Incentives, rebates and third party adjustments after the AP Group decision

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The GST in Australia is a relatively young tax and its boundaries are only now being tested in the courts. The AP Group case raises deceptively simple "boundary" issues. Is there a supply for consideration? Is there third party consideration? It does so in the context of trade incentive payments that are common in commercial transactions. Yet the answers to the questions are not so clear and answers cannot be given by a contractual analysis alone. The decision in AP Group is troubling because it suggests there is a class of payment made by a business in the course of its enterprise that does not give rise to an entitlement to an input tax credit, an outcome contrary to the structure of the GST legislation. A suggested answer to avoiding the result of over-taxing business is that a decreasing adjustment should be available to the business making the payment. This possibility was not canvassed in argument in AP Group and, if accepted, would almost certainly have changed the result.

OVERVIEW

The GST complexities inherent in multiple party transactions and third party consideration were again highlighted by the decision of the Administrative Appeals Tribunal (AAT) in *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493. That decision has wide implications for the payment of trade incentives and rebates across many industries and will be the subject of further judicial analysis when the appeal against the decision is heard by the Full Court of the Federal Court.[1]

In broad terms, AP Group operated motor vehicle dealerships and acquired motor vehicles from finance companies under typical "floor plan" arrangements. AP Group acquired the vehicles from a finance company, which in turn acquired the vehicles from manufacturers or distributors.

The AAT was asked to determine the GST treatment of five particular incentive payments received by the Applicant from manufacturers and distributors. The Commissioner's first argument was that the payments were consideration for supplies made by AP Group to the manufacturers and distributors. This argument was rejected by the tribunal. The Commissioner's second argument was that three of the five payments should be characterised as consideration for the retail sales of the vehicles by AP Group to the end customer. In other words, the payments should be treated as third party consideration. The tribunal agreed with the Commissioner in respect of two of the payments.

The case therefore involved deceptively simple issues on some of the most basic GST rules. Was there a supply for consideration? Was there third party consideration? Despite the relative simplicity, the decision is troubling because it suggests there is a class of payment made by a business in the course of its enterprise that does not give rise to an entitlement to an input tax credit. That is the antithesis of a value-added tax (VAT), and a result that should bear close scrutiny.

This article considers the arguments raised by the parties. It also considers an argument not advanced by either party. Did the various payments considered by the tribunal give rise to adjustment events? After the earlier decision of the AAT in *Electrical Goods Importer v Commissioner of Taxation* (2009) 74 ATR 982, it might be thought that the answer is "no". However, as will be

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[1] At the time of writing the appeal was scheduled to be heard on 20-21 May 2013.

discussed in this article, the *Electrical Goods Importer* case should not be seen as the last word on third party adjustments, especially in the light of *Commissioner of Taxation v Qantas Airways Ltd* (2012) 86 ALJR 1243; 83 ATR 1.

THIRD PARTY CONSIDERATION

Much of this article is concerned only with the basic GST legislative provisions, which are deceptively simple. You make a "taxable supply" if "you make the supply for consideration".[2] The expression "consideration" is defined expansively to include any payment, or any act or forbearance, in connection with, in response to or for the inducement of, a supply of anything.[3]

The GST Act tells us that it does not matter whether the payment, act or forbearance was by the recipient of the supply.[4] Thus, consideration for a supply can include third party consideration. Before discussing that concept further, it is helpful to briefly consider what is *not* third party consideration – since it necessarily excludes at least two categories of payment.

First, third party consideration self-evidently cannot include second party consideration. That is, consideration furnished by the recipient of a supply cannot be third party consideration. As discussed below, the Commissioner's primary argument in *AP Group* was simply that there were supplies for consideration.

Secondly, a payment that is made in return for a "Redrow" supply, ie a supply of agreeing to make a supply to somebody else, cannot be third party consideration.[5] This is actually an aspect of second party consideration but is quite a distinct sub-set. It can be seen in *Commissioner of Taxation v Secretary to the Department of Transport (Vic)* (2010) 188 FCR 167; 76 ATR 306, discussed below, in which the Commissioner's submissions that a payment was third party consideration were rejected.

TT-Line Company

In seeking to understand the concept of third party consideration, this article first discusses the decision in *TT-Line Company Pty Ltd v Commissioner of Taxation* (2009) 181 FCR 400; 74 ATR 771 – a case relied upon by the AAT in *AP Group* to support its finding of third party consideration. 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.[6]

This is illustrated in Figs 1 and 2.

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[2] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 9-5(a).

[3] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 9-15(1).

[4] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 9-15(2).

[5] *Customs and Excise Commissioners v Redrow Group plc* [1999] STC 16.

[6] *TT-Line Company Pty Ltd v Commissioner of Taxation* (2009) 181 FCR 400; 74 ATR 771 at [50]; see also Emmett J at [18].

FIGURE 1 TT-Line – "Actual" flow

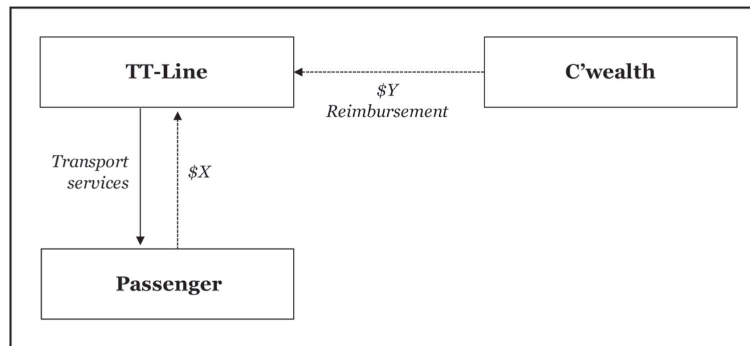
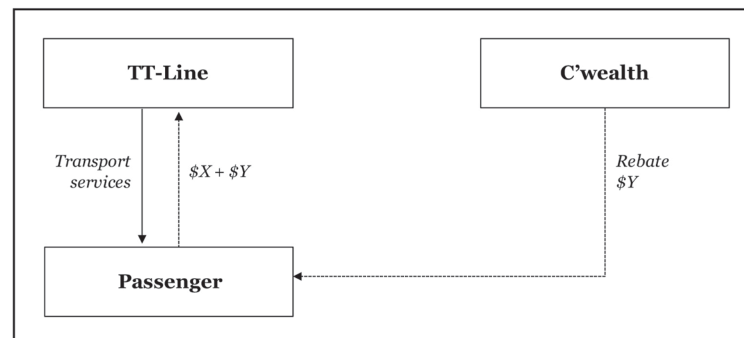


FIGURE 2 TT-Line – "GST" flow



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. In other words, the subsidy became Mr Egan's own money such that the consideration furnished by Mr Egan, which included the subsidy, 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 (Vic)*, the Commissioner unsuccessfully argued that a payment was third party consideration. 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 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. Kenny and Dodds-Streeton JJ stated, at [56]: "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]" (emphasis in original).

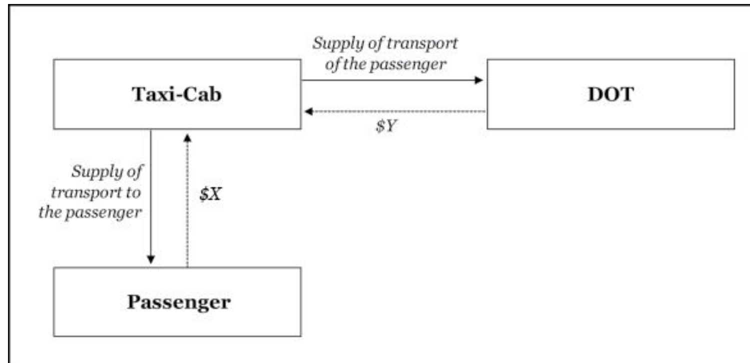
As to consideration, their honours held that the payments by DOT were within s 9-15(1) because:

> 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.[7]

The arrangement is illustrated diagrammatically in Fig 3.

FIGURE 3 DOT – “Actual” and “GST” flow

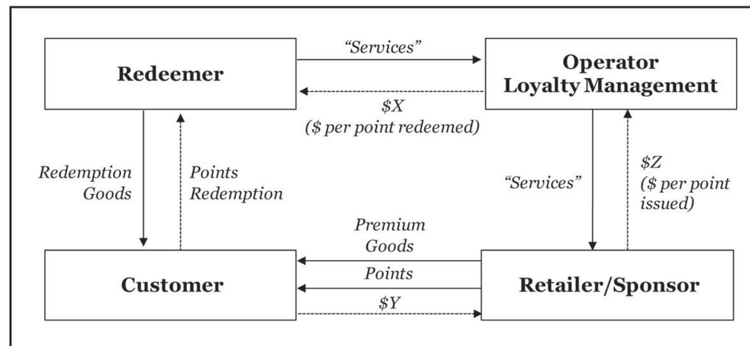


No issue of third party consideration arose here as the taxi-cab operator had remitted GST on the entirety of the fare. It might have been a very different case if the taxi-cab operator had only accounted for GST on that part of the fare paid over by the passenger.

Loyalty Management

Article 11A(1)(a) of the Sixth Directive of the European Community, like s 9-15(2) of the GST Act, expressly provides that consideration may be obtained from a third party. In *HMRC v Aimia Coalition Loyalty UK Ltd (formerly Loyalty Management UK Ltd)* [2013] UKSC 15 (*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 in Fig 4.

FIGURE 4 Loyalty Management – “Actual” flow



[7] *Commissioner of Taxation v Secretary to the Department of Transport (Vic)* (2010) 188 FCR 167; 76 ATR 306 at [67].

The Inland Revenue 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 of Justice of England and Wales 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:

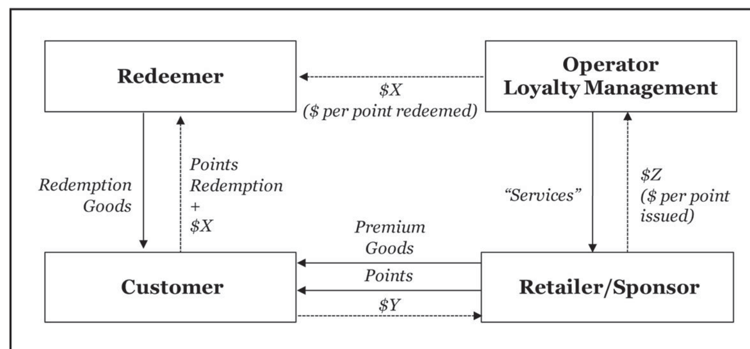
> … under the contract entered into by [Loyalty Management] with each redeemer, the possibility of the redeemers receiving any payment from [Loyalty Management] *is in fact conditional* on the supply by the redeemers of loyalty rewards to the customers, rewards which can take the form not only of tangible 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].[8] [emphasis added]

The European Court of Justice thus found for the Commissioners and stated:

> … 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 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.[9]

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 conclusion reached by the European Court of Justice is illustrated in Fig 5.

FIGURE 5 Loyalty Management – "VAT" flow



Somewhat surprisingly, the Supreme Court of the United Kingdom has recently restored the decisions of the VAT and Duties Tribunal and Court of Appeal in the face of the European Court of Justice decision.[10] This was on the basis that the referral of the matter to the European Court of Justice did not include relevant findings of fact made by the VAT and Duties Tribunal that had a direct bearing upon the issues.[11] The majority made some important comments about third party consideration and, in a critical passage, stated:

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

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

[10] *HMRC v Aimia Coalition Loyalty UK Ltd (formerly Loyalty Management UK Ltd)* [2013] UKSC 15.

[11] *HMRC v Aimia Coalition Loyalty UK Ltd (formerly Loyalty Management UK Ltd)* [2013] UKSC 15 at [30] per Lord Reed (with whom Lords Hope and Walker agreed).

> … it is also necessary to bear in mind that consideration paid in respect of the provision of a supply of goods or services to a third party may sometimes constitute third party consideration for that supply, either in whole or in part. The speeches in *Redrow* should not be understood as excluding that possibility. Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded *a priori*. A business may, for example, meet the cost of a supply of which it cannot realistically be regarded as the recipient in order to discharge an obligation owed to the recipient or to a third party. In such a situation, the correct analysis is likely to be that the payment constitutes third party consideration for the supply.[12]

As the majority point out, the economic reality for most businesses is that the payments they make will usually be for a supply to themselves (including the supply of making a supply to someone else), and will not therefore amount to third party consideration. This considerably narrows the scope of what might be regarded as third party consideration to, for example, payments made to discharge an obligation owed to a third party.

AP GROUP DECISION – THE FACTS

In *AP Group Ltd*, the Applicant was the GST representative member of a group of companies engaged in motor vehicle dealerships throughout Australia. The Applicant acquired motor vehicles from finance companies under typical "floor plan" arrangements. That is, the Applicant acquired the vehicles from a finance company, which in turn acquired the vehicles from manufacturers or distributors.

The AAT was asked to determine the GST treatment of five particular incentive payments received by the Applicant from manufacturers and distributors. Historically, the payments had each been treated as consideration for a taxable supply. In the tribunal, however, the Applicant contended that no GST was payable and sought a refund of overpaid GST. The five payments are each described below and the facts pertaining to each of these payments are summarised. As arrangements in the motor vehicle industry can be more complex than those outlined in the tribunal's decision, the tribunal may have omitted various details of the arrangements for simplicity.

Toyota fleet rebates

For many years Toyota operated a fleet sales program that provided for discounted retail prices for vehicles sold to specific classes of customer, including government and business enterprises. Toyota, and not the Applicant, determined the level of fleet discount that applied to each category of customer, and effectively specified a maximum selling price that the Applicant could charge the customer.

How the discount to the selling price was given by Toyota depended on whether Toyota knew, at the time it delivered a vehicle to the Applicant, that the vehicle was destined for a fleet customer. Where Toyota knew that the vehicle was destined for a fleet customer (either because Toyota had negotiated directly with the customer or because the Applicant ordered the vehicle from Toyota specifically for a fleet customer), Toyota reduced the wholesale selling price of the vehicle to take account of the discounted retail selling price. However, where Toyota did not know that the vehicle was destined for a fleet customer (because the fleet customer purchased a vehicle already held in stock by the Applicant), but later became aware of that fact, Toyota paid a "fleet rebate" to the Applicant to achieve the same result. Under the conditions applicable to the payment of the fleet rebate, the entirety of the rebate was to be passed on to the customer. While it does not appear from the decision, it is common for the discount to the customer to exceed the fleet rebate paid by the distributor. In that event, the dealer, often under an agreement with the distributor, funds the additional discount at its own expense.

Toyota run-out model support payments

Toyota also made run-out model support payments designed to ensure that vehicles that were not current models were sold by dealers on a timely basis. That is, to ensure that all old models were sold before too many of the new models appeared on the showroom floor. According to the evidence,

[12] *HMRC v Aimia Coalition Loyalty UK Ltd (formerly Loyalty Management UK Ltd)* [2013] UKSC 15 at [67] per Lord Reed (with whom Lords Hope and Walker agreed).

although there was an expectation that the dealer would discount its old stock, the support payments were not required by Toyota to be passed onto the customer. The AAT found that it was the retail sale of the vehicle by the Applicant, and its recording in the Toyota sales system, which entitled the Applicant either to receive the payment, or to retain it in the event that Toyota had paid it earlier.

Holden transit/interest protection payments

As discussed above, the Applicant acquired the vehicles from a finance company, which in turn acquired the vehicles from manufacturers or distributors. The finance company paid the manufacturer or distributor in full for the vehicles as soon as they were dispatched. In turn, the finance company immediately imposed a finance charge on the Applicant from the date of dispatch, even though it took time before the vehicle arrived at the Applicant's premises and was placed in a saleable condition.

Holden paid allowances to the Applicant to "compensate" it for those finance charges. The allowances were described in various ways, but the parties referred to them collectively as transit/interest protection payments. The allowances in evidence were calculated at the prevailing Bank Bill Rate plus a margin of 150 basis points (1.5%).

Ford retail target incentive payments

In 2006 Ford had introduced a sales incentive program designed to assist in increasing sales. Ford would pay dealers incentives solely on meeting monthly and quarterly sales targets based on the number of vehicles sold and delivered to eligible customers in a qualifying period. The targets were set by Ford based in part on past performance.

Subaru wholesale target incentive payments

Subaru operated a wholesale target incentive payment program in respect of eligible new vehicle orders placed by a dealership with Subaru. Under the program Subaru would set a monthly maximum ordering entitlement for each dealership in respect of each particular model and configuration of motor vehicle. This maximum ordering entitlement was based on the size and purchase history of the particular dealership in question. A dealership could not order any more than the maximum ordering entitlement set by Subaru for any month.

A payment to the Applicant was triggered when the Applicant ordered in excess of a specified percentage of the Applicant's maximum order entitlement. Subaru set that figure at 70%. Once that percentage was met, Subaru paid the Applicant 1.5% of the dealer invoice price for each vehicle ordered from Subaru. There was no requirement for a retail sale to occur in order for a dealership to be entitled to the payment.

THE AP GROUP DECISION – THE ARGUMENTS

The Commissioner's first argument – supply for consideration

The Commissioner contended that the payments were consideration for supplies made by AP Group Ltd to the manufacturer. This is essentially the opposite of what was contended in the earlier case of *KAP Motors Pty Ltd v Commissioner of Taxation* (2008) 168 FCR 319; 68 ATR 927. That case had proceeded on the basis of agreed facts that were not dissimilar to *AP Group*.

KAP Motors was a motor vehicle dealer who sold vehicles under a floor plan arrangement. There was an agreement in place with the distributors of the vehicles for the payment of a rebate (known as a holdback payment) in respect of vehicles acquired and sold under the floor plan arrangement. The proceeding was conducted on the basis that it was common ground between the parties that the holdback payments were not consideration for any supply made by KAP Motors to the distributors. What was in issue, therefore, was the entitlement to a refund of GST overpaid. Given how the proceedings were conducted there was no detailed evidence about the holdback payments. The court

proceeded on the assumption that there was no supply "without necessarily accepting the correctness of that assumption".[13] The Commissioner may well have been emboldened by that comment.

Returning to *AP Group*, the AAT rejected the Commissioner's contention that the payments were consideration for supplies made by AP Group Ltd to the manufacturer. According to the tribunal, a "critical question" was whether the Applicant made a supply to the manufacturer by performing (or agreeing to perform) the obligations imposed by the manufacturer. Examples of the types of obligations to which the Applicant committed were:

- to do its best to promote and maintain the manufacturer's reputation;
- to use its best endeavours to promote and maximise sales;
- to advertise and promote products;
- to maintain and display manufacturer-supplied vehicles in first class condition;
- to comply with rules and conditions imposed by the manufacturer in relation to such issues as ordering product and recording and notifying sales;
- to provide full published discounts to customers;
- not to make offers less advantageous than those advertised; and
- to act in the best interests of the manufacturer.

Despite the breadth of the concept of supply, the AAT considered there to be "an air of unreality" in characterising the various obligations as supplies,[14] and concluded:

> In the context of the overall business relationships and contractual arrangements between the Applicant on the one hand, and the various manufacturers on the other, we do not think that the Applicant's acceptance of the obligations or the making of the promises is properly viewed as the making of supplies to the manufacturers. Instead, they are part of the foundation underpinning the relationships, the background to the bargain the parties have made – in a sense, the rulebook by which the game is to be played.[15]

That conclusion seems to be correct. It is reminiscent of the facts in *Ballarat Brewing Co Ltd v Federal Commissioner of Taxation* (1951) 82 CLR 364. At issue in that case was the time at which certain rebates and discounts affecting sales should be brought to account for income tax purposes. The company sold products to its customers and allowed a discount and a rebate on the gross purchase price if the customer fulfilled certain specified conditions. Nothing turned on the precise nature or content of the conditions. Fullager J in the High Court put the conditions succinctly:

> It is sufficient to say that they are concerned with punctual payment for the liquor supplied, with the prices at which the customer is to sell or dispose of the liquor, and with certain aspects of the conduct of the customer's business.[16]

The obligations imposed on the Applicant in *AP Group* might also fairly be described as going to pricing and to the conduct of the Applicant's business. Those obligations should be seen as a framework for the making of supplies, rather than being supplies in themselves.

The recent decision in *Qantas* is not inconsistent with that analysis. The High Court held that the relevant supply was a promise by Qantas to use its best endeavours to carry the passenger, and that this was the supply for which the consideration, being the fare, was received.[17] In other words, a promise (not necessarily unconditional) to make an intended supply is itself a supply and, when made for consideration, is a taxable supply. In this regard, a distinguishing factor in *AP Group* was that the promises (or obligations) by the Applicant were not to make intended supplies, as in *Qantas*, but were to constitute the business framework or trading relationship within which other supplies would be made.

[13] *KAP Motors Pty Ltd v Commissioner of Taxation* (2008) 168 FCR 319, 68 ATR 927 at [27] per Emmett J.

[14] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [81].

[15] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [85].

[16] *Ballarat Brewing Co Ltd v Federal Commissioner of Taxation* (1951) 82 CLR 364 at [2].

[17] *Commissioner of Taxation v Qantas Airways Ltd* (2012) 86 ALJR 1243; 83 ATR 1 at [33] per Gummow, Hayne, Kiefel and Bell JJ.

The Commissioner's second argument – third party consideration

The Commissioner's second argument was that three of the five payments (the Toyota fleet rebate, the Toyota run-out model support payment, and the Ford retail target incentive payment) should be characterised as consideration for the retail sales of the vehicles by the dealer to the end customer. In other words, the payments should be treated as third party consideration.

The AAT observed: "[T]he 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."[18] Nor did it matter that the customer was unaware of the amount of the payment.[19] The Commissioner relied principally on the decision of the Full Federal Court in the *TT-Line* case.

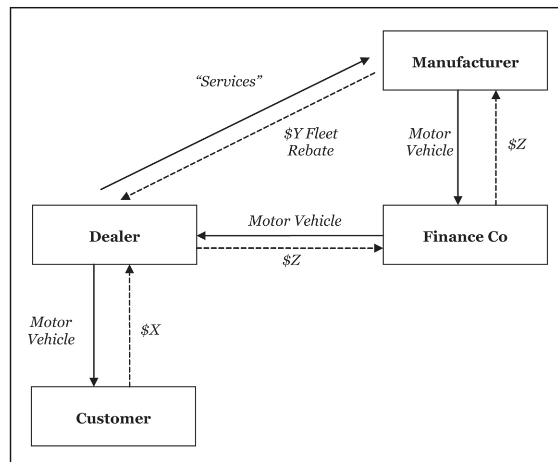
Toyota fleet rebates

The AAT concluded that the Toyota 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.[20] [emphasis added]

This is represented in Figs 6 and 7.

FIGURE 6 AP Group – "Actual" flow

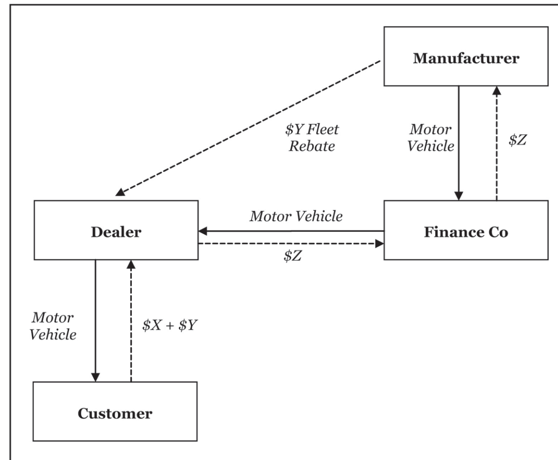


[18] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [94].

[19] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [99]-[100].

[20] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [104].

FIGURE 7 AP Group – "GST" flow



The reasoning of the AAT 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. That reasoning did not prevail in the subsequent decision of the Supreme Court of the United Kingdom. There is also something peculiar about this result, quite apart from the fact that the reliance on *TT-Line* is misplaced (it not being a third party consideration case). What is peculiar is that the means by which the discount to the selling price was achieved by Toyota was held by the tribunal to result in different GST outcomes. How the discount to the selling price was given by Toyota depended on whether Toyota knew, at the time it delivered a vehicle to the Applicant, that the vehicle was destined for a fleet customer. So Toyota paid the same amount of money to achieve the same selling price to the customer, but with entirely different GST consequences. This would appear to be an absurd outcome in the interpretation of the GST Act. An alternative argument that avoids such a distortionary outcome is discussed in more detail below.

Toyota run-out support payments

The AAT reached the same conclusion, for the same reason, in respect of the Toyota run-out support payments.[21] It was important that the payment of the rebate was conditional on the supply of the vehicle, which was the very act that triggered the payment.

Ford retail target incentive payments

The AAT's reasoning was slightly different for Ford's retail target incentive payments. The payments were "triggered at the time, and by reason, of the Applicant's recording of a level of new sales for a relevant period of eligible vehicles to eligible customers in excess of a specified target set by Ford".

The tribunal thought it significant that the payments had no nexus with any one supply, but were made in connection with the making of supplies generally.[22] It found that the use of the word "supply" in the singular in s 9-15, and in the definition of "consideration" in s 195-1, implied that the payment must relate to a specific supply rather than to supplies in general.[23] For this reason, the tribunal held that the retail target incentive payments were not "in connection with" a supply, and so were not consideration.[24]

[21] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [105].

[22] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [106].

[23] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [107].

[24] *AP Group Ltd v Commissioner of Taxation* (2012) 83 ATR 493 at [108].

AN ALTERNATIVE ARGUMENT – ADJUSTMENT EVENTS

Third party payments can give rise to adjustment events

An argument not advanced by the parties, nor considered by the AAT, is whether the payments gave rise to adjustment events. Where, for example, Toyota paid a fleet rebate to the Applicant, would that payment give rise to an adjustment event? An adjustment event is defined in the GST legislation as any event that has the effect of, among other things, "changing the consideration for a supply".[25] Without limiting that description, an 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".[26]

The whole concept of third party consideration, that "it does not matter whether the payment, act or forbearance was… by the recipient of the supply", is naturally enough linked to the definition of consideration.[27] If a payment by a third party can constitute consideration for a supply, then it would seem to follow that a payment by a third party can change the previously agreed consideration for a supply, since a change in consideration is merely an aspect of consideration itself.

Adjustment events need not be contractual

In the phrase "supply for consideration", "the word 'for' is not used to adopt contractual principles. Rather, it requires a connection or relationship between the supply and the consideration".[28] Presumably, a payment that adjusts consideration must have a similar connection or relationship to the earlier supply, which need not be contractual. The fleet rebate paid by Toyota would seem to answer the description of an adjustment event, but an adjustment to which supply? The prime candidates are the supply of the vehicle by Toyota to the finance company, and the supply of the vehicle by the dealer to the fleet customer.

Where Toyota knew that the vehicle was destined for a fleet customer, Toyota reduced the wholesale selling price of the vehicle to the finance company. However, where Toyota did not know that the vehicle was destined for a fleet customer, and later paid a rebate to the applicant, it seems arguable that the rebate likewise reduced, by way of adjustment, the wholesale selling price of the vehicle to the finance company. This was a supply with which the rebate had a close connection or relationship, evidenced by what happened when Toyota knew in advance that the vehicle was destined for a fleet customer.

But what then of the supply of the motor vehicle by the finance company to the dealer? It could hardly be right that the same payment might constitute two separate adjustment events. It is more likely that the agreements entered into with the finance company were such that the "back to back" sales of the motor vehicles were to be at the same price. As such, the payment of the rebate adjusting the consideration between Toyota and the finance company would most likely trigger an adjustment to the consideration between the finance company and the applicant dealer.

A payment can be both consideration and an adjustment to the consideration

The other possible adjustment event is the supply of the vehicle by the dealer to the fleet customer. Certainly the tribunal considered that the rebate paid by Toyota had the closest connection with this supply, albeit as third party consideration for the supply. But there is no reason in principle why a payment treated as third party consideration cannot also be treated as a third party adjustment. That may seem surprising but a simple example illustrates the point.

A supplier agrees to sell a widget to a recipient for a gross price of $Z, and agrees to pay a rebate of $Y if certain sales targets are achieved, so that the price net of rebate is $X ($Z - $Y). In circumstances where the sales targets are achieved and the rebate is paid, it can be said that the gross

[25] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 19-10(1)(b).

[26] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 19-10(2)(b).

[27] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 9-15(2).

[28] *Commissioner of Taxation v Qantas Airways Ltd* (2012) 86 ALJR 1243; 83 ATR 1 at [14] per Gummow, Hayne, Kiefel and Bell JJ.

selling price is $X + $Y, and the rebate $Y, leaving a net selling price of $X. It can be seen that $Y is both an element of the selling price *and* comprises the rebate amount itself. In GST terms, $Y is both part of the initial consideration for the supply, and is an adjustment to that initial consideration.

It should not matter that, under the conditions applicable to the payment of the fleet rebate, the entirety of the rebate was to be passed on to the customer. That condition hardly amounts to an independent act or supply for which the payment is consideration.[29] It is simply further evidence that the rebate was intended to flow through the distribution chain as an adjustment to price.

Nor should it matter that there may be practical difficulties in administering the adjustments since, as stated by the High Court in *Travelex Ltd v Commissioner of Taxation* (2010) 241 CLR 510 at [36], this does not provide any basis for reading down the provisions. A similar analysis would apply to the Toyota run-out model support payment.

Adjustment events and the retail incentive payments

It will be recalled that the AAT's reasoning was different for Ford's retail target incentive payments, holding that the payments must relate to a specific supply rather than to supplies in general. The tribunal held that the retail target incentive payments were not "in connection with" a supply, and so were not consideration. That conclusion must be open to doubt.

In this context it is worth revisiting the judgment of Hill J (with whom Davies and Lee JJ agreed) in the Full Court in *Queensland Independent Wholesalers Ltd v Commissioner of Taxation* (1991) 29 FCR 312; 22 ATR 45, decided under the former sales tax regime. Queensland Independent Wholesalers Ltd (QIW) was an independent wholesaler and distributor of grocery products whose principal customers were small, independently owned grocery stores. QIW acted as a "co-operative buyer" for its customers and by doing so was able to place large orders with suppliers and thus obtain volume discounts, which it could pass on to its customers as "rebates".

As Hill J observed, sales tax was to be levied and paid upon "the sale value" of the relevant goods, and the statute specified that "the sale value of goods shall be the amount for which those goods are sold". His Honour did not approach the issue by saying that the amount must relate to a specific sale of goods rather than to sales of goods in general, which was the approach taken by the tribunal in *AP Group* in respect of the Ford incentive payments.

Hill J proceeded on the basis that the payment of the rebate was in a legal sense voluntary, and acknowledged "the amount for which the goods are sold" cannot be confined to the contract price.[30] His Honour observed that "the rebate was not motivated by an element of benefaction… It was a purely commercial arrangement",[31] and held that the rebates reduced the amount for which the goods were sold:

> The fact that rebates were deferred and were discretionary would not prevent them being taken into account in determining the amount for which goods were sold provided that the nature and manner of payment of the rebate remained sufficiently proximate to and connected with the sale transactions to allow them to be accounted for in that way.[32]

This is remarkably similar to the approach taken by the High Court in *Qantas* in considering the phrase "supply for consideration", where the majority held that "the word 'for' is not used to adopt contractual principles. Rather, it requires a connection or relationship between the supply and the

[29] Compare eg *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" at [35]-[37].

[30] Following *EMI (Australia) Ltd v Commissioner of Taxation* (1971) 45 ALJR 349; 2 ATR 325 per Windeyer J.

[31] *Queensland Independent Wholesalers Ltd v Commissioner of Taxation* (1991) 29 FCR 312; 22 ATR 45 at [36] per Hill J (with whom Davies J and Lee J agreed).

[32] *Queensland Independent Wholesalers Ltd v Commissioner of Taxation* (1991) 29 FCR 312; 22 ATR 45 at [39] per Hill J (with whom Davies J and Lee J agreed).

consideration".[33] The incentive payments paid by Ford were "triggered at the time, and by reason, of the Applicant's recording of a level of new sales for a relevant period of eligible vehicles to eligible customers in excess of a specified target set by Ford". There must surely be a sufficient connection or relationship between those payments and the vehicles sold by Ford, which can be said to be sufficiently proximate to and connected with those sales. It is therefore likely that such payments should have given rise to adjustment events.

The Electrical Goods Importer case

The decision of the AAT in the *Electrical Goods Importer* case seems to have been the death knell for the very notion of third party adjustments since the concept virtually disappeared following the decision. That may partly be explained by the insertion of Div 134 into the GST Act, though that has hardly solved all the problems that have arisen, as discussed below. So what did the tribunal decide in this case?

The Applicant was an importer and wholesaler of consumer electrical goods, which it supplied to various retailers who in turn supplied the goods to consumers. The Applicant undertook a "cash back offer" promotion in relation to some of its goods. Information of the cash back offer promotion was forwarded to retailers in advance of the promotion setting out the relevant terms and conditions. The Applicant provided "point of sale" advertising material for the promotion to the retailers and vouchers to be filled in by eligible customers to claim the cash back offer. Once a customer ordered from a retailer and paid for the goods, the customer would be provided with a voucher. The customer would complete the voucher, attach the original tax invoice showing payment, and send the voucher directly to the Applicant, who would then send to the customer their original tax invoice together with a cheque for the relevant cash back amount.

For those cash back payments that were made by the Applicant in a tax period different from that in which the goods were supplied, the Applicant treated the cash back payment as an "adjustment event" within the meaning of s 19-10(b). However, the tribunal rejected this approach:

> The first supply is that by the Applicant to the retailer and that is never altered or adjusted. The retailer… is never obliged to pay anything back. The second supply is by the retailer to the customer and that too is a transaction which is never altered.[34]

That passage is revealing, and the author respectfully ventures to suggest that the tribunal fell into error. The tribunal was effectively adopting a contractual analysis in referring to transactions that were not altered, since that is implicitly a reference to transactions that were not altered *contractually*. While the contractual position could never be irrelevant to the analysis, that cannot be the end of the enquiry either. As discussed above in relation to *Qantas*, the GST Act has not adopted contractual principles, and the relevant enquiry is into the connection or relationship between the supply and the consideration, or in this case the altered consideration. The tribunal clearly acknowledged that there was a connection or relationship:

> There is, it might be said, a link between the payment of the cash back and the transactions which preceded it, but it is not made in consideration of either of them.[35]

While the AAT clearly acknowledged the connection or relationship that existed between the payment and the two supplies, the reference to the payment not being made in consideration of either one of them seems again to be an implicit reference to *contractual* consideration. That is because the existence of a sufficient connection or relationship necessarily implies that the payment must be consideration in the wider sense. The *Electrical Goods Importer* case should not be seen as the last word on third party adjustments, especially in the light of the *Qantas* decision.

[33] *Commissioner of Taxation v Qantas Airways Ltd* (2012) 86 ALJR 1243; 83 ATR 1 at [14] per Gummow, Hayne, Kiefel and Bell JJ.

[34] *Electrical Goods Importer v Commissioner of Taxation* (2009) 74 ATR 982 at [58] per Block DP.

[35] *Electrical Goods Importer v Commissioner of Taxation* (2009) 74 ATR 982 at [59] per Block DP.

The Commissioner's likely view on adjustment events

The Commissioner's view in respect of all the arrangements in *AP Group* would most likely be that no adjustment event arises. In his ruling on adjustments, the Commissioner discusses an example with a fact pattern remarkably similar to that in *AP Group*, with the example covering a motor vehicle sold under a floor plan arrangement, where the manufacturer pays the dealer an incentive "to take part in a special promotion and marketing of… vehicles for the purpose of boosting… market share". The Commissioner concludes that the dealer is making a supply to the manufacturer, being the entry into and fulfilment of the obligation to promote and market the manufacturer's vehicles, and that the payment by the manufacturer is consideration for this supply.[36] In essence, this reflects the Commissioner's primary argument in *AP Group*. Given that conclusion, it is unsurprising that the Commissioner also concludes that the payment does not give rise to an adjustment event.[37]

Nevertheless, it seems that the Commissioner simply rejects the concept of third party payments being adjustments. As he states in the ruling: "Provided such a payment is made directly by the manufacturer to that third party entity, it does not give rise to an adjustment event."[38] No additional reasoning is offered by the Commissioner to support this conclusion and, for the reasons given above, it must be considered doubtful.

IMPLICATIONS FOR OTHER INDUSTRIES

The decision in *AP Group* has clear implications for other industries in which incentives are paid. Financial planning is a good example. Leaving to one side the complexities of the new Future of Financial Advice regime, it has been commonplace in the market for many financial planners not to charge a fee directly to their clients. The financial planners are instead remunerated by way of commissions and rebates from financial institutions to which clients' funds are directed. To paraphrase the AAT in *AP Group*, the commissions and rebates paid by financial institutions have a direct and immediate connection with the supply of financial planning advice to clients. That is because the supply of the advice is the very act that triggers the placement of the funds and the payment of commissions and rebates. If *AP Group* has been rightly decided, why should the result for the financial planning industry be any different? That conclusion, if correct, would be a nightmare for the financial planning industry, already in the midst of dramatic structural change, because it would result in a significant denial of input tax credits to financial institutions in respect of the GST charged on commissions and rebates.

These comments apply equally to the insurance industry where commissions and rebates are paid to brokers for directing clients' funds into policies of life insurance. The insurance industry is necessarily replete with multiple party transactions given that brokers and other providers have dealings with both the insurer and the insured. This has led to recent legislative amendments said to result from the decision in *Department of Transport*.[39]

DIVISION 134

Following the decision in the *Electrical Goods Importer* case, discussed above, the law was amended through the enactment of Div 134 to provide adjustments for certain third party payments made on or after 1 July 2010. That Division could properly be the subject of a separate article. Division 134 was not relevant in *AP Group* as the payments there under consideration were all payments made before 1 July 2010. However, it is clear that the new law is intended to apply to motor vehicle holdback payments, discussed above in the context of the *KAP Motors* decision, as they are the subject of a specific example in the explanatory memorandum.[40]

[36] GSTR 2000/19, "Goods and Services Tax: Making Adjustments under Division 19 for Adjustment Events" at [42C].

[37] GSTR 2000/19, "Goods and Services Tax: Making Adjustments under Division 19 for Adjustment Events" at [42B].

[38] GSTR 2000/19, "Goods and Services Tax: Making Adjustments under Division 19 for Adjustment Events" at [42B].

[39] New s 38-60 inserted by the *Tax and Superannuation Laws Amendment (2012 Measures No 1) Act 2012* (Cth).

[40] Explanatory Memorandum to the *Tax Laws Amendment (2010 GST Administration Measures No 1) Bill 2010*, Example 1.2.

The explanatory memorandum explains that the amendments were needed:

> to ensure that the appropriate amount of goods and services tax (GST) is collected and the appropriate amount of input tax credits claimed in situations where there are payments between parties in a supply chain which indirectly alter the price paid or received by the parties for the things supplied… This is achieved by creating an adjustment to apply in situations where an entity (the payer) supplying things for re-sale makes a monetary payment to a third party (the payee) in connection with the payee's acquisition of those things.[41]

The explanatory memorandum then describes the problem: "A third party rebate may not give rise to an adjustment because it would not, ordinarily, alter the consideration for the supply by the payer to its customer, or the consideration paid for the acquisition by the payee from its supplier."[42] As discussed above, that proposition is clearly debatable and it is fairly arguable that Div 134 is superfluous.

The argument that Div 134 is superfluous is perhaps emphasised by the preconditions to it applying, which include that "the payment is made in connection with, in response to, or for the inducement of the payee's acquisition of the thing".[43] If that precondition is satisfied, one might think the connection is close enough to have given rise to an adjustment under the normal rules in any event.

Division 134 arguably creates more problems than it seeks to solve. First, it muddies the water and doesn't address the issue of whether third party payments would have been adjustments in the absence of the Division. Is the Division there out of an abundance of caution or does it tell us something more about third party payments and adjustments?

Secondly, the requirement that the payee acquires the same thing as the payer supplied to another entity narrows the scope of the Division considerably.[44] It is targeted at "back to back" supplies of the same thing, typically goods. It would not cover, for example, rebates paid to financial planners described above.

Thirdly, Div 134 adds considerable complexity to the GST law. It was amended early in its life to cope with the interaction between third party payments and the various grouping and joint venture provisions.[45] Further amendments are likely to follow over time.

CONCLUSION

The GST in Australia is a relatively young tax, the boundaries of which are only now being tested in the courts. The *AP Group* case raises deceptively simple "boundary" issues. Is there a supply for consideration? Is there third party consideration? It does so in the context of trade incentive payments that are common in commercial transactions. Yet the answers to the questions are not so clear and answers cannot be given by a contractual analysis alone.

It was stated at the outset of this article that the decision in *AP Group* is troubling because there is now a class of payment made by a business in the course of its enterprise that does not give rise to an entitlement to an input tax credit. That is contrary to the structure of the GST, which should generally allow full input tax credits (or decreasing adjustments) to a business as part of the means of taxing the value added by it.

A suggested answer to avoiding the result of over-taxing business is that a decreasing adjustment should be available to the business making the payment. This possibility was not canvassed in argument before the AAT in *AP Group*. Had it been considered, the relevant enquiry should have been whether there was a connection or relationship between the payment and the supply such that the

[41] Explanatory Memorandum to the *Tax Laws Amendment (2010 GST Administration Measures No 1) Bill 2010*, at [1.1], [1.2].

[42] Explanatory Memorandum to the *Tax Laws Amendment (2010 GST Administration Measures No 1) Bill 2010*, at [1.3].

[43] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 134-5(1)(d).

[44] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 134-5(1)(a).

[45] *Tax Laws Amendment (2010 GST Administration Measures No 3) Act 2010* (Cth).

consideration should be taken as having altered, though not necessarily in a contractual sense. That reasoning, if accepted, would almost certainly have changed the result in *AP Group*.

The likely outcome of the Full Court appeal is not easy to predict. Every litigator knows that much depends on the facts and the tribunal may have omitted various details for simplicity. Those details may be critical before the Full Court. Additionally, important arguments on adjustments were not made by either party before the tribunal and these might have a material bearing on the outcome. The decision of the Full Court will therefore be awaited by practitioners with great interest.