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CORNWALL STODART TAX DIGEST: The Commissioner of Taxation can ascribe a Taxable Value to a supply where it is provided with a GST-free supply

Introduction

A recent case heard by the Administrative Appeals Tribunal (**Tribunal**) highlights the importance of taxpayers being able to supply evidence demonstrating the commercial rationale for discounts offered on supplies.

This is of particular importance where discrete items comprise a supply (mixed supply) that contains a GST-free component. A mixed supply occurs where two or more items comprising a single supply are significant in their own right and one of the items is GST exempt. This contrasts with the position where a GST-exempt component of a supply is 'ancillary' to the provision of the other significant item or items representing the supply (composite supply). The *A New Tax System (Goods and Services Tax) Act 1999* (**Act**) does not define the meaning of composite supply; however, the Commissioner of Taxation (**Commissioner**) accepts that composite

supplies arise. Where GST-free items are ancillary, and therefore a composite supply to the main supply, the taxpayer would not be eligible for relief under the apportionment provision contained in s9-80 of the Act.

The Case

In *Luxottica Retail Australia Pty Ltd v FCT* 2010 ATC 10-119 (**Luxottica**), a supplier of prescription eyeglasses (**Taxpayer**) was assessed to GST under s9-80. This provision requires that the price of the supply is apportioned between the taxable supply and that part which is GST-free, so that GST can be levied on the taxable component. Prescription lenses (medical devices) are GST-free. A discount offered on the frames was conditional on their purchase being made in combination with the prescription lenses which were not discounted. The discount arose as a consequence of a promotional offer the taxpayer offered from time to time.



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In calculating the apportionment, the Commissioner ignored the discount on the frame price; in s9-80, the 'value' (taxable value) to be placed on the taxable supply is not a defined term for the purposes of this section. This had the effect of increasing the value of the supply that was subject to GST. The following example illustrates the point.

Assume the undiscounted price of the frames was \$200 and the lens price was \$100. After the discount of \$100 (which related exclusively to the frames) the price paid by a customer for the spectacles was \$200. For the purpose of working out the taxable value that was subject to GST, the Commissioner applied the following calculation:

$\$200/\$300 = 66\%$ (The Commissioner attributed the undiscounted price as the 'value of the taxable supply' of the frames to determine the relevant proportion that they represented of the supply).

The 66% was then applied to the actual price for which the

goods were sold to determine the taxable value on which to levy GST; ie, $\$200 \times 66\% = \$132.00 \times 10\% = \$13.2$ GST.

By contrast, if the value of the taxable supply was calculated using the actual price paid by a customer for the items, the result would produce a lower taxable value component of the value of the supply on which GST would be levied, as is demonstrated by the following (note: s9-80 applies some additional factors which have been disregarded for these purposes but which do not materially affect the result):

$$\$100/\$200 = 50\%$$

$$50\% \times \$200 = 100 \times 10\% = \$10 \text{ GST}$$

If the Commissioner's approach was adopted the GST payable would be increased by \$3.20 (ie $\$13.20 - \$10 = \$3.20$).

The Commissioner argued that the discount only occurred as a consequence of the conditionality requiring both the frames and lenses to be purchased together, and therefore the discount should be ignored for the purpose of valuing the taxable supply. (If this submission had been successful, it would have had the effect of imposing GST on a portion of an otherwise GST-exempt item.)

The Tribunal was unable to determine the exact basis for the Commissioner's argument. The Tribunal said: '[t]he...[Commissioner] argued strenuously that the conditionality issue brings about the result for which the Commissioner contends but he did not explain why this conclusion follows, and we do not accept that it is so.'¹

The Taxpayer argued that the frames were separate to the lenses and should be taxed under s9-75, as they had become fashion items.

¹ *Luxtotta Retail Australia Pty Ltd v F C of T* 2010 ATC 10-119 at 42

Although clients purchased new lenses, that purchase was incidental to the purchase of the frames, which was unconnected to a client's need for corrective lenses.

Importantly, as it was possible to buy frames and lenses separately, the Taxpayer argued that each should be treated as a separate supply. Ultimately such matters turn on their facts and the Tribunal, while noting that frames were fashion accessories, concluded there was only one supply and that s9-80 operated in the circumstances. However, the Tribunal found that commonsense dictated the taxable value proportion of the supply was to be calculated by dividing the discounted frame price (less GST) by the actual selling price of the complete pair of spectacles (less GST).

In reaching its conclusion the Tribunal took the following factors into account:

- there were sound commercial reasons for discounting the frames;
- there was no commercial imperative for discounting the lenses; and
- there was nothing contrived or artificial about the pricing methodology adopted by the Taxpayer in its promotional arrangements.

The Commissioner also argued that this case was not distinguishable to that of *Re Food Supplier and FCT?* (**Food case**). There, the sale of food hampers (uncooked food being GST-exempt) which contained a promotional mug was held to be a mixed supply and required a value to be attributed to the mug (a non-exempt item under the Act) so that GST 2 [2007] AATA 1550



could be levied. It was found that the food product was being sold at an excessive discount, with no value being attributed to the mug. This conclusion was reached because the promotional item could only be purchased from the taxpayer with the food and the taxpayer would not separately provide the mug free of charge.

While the outcome in the *Food* case is arguably correct, the decision of the Tribunal here does not explain why the Commissioner determined the *Food* case justified the approach he adopted for *Luxottica*. The Commissioner may have considered that, as the apportionment of the undiscounted value of the mug in the *Food* case was used to determine the apportionment under s9-80, this justified the taxable value for present purposes being the undiscounted price of the frames.

However, the Tribunal distinguished the *Food* case and found that '*in this case [Luxottica] there were two items or components and in respect to each of those components there was an agreed price which was in no way artificial or contrived*'.³ In other words, the Taxpayer sold the frames and the lenses in the marketplace at separate and distinct prices that could be commercially justified. The discount could also be clearly attributed to the frames because there was no commercial imperative to discount the lenses.

Comment

Taxpayers will need to ensure that, if a discount is offered in respect to a mixed supply which includes a GST-free supply, they can prove (as noted by the Tribunal) that:

- there are sound commercial reasons for discounting an item;
- where only one of the items is discounted, there is a commercial

justification to support the non-discounting of the other item; and

- there is nothing contrived or artificial about the pricing methodology adopted by the taxpayer in respect of the arrangements.

If these factors cannot be demonstrated, the Commissioner is at liberty to ascribe a value to the taxable portion of the supply as he thinks appropriate. Clearly this could have significant consequences for the competitiveness of the particular supply in the marketplace.

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³ *Luxottica Retail Australia Pty Ltd v FC of T* 2010 ATC 10-119 at 51