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**THE PARLIAMENT OF THE COMMONWEALTH
OF AUSTRALIA**

SENATE

Sales Tax Assessment Bill 1992

Sales Tax Amendment (Transitional) Bill 1992

**Sales Tax (Exemptions and Classifications)
Bill 1992**

**SUPPLEMENTARY EXPLANATORY
MEMORANDUM**

**(Circulated by the authority of the Treasurer,
the Hon. J.S. Dawkins, M.P.)**



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General Outline and Financial Impact

Sales Tax Assessment Bill 1992

Sales Tax Amendment (Transitional) Bill 1992

Sales Tax (Exemptions and Classifications) Bill 1992

The amendments will make the following changes to the Bills:

General anti-avoidance provision

Change to the Bill: The amendments will clarify the circumstances in which the general anti-avoidance provision will apply. In particular, the provision will list the factors that the Commissioner must have regard to in deciding whether or not a scheme has been entered into for the sole or dominant purpose of obtaining a tax benefit. Also, the definition of 'dominant purpose' will be changed to refer to a purpose which is dominant as against *all* of the other purposes combined.

What the Bill currently provides: The conclusion as to whether or not a scheme has been entered into for the sole or dominant purpose of obtaining a tax benefit must be based on an objective consideration of relevant circumstances, but these circumstances are not listed. The definition of 'dominant purpose' refers to a purpose which is dominant when compared to *each* of the remaining purposes.

Revenue impact: None.

External costs

Change to Bill: The tax liability to be imposed on design, formulation or development costs, incurred by persons not otherwise liable to sales tax, will be deleted. The taxable value for royalty costs will be limited to the wholesale purchase price of the goods plus the royalty component for the goods.

What the Bill currently provides: The Bill provides for a liability to be imposed on a person, other than the manufacturer, who incurs design, formulation or development costs in relation to goods and sells the goods by retail or applies them to own use.

Revenue impact: Cost to revenue of \$61m.

Untaxed goods

Change to Bill: Goods that have been acquired tax-free from a person covered by the small business exemption will no longer be regarded as untaxed goods when sold by retail or applied to own use.

What the Bill currently provides: Goods that have not previously been taxed are liable to tax if sold by retail or applied to own use. This includes goods that have previously been exempted from tax by the small business exemption (SBE).

Revenue impact: No cost to revenue as the original revenue estimates did not include an amount for goods covered by the SBE being treated as untaxed goods.

Leases

Change to the Bill: The leasing provisions will be extended to allow concessions for leases granted on a short-term basis in exempt circumstances. An exemption will apply if continuous short-term leases are to be granted exclusively in exempt circumstances. If short-term leases of goods are made in both taxable and exempt circumstances, there will be a pro-rata reduction in the tax payable on the goods. The new concessions will only apply if the lessor has entered into an agreement with the Commissioner of Taxation. The exemption for pallets will be omitted.

What the Bill currently provides: There is an exemption for a long-term lease if the lessee intends to use the goods for an exempt purpose.

Revenue impact: Cost to revenue of \$3m in 1992-93 and \$4m in 1993-94.

Deemed Manufacturers

Change to the Bill: Business inputs concessions will be available for a person who supplies materials to a manufacturer to be made up into

goods, provided that the made-up goods are mainly for wholesale sale by the supplier.

What the Bill currently provides: If a person supplies materials to a manufacturer to be made up into goods for resale by the person, then the Bills will limit liability to the actual manufacturer. As an offset to the removal of liability from the supplier, business inputs concessions were not to be available to the supplier.

Revenue impact: No cost to revenue as original estimates did not provide for any revenue gain from the removal of the business inputs concessions.

Donations to and by exempt bodies

Change to Bill: An exemption will be provided for:

- goods donated to exempt bodies;
- goods given away by exempt bodies; and
- goods for use as prizes and awards by exempt bodies.

What the Bill currently provides: Goods donated to exempt bodies by taxable persons may be taxable in certain circumstances. Goods given away by, or for use as prizes by, exempt bodies could also be taxable in certain circumstances.

Revenue impact: No cost to revenue as original estimates did not provide for any revenue gain from the removal of this exemption.

Repairs to goods owned by exempt bodies and exempt users

Change to Bill: An exemption will be provided for parts and materials incorporated by external repairers into goods owned by exempt bodies and exempt users.

What the Bill currently provides: Parts and materials used by external repairers in repairing goods owned by exempt bodies and exempt users will be taxable.

Revenue impact: No cost to revenue as original estimates did not provide for any revenue gain from the removal of this exemption.

Buildings owned or leased by exempt bodies

Change to Bill: An exemption will be provided, broadly, for goods incorporated into buildings that are owned by exempt bodies or leased by exempt bodies.

What the Bill currently provides: Goods that are incorporated into buildings by private builders and repairers will be taxable.

Revenue impact: No cost to revenue as original estimates did not provide for any revenue gain from the removal of this exemption.

1. General anti-avoidance provision

A. Summary of amendments to the Bills

1.1 The general anti-avoidance provision (GAAP) will be amended to more clearly identify the circumstances in which it will be applied. The changes will be as follows:

- i. there will be an exhaustive list of factors to which the Commissioner must have regard in deciding whether the scheme was entered into for the purpose of obtaining a tax benefit;
- ii. the provision will apply only to schemes that are entered into for a purpose that is dominant as against *all* of the other purposes combined;
- iii. the circumstances in which the reconstruction power can be exercised will be more clearly set out; and
- iv. the GAAP will be extended to apply to a tax benefit that is obtained under a scheme entered into *prior* to 26 May 1992, if the scheme would have been caught by the specific anti-avoidance provisions in the existing law.

B. Explanation of the changes

1.2 The GAAP is set out in clauses 92 and 93 of the Sales Tax Assessment Bill 1992. The provision has been restructured as part of the amendments. The explanation below discusses only those parts of the GAAP that are proposed to be altered in substance.

Factors relevant to cancelling a tax benefit

1.3 The Bill will be amended to set out an exhaustive list of factors to which regard must be given in concluding whether a scheme was entered into for the sole or dominant purpose of obtaining a tax benefit.

1.4 The Bill requires that conclusion to be based on an objective consideration of relevant circumstances but does not list them [*existing subclause 93(1)*]. However, the actual purpose for which any person

entered into or carried out the scheme is expressly excluded from the things that can be taken into account [*existing subclause 93(2)*].

1.5 In response to suggestions that 'relevant circumstances' does not provide either the Commissioner or taxpayers with sufficient guidance, the Bill will be amended to include an exhaustive list of objective factors which must be taken into account in concluding the purpose for entering into the scheme.

[Amendment No. 11 of the Assessment Bill (New subclause 93(2))]

1.6 The factors will provide an objective standard. The actual subjective purpose for which any person entered into the scheme is not to be taken into account. The factors will be:

- the manner in which the scheme was entered into or carried out;
- the form and substance of the scheme;
- the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- the sales tax result achieved by the scheme (but for the general anti-avoidance provision);
- any change in the financial position of the taxpayer that has resulted from the scheme;
- any change in the financial position of a person who has business, family or other connections with the taxpayer, being a change that has resulted from the scheme;
- any other consequence for the taxpayer as a result of the scheme having been entered into; and
- the nature of the connection between the taxpayer and another person whose financial position changes as a result of the scheme.

Note: These are the same factors as are set out in Part IVA of the *Income Tax Assessment Act 1936* and on which the general anti-avoidance provision is based. As with Part IVA, the list will not give any indication as to the weighting to be placed on each factor. That is something that must be decided on the basis of the facts in each particular case.

Dominant purpose

1.7 A tax benefit under a tax avoidance scheme may only be cancelled if the scheme was entered into for the dominant purpose of obtaining a benefit. The Bill defines a dominant purpose as a purpose that is dominant when compared against *each* of the other purposes [*existing subclause 93(3)*].

1.8 The Bill will be amended to define 'dominant purpose' to mean a purpose that is dominant as against *all* of the other purposes combined. If a scheme or arrangement is entered into for several purposes, and the avoidance purpose is greater than each of the other purposes but not greater than all of them combined, then the general anti-avoidance provision will *not* apply.

[Amendment No. 11 of the Assessment Bill (New subclause 93(4))]

Reconstruction power

1.9 If the Commissioner cancels a tax benefit obtained under a tax avoidance scheme, then the Commissioner will also have the power to reconstruct events so that a proper assessment of tax may be made [*existing subclause 92(2)*]. There have been concerns expressed that the reconstruction power can be used to create a tax benefit. The circumstances in which the reconstruction power can be exercised will be more clearly spelt out. The power to reconstruct can only be exercised for the purposes of cancelling an already identified tax benefit, and even then only when it has been concluded that the scheme or arrangement was entered into for the sole or dominant purpose of obtaining that tax benefit.

1.10 There have been two drafting measures taken to meet the concerns expressed:

First, the general anti-avoidance provision has been restructured so that the reconstruction power, which can only be exercised in the cancelling of a tax benefit, will now appear after the part which deals with actually obtaining the tax benefit; and

[Amendment No. 11 of the Assessment Bill (New clauses 92, 93 and 93A)]

Secondly, the reconstruction power itself will be amended to make it clear that the determination which the Commissioner can make can only be made after it has been ascertained that a tax benefit has been obtained under a scheme. However, there will be no change to the wording of the determination that the Commissioner

may make. These words are the clearest expression, in plain English, of the extent of the Commissioner's powers.

[Amendment No. 11 of the Assessment Bill (New subclause 93A(2))]

Transitional

1.11 The Bill will limit the application of the GAAP to schemes that were entered into, or commenced to be carried out, *after* 26 May 1992 (the date on which the existing Bill was introduced into the House of Representatives) *[existing subclause 92(1)]*. However, the specific anti-avoidance provisions will cease to apply once the new law starts. As a consequence, the new law would not apply to tax avoidance schemes entered into before 26 May, and which would have been caught under the existing law.

1.12 The Bill will be amended to ensure that the GAAP will be capable of cancelling a tax benefit that is obtained under a scheme entered into *before* 26 May 1992, if the scheme would have been caught by one of the specific anti-avoidance provisions in the existing law.

[Amendment No.2 of the Transitional Bill (Clause 5)]

Consequential amendments

1.13 As part of the restructure of the general anti-avoidance provision, the Commissioner's power to make an assessment will now be contained in proposed clause 93A of the Assessment Bill, rather than clause 92 (where it now appears). There will be 4 amendments of the Bill to change references to assessments made under clause 92 to assessments made under clause 93A.

[Amendments No. 1, 12, 13 and 14 of the Assessment Bill]

2. External costs

A. Summary of changes

2.1 There are two broad changes proposed to be made to the external costs provision. The first change is the removal of the liability to be imposed on the retail sale or AOU of goods by a person who has incurred design, formulation and development costs in relation to those goods. Retailers and other persons who incur these costs, and who are not otherwise liable to tax, will not have a liability on them if they are involved only in the retail sale or application to own use of tax-paid goods.

2.2 The second change is to the taxable value of the goods covered by the external costs dealing. These are goods in respect of which a royalty payment has been made. In these cases, the taxable value will be limited to the notional wholesale purchase price of the goods if the manufacturer or importer had incurred that royalty payment.

B. Explanation of the changes

2.3 Under the new law certain costs associated with the manufacture of goods can attract a sales tax liability if they are incurred by a person who is not otherwise liable to tax (for example, a retailer of tax-paid goods) (existing clause 19 of the Assessment Bill). The costs involved are:

costs incurred in connection with the design, formulation or development of the goods; or

royalties paid in connection with the goods.

2.4 In response to the identification of practical difficulties in the application of the design, formulation and development costs component of the new law, the amendments will exclude these costs from the provision.

[Amendment No. 5 of the Assessment Bill (New clause 19)]

Royalties

2.5 With the exception of taxable value, there will be no change to the position of royalties under the new law *[clause 19 of the Assessment Bill]* in relation to tax liability. The inclusion of royalties in the external costs dealing was designed to replace the taxation treatment of royalties under

existing Sales Tax Assessment Act (No. 10) 1985. It is not a new liability. Under the new law, royalties will either be caught by the special taxable value rules for royalty payments [*clause 36 of the Assessment Bill*] or under clause 19 as an external cost.

2.6 The liability on royalty payments that are not caught by the special taxable value rules for royalties will be imposed by amended clause 19 of the Sales Tax Assessment Bill which will be titled "Royalty-inclusive sale or AOU." in lieu of "external costs".

[Amendment No.5 of the Assessment Bill (New clause 19)]

Taxable value

2.7 There will be a change to the taxable value of goods which are the subject of a royalty-inclusive sale or AOU. Under the Bill the proposed taxable value for these dealings is the *notional wholesale selling price [assessable dealings AD2c, AD3d, AD12c and AD13d in Table 1, Schedule 1 to the Assessment Bill]*. The intention, however, is that the taxable value should be limited to the actual amount of royalty payment recouped in the selling price of the goods. The amendments will achieve this by altering the taxable value to *the notional wholesale purchase price of the goods if the manufacturer or importer had incurred the royalty payments*. This change will effectively mean that the taxable value of the goods sold or applied to own use by a person who incurs royalty costs, and who is not otherwise liable to tax, will be the wholesale purchase price of the goods plus the value of the royalty recouped in the selling price of the goods.

Change of name of dealing

2.8 Amendments will also be made to column 5 of Table 1, Schedule 1 for the relevant assessable dealings to omit the reference to notional wholesale selling price and replace it with a taxable value based on the *notional wholesale purchase price of the goods including the royalty cost*.

[Amendments Nos. 16, 18, 20 and 22 of the Assessment Bill (assessable dealings AD2c, AD3d, AD12c, AD13d, Table 1, Schedule 1)]

2.9 As a consequence of the removal of the design costs component of this dealing, and its restriction to royalty payments, the dealing is to be renamed a '*royalty-inclusive sale or a royalty inclusive AOU*'. A number of minor amendments will be required to column 2 of Table 1, Schedule 1 for the relevant assessable dealings to omit the words "external costs" and replace them with "royalty-inclusive".

[Amendments Nos. 15, 17, 19, and 21 of the Assessment Bill (assessable dealings AD2c, AD3d, AD12c, AD13d, Table 1, Schedule 1)]

Transitional arrangement

2.10 It is possible that a liability to pay tax on a royalty payment could arise under existing Assessment Act (No.10) and the same royalty payment could be caught under the royalty-inclusive dealing in the new law. To overcome the possibility of double taxation occurring, there will be a transitional provision to provide that if tax was or is payable under Assessment Act (No.10), then no liability to tax on the royalty payment associated with the goods will arise under the royalty-inclusive dealings. These dealings are AD2c, AD3d, AD12c and AD13d.

[Amendment No.1 of the Transitional Bill (New subclause 5(2))]

3 Untaxed goods

A. Summary of changes

3.1 The liability to be imposed on the retail sale or application to own use (AOU) of untaxed goods by a retailer or other person is to be deleted if the goods are sourced from a supplier covered by the small business exemption (SBE). If a person acquires goods from an SBE supplier, the person will not be liable on any subsequent retail sale or AOU of the goods solely on the basis that they are untaxed goods. The change will, however, not remove any other liability that a retailer may have in relation to the goods under any other assessable dealing.

B. Background

3.2 The existing law assumes that a person will be liable to tax on goods not previously taxed, either because the person has manufactured them or has purchased them under quote. If the goods are acquired tax-free in other ways, such as a transfer of goods by court order, and the goods do not pass through a normal taxing point such as a wholesale sale, then the goods are not liable to tax. The new law will close this gap by imposing a liability on a retail sale or AOU of goods that have not previously passed through a taxing point *[existing clause 21 of the Assessment Bill]*.

3.3 The effect of the new law is that, if a retailer purchases goods from a person covered by the SBE, then those goods will be untaxed goods and a retailer will be liable to pay tax on them when they are sold or applied to own use.

C. Explanation of the changes

3.4 In response to difficulties identified by retailers in identifying, at the point of retail sale, goods previously covered by the SBE, the untaxed goods assessable dealing will be amended so that it does not apply to such goods. The amendments will apply to both retail sales and applications to own use of untaxed goods.

Note: A liability to pay tax on goods sourced from an SBE supplier will remain if the goods are subsequently sold by wholesale or by a retailer who is otherwise liable to tax on the retail sale.

[Amendment No. 6 of the Assessment Bill (clause 21)]

4. Leases

A. Summary of amendments to the Bills

Sales Tax Assessment Bill 1992

4.1 The changes to the proposed treatment of leases are as follows:

Exemption for certain short-term leases: There will be an exemption for assessable goods which are to be leased on a short-term basis exclusively in exempt circumstances throughout the statutory period.

Reduced taxable value for certain short-term leases: There will be a reduction in the taxable value of assessable goods which are for short-term lease partially in exempt circumstances. The reduction will be equal to the likely use of the goods in exempt circumstances.

Quotation grounds: A lessor of short-term leasing stock will be entitled to obtain the leasing stock on a tax-free basis.

Credit Ground 18A - Eligible short-term lease: There will be a new credit ground available for tax-paid short-term leasing stock for lease in exempt circumstances. The amount of the credit will be based on the likely use of the goods in exempt circumstances.

Agreements with the Commissioner: The changes outlined above will only apply to lessors who have entered into an agreement with the Commissioner identifying the extent of likely use of short-term leasing stock in exempt circumstances.

Credit Ground 18B - Trial loan or trial lease: A credit will be available if there is an initial short-term lease or loan of assessable goods, followed by a sale (or another lease) of the goods, to the same person for use in exempt circumstances for a combined period of 2 years or more from the date of the first lease or loan.

Sub-leases: The new rules will apply to sub-leases in broadly the same way that they will apply to leases.

Sales Tax (Exemptions and Classifications) Bill 1992

4.2 The changes to the proposed treatment of leases will be as follows:

Exemption for associated goods:

There will be an exemption for associated goods (such as parts) which are for use by a lessor exclusively in relation to:

- short-term leasing stock, provided the agreed exempt percentage for those associated goods is 100%; or
- goods to be leased under an eligible long-term lease.

Exemption for certain repair equipment:

There will be an exemption for equipment which is for use by a lessor exclusively in repairing:

- short-term leasing stock which has an agreed exempt percentage under *business inputs* exemption Items of 100%; or
- goods to be leased as *business inputs* under an eligible long-term lease.

Pallets:

The proposed unconditional exemption for certain pallets will be withdrawn.

B. Background

Existing law

4.3 The existing law relating to leases is complex and difficult to apply. A registered lessor who leases goods from tax-free stock is liable to tax on each successive lease of the goods. However, the tax is not self-assessing, as the taxable value of each lease is the amount the Commissioner considers to be fair and reasonable. Liability to tax continues until an amount equal to the tax on the notional wholesale value of the goods is recouped. On the other hand, unregistered lessors would buy in their stock tax-paid with no further accounting for tax.

4.4 Short term hire pools: The Commissioner has entered into individual agreements with many *registered* lessors of multiple short term hire stock who cannot track individual items of goods between taxable and exempt leases. Under these agreements, percentages of exempt use of particular classes of goods are calculated and agreed. The lessors are then entitled to either quote their registration number on that percentage of purchases for the hiring pool, or to quote for all stock and then account for tax on the taxable percentage of the new acquisitions in each month. The Commissioner then requires no tax to be levied on the individual short term leases of the goods.

4.5 Similar agreements have been entered into with *unregistered* lessors of short term hire stock in order to place them on an equal footing with their registered competitors. These lessors are then either entitled to provide an exemption certificate for the exempt percentage of purchases for the hiring pool, or they purchase all stock on a tax-paid basis and claim a refund for the exempt percentage of new acquisitions each month. (Some of these refund agreements set minimum capital costs below which no refund is allowed).

Content of the current Bills

4.6 Assessable dealings: Under the new law, a lease of goods will be treated as an application to own use by the lessor. This means that only the first lease of assessable goods will be an assessable dealing. The lessor will be liable to tax on that lease, unless an exemption applies at the time the lease is granted.

4.7 Exemptions: A lease of assessable goods will only be exempt if:

- (a) the lease is an *eligible long-term lease*;
- (b) the leased goods are intended for export prior to use;
- (c) the leased goods are always exempt goods; or
- (d) the small business exemption applies to the lessor.

4.8 An *eligible long-term lease* is a lease of assessable goods for at least two years (or the effective working life of the goods, if less than 2 years), provided that the lessee gives the lessor evidence of its intention to use the goods so as to satisfy an exemption Item. There is a requirement that any tax borne by the lessor on the goods must not have been passed on to any person.

4.9 Short term hire: The Bills do not provide a quotation ground, reduced taxable value or exemption for goods to be placed in short term hire pools or to be leased short term (ie for less than 2 years) to exempt bodies or for exempt uses (such as for business inputs purposes).

C. Explanation of the amendments to the Bills

Sales Tax Assessment Bill 1992

Agreements with the Commissioner

4.10 The Bill will enable the Commissioner to enter into an agreement with any person (referred to as 'the lessor') who grants leases of goods *in the course of a business*. It will not be necessary that the lessor is carrying on a business of leasing goods. The agreements will relate to goods of a *particular kind*, and may relate to more than one such class of goods which are leased out by the lessor.

[Amendment No. 4 of the Assessment Bill (new subclause 15A(2))]

4.11 A short-term lease of goods (i.e. a lease of less than the statutory period) will be an 'eligible short-term lease' if the goods are of a particular kind covered by such an agreement.

[Amendment No. 4 of the Assessment Bill (new subclause 15A(1))]

4.12 Exempt percentage: The key objective of these agreements will be to establish a percentage (referred to as the 'exempt percentage') which will be the percentage of the statutory period during which it is agreed that it is likely that goods of that particular kind will be leased out (or sub-leased) in exempt circumstances. In this context, 'exempt circumstances' means circumstances in which the lessee, or sub-lessee, would have been entitled to quote for the purchase in reliance on one or more exemption Items, if the lessee, or sub-lessee, had purchased the goods instead of leasing them.

4.13 The exempt percentage for any particular class of goods may be up to, and including, 100% of the statutory period.

4.14 The agreement will usually take into account past leasing patterns in order to determine the percentage of the statutory period during which it could reasonably be expected that those goods will be leased out in exempt circumstances.

4.15 The Commissioner and the lessor may agree upon a method of measuring exempt use which will accurately establish likely percentages

of exempt use in the future. The appropriate method may vary depending upon the character of the particular goods concerned.

Example 1: Exempt percentages for small value, large volume items of leasing stock, such as pallets, may be determined by reference to the number of units held on lease by exempt end-users at a particular point in time when a survey is conducted.

Example 2: Exempt percentages for high value items, such as forklift trucks, may be determined by reference to the proportion of leasing revenue received from exempt end-users compared with receipts from taxable end-users.

4.16 Any likely eligible long-term leases (i.e. single leases in exempt circumstances for the whole of the statutory period) may not be taken into account in determining the exempt percentage for short-term leases of any particular class of goods. This is to prevent exempt percentages from being distorted by possible eligible long-term leases for which exemption will be available separately.

4.17 Sub-leases: Sub-leases of the goods may be taken into account in determining the exempt percentage for a particular class of goods.

Example 3: *A* is a lessor who regularly leases goods of a particular kind to *B* (who is the lessee of the goods). *B*, who is also the first sub-lessor, does not use the goods, and regularly sub-leases the goods to *C* who uses the goods in exempt circumstances.

Result: *A* is entitled to take *C*'s use of the goods into account when reaching agreement with the Commissioner regarding the exempt percentage that will apply to that class of goods. The Commissioner may require *A* to provide evidence of *C*'s intended use of the goods before taking that use into account. The evidence concerned may be obtained by *A* either via *B*, or directly from *C*.

4.18 Other conditions: The agreement may also include other conditions that are to be complied with for the agreement to have effect.

[Amendment No. 4 of the Assessment Bill - new subclause 15A(6)]

Example 4: The lessor may be required to advise the Commissioner of any significant changes of leasing patterns which arise unexpectedly in the period of time covered by the agreement.

Example 5: Appropriate stock control systems may be required to be kept where differing exempt percentages have been agreed for the same kind of goods at different locations of the one lessor.

4.19 The Commissioner may also require that patterns of exempt usage be surveyed at specified time intervals e.g. quarterly or half-yearly, and that the exempt percentage specified in the agreement be reviewed at that time. The regularity of the reviews may be determined by the history of the lessor's business. A fledgling leasing business may be required to review its emerging patterns of exempt usage more frequently than a well established leasing operation.

4.20 Associated goods: The agreement may also specify a separate exempt percentage for particular kinds of 'associated goods'. These could be parts, fittings, accessories or attachments for, or materials for use so as to become an integral part of, the goods covered by the leasing agreement. The associated goods must be for use by the lessor *exclusively* in relation to the goods covered by the leasing agreement.

[Amendment No. 4 of the Assessment Bill (new subclause 15A(3))]

4.21 These separate exempt percentages may be necessary to take account of the differences in the treatment of parts etc across the various exemption Items, and also to recognise that different lessees of the same goods may rely on different exemption Items. This will ensure that the treatment of parts for leased goods is broadly the same as if the goods had been purchased by an exempt user.

Example 6: A leases out a particular class of goods under short term leases *exclusively* to exempt lessees for use in activities covered by a certain exemption Item. However, that exemption Item does not provide exemption for attachments for goods covered by the Item. The leasing agreement in relation to the goods concerned may specify that the exempt percentage applicable to the goods is 100%. However, the agreement will not specify an exempt percentage for the attachments for those goods (this is consistent with the position of the lessee, who would have been denied exemption for purchases of attachments for goods for use under that exemption Item).

Result: The first lease of assessable goods covered by the leasing agreement will be exempt *[Amendment No. 7 of the Assessment Bill (New paragraph 26(b))]*. However, purchases of attachments for those goods will *not* be exempt under new exemption Item 195(1) *[Amendment No. 17 of the E&C Bill]*.

4.22 In other cases, the leasing agreement may specify a different exempt percentage for associated goods than applies to the goods covered by the leasing agreement.

Example 7: A particular kind of forklift truck is leased out 60% to stevedoring companies for transporting sea cargo within wharf precincts (i.e. as 'business inputs') and 40% to retailers in taxable circumstances. One specialised attachment for use with that type of forklift truck is used to secure shipping containers and if used 100% under leases to the stevedoring companies, but never to retailer lessees.

Result: The Commissioner may agree with the lessor that although a 60% exempt percentage applies to the kinds of forklift trucks concerned, a 100% exempt percentage will apply to the specialised sea cargo attachments for use exclusively with those forklift trucks. Exemption will be available for these attachments under proposed new exemption Item 195(1). This is consistent with the situation under which the stevedores could have obtained an exemption for such attachments under exemption Item 30.

4.23 Repair equipment: A leasing agreement may also specify a separate exempt percentage for 'repair equipment' which is for use by the lessor *exclusively* to repair or maintain the goods covered by the leasing agreement.

[Amendment No. 4 of the Assessment Bill (new subclause 15A(4))]

4.24 A separate exempt percentage for repair equipment may only be specified in a leasing agreement where the goods covered by the agreement are leased out more than 50% in exempt circumstances under one or more of business inputs exemption Items 1, 2, 18, 23, 28, 29, 30, 33, 34, 35, 36 and 38.

[Amendment No. 4 of the Assessment Bill (new subclauses 15A(4) (and 15A(5))]

Example 8: A lessor leases out a particular line of goods, such as certain collapsible boxes, which are used:

- 60% in exempt circumstances under business inputs exemption Items (e.g. by manufacturers whose use of the goods would satisfy exemption Item 28);
- 30% in exempt circumstances under non-business inputs exemption Items (e.g. by public hospitals whose use of the goods would satisfy exemption Item 140); and

10% in taxable circumstances (e.g. by retailers).

The lessor purchases certain welding equipment which is used exclusively to repair and maintain the collapsible boxes.

Result: The leasing agreement will specify that the exempt percentage for the collapsible boxes is 90% (i.e. 60% business inputs exempt use plus 30% non-business inputs exempt use). The agreement will also specify that the exempt percentage for the repair equipment is 60% (i.e. the business inputs percentage applicable to the collapsible boxes). If the leases by business inputs exemption users had only been agreed to be 40%, then no proportional exemption will be available for the repair equipment, as a minimum use of 50% in business inputs circumstances is required.

Exemption for certain short-term lease AOU's etc

4.25 Leasing goods: An additional exemption will apply to a lease AOU where:

- the lease is an eligible short-term lease; and
- the exempt percentage specified in the leasing agreement covering that particular kind of goods is 100%.

[Amendment No. 7 of the Assessment Bill (paragraph 26(b))]

Example 9: A is a lessor of goods which are leased out on a short-term basis and which have an exempt percentage of 100% under a leasing agreement with the Commissioner. A obtains replacement stock for the short-term leasing pool under quotation.

Result: The first lease AOU of the goods will be exempt.

Reduced taxable value for certain short-term leases

4.26 Goods to be leased: A reduced taxable value will apply to a dealing with goods if:

- (a) the first AOU in Australia of the goods consisted of the grant of a lease of the goods;
- (b) the lease is an eligible short-term lease; and
- (c) the exempt percentage specified in the leasing agreement in relation to that particular class of goods is less than 100%.

[Amendment No. 8 of the Assessment Bill (new subclause 50A(1))]

4.27 In these circumstances, the exempt part of the taxable value will be an amount equivalent to the taxable value multiplied by the exempt percentage that applies to the goods under the leasing agreement. This

amount will be deducted from the taxable value before applying the appropriate rate of tax. The net amount will be the taxable value for the dealing, regardless of the actual percentage of the statutory period during which the goods happen to be leased out in exempt circumstances.

4.28 Associated goods: A reduction in taxable value will also be available for goods for use by a lessor exclusively as parts, fittings, accessories or attachments for, or so as to become an integral part of, goods covered by a leasing agreement where the exempt percentage for the parts etc is specified in the agreement to be less than 100%. This reduction in taxable value will only be available if the parts etc are of a kind, and for use in a way, that complies with the conditions of the leasing agreement concerned.

[Amendment No. 8 of the Assessment Bill (new subclause 50A(2))]

4.29 Repair equipment: A reduction in taxable value will also be available for goods exclusively for use by a lessor in repairing or maintaining goods leased under a leasing agreement where the agreed exempt percentage for the leased goods as *business inputs* is between 50% and 100%.

4.30 This reduction in taxable value will only be available if the repair equipment is of a kind, and for use in a way, that complies with the conditions of the leasing agreement concerned.

[Amendment No. 8 of the Assessment Bill (new subclause 50A(2))]

Quotation for goods covered by leasing agreements

4.31 Lessors who have concluded leasing agreements with the Commissioner will be entitled to obtain the following goods tax-free under quotation:

the goods to be leased out in accordance with the terms of the agreement;

certain associated goods (such as parts etc) for the leased goods; and

certain repair equipment for use exclusively in repairing those lines of leased goods which are to be leased out more than 50% as business inputs.

4.32 Leased goods: New quotation grounds will enable a registered person to quote a registration number for a dealing with goods, and an unregistered person to quote an exemption declaration for a dealing with goods if, at the time of quoting, there is:

a leasing agreement relating to that particular class of goods; and

the person has the intention of granting an eligible short-term lease of the specific goods subject to the quote.

[Amendment No's. 9 and 10 of the Assessment Bill (new paragraphs 82(1)(g) and 83(1)(c))]

4.33 Associated goods and repair equipment: New quotation grounds will also enable a registered person to quote a registration number for a dealing with goods, and an unregistered person to quote an exemption declaration for a dealing with goods if, at the time of quoting, there is:

- a leasing agreement relating to that particular class of associated goods or repair equipment; and
- the person quoting (i.e. the lessor) has the intention of either:
 - using the associated goods exclusively as associated goods (such as parts or attachments) for goods covered by a leasing agreement; or
 - using the repair equipment exclusively to repair a particular line of leased goods which is covered by a leasing agreement and which is to be leased out more than 50% as business inputs.

[Amendment No's. 9 and 10 of the Assessment Bill (new paragraphs 82(1)(h) and 83(1)(ca))]

Credit Ground 18A: Eligible short-term lease

4.34 General description: The first lease of goods is an eligible short-term lease and the claimant has previously borne tax on the goods.

[Amendment No. 23 of the Assessment Bill (new credit ground CR18A)]

Coverage: This ground will provide a mechanism to enable a lessor who has a leasing agreement with the Commissioner relating to a particular class of goods to claim a credit where goods to be leased out in accordance with the agreement are acquired on a *tax-paid* basis e.g. where the lessor did not quote on the acquisition of the goods. A credit will be available if:

- (a) the first AOU in Australia of goods consisted of the lessor granting a lease of the goods;
- (b) the lease is an eligible short-term lease (i.e. the goods are of a particular kind covered by a leasing agreement); and

- (c) the lessor has previously borne tax on the goods.

The amount of the credit will be the amount of tax previously borne on the goods by the lessor multiplied by the exempt percentage specified in the leasing agreement in relation to goods of that particular kind. This will be the claimant's credit entitlement, regardless of the actual percentage of the statutory period during which the goods happen to be leased out in exempt circumstances.

Example: The exempt percentage applicable to a particular class of goods under a leasing agreement is 40%. The lessor has obtained all the goods on a tax-paid basis. One such piece of equipment happens to have been leased out only 30% in exempt circumstances during the statutory period. A second similar piece of equipment happens to have been leased out 60% in exempt circumstances during the statutory period.

Result: The lessor is entitled to a credit of 40% of the tax previously borne on *both* pieces of equipment. The credit entitlement is *not* affected by the actual use of leasing goods while the goods are covered by a leasing agreement and the lessor is complying with the conditions of that agreement. However, a consistently higher or lower actual exempt usage of the leasing stock than the percentage that has been agreed may lead to a review of the agreed exempt percentage.

Requirement that the tax has *not* been passed on: No.

Change from existing law: Some of the existing administrative arrangements which the Commissioner has entered into with lessors of short-term hire pools require the lessor to acquire the leasing stock on a tax-paid basis. The lessor is then allowed to claim a credit for the agreed exempt percentage applicable to goods of that particular kind under the agreement. There is no specific refund provision in the existing law. This credit ground will be broadly consistent with those arrangements.

Credit Ground 18B: Trial lease or-trial loan

4.35 General description: The claimant has borne tax on goods which are the subject of an initial short-term lease or loan, followed by a sale (or a second lease) of the goods, to the same person for use in exempt circumstances for a combined period equal to or greater than the statutory period.

[Amendment No. 23 of the Assessment Bill (new credit ground CR18B)]

Coverage: This credit ground will operate where the following conditions are satisfied:

- (a) the claimant grants a short-term lease (referred to as a 'trial-lease'), or makes a loan, of *assessable* goods to another person;
- (b) immediately after the end of the trial-lease or loan, the claimant sells the goods, or leases them for at least the remainder of the statutory period, to that other person;
- (c) at or before the end of the trial-lease or loan, the other person gives the claimant evidence, in a form approved by the Commissioner, of the other person's:
 - use of the goods during the period of the trial-lease or the loan; and
 - intended use of the goods during the remainder of the statutory period;
 so as to satisfy an exemption Item; and
- (d) the claimant has borne tax on the goods before the time of the sale or the granting of the second lease.

Requirement that the tax has *not* been passed on: Yes.

Change from existing law: There is no equivalent refund ground under the existing law.

Reasons for change: The introduction of this new credit ground will enable a credit to be obtained where, in effect, assessable goods are for use by the one person in exempt circumstances during the whole of the statutory period (which commences at the time of the grant of the trial-lease or loan). This will deal with those various situations where, for reasons of commercial practice, the goods are not the subject of an eligible long-term lease, or are used on a trial basis before a sale is completed.

Eligible long-term leases which are sub-leases

4.36 The Bill will extend the definition of 'eligible long-term lease' to include a situation where there is a lease of assessable goods with an immediate sub-lease of the goods to a sub-lessee. It will be necessary that, at or before the time of the grant of the lease, the head-lessor is given evidence, in a form approved by the Commissioner, of the intention of the

sub-lessee to use the goods in exempt circumstances for the whole of the statutory period.

[Amendment No. 2 of the Assessment Bill (paragraph (b) of the definition of 'eligible long-term lease in clause 5)]

Example: **A** grants a lease of assessable goods to **B**, who grants an immediate sub-lease of the goods to **C**. **B** does not use the goods, and is in fact only a financial intermediary between the other two parties. **C** intends to use the goods during the whole of the statutory period in exempt circumstances. No part of any tax borne by **A** on the goods before the time of the grant has been passed on by **A** to any person. Evidence of **C**'s intention is given to **A**, in a form approved by the Commissioner, at or before the time of the grant of the head-lease by **A** (this evidence may have been passed through **B**, or obtained directly from **C**).

Result: The grant of the head-lease by **A** is an eligible long-term lease, and is exempt.

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Item 31: Pallets

4.37 The Item will be omitted. The proposed unconditional exemption for certain pallets will be withdrawn, as pallets used in exempt circumstances by manufacturers etc. are usually leased on a short-term basis, and therefore these goods will be covered by the new rules for eligible short-term leases.

[Amendment No. 16 of the E&C Bill]

Item 195: Parts, repair equipment etc. for use in relation to certain leases

4.38 General description: Goods for use *exclusively*:

- (a) as parts, accessories, fittings or attachments for, or so as to become an integral part of, other goods which are covered by a short-term leasing agreement. Exemption will only apply where the agreed exempt percentage for the parts or materials is 100%;

[Amendment No. 17 of the E&C Bill (new subitem 195(1))]

- (b) in repairing or maintaining other goods which are covered by a short-term leasing agreement. Exemption will only apply where the agreed exempt percentage of the leased goods as *business inputs* is 100%;

[Amendment No. 17 of the E&C Bill (new subitem 195(1))]

- (c) by the lessor as parts, accessories, fittings or attachments for, or so as to become an integral part of, other goods which are subject to an eligible long-term lease. It will be a requirement that the lessee, or sub-lessee, would have been entitled to quote for the purchase of the parts or materials in reliance on one or more exemption Items, if the lessee, or sub-lessee, had purchased the parts or materials for use in the same manner as the lessor;

[Amendment No. 17 of the E&C Bill (new subitem 195(2))]

- (d) by the lessor in repairing or maintaining goods leased as business inputs under an eligible long-term lease.

[Amendment No. 17 of the E&C Bill (new subitem 195(3))]

Change: Exemption for certain of these goods is available under existing administrative arrangements which the Commissioner has entered into with some short-term lessors. This exemption Item will clarify the requirements that must be satisfied for exemption to apply in these circumstances.

Existing item: There is no equivalent existing exemption Item.

Links with other Items: Under exemption Item 194 [*Amendment No. 17 of the E&C Bill*], a contract repairer who repairs leasing stock for a lessor will, in effect, be eligible for exemption for the parts and materials used in the repair, if the goods being repaired are the subject of:

- an eligible long-term lease; or
- an eligible short-term lease with an agreed exempt percentage of 100%.

5 Deemed manufacturers

A. Summary of amendments to the Bills

5.1 Access to business inputs concessions will be extended to a person who supplies materials to a manufacturer to be made up into goods, provided that the made-up goods (to be referred to as 'wholesaler's-materials goods') are mainly for wholesale sale by the supplier of the materials. The new provision will not apply if the materials supplied have been purchased from the manufacturer.

[Amendment No. 3 of the E&C Bill (new definition of 'wholesaler's-materials goods' in subclause 3(2))]

5.2 The new exemptions will be:

Various manufacture-related activities: exemption will be available for equipment and consumables for use by the supplier mainly in undertaking *various manufacture-related activities*, such as quality testing, packaging and labelling etc, in relation to the made-up goods described above;

[Amendment No's 11, 12, 13 and 14 of the E&C Bill]

Other higher-level activities: exemption will generally be available for equipment and consumables for use by the supplier mainly in carrying out a number of *higher-level activities* in relation to *either* the made-up goods concerned, *or* in relation to the materials wholly or partly out of which the made-up goods are to be manufactured. These higher-level activities include:

- in-house storage, handling, transport or dispatch
[existing exemption Item 28];
- transporting by private railway, pipeline or conveyor
[existing exemption Item 29];
- research and development *[existing exemption Item 33];* and
- engineering, or technical design *[existing exemption Item 35].*

[Amendment No. 2 of the E&C Bill]

Ancillary activities: exemption will be available for equipment and consumables for use by the supplier mainly in carrying out certain *ancillary activities*, such as ordering, storing, handling, transporting, monitoring, controlling and costing etc, carried out in relation to the *materials* out of which the made-up goods are to be manufactured *[existing clause 10(1)(b) of the E&C Bill];*

[Amendment No. 10 of the E&C Bill]

Newspaper and magazine advertising: exemption will be available for equipment and consumables for use by a person mainly to record advertisements to be included in a newspaper or magazine which is to be manufactured out of materials supplied by that person, if the newspapers or magazines are to be sold mainly by wholesale by that person.

[Amendment No. 15 of the E&C Bill]

B. Background

Existing law

5.3 It is common practice for a person to manufacture goods for a customer from materials supplied by the customer. If a significant amount of the materials used in the manufacture of goods are supplied by the customer, then the manufacturer may *not* legally be the owner of the goods. Consequently, the delivery of the manufactured goods to the customer may not be a sale of the goods to the customer and, therefore, not be covered by the normal taxing provisions. The existing law overcomes this problem by deeming the delivery of the made-up goods to be a sale by the manufacturer to the customer.

5.4 If the customer supplying the materials intends to *re-sell* the made-up goods, the customer is deemed to be the manufacturer of the goods, and the actual manufacturer is deemed *not* to be the manufacturer. The intention of this treatment is to postpone the taxing point so that the customer will be liable to tax on its subsequent sale of the manufactured goods as if it were a sale by the real manufacturer. The relevant sale value will be either the actual wholesale selling price or the notional wholesale selling price if the sale is by retail.

5.5 These sale values will generally include amounts to reflect the cost of any business inputs equipment for use mainly by the customer in relation to the *materials* supplied, or in relation to the *made-up goods*.

5.6 As an offset to imposing liability on the customer (i.e the 'deemed manufacturer'), the existing law allows the customer to have access to all of the business inputs concessions to which it would have been entitled if it had actually manufactured the goods.

Content of the current Bills

5.7 Under the new law, the delivery of the goods to the customer by the actual manufacturer will be treated as a separate assessable dealing (known as a delivery of customer's materials goods - see paragraphs **7.29 to 7.32** of the explanatory memorandum to the Assessment Bill). Tax will therefore be imposed, *at the time of the delivery*, on the actual manufacturer and not on the customer. The customer will no longer be treated as the manufacturer of the goods.

5.8 There will be a special taxable value for this dealing, which will be the manufacturer's charge (excluding sales tax) plus the value (i.e. the notional wholesale purchase price) of any always exempt materials supplied by the customer (see paragraphs **9.5 to 9.6** of the explanatory memorandum to the Assessment Bill).

5.9 In general terms, the current Bills will effectively allow business inputs costs to be excluded from the sales tax base if they are incurred by the customer, either before the supply of the materials to the manufacturer, or after the time of delivery of the made-up goods from the manufacturer to the customer. As a set off, the Bills would have withdrawn the access of the customers to business inputs concessions in relation to the supply of the materials and the receipt of the made-up goods.

C. Explanation of the amendments to the Bills

Sales Tax (Exemptions and Classifications) Bill 1992

5.10 In broad terms, access to business inputs concessions will be extended to a person who supplies materials to a manufacturer to be made up into goods, provided that the goods (to be referred to as 'wholesaler's-materials goods') are made up mainly for wholesale sale by the supplier of the materials.

Wholesaler's materials goods

5.11 These will be goods which satisfy all the conditions set out below:

- (a) the goods must have been manufactured for a person (referred to in this supplementary explanatory memorandum as the 'wholesaler') by a manufacturer in the course of a business;

- (b) the goods must have been manufactured wholly or partly out of *materials* supplied by the wholesaler (or supplied by a third person at the request of the wholesaler);

Note: Materials will specifically include exposed photographic film or cinematograph film that is processed or treated so as to produce a negative, transparency or film strip. This is consistent with the approach taken in clause 22 of the Assessment Bill, which will remove any doubt about the matter by defining 'materials' to include such film.

- (c) the goods must not have been manufactured from materials obtained by the wholesaler from the manufacturer or an associate of the manufacturer. This requirement will ensure that a wholesaler cannot obtain business inputs concessions simply by purchasing the manufacturer's raw materials under a separate contract; and
- (d) it must be likely, at the time of the delivery of the made-up goods by the manufacturer, that the made-up goods are to be sold *mainly by wholesale* by the wholesaler. Made-up goods intended for retail sale by the supplier of the materials will not qualify as wholesaler's materials goods.

Note: Later *wholesale* sales of made-up goods will be subject to an assessable dealing (i.e. AD 1b), the taxable value of which will include an amount to reflect the cost of the supplier's business inputs. However, where the made-up goods are for later *retail* sale, they will generally not be subject to a later assessable dealing, and the cost of this supplier's business inputs will not have been included in the taxable value of the delivery of the made-up goods.

[Amendment No. 3 of the E&C Bill (new definition of 'wholesaler's materials goods' to be inserted in subclause 3(2))]

Manufacture-related activities

5.12 Exemption will be available for equipment and consumables for use by the wholesaler mainly in undertaking the full range of *manufacture-related activities* in relation to the wholesaler's materials goods.

5.13 Specific amendments of the definition of 'manufacture-related activity' contained in exemption Item 18(5) will only be necessary in relation to the following activities:

applying a process or treatment to the wholesaler's materials goods for the purpose of bringing them into the form or condition in which they are to be marketed or used by the wholesaler;

[Amendment No. 11 of the E&C Bill (Item 18(5)(c))]

packaging or labelling the wholesaler's materials goods (except where the packaging or labelling is carried out mainly for purposes connected with the delivery of the wholesaler's materials goods);

[Amendment No. 11 of the E&C Bill (Item 18(5)(d))]

- testing or checking the quality or specifications of the wholesaler's materials goods; and

[Amendment No. 12 of the E&C Bill (Item 18(5)(e))]

- cleaning, sterilising or repairing receptacles that the wholesaler uses mainly in the storage or marketing of the wholesaler's materials goods.

[Amendment No. 13 of the E&C Bill - Item 18(5)(g)]

5.14 The definition of 'manufacture-related activity' will be extended to include supplying materials, wholly or partly out of which wholesaler's-materials goods in relation to the exemption user are to be manufactured. This is to allow the full range of exemptions for ancillary activities to be available as discussed below.

[Amendment No. 14 of the E&C Bill - new Item 18(5)(ha)]

Other higher-level activities

5.15 Exemption will generally be available for equipment and consumables for use by the wholesaler mainly in carrying out a number of other *higher-level activities* in relation to *either* the made-up goods concerned, *or* in relation to the materials wholly or partly out of which the made-up goods were manufactured. These higher-level activities will include:

- in-house storage, handling, transport or dispatch
[see exemption Item 28];
- transporting by private railway, pipeline or conveyor
[see exemption Item 29];
- research and development *[see exemption Item 33];* and
- engineering, or technical design *[see exemption Item 35];*

5.16 The higher-level activities listed above are able to be undertaken in relation to a class of goods referred to as 'qualifying goods'. In order to allow these wholesalers to obtain exemption for equipment and consumables for use mainly to undertake these activities (whether carried out in relation to the wholesaler's materials goods, or in relation to the materials concerned), the definition of 'qualifying goods' will be extended to include:

- wholesaler's materials goods; and
[Amendment No. 2 of the E&C Bill - new paragraph (aa) in the definition of 'qualifying goods' in subclause 3(2)]

materials to be supplied by the wholesaler (or by someone else at the request of the wholesaler) wholly or partly out of which wholesaler's materials goods are to be manufactured for the wholesaler.

[Amendment No. 2 of the E&C Bill - new paragraph (ab) in the definition of 'qualifying goods' in subclause 3(2)]

Ancillary activities

5.17 Exemption will be available for equipment and consumables for use by the wholesaler mainly in carrying out the full range of ancillary activities either in relation to the *wholesaler's materials goods*, or in relation to the *materials* wholly or partly out of which those goods are to be manufactured.

Note: Ancillary activities are a list of defined activities that complement or assist in the conduct of higher-level activities for which business inputs concessions are available (such higher-level activities include primary production, mining or manufacturing). Ancillary activities may also assist in the carrying out of ancillary activities themselves - see paragraphs 5.24 to 5.26 of the explanatory memorandum to the Exemptions and Classifications Bill.

5.18 Equipment and consumables for use in carrying out ancillary activities may only qualify for exemption where those ancillary activities are carried out in relation to higher-level activities. The following two changes will be necessary to ensure that exemption will be available for equipment and consumables for use by the wholesaler mainly in undertaking ancillary activities in relation to the materials, out of which wholesaler's materials goods are to be manufactured:

the supply of materials, wholly or partly out of which wholesaler's materials goods are to be manufactured for the wholesaler, will be included as a *manufacture-related activity* (and therefore the supply of the materials will be a higher-level activity);

[Amendment No. 14 of the E&C Bill (new paragraph 18(5)(ha))]

- in relation to the second category of ancillary activities - [see clause 10(1)(b) of the E&C Bill] - the five types of goods that can be ordered, stored, handled, transported, monitored, controlled or costed etc. will be extended to include *materials* wholly or partly out of which

wholesaler's materials goods are to be manufactured for the wholesaler. Therefore the ordering, costing etc of these materials will be an ancillary activity.

[Amendment No. 10 of the E&C Bill - new subparagraph 10(1)(b)(iia)]

Newspaper and magazine advertising

5.19 Background: Exemption will be available under the current Bills for equipment or materials for use by a person mainly to record advertisements that are to be included in a newspaper, periodical or magazine *manufactured* by that person *[exemption item 23(1)(b)]*.

However, in circumstances where the publisher of a magazine supplies materials (such as paper) to a printer who will manufacture the magazine for the publisher, the magazine will *not* have been manufactured by the publisher. In such a case, the publisher will no longer be entitled to exemption for the equipment used to record the advertisements for the magazine.

5.20 Change: It is intended that exemption will be available for equipment and consumables for use by a person (to be referred to as the wholesaler) mainly to record advertisements to be included in a newspaper, periodical or magazine which is to be manufactured by another person out of materials supplied by the wholesaler. This will only apply where the newspapers, periodicals or magazines are to be sold mainly by *wholesale* by the wholesaler.

5.21 A reference to 'wholesaler's materials goods' in relation to the exemption user will be inserted in paragraph 23(1)(b) to make this change.

[Amendment No. 15 of the E&C Bill (Item 27(1)(b))]

6. Exempt use

This chapter will cover three areas of exempt use of goods:

- donations to and by exempt bodies;
- repair of goods owned by exempt bodies and exempt users; and
- buildings owned or leased by exempt bodies.

Donations to and by exempt bodies

A. Summary of changes

6.1 A new exemption item will be introduced to provide exemption for goods donated to an always-exempt person (exempt body) if the goods are still assessable goods at the time of donation. This will restore the position under the existing law. Exemption will not apply to donations of Australian-used goods because they are outside the sales tax law. An always-exempt person will be defined to mean a person who is entitled to exemption on goods used by them, irrespective of the kind of use. Examples of always-exempt persons are government departments and authorities, local councils, schools and public hospitals and public benevolent institutions.

6.2 A new clause will also be introduced to provide that goods donated by an exempt body to another person or for use as a prize or award will be covered by the exemption item relevant to the exempt body. The effect of the clause will be that the act of donation by the exempt body will result in the goods being exempted, because all conditions for exemption will have been satisfied. The same position will apply to goods used as prizes or awards by the exempt body. The use of goods in such manner will make them exempt goods.

6.3 The changes will also extend to goods for use by foreign governments. These bodies also are entitled to a general exemption on goods for their own use but they do not strictly fit into the definition of always-exempt persons because use of the goods by diplomatic and consular posts and Trade Commissioners is excluded from the exemption. The change makes separate provision for foreign governments so that the exemptions available under new Items 192, 193 and 194 to always-exempt persons will also apply to similar transactions involving a foreign government.

B. Background

6.4 Under the existing law goods for use and not for sale by an exempt body qualify for sales tax exemption. The exemption is wide enough to cover goods donated to exempt bodies, goods given away by exempt bodies and goods for use as prizes in raffles etc or awards by exempt bodies.

6.5 The wording of the exemption items does not specify how far exemption extends. In drafting the new law the extent to which goods have to be used by exempt bodies to qualify for exemption has been clarified, including whose use is relevant to exemption.

6.6 Under the new law a donation of goods will be an AOU by the donor and exemption will depend on the status of the donor and not the recipient. Also, for goods to qualify for exemption they must satisfy a statutory use period of at least two years or the effective working life of the goods. Goods given away new by exempt bodies or used by them as prizes in fund raising ventures would not ordinarily satisfy the statutory use test.

6.7 Thus, as the new law is drafted exemption would not apply to:

- goods donated to exempt bodies by taxable persons;
- goods given away by exempt bodies; or
- goods used as prizes in raffles or as awards to staff.

It is possible that these goods may qualify for exemption under the Bills as originally drafted but it would depend on the exercise of a discretion by the Commissioner that the statutory use period did not apply to such transactions. However, it is not clear that this would be the situation and the amendments proposed are designed to ensure that exemption does apply.

C. Explanation of the changes

6.8 It was not intended to deny exemption to exempt bodies in the situations set out in paragraph 6.7 above. This resulted from a restructuring and clarification of the law as to the meaning of "use" which, in the existing law, is very uncertain. The change to the Bill will restore these exemptions which exempt bodies enjoy under the existing law. However, exemption will be by means of a separate exemption for the goods. The structure of the new law under which the donation of goods is an application to own use by the donor will be retained. This is because

there are other situations where goods are donated and the new structure is necessary to deal with these situations. It is simpler to determine liability on the status of the donor rather than the recipient.

[Amendments Nos. 1, 9 and 17 of the Exemptions and Classifications Bill (proposed new Item 193 in the First Schedule)]

Goods repaired for exempt bodies and exempt users

A. Summary of changes

6.9 A new exemption Item will be introduced to provide exemption for goods that are incorporated by a repairer into other goods that are for use by another person in exempt circumstances.

6.10 To qualify for exemption, property in the goods has to pass under a contract (other than a contract of sale) from the repairer to the other person where the other person would have been entitled to exemption had the goods been purchased by that other person. For example, a manufacturer is entitled to purchase parts for use in the repair of exempt business inputs free of sales tax. If, instead of purchasing the goods direct, the manufacturer arranges for an external repairer to supply the parts and repair the goods, then exemption will also apply to the parts in the hands of the repairer. The same position will apply if an external repairer repairs goods owned by exempt bodies.

B. Background

6.11 Under the existing law, if parts and materials are used by professional repairers in the repair of goods owned by other persons (i.e. the customer), then the law deems the parts and materials used in the repair to be sold to the customer. If the customer is entitled to exemption for the goods that it acquires by the deemed sale, the repairer can claim exemption for the parts and materials used to repair the goods. Exempt bodies and exempt users such as manufacturers, miners and primary producers can obtain exemption on parts etc that are incorporated into exempt goods owned by them by professional repairers.

6.12 The provision which deems a sale of goods to take place in a repair situation will not be incorporated into the new law. Rather, under the new law [*definition of "application to own use", clause 5 of the Assessment Bill*] the use of parts and materials in a repair contract will be regarded as an AOU of the parts etc by the repairer. Exemption for the repair parts and materials will depend on the status of the repairer. Ordinarily repairers are not entitled to any exemption which means that the parts and

materials provided by them would normally be taxable. The fact that the owner of the goods may be entitled to exemption will not be relevant.

C. Explanation of the changes

6.13 The new exemption Item is modelled largely on the provision in the existing law which deems the supply of parts etc in the course of repairing goods to be a sale of the parts. It will effectively restore the position under the existing law by providing a specific exemption for the goods in the hands of the repairer. In this way the structure of the new law, under which parts and materials used in the repair of goods is an AOU of the parts and materials by the repairer, can be retained.

6.14 The new Item will provide exemption for parts held tax-free by repairers and it will allow repairers to purchase repair parts tax-free where the repairer is aware that the parts will be for use in the repair of goods owned by exempt bodies or exempt users.

[Amendments Nos. 1 and 17 of the Exemptions and Classifications Bill (proposed new Item 194 in the First Schedule)]

Buildings owned or leased by exempt bodies

A. Summary of changes

6.15 A new exemption Item will be introduced to provide exemption for goods incorporated into buildings and other structures (property) where the buildings etc are either owned by the exempt body, held under lease by the exempt body or are in the course of construction, improvement or other preparation for an exempt body.

B. Background

6.16 Under the existing law, exemption is allowed for materials and goods purchased for use by a contractor in the construction or repair of buildings and other structures owned by exempt bodies. Exemption is allowed whether the building is occupied by the exempt body or leased out to another exempt body or a taxable body or person. With private buildings, exemption is allowed for materials used in the repair of such buildings if the building is fully leased by an exempt body. Exemption is also allowed for a private building during the course of construction if the owner has a lease with an exempt body for the building. However, exemption is not allowed if, at the time of construction, the private owner does not have a lease with an exempt body even though the building, on completion or at a later date, may be leased to an exempt body.

6.17 Under the new law all goods incorporated into buildings and other structures in the course of construction or repair will be treated as an application to own use of those goods by the person carrying out the construction, repair etc work. This is consistent with the concept of AOU in the new law. Unless the builder or repairer is entitled to exemption, the goods will be taxable. The fact that property in the goods may pass to an exempt body, or an exempt body will lease the building and thus have use of the goods, will not affect the position.

C: Explanation of the changes

6.18 The new Item is designed to largely restore the exemptions available under the existing law and to clarify the situation with buildings or other structures owned or leased by exempt bodies or in the course of construction, improvement or other preparation for an exempt body which, under the existing law, is not clear.

6.19 There are, broadly, two kinds of situations in which exemption will apply. The first situation is where the goods are provided under a contract with an exempt body. Exemption will be provided for goods that are, under the contract, either incorporated into buildings that are owned or leased by exempt bodies or incorporated into buildings in the course of construction, improvement or other preparation for ownership or lease by an exempt body. The essential feature is that the contract must be with the exempt body. In effect, the exemption places the exempt body in the same position as if it had purchased the goods separately, for which an exemption would apply.

6.20 Exemption is also extended under this first situation to a sub-contractor to the primary contractor. In the construction or repair of buildings it is common practice for the primary contractor to contract out part of the work to sub-contractors. If the primary contract is with the exempt body, and the goods incorporated would qualify for exemption in the hands of the primary contractor, then any goods provided by a sub-contractor under the primary contract and which become part of the building owned or leased by the exempt body will also qualify for exemption.

6.21 The second situation is where the building is privately owned and leased to an exempt body. In this situation the contract is between the contractor and the lessor. While there is no direct contract with the exempt body, there is still a use of the building and the goods incorporated into it by the exempt body. Exemption will be provided for goods that become part of buildings that are privately owned but leased to exempt bodies, subject to the condition that the work carried out is required to be done under the lease. This condition is to ensure that any exemption

available to the lessor is on the basis of the contract (lease) with the exempt body. It is not intended that an exemption should apply to a private lessor for general improvements made to the building while leased to an exempt body, but which are neither required under the lease nor the cost of which is required to be met by the exempt body. Any general improvements outside the conditions of the lease are a matter for the lessor only and do not qualify for any sales tax exemptions.

6.22 The exemption will apply to the person who incorporates the goods into the building or other property. It is that person who uses the goods and consistent with the structure of the new law it will be an AOU of the goods by that person. Exemption will also apply if the goods are incorporated by a sub-contractor under the contract between the lessor and contractor and the conditions applying to the lessor for exemption are met.

6.23 The exemption will apply to goods held in tax-free stock by the builder/repairer contractor or sub-contractor and used in accordance with the exemption Item. It will also allow such persons to obtain goods tax-free where they are purchased specifically for use in circumstances covered by the new exemption Item.

[Amendments Nos. 1 and 17 of the Exemptions and Classifications Bill (proposed new Item 192 in the First Schedule)]

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