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Abstract

This article analyses the application of GST to situations involving third party consideration. It discusses the connection between supply and consideration required by the GST Act, critically analyses the Commissioner's views on the matter and makes a series of suggestions that may assist in the analysis of the issue.

Keywords

GST, goods and services tax

Cover Page Footnote

Lecturer, Faculty of Law, University of Technology Sydney; Consultant, Blake Dawson Waldron. The author is indebted to Justice Hill, in his capacity as Challis Lecturer in Taxation at the University of Sydney, and to Helen Cosby, PricewaterhouseCoopers, for comments on drafts of this article. Any errors remain the responsibility of the author.

AN ANALYSIS OF GST AND THIRD PARTY CONSIDERATION

By Peter Edmundson¹

This article analyses the application of GST to situations involving third party consideration. It discusses the connection between supply and consideration required by the GST Act, critically analyses the Commissioner's views on the matter and makes a series of suggestions that may assist in the analysis of the issue.

Introduction

The Australian Goods and Services Tax ('GST') regime is about to face a challenging period. While many difficulties of implementation have been addressed the next wave of problems is likely to involve deeper conceptual issues. One of the key challenges is determining the required nexus between supply and consideration in order for there to be a taxable supply.² This issue of 'nexus' is a central conceptual and practical issue in all 'output-based' value added tax regimes.³ It is relevant to whether there is a taxable supply,⁴ a financial supply,⁵ some GST-free supplies,⁶ and entitlement to input credits.⁷

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- 1 Lecturer, Faculty of Law, University of Technology Sydney; Consultant, Blake Dawson Waldron . The author is indebted to Justice Hill, in his capacity as Challis Lecturer in Taxation at the University of Sydney, and to Helen Cosby, PricewaterhouseCoopers, for comments on drafts of this article. Any errors remain the responsibility of the author.
 - 2 The issue was highlighted in DG Hill, 'Flagging for the courts the problems of the GST' (a paper prepared for the GST discussion Group meeting, Monday 3 April 2000) 8-10. See also G Cooper and R Vann, 'Implementing the Goods and Services Tax' (1999) 21(3) *Sydney Law Review* 337, 370-1 and comments in P McMahon and A MacIntyre, *GST and the Financial Markets* (2001) 15-16.
 - 3 In the context of the New Zealand regime, Blanchard J commented: 'There is a practical necessity for a sufficient connection between the payment and the supply. The mechanics of the legislation will otherwise make it impossible to collect the GST' (*C of IR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13187 at 13193). See also comments in GSTR 2001/4 para80.
 - 4 See the combined operation of para 9-5(a) and s 9-15 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (the 'GST Act'). All references are to sections in the GST Act unless stated otherwise.
 - 5 In the Australian context see sub-para 40-5.09(1)(a)(i) of the *A New Tax System (Goods and Services Tax) Regulations 1999* (Cth) (the 'GST Regulations').

While the issue of nexus between supply and consideration is fundamental, it provides particular problems where it is argued that a supply is made to a recipient yet the consideration for that supply is provided by another party. For the sake of convenience, this will be referred to as the problem of 'third party consideration'. However, when using this description it is acknowledged that to label the payment 'third party consideration' is to pre-empt the result of any inquiry into connection between the supply and the payment by the third party. Consequently, for the purposes of discussion, the term 'third party consideration' includes reference to situations where there is a question about whether a payment relates to the supply of services to a third party or to some form of supply made to the payer.

This article examines the application of the Australian GST to third party consideration scenarios. The approach is as follows:

- first, there is discussion of three hypothetical scenarios designed to highlight the significance and difficulty of the issue;
- this is followed by discussion of relevant legislative provisions;
- relevant comments in GST Rulings are also considered; and
- finally, some tentative suggestions are made for approaching the issue.

Problems arising from GST and third party consideration

This portion of the article outlines three scenarios that involve third party consideration. The scenarios are outlined on a general level and are designed to highlight conceptual issues rather than be complete hypothetical case studies. It is assumed that all supplies are connected with Australia, all parties who are entitled to register for GST are registered and parties are not associates.

6 See para 38-325(1)(b) which deals with the GST-free supply of a going concern.

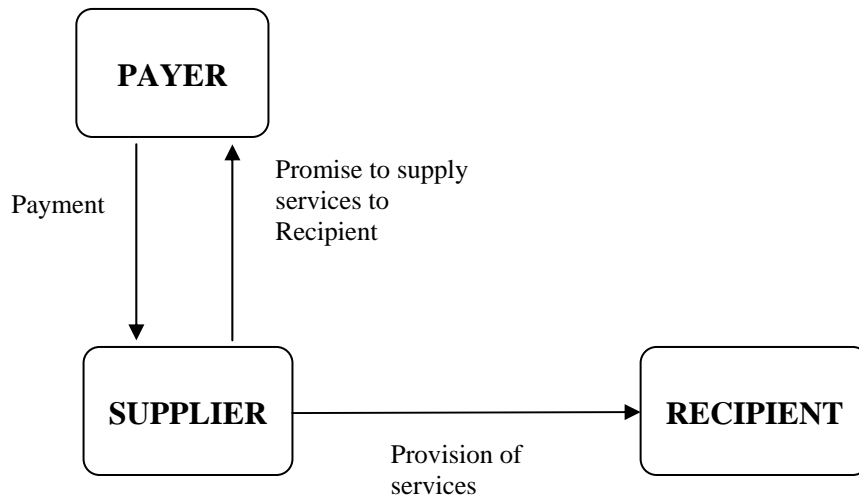
7 An acquirer is not entitled to input tax credits unless they provide or are liable to provide consideration for the supply: para 11-5(c). Further, the issue of entitlement to credits only arises where there is sufficient connection between supply and consideration to make the supply itself taxable.

Scenario 1: Taxable supplies

Consider the following:

- Payer pays an amount to Supplier;⁸
- in return for the payment Supplier promises to supply some services to Recipient.⁹ The nature of those services is such that, if for consideration, they ordinarily would be taxable;
- Supplier makes the promised supply to Recipient.

The arrangement can be depicted as follows:



There are three main ways this dealing can be viewed:

- First, the payment by Payer is for the promise that Supplier makes to Payer.¹⁰ This promise is a taxable supply and Payer may be entitled to input tax credits.¹¹ The provision of services to Recipient is not for consideration and therefore this supply is not taxable and its acquisition is not creditable.¹² The

8 While consideration can take forms other than payment of money, payment simplifies the example.

9 Note that the example is not dependent upon the supply being a supply of services and will also hold if goods are supplied.

10 The making of the promise will be the entry into an obligation to do something by the Supplier and will therefore be a 'supply': s 9-10.

11 Assuming that Payer's acquisitions are fully creditable.

12 Para11-5(b).

result is that the tax paid may be reflected fully in a credit, leaving no net GST burden.

- Secondly, the payment by Payer is for the services supplied by Supplier to Recipient. The supply to Recipient will be a taxable supply. Assuming that Recipient made no payment for the supply and had no obligation to make such a payment, Recipient will not be entitled to an input tax credit.¹³ As the promise to Payer is not for consideration it is not taxable and its acquisition is not creditable. As GST is paid yet there is no corresponding credit there is a net GST burden.
- Thirdly, the payment is partly for the promise to Payer and partly for the supply of services to Recipient. Both supplies by Supplier will be taxable and the consideration will be apportioned between these two supplies. Payer may be entitled to an input tax credit that reflects the tax on the promise by Supplier to Payer. However, Recipient will not be entitled to any input tax credits. This outcome is essentially a combination of the first two treatments and there is a partial GST burden. However, this is not a *neutral* compromise between the first two views, as it involves the difficult task of apportionment.¹⁴

The GST treatment varies depending upon whether the payment is seen as relating to the promise made to Payer or the services supplied to Recipient. Differing constructions give rise to differing net GST burdens and administrative requirements. There is also potential that, using structures similar to this, credits may be recouped by a registered party in the position of Payer where services are supplied to recipients who would not ordinarily be entitled to input tax credits. This was the situation in the case of *Redrow*,¹⁵ which is explored below.

Scenario 2: Financial supplies

Consider this variation on *Scenario 1*:

- Payer makes a payment to Supplier;
- In return Supplier promises to make a supply to Recipient that, if made for consideration, would normally be a financial supply;¹⁶
- Supplier makes the promised supply to Recipient.

Again, there are three main ways this scenario can be viewed:

13 Para 11-5(c).

14 The Commissioner's general views on this process of apportionment can be found in GSTR 2001/8.

15 *Customs and Excise Commissioners v Redrow Group Plc* [1999] 2 All ER 1.

16 For example, the sale of shares or grant of an option.

- First, the payment is for the promise that Supplier makes to Payer. This promise is a taxable supply¹⁷ and Payer may be entitled to an input tax credit. The supply to Recipient is not for consideration, and is not a financial supply.¹⁸ While GST has been paid, there is an offsetting credit and no net GST burden. Further, as Supplier has made taxable supplies it may recoup input tax credits on relevant inputs.
- Secondly, the payment is for the supply made to Recipient. In this case, the supply to Recipient will be input taxed. As the promise to Payer is not for consideration it will not be taxable and will not give rise to input tax credits. No GST is payable in relation to the dealing. However, as Supplier has made an input taxed supply, it will be denied input tax credits in relation to the costs of making this supply.
- Thirdly, the payment is partly for the promise made to Payer and partly for the supply to Recipient. As with *Scenario 1* this gives an amalgam of the two treatments described immediately above.

As with *Scenario 1*, differences arise depending upon which supply is connected with the payment. While there is no immediate GST difference, to put the matter crudely the distinction between the first and second treatment in *Scenario 2* is that an input taxed supply has been 'turned into' a taxable supply.¹⁹ This is desirable from Supplier's perspective as its entitlement to input credits may be improved on both a direct level²⁰ and in relation to general enterprise costs.²¹

17 Note that para 9-30(2)(b) does not affect this characterisation. This paragraph extends input taxation to include the 'supply of a right to receive a supply that would be input taxed' (emphasis added). Payer has not been supplied a right to receive such a supply, instead Payer has been supplied the right to demand that such a supply is made to another party.

18 Regulation 40-5.09(1)(a)(i).

19 Of course, one should be extremely wary of the application of the general anti-avoidance provision in Division 165, if there is any contemplation of restructuring a dealing in this manner. Acknowledgment that an input taxed supply has been 'turned into' a taxable supply would give powerful evidence to the Commissioner in relation to the application of Division 165.

20 For example, on the acquisition of taxable supplies that relate to the Supplier's enterprise but do not relate to input taxed supplies or that are private or domestic in nature.

21 For example, if Supplier makes a mix of taxable and input taxed supplies, some general business overheads that cannot be allocated to specific types of supply will need to be apportioned. Any increase in the extent to which the entity makes taxable supplies will increase the proportion of input tax credits to which it is entitled on this general expenditure.

Scenario 3: GST-free supplies

A final variation involves supplies that are potentially GST-free. Consider the situation where Payer pays Supplier in return for a promise to make what would ordinarily be a GST-free supply to Recipient.²² Consequently:

- If the payment is consideration for the promise made by Supplier, this will be a taxable supply and Payer may be entitled to input tax credits. The supply to Recipient will typically be a GST-free supply, despite the lack of consideration.²³
- If the payment relates to the supply of the GST-free services by Supplier, the promise made by Supplier to Payer will not be taxable.
- If the payment is seen as relating to both supplies made by Supplier, this gives the 'compromise' result.

Yet again, the nexus issue determines the GST treatment. While the different potential treatments in *Scenario 3*, as described, do not give different net GST liabilities, they may cause cash flow and administrative burdens. For example, the first treatment sees Supplier making taxable supplies. This may require suppliers who have made only GST-free supplies to put in place administrative mechanisms to charge and remit GST. For example, if it was the case that every time a doctor provided health services to a patient and was paid under 'Medicare' that doctor made a taxable supply to the Commonwealth, even if the doctor recovered a GST-inclusive amount this would place an administrative burden on the medical profession with no net tax gain.²⁴

It is also possible, by varying the facts in *Scenario 3*, to see the provision of a GST-free service indirectly give rise to a net GST liability. Consider a bank or financial institution that wishes to provide its employees with education services that are related to the employees' work. If it pays a supplier who promises to provide the education services to the employees, the promise may be a taxable supply and the employer may not be entitled to input tax credits as it makes only input taxed

22 For example, the supply of some health or education services as set out in Subdivisions 38-B and 38-C respectively.

23 For example, the central provisions in Subdivisions 38-B and 38-C do not require that there be consideration for there to be a GST-free supply of health or education services. However, some GST-free supplies do require there to be consideration. See, for example, s 38-325 which deals with supply of a going concern and s 38-250 which deals with some non-commercial activities of charitable institutions and the like.

24 This example is used hypothetically and the Commissioner has accepted that, because of the particular administrative features of the Medicare regime, no such taxable supply is made: see GSTR 2000/11 para 104. However, the author is aware of situations where the Commissioner has taken a different view in relation to facts that fall slightly outside those of the Medicare system.

supplies. Therefore, there will be a net GST burden that arises from the organisation of supplies that should be GST-free.

Relevant Australian legislation

While all scenarios above involve problems of varying nature and significance, the common thread is that the GST treatment in all cases relies upon the determination of whether the payment by Payer is connected with the supply of the promise by Supplier to Payer, or the supply of the services by Supplier to Recipient. This makes it vital to examine the Australian provisions that deal with this nexus.

The Australian GST regime doesn't have a distinct regime that deals with third party consideration. The only direct reference to such a possibility is in the definition of consideration itself. There it is stated that consideration can exist regardless of whether the relevant payment, act or forbearance was by the recipient of the supply.²⁵ This contemplates the possibility of linking a supply with a payment made by a third party but does not clarify when that link will exist. Further, it is within the definition of consideration which, as is discussed below, only forms a part of the nexus requirement.

In the absence of specific provisions, the application of GST to third party consideration scenarios relies upon the general provisions dealing with nexus. Section 9-5 states that 'you make a taxable supply if [among other requirements] you make the supply *for* consideration'.²⁶ The definition of 'consideration' also imports certain nexus requirements. Section 9-15 defines consideration inclusively as:

- (a) any payment, or any act or forbearance, *in connection with* a supply of anything; and
- (b) any payment, or any act or forbearance, *in response to or for the inducement of* a supply of anything.²⁷

These provisions give a 'compound' definition of nexus that is difficult to interpret. This is obfuscated further by the definition of 'consideration' in s 195-1. The definition states:

consideration, for a supply or acquisition, means any consideration within the meaning given by section 9-15, *in connection with* the supply or acquisition.²⁸

25 Subsection 9-15(2).

26 Emphasis added.

27 Emphasis added.

28 Emphasis added.

This defines 'consideration' yet does so in the context of the consideration being 'for a supply'. It is not clear the extent to which this definition is intended to affect the interpretation of 'supply for consideration' or whether it is merely a definition of 'consideration'. In either case the formulation 'in connection with' is problematic. If the definition is intended to affect the definition of 'supply for consideration', then it appears to replace the 'for' test with a potentially broader 'connection' test.²⁹ Alternatively, if the definition is restricted to the term 'consideration', it is narrower than s 9-15, as the 'in connection' test is only one *alternative* test of nexus in that section.

While ultimately it is necessary to examine the relationship between the provisions, a starting point is to examine the individual components.

The initial requirement that a supply is 'for' consideration is in itself indeterminate. The word 'for' connotes nexus but does not give real guidance as to the breadth of the required connection. The context suggests that a supply is for consideration where the supply is induced, motivated or caused by the provision of consideration within some form of bargain between the parties. However, it is not clear whether it is sufficient to state that there is the required connection if the giving of consideration is an essential pre-requisite for the making of the supply,³⁰ or if in some cases where there is such a 'but-for' relationship the required nexus is not present.

The 'supply for consideration' nexus is a broad one³¹ and it has been argued that it is broader than equivalent tests in other jurisdictions.³² However, it has some implied limits. One is that consideration should not attach *in its entirety* to more than one supply.³³ In other words, GST-inclusive consideration of \$110 should not give rise to more than one GST liability of \$10 even though it might be said that the consideration was for a number of different supplies. Further, even though explicit acknowledgement of the possibility of third party consideration is only made in the definition of consideration, the 'supply for consideration' test does not preclude situations where the receipt of the supply and the provision of consideration are by different parties.

The nexus tests in the definition of consideration perhaps are even broader and more indeterminate. The broadest and most obscure alternative is the requirement that there must be a 'connection' with a supply for a payment, act or forbearance to be

29 See *Berry v FC of T* (1953) 89 CLR 653 at 659 for a comparison in a different context of the concepts of 'for' and 'connection'.

30 Here contrast the definition of consideration that includes a nexus formulation that is satisfied if the payment, act or forbearance is 'in response to' a supply: para 9-15(1)(b).

31 See McMahon and MacIntyre, above n 2 at 15-6.

32 The Commissioner expresses this view in GSTR 2000/11 para 79.

33 McMahon and MacIntyre, above n 2 at 16.

consideration.³⁴ The formulation 'in connection with' *can be* interpreted very broadly,³⁵ but does not give any real guidance as to the nature of the required nexus. Paragraph 9-15(1)(b) provides two further alternatives. There is consideration where a payment, act or forbearance is 'for the inducement of a supply'. Conceptually, this appears similar to the requirement in paragraph 9-5(a) that the supply be for consideration. It suggests that the payment, act or forbearance motivates the supply. The alternative, that the payment, act or forbearance may be 'in response to' the supply, suggests the opposite concept: that the supply motivates the payment, act or forbearance.

In summary, the provisions that set the required nexus between supply and consideration are complex and indeterminate. There are several tests of nexus and the relationship between them is problematic. It is submitted that these tests should be read together to provide one single concept of nexus, rather than being read separately to give a range of different levels of nexus within different provisions in the Act. However, even if this approach is taken, it is difficult on the face of the legislation to discern a definitive test capable of consistent practical application.

It is trite to say that the tests require a subjective judgment of nexus. Issues of nexus have long caused problems in the law generally and in tax specifically. It will always be difficult to draft legislation that gives a clear indication of required nexus. Even the addition of adjectives such as 'direct' and 'indirect' ultimately add little, apart from the ability to make a statement about the *comparative* breadth of formulations.³⁶ Ultimately, as in other situations where taxation law requires the construction of provisions dealing with nexus, what is required is a body of case law based on the nexus test read in the context of the words of the legislation and its aims.³⁷ It is likely that this will lead to predominantly 'fact-based' decisions that can be used comparatively in order to gain a feel for the required connection in an individual instance. However, in the meantime the language of the GST Act in itself does not give clear, practical guidance on the required connection between supply and consideration, whether in the context of third party consideration or otherwise.

Comments in the rulings

The Commissioner has not set out a comprehensive analysis of third-party consideration. However, in rulings on discrete issues the Commissioner has expressed

34 Paragraph 9-15(1)(a)

35 See *Berry v FC of T* (1953) 89 CLR 653 at 659 per Kitto J.

36 For example, it can be said with some confidence that a test of 'indirect connection' is broader than a test of 'direct connection'.

37 For example, consider the nexus required between outgoing and the earning of assessable income in s 8-1 of the *Income Tax Assessment Act 1997* (Cth). The similarity between such fundamental issues in income tax and the challenges likely in the context of GST was noted in Hill, above n 2 at 1 and generally in Cooper and Vann, above n 2.

views on relevant matters and this section of analysis describes and evaluates these comments. Of course, the Commissioner's opinion does not carry the weight of law and is subject to the text of the legislation as interpreted by the courts. However, it is examined in order to see if it provides effective guidance on the issue of third party consideration while we are waiting for litigation on the matter to surface. First, there is an examination of general comments on the nexus between supply and consideration. This is followed by a discussion of comments on matters that are relevant to the more specific issue of third party consideration.

General comments on nexus

The Commissioner has explored the issue of connection between supply and consideration in GSTR 2000/11³⁸ and GSTR 2001/4.³⁹ While these rulings deal with specific issues they also analyse the connection between supply and consideration on a general level.⁴⁰ In both rulings there is separate discussion of the definition of consideration and the concept of 'supply for consideration'.

Nexus in the definition of consideration

Relevant analysis in the rulings starts with a comparison of the definition of 'consideration' in New Zealand. The New Zealand provisions define consideration as a payment, act or forbearance that is 'in respect of, in response to, or for the inducement of' a relevant supply.⁴¹ This is a broad formulation⁴² and the Commissioner is of the view that the Australian definition is 'similarly wide'.⁴³

The New Zealand provision is distinguished in one respect. It is stated that while the New Zealand formulation 'in relation to' may be so broad that there is limited residual operation of the phrases 'in response to' or 'for the inducement of', the test of 'connection' in para 9-15(1)(a) of the Australian definition perhaps is not so broad that it eclipses the alternatives in para 9-15(1)(b).⁴⁴ However, this suggestion is conditional and said only to give rise to the result that the phrases 'in response to' and 'for the inducement of' in para 9-15(1)(b) may 'assume added stature'.⁴⁵

38 This ruling deals with GST and grants of financial assistance.

39 This ruling deals with the GST consequences of court orders and out-of-court settlements.

40 The general applicability of a portion of the discussion is acknowledged in GSTR 2001/4 paras 9-10. This is supported by the fact that much of the general discussion of the matter in GSTR 2000/11 and GSTR 2001/4 is worded similarly or is verbatim.

41 *Goods and Services Tax Act 1985* (NZ) subs 2(1).

42 *New Zealand Refining Co Ltd v C of IR* (1995) 17 NZTC 12307 at 12314 per Henry J.

43 GSTR 2000/11 para 48, GSTR 2001/4 para 79.

44 *Ibid.*

45 *Ibid.*

The concept of 'supply for consideration'

The Commissioner expresses the view that, similar to New Zealand, 'the nature of the link required between supply and consideration is specified in the definition of consideration' and that there will be 'consideration for a supply' where the nexus tests set out in the definition of consideration are satisfied.⁴⁶ It is not clear from these statements whether the Commissioner is expressing the view that the nexus requirement in s 9-5 is simply to be determined by looking at the definition of consideration in s 9-15. While the New Zealand provisions contain the nexus test in the definition of consideration (and to this extent are similar to the Australian provisions) the Australian provisions contain multiple nexus tests. The Commissioner equates the phrase 'supply for consideration' with the phrase 'consideration for a supply'⁴⁷ and then, in turn, states that there is 'consideration for a supply' where the nexus requirements in the definition of consideration are satisfied. While this appears to suggest that the nexus requirements in ss 9-5 and 9-15 are the same, it does so without exploring the complexity of the relationship between the provisions or the complications caused by the definition of consideration in s 195-1. It is also difficult to reconcile with the cautious reference to case law that suggests that the test 'in connection with' is broader than the relationship described by the word 'for'.⁴⁸

Leaving aside this issue, various descriptions are made of the nature of the relationship required, some comparative, others by way of synonym. Those statements that are comparative in nature are highly conditional. For example, it is stated that the nexus requirement *may* be broader than the 'direct link' test in Canada and the European Union.⁴⁹ Those descriptions that rely upon synonym are also worthy of comment. An example is the statement that there must be a '*close coupling* between the supply and the consideration'.⁵⁰ While not in itself problematic, this statement adds little by way of practical guidance. A more curious example is the clear statement in the earlier ruling that the test is to be one of '*substantial relation*

46 GSTR 2000/11 para 78, GSTR 2001/4 para 92.

47 GSTR 2000/11 para 77, GSTR 2001/4 para 90.

48 GSTR 2000/11 para 79, GSTR 2001/4 para 95.

49 GSTR 2000/11 para 79, GSTR 2001/4 para 94. Reference is made to the UK case of *Apple and Pear Development Council v Customs and Excise Commissioners* [1988] BTC 5116 to establish this 'direct link' test.

50 GSTR 2000/11 para 77, GSTR 2001/4 para 91. Emphasis added.

between the substance of the obligation and the [payment]'.⁵¹ This clear statement is omitted from otherwise identical analysis in the later ruling.⁵²

An unequivocal statement is made in at least one matter. That is that the true character of the transaction is to be examined when determining the relationship and that a finding of sufficient nexus will not be made solely by reference to the description of the parties. The Commissioner states that one must look at 'all of the agreements entered into and the circumstances in which the agreements are made'.⁵³

The Commissioner's general comments do not clarify the nexus requirement

The general comments on nexus made by the Commissioner should not be criticised on the basis that they do not provide all of the answers in relation to third party consideration. This is asking too much of such general analysis. However, it is fair to expect general discussion to provide a coherent and robust framework for analysis. Unfortunately, it fails to do this in two main ways:

- Where the New Zealand test is contrasted, the Commissioner's analysis is qualified rather than absolute. Similarly, comparisons with European provisions tend to suggest that the Australian test is broader but such assertions are conditional. This does not leave the adviser with a clear idea of the Commissioner's view of the relevance of overseas case law.
- While formally divided into discussion of the definition of consideration and the nexus requirement in s 9-5, the examination drifts between the various nexus formulations without adequate explanation of their relationship.

GSTR 2000/36: Insurance settlements by making supplies of goods or services

Ruling GSTR 2000/36 deals with insurance settlements and acquisitions by insurers. While direct reliance upon this ruling probably is limited to insurance situations, the analysis deals with concepts that relate to third party consideration, particularly *Scenario 1* outlined above.

The ruling states that an insurer provides or is liable to provide consideration for an acquisition where the insurer:

51 GSTR 2000/11 para 79. Emphasis added and the term 'payment' is substituted for 'grant'. It appears that in this context the Commissioner is making a general statement about the nexus test in Australia, although if the words of the ruling are read narrowly this phrase merely reflects the test of 'connection' (which appears in s 9-15).

52 See GSTR 2001/4 para 95 where although reference is made to the formulation 'substantial relation', it is in the context of a quotation from *Berry v FC of T* (1953) 89 CLR 653 and is not stated to be the Commissioner's view of the test.

53 GSTR 2000/11 para 81.

- 'pays one entity to make a supply to a third entity'; and
- 'chooses the supplier'; and
- 'instructs the supplier about the supply'; and
- 'enters into a contractual relationship with the supplier for a right to have the supply made to the insured and is liable to pay for the supply of the goods, services or anything else to the insured.'⁵⁴

Fulfillment of these conditions may then give rise to a creditable acquisition.⁵⁵ This is stated to be supported by UK authority, including *Customs and Excise Commissioners v Redrow Group Plc*⁵⁶ and *British Airways Plc*.⁵⁷

Redrow deserves some initial comment and will be discussed further in the final section of this article. The taxpayer in that case constructed and sold residential property. Most of the taxpayer's customers had existing houses that had to be sold before the purchase of a house from the taxpayer could proceed. Ordinarily the customer would engage a real estate agent to sell their existing house, would pay a VAT-inclusive amount for these services and would not be entitled to credits for the VAT component. In order to provide a financial incentive to purchase a home from the taxpayer and to expedite such purchases,⁵⁸ the taxpayer:

- selected a real estate agent and instructed the agent to provide services to a prospective customer of the taxpayer;
- monitored this process and placed pressure on the agent to achieve a sale; and
- entered into arrangements with both the agent and the prospective purchaser such that the taxpayer was liable for the agent's fee if the prospective purchaser completed a purchase of a property from the taxpayer.

The taxpayer claimed input credits on amounts paid to agents under this arrangement and this claim was disallowed by the Customs and Excise Commissioners. On appeal to the House of Lords it was held unanimously that the taxpayer was entitled to the credits. It was found that while the agent was providing services to the prospective purchasers, as the taxpayer instructed the agents and paid their fee, the agent was also providing services to the taxpayer.⁵⁹ The fact that another party (such as the prospective purchaser) benefited from the transaction did not prevent entitlement to credits in the hands of the taxpayer.⁶⁰

54 GSTR 2000/36 para 6.

55 GSTR 2000/36 para 7.

56 [1999] 2 All ER 1.

57 [2000] BVC 2207.

58 [1999] 2 All ER 1 at 3.

59 [1999] 2 All ER 1 at 5, per Lord Hope of Craighead.

60 [1999] 2 All ER 1 at 6, per Lord Hope of Craighead at 6.

Presuming for the moment that the Commissioner's reliance on *Redrow* is sound, two questions arise:

- To what extent is the ruling relevant to the issue of 'supply for consideration'?
- If relevant to the issue of supply for consideration, do the criteria in Paragraph 6 of the ruling provide a workable test in relation to third party consideration issues?

As GSTR 2000/36 deals with entitlement to input tax credits, an initial question is whether it is relevant to the issue of nexus between supply and consideration. It is relevant when seen in the light of the structure of the GST Act and the context of the analysis in GSTR 2000/36. Put simply, entitlement to input tax credits cannot arise unless the party claiming the credits is the recipient of a taxable supply.⁶¹ Therefore, a finding that a person is entitled to input credits necessarily means that the relevant supply to them was taxable. The entire scheme of the GST Act relies upon this assumption. In GSTR 2000/36, the Commissioner is analysing whether or not an insurer is entitled to credits because of a liability to provide 'consideration for an acquisition when it pays one entity to make a supply to a third entity'.⁶² As the making of a taxable supply to the insurer is one of the preconditions of the availability of the insurer's credit, the statement of circumstances in which such a credit will arise must also be taken to be a subset of the situations in which the supply to the insurer is taxable.

If relevant to the finding of consideration for a supply, the next question is whether the criteria in paragraph 6 give a workable test for the finding of nexus between supply and consideration in third party consideration situations. Here returning to the hypothetical scenarios is instructive. Consider a taxpayer in the position of Payer in *Scenario 2*. If the taxpayer claimed that a payment made to Supplier was consideration for a promise made by Supplier simply because Payer:

- 'chose' Supplier;
- instructed Supplier about the supply; and
- entered into a contractual relationship with Supplier for a right to have a supply made to Recipient;

the response of the Commissioner would be to resort immediately to distinguishing the scenario from that contemplated in GSTR 2000/36. If the Commissioner accepted GSTR 2000/36 as setting out generally the required nexus between supply and consideration in third party payment situations, there would be massive opportunity

61 Section 11-5.

62 GSTR 2000/36 para 6.

for abuse, as the criteria in GSTR 2000/36 Paragraph 6 are vulnerable to the most basic manipulation. For example, a taxpayer in the position of Payer in *Scenario 2* could enter into a contract with Supplier that bound Supplier to grant an option⁶³ to Recipient and could instruct Supplier in relation to the details of the option. This would appear to result in Supplier making only a taxable supply to Payer upon which Payer may be able to claim input credits. It is submitted that the Commissioner rightly would reject such an approach.

The result is that, while GSTR 2000/36 in theory deals with matters relevant to the nexus between supply and consideration, the Commissioner will restrict it tightly to insurance dealings. In addition, the Commissioner may have cause in the future to re-think the implicit approval given to *Redrow* and *British Airways*. These cases are outside the context of insurance and the more conservative path would be to avoid tacit approval of the results in these cases until it is clear that the Australian legislation would give similar results and the Commissioner is comfortable with the implications of this outside insurance settlements.

GSTR 2000/11: Grants of financial assistance

Ruling GSTR 2000/11 deals with grants of financial assistance. While the ruling deals with 'grants'⁶⁴ made by a 'grantor' to a 'grantee',⁶⁵ this encompasses situations where a grant is made on the condition that the grantee does something for a third party.

On the nexus required, the Commissioner states:

Where the grant involves a supply of only a right or obligation, there needs to be some binding commitment supplied by the grantee which goes to the substance of the grant transaction. In determining what the substance of the transaction is... the key consideration will be the object or purpose which the grant is intended to achieve.⁶⁶

The centrality of the purpose of the grant in determining nexus is reinforced throughout the ruling.⁶⁷

In addition, the ruling emphasises the idea that for there to be connection between a payment by a party and a supply by the payee to a third party, the payment must be for securing the giving of particular supplies to identified individuals.⁶⁸ In other

63 The granting of many options will be input taxed pursuant to Regulation 40-5.09 Item 11.

64 GSTR 2000/11 Para 7.

65 GSTR 2000/11 Para 8.

66 GSTR 2000/11 para 82.

67 See, GSTR 2000/11 paras 85-86.

68 See GSTR 2000/11 paras 88, 103-105, 118.

words, a payment by a party such as Payer will not be consideration for a supply to Recipient, unless both Recipient and the relevant supply are identified. It is difficult to state that there is connection between a payment and a supply if matters such as the type of supply, time of the supply and recipient of the supply are not identifiable. However, it is questionable whether a sufficient connection should be denied simply because the recipient is the member of a defined class rather than identified individually. GSTR 2000/11 does make some reference to an 'identifiable' recipient⁶⁹ which is consistent with the identification of a class of persons, but also refers to 'identified' and 'individual' recipients.⁷⁰

To the extent that the ruling states that an individual recipient must be identified, the source of this requirement in the law is not clear. The requirement appears in Paragraphs 88, 103, 105 and 118 without derivation. There is mention of the requirement that there be an 'identified recipient' in Paragraph 21 of the ruling and there is reference to the case of *Mohr v Finanzamt Bad Segeberg*.⁷¹ However, this is in the different context of the identification of a supply and not the linking of supply and consideration.⁷² The identification of an individual third-party recipient should not be seen as a pre-requisite for the connection between payment and supply to that third party. Instead, the specificity with which the third party is identified should merely be one factor that is evaluated.

A suggested approach

In the light of the discussion above, the following analysis aims to develop and discuss a general methodology that may be adopted to analyse third party consideration issues. Ultimately, no single test capable of practical application will be devised. As is submitted above, there will only be certainty when a body of case law emerges that explains relevant principles and allows comparison of facts. For this reason, the proposals only aim to provide a framework for analysis that gives more detail than the legislation alone but falls well short of being a complete code.

Identifying the relevant supplies

It is suggested that the first step should be to identify the relevant supplies. Usually there will be two supplies: the supply of a promise to the payer and the supply of goods or services by the payee to a third party. If there is to be a supply to the payer,

69 See GSTR 2000/11 para 88.

70 See GSTR 2000/11 paras 103 and 105 respectively.

71 [1996] 3 All ER (EC) 450.

72 The case involved the question of whether there can be a supply to the world at large and this is contrasted with other cases where the question was whether there is an appropriate link between supply and consideration: see para 29 of the opinion of Advocate General Jacobs.

there must be some form of binding obligation made by the payee to the payer.⁷³ The usual source of such an obligation will be a contract. While absence of such an obligation means that there is not a supply to the payer, the existence of the obligation is not sufficient to connect the consideration with this supply. It is a necessary, but not sufficient requirement for this connection.

This process of starting with supplies is in contrast to the approach of Lord Millett in *Redrow*. While ultimately the dispute was about entitlement to input credits, Lord Millett identified the central issue in the case as whether the services of the real estate agent were supplied to the taxpayer at all.⁷⁴ The relevant nexus requirement is found in the UK definition of what amounts to a supply of services⁷⁵ and the finding of such a supply implies satisfaction of the nexus requirement. In order to decide the case, Lord Millett stated that one should start with the claim for input credits.⁷⁶ Once a payment is identified, it is then necessary to work out if the taxpayer obtained anything for that payment.⁷⁷ It is submitted that the Australian legislation is best analysed by looking first at the supplies. As the Australian definition of *supply* does not require there to be nexus with consideration, supplies can be identified without pre-empting any conclusion on the issue of nexus. For this reason alone the decision in *Redrow* should be treated with caution in Australia.

A single nexus test

Where there are two supplies, the next step involves the identification of the supply that is connected with the consideration. As is discussed above, the Australian legislation does not contain a single, simple statement of nexus. While the words of the legislation cannot be usurped, they must be seen in the context of the aim of the provisions and the legislative regime. In this light, the provisions should be seen as setting down one single concept of nexus.

This nexus test should not vary according to the nature of the supplies involved. In other words, there should not be one attitude towards the test in situations such as *Scenario 2* in order to prevent financial supplies being 'turned into' taxable supplies, and another attitude towards the test in *Scenario 3* situations in order to prevent GST-free supplies giving rise to unrecouped credits. While the nexus test itself should not vary according to the types of supplies involved, the characteristics of the supplies should be relevant to an evaluation of the motives and objectives of the parties. This

73 Para 9-10(2)(f).

74 [1999] 2 All ER 1 at 6.

75 *Value Added Tax Act 1983* (UK) section 3(2). The relevant legislation in the UK is now the *Value Added Tax Act 1994* (UK).

76 [1999] 2 All ER 1 at 11.

77 *Ibid.*

may be relevant to both the *application* of the nexus test and to the application of the general anti-avoidance provisions.⁷⁸

While comparison with overseas legislation and tests is interesting, its usefulness is limited. Broad statements of the relative breadth of nexus tests may allow comparison of the facts and results of overseas cases, but relying upon overseas case law to interpret the text of our provisions is dangerous.⁷⁹ Further, general comparison of the breadth of the nexus tests gives limited guidance when the issue is not simply the finding of a connection between one payment and one supply, but choosing which of two supplies is relevantly connected to a payment. Stating that the Australian test is broader than the European test of direct link allows for the expanded *possibility* that a payment will be consideration for a supply to a third party, but does not otherwise assist in selecting the relevant supply.

Analysis of the purpose of payment in the context of the facts

A key question in determining whether there is supply for consideration will be whether the payment was made (or was agreed to be made) with the aim of motivating a particular supply. This assessment of purpose or motivation is difficult, as examining facts with a shifting focus reveals different potential motivations.⁸⁰ For example, if the facts of *Redrow* are viewed 'tightly' it can be concluded that the purpose of the payment by the taxpayer was to secure the *promise* by the estate agent to perform certain acts. A broader view could conclude that the payment was to secure the *actual performance* of the acts in order to facilitate the taxpayer's own sales. As a suggested way of facilitating this enquiry, outlined below are some general principles and indicia that may be useful. In order to maintain sufficient flexibility in approach, any such principles cannot be absolute and individual indicia cannot themselves be determinative.

Viewing the facts as a whole

As is suggested by the Commissioner,⁸¹ the entirety of the arrangement should be evaluated. Of particular relevance is any collateral arrangement between the payer and the third party recipient. If the substance of the arrangement is such that payment merely flows from the third party recipient to the payer and, in turn, to the supplier, then the presumption should be that the payment is consideration for the supply

78 Division 165.

79 The Commissioner acknowledges this when he states that 'caution needs to be exercised in applying decisions on connective terms in other contexts': GSTR 2000/11 para 79.

80 This has caused difficulties in the general anti-avoidance rule in Part IVA of the *Income Tax Assessment Act 1936* (Cth). See generally *FCT v Peabody* (1994) 181 CLR 359 for an illustration of the difficulties of finding the correct breadth of a 'scheme'.

81 GSTR 2000/11 para 81.

made to the third party recipient. Even without such flows, if the arrangement merely involves a payment system for supplies provided at the request of the third party recipient, a similar presumption should apply. One aspect of this broad view of the facts should include the contemplation of the typical dealings in the relevant industry. While not determinative, this may assist in deciding whether any flows merely give effect to a payment by Recipient.

An objective test that takes into account subjective intention

Regard should be had to the statements of the parties on their intentions and view of any connection between supply and consideration. The primary source for such statements will be contracts and documents surrounding their negotiation. However, as is suggested by the Commissioner, the statement of the parties should not be determinative.⁸²

The terms of the agreement between the payer and supplier

A broad range of features of the agreement between payer and supplier will be relevant. One, already mentioned above, is any expressed view by the parties of the nature of the dealing. Many of these factors spring from views expressed in the rulings. However, their statement as a series of general indicia rather than firmer rules makes them more workable in this context.

The less specific the agreement in terms of:

- the identity of the third party recipient;
- the nature of the supply; and
- the timing of the supply,

generally the weaker any link between payment by the payer and any supply made by the payee to the third party recipient. This springs quite simply from the fact that it is difficult to say that payment is for a supply when the payer doesn't know what is being supplied, when the supply is made and to whom the supply is made. However, it should not be stated absolutely that there is no such nexus simply because:

- the recipient is identified in terms of a definable class;
- the type of supply is definable but not specified exactly; or
- the timing of the supply is not precisely specified.

If the payer enters into the arrangement at the request of the third-party recipient or the supplier is selected or controlled by the third-party recipient, this suggests that the

82 Ibid.

payment is part of an arrangement under which the third-party recipient is acquiring supplies for consideration with the assistance of the payer. This suggests that the payment should be seen as consideration for the supplies to the third party recipient. Conversely, where the payer not only procures the supply made to the third party but, as in *Redrow*, is entitled to intervene in or control the provision of the supply, this will strengthen any connection between the payment and the promise made to the payer.

Concluding comments

The application of the Australian GST to situations involving third party consideration raises difficult and fundamental issues that will remain uncertain until a body of case law is developed. In the meantime it is hoped that this analysis, and the suggested structure for analysing third party consideration can form a starting point for deeper exploration.