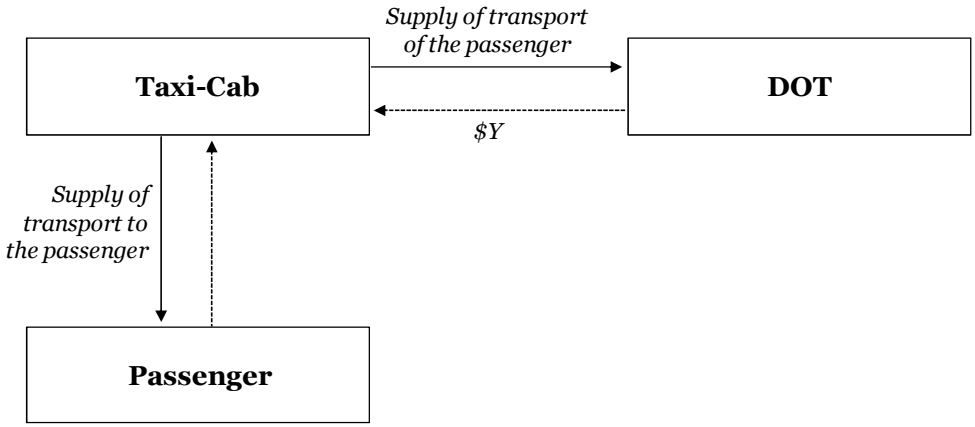
[65] *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84

taxable supplies to the DOT. That is, the only taxable supply was the supply of transport by the taxi-cab operator to the passenger.

The Full Court of the Federal Court accepted that each payment made by the DOT was a subsidy for taxi-cab travel for a passenger. The DOT assumed an obligation to fund in part the use of taxi-cabs by persons unable to take ordinary public transport. But this did not mean that there was only one supply: "On the contrary, there were two supplies: the supply of transport to the [passenger] **and** the supply to the DOT of the transport of the [passenger]."[66]

As to consideration, the Full Court held that the payments by DOT were within s 9-15(1) because "the DOT agreed to pay . . . the taxi-cab operator for, or, as s 9-15(1) has it, "in connection with" the supply to the DOT of the transport of the [passenger]. It follows from this that the [p]ayments are properly characterised as "consideration" within the meaning of s 9-15(1). Section 11-5(c) was therefore satisfied. It was immaterial that the [p]ayments represented only part of the fare payable. . ."[67] The arrangement is illustrated diagrammatically as follows:

DOT – 'Actual' and 'GST' Flow



No issue of third party consideration arose here as the taxi-cab operator had remitted GST on the entirety of the fare. It might have been a very different case if the taxi-cab operator had only accounted for GST on that part of the fare paid over by the passenger. Had this been a third party consideration case, the strong dissent from Jessup J might have achieved more prominence:

> It seems that the position for which the Department contends starts from the silent proposition that, having undertaken an obligation to make a payment, it most likely paid for something. When you search for what that thing was, you find that the only

[66] *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84 at [56] per Kenny and Dodds-Streeton JJ

[67] *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84 at [67] per Kenny and Dodds-Streeton JJ

> service that was supplied to anyone was the transportation of a [passenger]. You conclude, therefore, that the Department paid, or at least made a part payment, for that service. However, where the payer is a government giving effect to social welfare policy, there is no reason to commence with the likelihood that it need receive something in return. Transfer payments by governments are a commonplace. I do not consider it at all unnatural that a government department would make such a payment – even bind itself to do so in defined circumstances – without acquiring anything in return. I am of the view that that is what occurred when the Department paid half the taxi fare of a [passenger].[68]

So the tale of two subsidies is really that; a tale of two very different arrangements, highlighting the fact that such arrangements do not take any generic form. In this respect, expressions such as "subsidy" and "rebate" often disguise, rather than reveal, the true nature of the arrangements.

5.2 Sales incentives

Sales incentives are integral to everyday commerce and take many forms. We will first consider the loyalty programs considered by the European Court of Justice in *Loyalty Management* and *Baxi.*[69] As discussed above, care must be taken in having recourse to overseas authorities and it is always necessary to return to the words of the Act. Nevertheless, it is noteworthy that article 11A(1)(a) of the Sixth Directive of the European Community, like section 9-15(2) of the GST Act, expressly provides that consideration may be obtained from a third party.

We will then consider the incentive payments made by manufacturers and distributors to motor vehicle dealers recently considered by the Administrative Appeals Tribunal in *A P Group Ltd*.[70] There is a striking similarity between the approach taken by the Tribunal and that taken by the European Court of Justice, though the Tribunal makes no reference to it.

Loyalty Management and Baxi

Loyalty schemes, and the GST consequences arising from them, are increasingly complex, much of which is beyond the scope of this paper. Typically, however, they involve a customer who parts with money to buy goods or services (known as "premium" goods or services). Points are then awarded in respect of the value of the purchase. After a certain number of points have been accumulated, the customer can redeem those points for, typically, "reward" goods or services. What happens between these events varies dramatically and may involve the interposition of several parties which adds layers of complexity to the arrangements.

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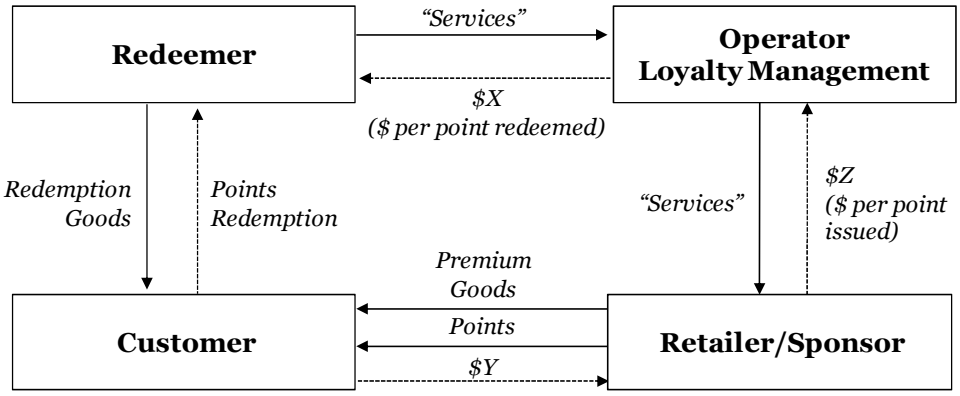
[68] *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84 at [82]

[69] *HMRC v Loyalty Management UK Ltd* [2010] C-53/09; *HMRC v Baxi Group Ltd* [2010] C-55/09

[70] *A P Group Limited v Commissioner of Taxation* [2012] AATA 409

In *Loyalty Management*, customers purchased premium goods from a retailer and were awarded with loyalty points in respect of the purchase. The retailer entered into an agreement with a loyalty scheme operator, Loyalty Management, pursuant to which the retailer paid money calculated by reference to the number of points issued. Loyalty Management in turn entered into an arrangement with a "redeemer", who provided the redemption (or reward) goods to the customer who redeemed points. Loyalty management paid money to the redeemer calculated by reference to the number of points redeemed. It was this payment that was the subject of the litigation. The arrangement is shown diagrammatically below.

Loyalty Management – 'Actual' Flow



The Commissioners were of the view that the money paid by Loyalty Management to the redeemer was third party consideration for the supply of redemption or reward goods by the redeemer to the customers. The practical consequence of this view was that Loyalty Management would not be entitled to an input tax credit in respect of the payment made by it. The High Court had agreed with this view, but the VAT and Duties Tribunal and Court of Appeal had found for the taxpayer. The House of Lords concluded that a ruling from the European Court of Justice was required to enable it to give judgment in the proceedings before it. That Court observed:

> . . . under the contract entered into by [Loyalty Management] with each redeemer, the possibility of the redeemers receiving any payment from [Loyalty Management] *is in fact conditional* on the supply by the redeemers of loyalty rewards to the customers, rewards which can take the form not only of tangible goods but also of services. Only in this way can the redeemers obtain points which then give rise to the making of payment by [Loyalty Management].[71] (emphasis added)

The European Court of Justice thus found for the Commissioners:

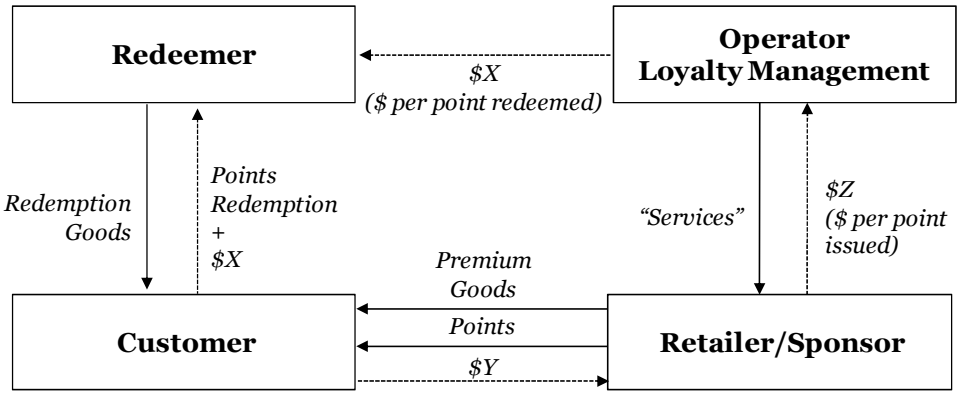
> . . . the exchange of points by the customers with the redeemers gives rise to the making of a payment by [Loyalty Management] to those redeemers. The amount of

[71] *HMRC v Loyalty Management UK Ltd* [2010] C-53/09; *HMRC v Baxi Group Ltd* [2010] C-55/09 at [47]

> that payment is the sum total of the charges, which are of a fixed amount for each point redeemed against all or part of the price of the loyalty reward. In that context, it must be considered that, as maintained by the United Kingdom Government, that payment corresponds to the consideration for the supply of the loyalty rewards.[72]

The finding that the payment received by the redeemers from Loyalty Management was conditional on the supply by the redeemers of loyalty rewards was important to the overall characterisation of that payment as third party consideration for the loyalty rewards. The true character of the arrangement can therefore be illustrated as follows:

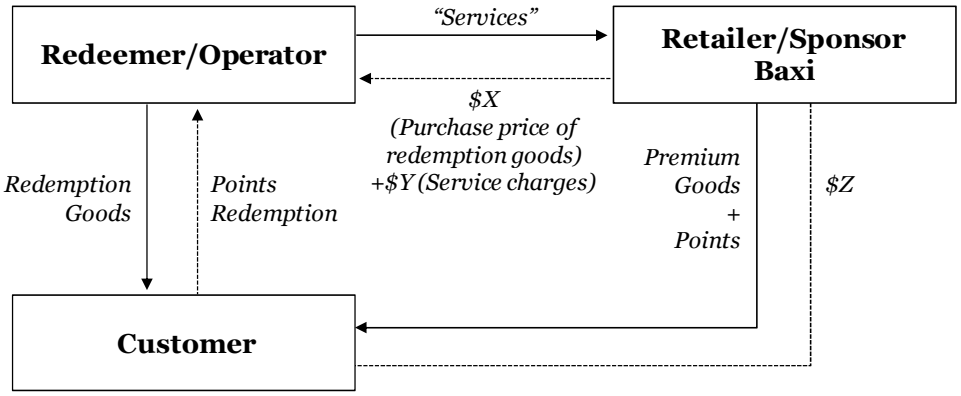
Loyalty Management – 'VAT' Flow



In *Baxi*, customers purchased premium goods from a retailer, Baxi, and were awarded with loyalty points in respect of the purchase. Baxi entered into an agreement with a loyalty scheme operator, who was also a redeemer, pursuant to which Baxi paid money calculated by reference to the retail selling price of the reward goods supplied to customers, together with service charges. It was this payment calculated by reference to the price of the reward goods that was the subject of the litigation. In particular, was Baxi entitled to an input tax credit in respect of the payment it made to the redeemer? The arrangement is shown diagrammatically below.

[72] *HMRC v Loyalty Management UK Ltd* [2010] C-53/09; *HMRC v Baxi Group Ltd* [2010] C-55/09 at [57]

Baxi – 'Actual' Flow



The High Court and Court of Appeal each held that Baxi was entitled to input tax credits on what might be described as *Redrow* reasoning, that is, the service supplied to Baxi included the service of supplying reward goods to customers. The VAT and Duties Tribunal also held that Baxi was entitled to input tax credits but also found that Baxi was liable to output tax in respect of the supply of reward goods to customers. As with *Loyalty Management*, the House of Lords concluded that a ruling by the European Court of Justice was required to enable it to give judgment in the proceedings before it. The Court observed:

> It is evident . . . that *the payments made by Baxi* to [the redeemer] *correspond to the retail sale price of the loyalty rewards* with the addition of the costs of packaging and delivery and, that, accordingly, [the redeemer] obtains a profit margin consisting of the difference between the retail sale price of the loyalty rewards and the purchase price at which [the redeemer] acquired those rewards.[73] (emphasis added)

The European Court of Justice therefore found for the Commissioners:

> Consequently, the purchase price constitutes the consideration for the supply of loyalty rewards to the customers, whereas the difference between the retail sale price, paid by Baxi, and the purchase price paid by [the redeemer] in order to acquire the loyalty rewards, namely the profit margin, constitutes the consideration for the services which [the redeemer] supplies to Baxi.[74]

While it could not be said there was a finding that the payment received by the redeemer from Baxi was conditional on the supply by the redeemer of loyalty rewards (given that Baxi was both redeemer and scheme operator), it was important that there was an obvious correspondence between the payment and the rewards such as to found the

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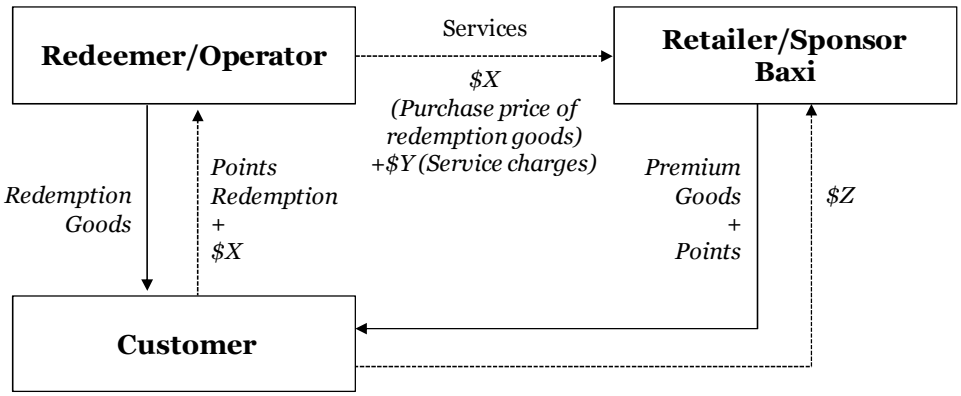
[73] *HMRC v Loyalty Management UK Ltd* [2010] C-53/09; *HMRC v Baxi Group Ltd* [2010] C-55/09 at [61]

[74] *HMRC v Loyalty Management UK Ltd* [2010] C-53/09; *HMRC v Baxi Group Ltd* [2010] C-55/09 at [63]

conclusion that the payment was in substance third party consideration for the reward goods. This conclusion can be illustrated as follows:

Baxi – 'VAT' Flow



A P Group Ltd

Since the commencement of GST, sales incentive payments have generally been considered to fall into one of two categories. The first category covers those payments which reduce price, such as volume rebates. These have been regarded as giving rise to adjustment events.[75] The second category covers payments which are directed to some other end, such as marketing or co-operative advertising. These have been regarded as consideration for a separate supply.[76]

It is fair to say that one might struggle to think of an example where a sales incentive payment between two registered parties has been treated as third party consideration for a supply between one of those parties and a consumer. But that was the result in *A P Group Limited*.[77]

I shall not deal here with all the payments before the Tribunal, but will focus on fleet rebates and run-out model support payments made by manufacturers and distributors to motor vehicle dealers.

The Commissioner contended that the payments were consideration for supplies made by the A P Group Limited (the representative member of a GST group engaged in motor

[75] In a sales tax context see, for example, *Queensland Independent Wholesalers Limited v Commissioner of Taxation* (1991) 29 FCR 312 (Full Federal Court); see also GSTR 2000/19, Goods and services tax: making adjustments under Division 19 for adjustment events, paragraph 24

[76] In a sales tax context see, for example, *Colgate-Palmolive Pty Ltd v Commissioner of Taxation* [1999] FCA 248 (Full Federal Court); see also GSTR 2000/19, Goods and services tax: making adjustments under Division 19 for adjustment events, paragraphs 35-37

[77] *A P Group Limited v Commissioner of Taxation* [2012] AATA 409

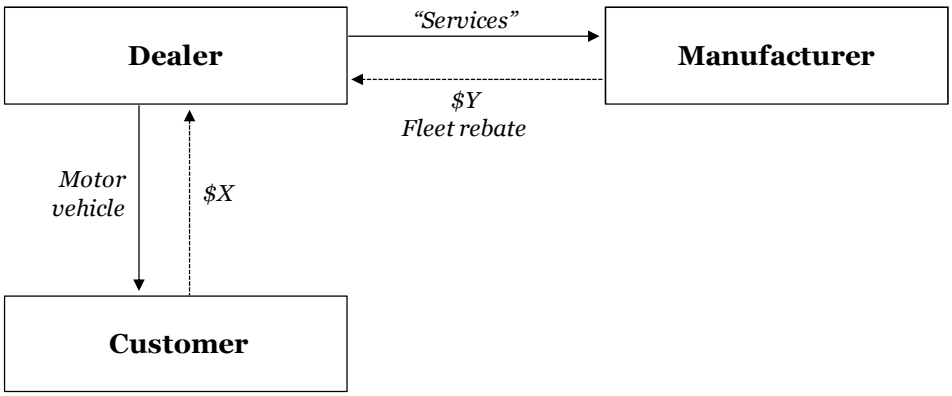
vehicle dealerships). He put his case on two alternative bases. Firstly, that the payments were properly characterised as consideration for supplies made by the dealer to the manufacturer. This argument was rejected. Secondly, that the payments were characterised as consideration for the retail sales of the vehicles by the dealer to the end customer. The Applicant contended that the true character of the payments was that of third party discounts to the underlying vehicles purchased.

The Tribunal, comprising Deputy Presidents Frost and Deutsch, observed that "the question for us is not "is the payment a discount?" but rather "is the payment consideration?" An answer to the first question, one way or the other, provides no clue to the way the second question might be answered."[78] Nor did it matter that the customer was unaware of the amount of the payment.[79] The Tribunal concluded that the fleet rebate was third party consideration:

> . . . the fleet rebate paid by [the manufacturer] has a direct and immediate connection with the supply of a vehicle to a fleet customer. That is because *the supply of the vehicle is the very act that triggers the payment of the rebate*. Put simply, the consideration that the Applicant received for the supply of a vehicle to a fleet customer comprised two components – the first component is the amount paid by the customer, and the second component is the amount received from [the manufacturer] as the "fleet rebate". Both components were paid for that supply, and together they form the consideration for the supply. In that respect, the fleet rebate arrangement is no different from Edmonds J's description of the arrangement in the *TT-Line* case . . . One need simply substitute "manufacturer" for "Commonwealth", "vehicle" for "transport services" and "customer" for "Mr Egan" to see that this is so. GST is accordingly payable on the fleet rebate.[80] (emphasis added)

This is represented diagrammatically as follows:

A P Group – 'Actual' Flow

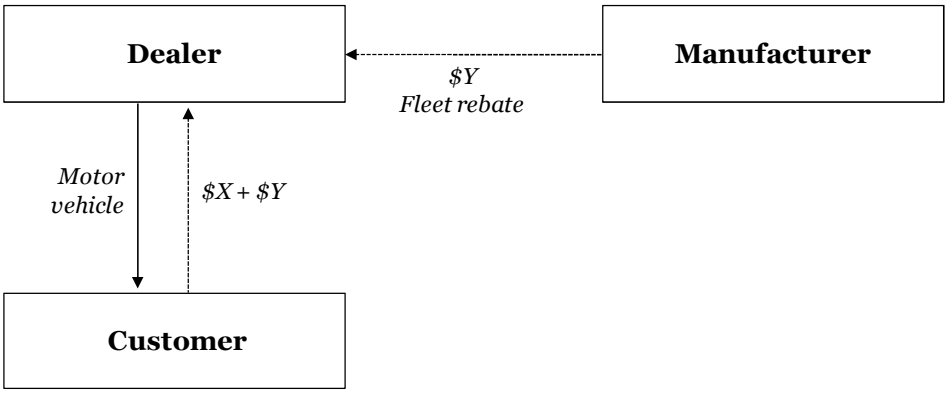


[78] *A P Group Limited v Commissioner of Taxation* [2012] AATA 409 at [94]

[79] *A P Group Limited v Commissioner of Taxation* [2012] AATA 409 at [99]-[100]

[80] *A P Group Limited v Commissioner of Taxation* [2012] AATA 409 at [104]

A P Group – 'GST' Flow



The Tribunal reached the same conclusion, for the same reason, in respect of the run-out support payments.[81] It is important that the payment of the rebate was conditional on the supply of the vehicle, which was the very act which triggered the payment. This bears a striking similarity to the reasoning of the European Court of Justice in *Loyalty Management*, which held that the payment there considered was conditional on the supply of loyalty rewards.

The result seems odd from a policy perspective. Why should a dealer who sells a motor vehicle at a discount, where the discount is subsidised by a manufacturer, be liable to pay GST both on the discounted price paid by the customer and on the discount given to the customer? There seems no reason why the discount should find its way into the private consumption expenditure base. Nevertheless, the express words of the Act support the Tribunal decision in much the same way as the express words of the Sixth Directive supported the decision of the European Court of Justice.

In analogous circumstances, where a payment is made by a manufacturer to a consumer (where the consumer makes a purchase through an intermediate trader), the manufacturer may have a decreasing adjustment pursuant to Division 134 for payments made on or after 1 July 2010. This seems to achieve the correct economic outcome and reflects the underlying policy intent of only taxing private consumption expenditure. Additional legislative measures may now be required to avoid further anomalous outcomes involving third party payments.

6 OTHER ISSUES

6.1 Adjustment events and changes in consideration

An adjustment event is any event which has the effect of, among other things, changing the consideration for a supply of acquisition.[82] Without limiting this statement, an

[81] *A P Group Limited v Commissioner of Taxation* [2012] AATA 409 at [105]

[82] GST Act, section 19-10(1)(c)

adjustment event includes a change to the previously agreed consideration for a supply or acquisition, whether due to the offer of a discount or otherwise.[83]

In the *TAB* case, Gzell J considered that the scratching of a horse from a race may be an adjustment event by changing the consideration for a supply,[84] but that the payment of a refund did not itself effect a change in consideration, but merely discharged a liability.[85]

These issues may now be addressed by the High Court in *Qantas*. The issue of adjustment events did not really feature in the AAT or Full Court proceedings. In the High Court, the Commissioner submitted that, in the event an intended passenger purchased a fully refundable fare and obtained a refund, there was no cancellation of the supply but a change to the consideration which was adjusted to nil.[86] Qantas, by contrast, submitted that there was a cancellation of a supply (the flight) and, in the alternative, that there was a change in the consideration to nil irrespective of whether the refund was claimed by the customer or not.[87]

6.2 GST-free and input taxed supplies

Section 9-5 sets out the criteria for a "taxable supply", including that it be made for consideration, and states that a supply is not a taxable supply to the extent it is GST-free or input taxed. Early in the life of GST there was speculation about whether this section was a "gateway" provision requiring that each criterion be satisfied in order for a supply to be GST-free or input taxed. Support for the contention that section 9-5 is not a gateway provision can be found in the following dicta of Lindgren J in the *AXA* case:

> Axa also argues that input taxed supplies and GST-free supplies are subsets of taxable supplies. Accordingly, to be an input taxed supply, a supply must first satisfy the Act's definition of "taxable supply". The Commissioner disagrees and submits that input taxed supplies, GST-free supplies and taxable supplies are three separate categories of supply.
>
> . . . The proviso at the end of [section 9-5] does not by its terms require that each of the categories "GST-free supply" and "input taxed supply" lie wholly within the category of "taxable supply". The proviso merely acknowledges the possibility that some taxable supplies may to some extent be GST-free supplies and/or input taxed supplies.[88]

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[83] GST Act, section 19-10(2)(b)

[84] *TAB Ltd v Commissioner of Taxation* [2005] NSWSC 552 at [51] per Gzell J

[85] *TAB Ltd v Commissioner of Taxation* [2005] NSWSC 552 at [52] per Gzell J

[86] *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA Trans 131 (4 June 2012)

[87] *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA Trans 132 (5 June 2012)

[88] *AXA Asia Pacific Holdings Ltd v Commissioner of Taxation* [2008] FCA 1834 at [98]-[99] per Lindgren J

In the case of financial supplies, the GST Regulations require that their provision, acquisition or disposal be for consideration.[89] However, for other input taxed supplies, or GST-free supplies, there is no similar requirement that they be made for consideration.

6.3 Supplies and acquisitions for no or inadequate consideration

Although the courts will generally accept the price contractually agreed between the parties to be determinative of the value for taxation purposes, certain supplies made between associates for no or inadequate consideration will have a deemed value for GST purposes equal to the GST-exclusive market value of the supply.[90] This occurs where the recipient of the supply is not entitled to claim full input tax credits.

Much here turns on the definition of "associate" which, by virtue of section 195-1 of the GST Act, has the meaning given by section 318 of the *Income Tax Assessment Act 1936*. That definition is both complex and problematic and sits uneasily with some of the GST entities set out in section 184 of the GST Act. For this reason, there are special "associate" rules in Subdivision 72-D of the GST Act covering GST branches, non-profit sub-entities and certain government entities.

6.4 Non-monetary consideration

The definition of "consideration" discussed earlier clearly includes non-monetary consideration by its reference to "any act or forbearance" in addition to "payment". There has not been any litigation on this aspect of consideration, most likely because the Commissioner has mostly taken a fairly sensible and straightforward approach since the early days of GST.[91] Much of this is encapsulated in public ruling GSTR 2001/6, dealing specifically with non-monetary consideration.[92]

In most circumstances where parties are dealing at arm's length, the Commissioner takes the view that the goods, services or other things exchanged are of equal GST inclusive market value.[93] He will also allow any reasonable method to determine the GST inclusive market value of non-monetary consideration including using the market value of an identical or similar good, service or thing, or a professional appraisal.[94] Where both the supply and the consideration are difficult to value (for example, a

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[89] *A New Tax System (Goods and Services Tax) Regulations 1999*, regulation 40-5.09(1)(a)(i)

[90] GST Act, Division 72

[91] Some difficulties have arisen, such as with "parts exchange" arrangements in the mining industry, but these have not led to significant disputes.

[92] See also GSTR 2003/14, Goods and services tax: the GST implications of transactions between members of a barter scheme conducted by a trade exchange

[93] GSTR 2001/6, paragraph 138

[94] GSTR 2001/6, paragraph 144

forbearance), he will allow other methods, such as '"cost plus margin", but will not allow the use of "historical cost" or "residual value".[95]

7 CONCLUSION

The concept of "consideration" serves two broad purposes in the GST law being both a measure of consumption and, when offset against GST payable, a measure of the value added by an intermediate trader. In a practical sense one often looks first to an identifiable payment to see if there is a supply to which it might be attached.

Beyond the broad concepts and practicalities, there is now a growing body of Australian jurisprudence on the wide definition of "consideration" in the GST law from which at least three important principles have emerged:

1. The Act takes transactions as it finds them and, as a general rule, and absent tax avoidance or sham, the courts will generally accept the price contractually agreed between the parties to be determinative of the value for taxation purposes.

2. Expressions such as "subsidy", "rebate" and "discount" often disguise, rather than reveal, the true nature of the underlying arrangements. The real question is whether the payment is "consideration" for a "supply" - two statutory expressions which breathe comprehensiveness. In answering the statutory question, it doesn't matter that the payment is voluntary, or is made by a third party, or is made in circumstances under which the customer is unaware of it.

3. The payment of a sales incentive between intermediate traders is more likely to be characterised as third party consideration in respect of a supply to a consumer where the payment is conditional on the supply to the consumer taking place (such that the supply is the very act that triggers the payment), or where there is an evident correspondence between the payment of the sales incentive and the supply to the consumer.

The complexity of multiple party transactions, with the prospect of some payments being characterised as third party payments, will present continuing challenges for practitioners. In that respect, the analysis of government subsidies and commercial trade incentive payments is but the tip of a much larger iceberg.

[95] GSTR 2001/6, paragraphs 157-158