

### **Member Update**

**Title:** **ATO Private Ruling on GST**

**Update No.:** **27 of 10**

**Date of Issue:** **20<sup>th</sup> October 2010**

**Reissue of:**

- 1. Member Update 18 of 05**

**1 Background**

GTA has received questions regarding whether GST is payable where a contract is financially settled. The original Member Update with the ATO Ruling is attached.

**Seek legal /accounting advice if you have questions**



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## Member Update

**Title:** ATO Private Ruling on GST

**Update No.:** 18 of 05

**Date of Issue:** 22 August 2005

### Distribution

- NACMA Members – primary contact list. Please circulate to all appropriate internal parties

### Background

- NACMA receives on a regular basis questions regarding GST on contracts that are financially settled.
- During the implementation of the Goods and Services Tax, NACMA approached the Australian Taxation Office and requested a ruling on the application of GST to situations where contracts are financially settled.
- The ATO response follows this Update.

### Bottom line

- Where there is no physical delivery against the contract and the parties have a financial settlement this is deemed a "Financial Supply" and is not subject to GST.

### Further advice

- Members are encouraged to contact their financial advisers if further clarification is required.



National Agricultural and Commodity Marketing  
Association  
Attn: Mr Geoff Honey  
PO Box 448  
TURRAMURRA NSW 2074

**Our reference:** GST/DAN/4757947  
**Contact officer:** Sandirasegaram Puvimanasingham  
**Telephone:** 13 28 66  
**Facsimile:** 1300 139 031  
**Your reference:**  
**E-Mail:** GSTmail@ato.gov.au

28 July 2005

Dear Mr Honey

**Request for a copy of your GST private ruling - Auth. No. 18155**

**For your information**

We refer to your letter faxed to us on 27 July 2005 in which you requested a copy of your goods and services tax (GST) private ruling. A copy of the private ruling is enclosed.

You can rely on this GST private ruling:

- if your factual circumstances remain unchanged
- if no material facts have been suppressed or misstated
- until there is either a change in the law affecting the treatment of the subject matter of the private ruling, or
- until the private ruling is superseded by a public ruling.

If you are not sure if you can continue to rely on your GST private ruling and you would like it reviewed, you should write to us at **GPO Box 9935 IN YOUR CAPITAL CITY** or send a fax to **1300 139 031**.


**More information**

If you have any further queries regarding this matter, please phone **13 28 69** between 8.00am and 5.00pm, Monday to Friday, and ask for Sandirasegaram Puvimnasingam on (03) 92153583 or phone this number direct. Please quote reference number 4757947 when you phone.

Yours sincerely

Yours faithfully

Neil Mann  
DEPUTY COMMISSIONER OF TAXATION

Per   
(Sandirasegaram Puvimanasingham)

Telephone: 13 28 66  
Facsimile: 1300 139 031

22 August 2002

**Our Reference:** GST/DAN/CW3142383  
**Contact Officer:** Sandirasegaram Puvimanasingham  
**Contact Phone:** (03) 92153582  
**Your Reference:**

Mr Bryce Bell  
National Agricultural Commodities Marketing Association  
500 Wilberforce Rd  
WILBERFORCE NSW 2756

copy

Dear Mr Bell

**GST and circle trades: commodity contracts**

**Authorisation Number:**  
18155

Note: This private ruling replaces the private ruling bearing the authorisation number 13531 that was never issued to you.

**You wrote to us on 28 January 2001 asking:**

What are the GST consequences of 'Circle Trades' as defined in the trade rules of National Agricultural Commodities and Marketing Association Inc (NACMA).

**You advised us of the following facts:**

You provided us with the Trade Rules as amended in July 2000 in relation to the relevant circle trade. We have attached the rules, in part, as 'Attachment A'

A circle trade (a circle) exists where sellers repurchase from their buyers or from any subsequent buyer the same commodity or part of thereof. A reference to 'same commodity' includes commodity of the same description, from the same country of origin, of the same quality. Where applicable it also means the commodity of same analysis warranty for delivery or shipment to the same ports of destination during the same period of delivery or shipment. Different currencies do not invalidate the circle.

All sellers and buyers will assist to establish the parties trading in the circle. The rules of NACMA bind all parties in the circle.

The seller must present to the buyer an invoice in the prescribed manner under Rule 20.0.

Repurchase means the actual purchase of a commodity of like kind and quantity in the open market but if this is not possible, the buyer has the privilege of establishing fair market value for the purpose of determining any loss properly chargeable to the seller. For the avoidance of doubt, in response to our queries, you have provided additional facts:

- The circle trade involves a future supply of a commodity.
- The commodity dealt with in this circle trade is subject to delivery at a definite time in the future.
- The definition of 'same good' in Rule 19.1 may refer to different stocks of the same commodity, but the physical delivery is definite and the delivery time is of the essence.
- The meaning of the term 'actual sale' and 'actual purchase' of a commodity as mentioned in Rule 21.4 and 21.5 means that the actual delivery (physical delivery) of the commodity takes place only once, at the end.
- Settlement between all the buyers and sellers does not necessarily take place at the same time. For instance in the example involving A, B, C, and D, when B sells to C, they may settle consequently. However, settlement between all the buyers and sellers must take place by the time specified in Rule 19.2 of the NACMA Trade Rules.
- The margin is calculated as the difference between the 'agreed contract price' and the 'relative contract price'. In the ABCD example, when B sells to C, the margin is the difference between the price of the sale between A and B and the price between B and C, that is, between \$100 and \$102. When the sale takes place between B and C, the agreed contract price is \$100 and the relative contract price is \$102. When the sale takes place between C and A, the agreed contract price is \$102 and the relative contract price is \$105, and so on. A profit is not always made, there could be a loss.
- The price of the contracts between the buyers and sellers is based on the market price of the commodity on the day, but is not necessarily equal to it. There is usually some haggling/negotiation involved. For instance, if a buyer really needs the grain he may be willing to pay more for it.
- The circle trades are not governed by any legislation.
- They are not traded on the Stock Exchange or the SFE.
- The same contract is used all the way through, including for the final sale involving the physical delivery of the goods.

On 29 August 2001, in a telephone conversation Mr Bell confirmed that:

- Most circle trades take place over the phone.
- Invoices are issued all along the line, transaction by transaction, and not at the end of the line.

## **We have made the following decision**

From the outset, a contract that involves the forward supply of a deliverable taxable commodity is not considered to be financial supplies for the purposes of subsection 40-5(1) of *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

In the subsequent event that the purchasing party novates or assigns their interest in the forward contract to a third party (an assignee/a novated party), such a novation or assignment will be a taxable supply where the requirements of section 9-5 of the GST Act are met. Such a supply is not considered to be a financial supply. This GST treatment would also apply in respect of any novation or assignment subsequently transacted by the assignee/novated party.

In the circumstances where the contracting parties (including an assignee/a novated party mentioned above) decide to invoke the operation of Rule 19 of the NACMA Trade Rules (to treat the transaction as a 'circle trade' and cash settle the contract), the transaction, at that point in time, takes on the character of a financial supply for the purposes of subsection 40-5(1) of the GST Act. Accordingly, no GST is payable in respect of this transaction or the subsequent payment that is required to be made to one of the parties (depending on the difference between the closing price and the contract price).

## **Why we have made this decision:**

### Derivatives

GST is payable on taxable supplies. Section 9-5 of the *A New Tax System (Goods and Services) Act 1999* (GST Act) sets out the requirements that must be met for you to make a taxable supply. A supply is not a taxable supply to the extent that it is GST-free or input taxed.

Under subsection 40-5(1) of the GST Act a financial supply is input taxed. Subsection 40-5(2) of the GST Act states that a financial supply has the meaning given by the regulations.

Subregulation 40-5.09(1) of the *A New Tax System (Goods and Services Tax) Regulations 1999* (GST Regulations) provides that the provision, acquisition or disposal of a 'financial interest' is a financial supply if:

- the interest is listed in subregulation 40-5.09(3) or (4); and
  - is for consideration;
  - is in the course or furtherance of an enterprise;
  - is connected with Australia (paragraph 40-5.09(1)(a) of the GST Regulations); and
- the supplier is:
  - registered or required to be registered for GST; and
  - a financial supply provider in relation to the supply of the interest (paragraph 40-5.09(1)(b) of the GST Regulations).

Item 11 in the table in subregulation 40-5.09(3) of the GST Regulations (Item 11) lists an interest in or under a derivative.

A derivative is defined in the dictionary of the GST Regulations as follows

**'derivative** means an agreement or instrument the value of which depends on, or is derived from, the value of assets or liabilities, an index or a rate.'

### Commodity Derivatives

Where an agreement is to give an instrument or agreement some value based on the price movements of a commodity, that instrument or agreement will be known as a commodity derivative. Commodity derivatives are further classified as non-deliverable commodity derivatives or deliverable commodity derivatives.

Non deliverable commodity derivatives are instruments or agreements that involve no option, right or obligation to the delivery of the commodity. Interests in or under non-deliverable commodity derivatives are financial interests under item 11.

Part 9 of Schedule 7 to the GST Regulations lists 7 examples of derivatives that are financial interests under Item 11 including: 'Cash settlement of a derivative over the counter or on the exchange rather than physical delivery of the underlying taxable assets.'

Deliverable commodity derivatives involve the option, right or obligation to delivery of the commodity. The supply of an interest in or under a derivative which involves the option, right or obligation to the delivery of a taxable commodity is a taxable supply and is specifically excluded from being a financial supply under item 7 in the table in regulation 40-5.12 of the GST Regulations.

On this basis, a contract that involves the forward supply of a deliverable taxable commodity is not considered (from the outset of the contract) to be a financial supply for the purposes of subsection 40-5(1) of the GST Act. This is because such an arrangement provides the purchaser with the right to receive a taxable supply, which is not a financial supply by application of item 7 in the table in regulation 40-5.12 of the GST Regulations

In circumstances where the acquiring party subsequently novates or assigns their interest in the forward contract to an assignee/ a novated party, such a transaction is also not a financial supply by application of item 7 in the table in regulation 40-5.12 of the GST Regulations. This is because the acquiring party is effectively providing the assignee/novated party with a right to receive a taxable supply. Such a transaction will be a taxable supply where the requirements of section 9-5 of the GST Act are satisfied. This GST treatment would also apply in respect of any novation or assignment subsequently transacted by the assignee/novated party to another party.

In the event that the contracting parties (including an assignee/novated party) decide to invoke the operation of Rule 19 of the NACMA Trade Rules, the nature of the arrangement is one of the selling party agreeing to repurchase the 'same' commodity from the acquiring party. In such a case, a 'circle trade' comes into existence. As a consequence of entering into a circle trade, the obligations owed by each party (including the delivery of a taxable commodity) are covered by means of a cash settlement mechanism. Therefore, when cash settlement occurs there is not an option,

right or obligation to deliver a taxable commodity. Consequently, item 7 in the table in regulation 40-5.12 of the GST Regulations has no application.

At the time of cash settlement, the agreement between the contracting parties have a value derived from the value of the underlying asset, and as such there is a derivative. As the taxable assets have not been delivered and cash settlement has occurred, the transaction results in both parties having an interest in or under a derivative which is a financial interest under item 11.

The provision of such an interest will be a financial supply where the requirements of subregulation 40-5.09(1) of the GST Regulations are satisfied. In respect of these requirements, the obligations exchanged by each party (to cash settle the contract) represent both the supply of a derivative and the provision of consideration to each party. With regards to each party being a financial supply provider, both parties necessarily create an interest in the derivative and therefore financial supply providers. Whether the other requirements are satisfied is dependent on the facts of each case.

Therefore, where all the requirements for a financial supply under regulation 40-5.09 of the GST Regulations are met, the cash settlement of a commodity derivative under Rule 19 of the NACMA Trade Rules, is a financial supply.

In respect of the cash settlement amount, the payment is not a supply or consideration for a supply. The payment of the cash settlement amount is a consequence of the financial supply of the derivative, and no GST is payable in relation to this amount.

For the avoidance of doubt, every transaction resulting in a physical delivery of a taxable commodity must be accounted for GST according to the normal rules.

This advice is a private ruling. I have attached an edited version of this ruling as well as explanatory notes on the effect, duration of this advice and your review rights.

Please contact Sandirasegaram Puvimanasingham on (03) 92153582 if you have any further queries regarding this matter. This private ruling has been authorised by Rodney Dunn.

Yours faithfully

Barrie Russell  
DEPUTY COMMISSIONER OF TAXATION

Per  
(Sandirasegaram Puvimanasingham)  
Encl.

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## **Explanatory Notes**

### **Effect**

This advice is a private ruling for the purposes of section 37 of the *Taxation Administration Act 1953*. You (the entity to which this advice relates) can rely on this ruling unless you have misstated or suppressed a material fact.

Should a public ruling subsequently issue that conflicts with this advice, the public ruling will prevail. However, if you have relied on this advice, you will be protected in respect of what you have done up to the date of the change. This means that if you have underpaid an amount of GST, you will not be liable for the shortfall prior to the later ruling. Similarly, you will not be liable to repay an amount overpaid by the Commissioner as a refund.

### **Duration**

You may rely on this advice until it is withdrawn, overridden by a public ruling or there is a change in the legislation affecting the treatment of the subject matter of this ruling for GST purposes.

### **Review Rights**

You have a right to have this advice reviewed under the Taxpayers' Charter. If you want to do this, you should contact the person handling your case or the Tax Office where the decision was made. The review is normally conducted by a tax officer who was not involved in making the original decision.

This advice cannot, however, be reviewed under the *Taxation Administration Act 1953* (TAA), as it is not a reviewable decision under subsection 62(2). Nor can it be reviewed under the *Administrative Decisions (Judicial Review) Act 1977*.

However, should you undertake your proposed transaction and it results in a net amount for a tax period, you can, under section 23 of the TAA, request us to make an assessment under section 22 of that Act of your net amount for that tax period. Under section 62 of the TAA, you may then object to the making of that assessment in the manner set out in Part IVC of that Act.

### **Freedom of Information**

The *Freedom of Information Act 1982* provides right of access to certain documents relating to this decision held by the Australian Taxation Office. Requests for access under this Act must be in writing and, if possible, made on a *Request under the Freedom of Information Act 1982* form, available at any Taxation Office. Charges apply for this service. In certain circumstances, access may be denied, however, there are rights of review should you disagree with this decision. Please do not hesitate to contact the Australian Taxation Office with regard to any matters concerning Freedom of Information.

## ATTACHMENT A

### *Rule 19.0 Circle Trades:*

Where Sellers repurchase from their Buyers or from any subsequent Buyer the same goods or part thereof, a circle shall be considered to exist, and the provision of Rule 21 [Default] and Rule 17 [Default on Delivery or Shipping Period] shall not apply.

### *Rule 19.1 The Same Goods Defined:*

For the purpose of this Rule 19 [Circle Trades] the term 'same goods' shall be construed as meaning goods of the same description, from the same country of origin, of the same quality, and, where applicable, of the same analysis warranty, for delivery or shipment to the same ports of destination during the same period of delivery or shipment. Different currencies shall not invalidate the circle.

### *Rule 19.2 Settlement of Circle Trades:*

All Sellers and Buyers shall give every assistance to ascertain the circle and when a circle shall have been ascertained in accordance with this Rule, the same shall be binding on all parties to the circle.

As between Buyers and Sellers in the circle, the non-presentation of documents by Sellers to their Buyers shall not be considered a Breach of Contract.

Subject to the terms of these Trade Rules, if the goods are not appropriated, or having been appropriated documents are not presented, settlement by all parties in the circle shall be calculated on the mean Contract Quantity and shall be settled over the agreed market price on the first day for contractual shipment and invoices shall be settled between each Buyer and his Seller in the circle by payment of the differences between the agreed market price and the relative Contract Price.

Payment shall be as per contract terms as if the day for appropriation was on the mean date of the established delivery or shipment period, or should the circle not be ascertained before the expiry of this time, then payment shall be as if the day for appropriation was on the last date of the established delivery or shipment period, but not later than thirty [30] days after the circle is ascertained.

Should any party in the circle prior to the due date of payment commit any act comprehended in Rule 21.2 [Default Due to Insolvency], which shall be taken as a basis for settlement. In this event respective Buyers shall make payment to their Sellers or respective Sellers shall make payment to their Buyers of the difference between the closing our price Contract Price.

### *Rule 20.0 Payment:*

It shall be the duty of the Seller to present to the Buyer, or other such consignee as may have been previously designated by the Buyer, an invoice, giving the road truck or railcar identification, Kind and Quality Grade of the Commodity, Actual or

Estimated Weights, Price, Contract Number on which the Delivery or Shipment is to apply, and the amount of invoice.

*Rule 21.4 Repurchase Defined:*

The term 'Repurchase' shall be construed as meaning an actual purchase of a commodity of like kind and quantity on the open market; provided that, when this is not feasible or would result in undue penalty to the Seller, the buyer shall have the privilege of establishing fair market value for the purpose of determining any loss properly chargeable to the Seller.