

To All Members

No. 303/99

Application of GST to Futures Contracts

The Government recently made regulations about the application of GST to financial services. Details can be found on the Treasury website: www.treasury.gov.au.

The attached document summarises the application of those regulations to futures and options trading. It also identifies aspects where the Exchange is seeking further clarification or amendments.

Any queries in relation to the attached outline can be directed to the undersigned on ph: 02 9256 0400.

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29 October 1999

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SUMMARY OF BASIC RULES ¹

All derivatives will be input taxed “financial supplies”, for GST purposes, unless they fall within either of the following exceptions:

- an option, right or obligation to make or receive a taxable supply
- a supply made as a result of the exercise of an option or right, or the performance of an obligation, to make or receive a taxable supply

As commodities are taxable supplies (rather than “financial supplies”), a delivery of wool or wheat in performance of the obligations under a futures contract is an example of the second of these exceptions, i.e. GST is payable by the party making a delivery under such a contract. The explanatory material accompanying the regulations evinces the following intentions:³

- GST payable on the price on settlement when a commodity is delivered pursuant to a futures contract;
- GST payable on broking services in relation to any contract;
- GST not payable on margins under any futures contract;
- GST not payable on cash-settled contracts, whether over commodities or anything else;
- GST not payable on deliverable contracts that are closed out before expiry of the contract;
- GST not payable on deliveries under bank bill or share futures contracts.

Input Tax Credits

GST will be payable on broking services. This gives rise to an input tax credit in respect of all services acquired for use in the provision of futures broking services.

A reduced input tax credit is available in respect of those acquired services listed in the regulations when used to conduct proprietary futures trading (or otherwise produce “financial supplies”). Listed services that may be inputs into such proprietary trading businesses are “arranging” the supply of a derivative and “transaction processing, account maintenance and report generation services provided to suppliers of derivatives”.

GST will be payable by the Exchange on transaction fees it charges members for providing execution and clearing facilities. Providers of broking services would obtain an input tax credit for the GST component incorporated into Exchange transaction fees (to the extent that the trades are on account of external clients).

GST PAYABLE ON SETTLEMENT PRICE ON WHEAT & GREASY WOOL FUTURES

¹ This information is for the guidance of Members and does not purport to be legal advice. It should be read in conjunction with the Legislation, Regulations and Explanatory Statement. Where appropriate, legal or other professional advice should be sought.

² Regulations 40-13 and 40-16 of *A New Tax System (Goods and Services Tax) Regulations 1999*.

³ It is questionable whether the regulations actually achieve all of these intentions. Some further amendments / rulings are likely to be necessary.

The explanatory statement says that “the supply of the taxable commodity when delivery takes place is not a financial supply and GST is payable on the basis of the *settlement price*”.

The basis for this latter conclusion is not spelt out in any detail in either the regulation or the accompanying explanatory statement. Accordingly, it is not entirely clear whether “the price on settlement when the commodity is delivered” is intended to refer to the daily settlement price on expiry of the contract *before* or *after* adjustment for location discounts / quality premiums.

The SFE is seeking clarification. On the assumption that the intention is to impose GST on the net amount (i.e. the amount calculated in accordance with Exchange by-laws), the following examples outline the anticipated effect of the latest regulations.

Examples

- ❑ A person contracts in August 1999 to sell a January 2001 wheat futures contract at \$182 per tonne. The daily closing settlement price at expiry in January 2001 turns out to be \$174 per tonne. The seller delivers at Moree, resulting in a location discount of \$25.50 per tonne. The net amount received by the seller will be \$148.50 per tonne. GST payable by the seller is one eleventh of \$148.50 or \$13.50.
- ❑ Similarly, if a person had contracted to buy an August 2000 greasy wool futures contract, which settles in August 2000 at 670 cents per kg and the buyer delivers to Brisbane at a 10 cents per kg location discount, the net amount payable by the buyer would be 660 cents per kilo. The buyer would receive an input tax credit for 60 cents per kilo, being the amount of GST payable by the party delivering ($1/11 \times 660 = 60$).
- ❑ If on the other hand, the buyer of either contract had closed out their contract by an offsetting sell contract prior to expiry of the contract, no GST would be payable on the sell contract and no input tax credit available in respect of any GST priced into the original bought position.

Commodity Options

Whether or not an *option* over a deliverable wool or wheat futures contract will be subject to GST is unclear. The explanatory part of the regulations evidence an intention to impose GST on “deliverable commodity options”. However, there is considerable basis for doubting whether the substantive provisions actually achieve this intention, *in relation to options over commodity futures contracts*. (It seems reasonably clear that the intention has been achieved in relation to other commodity options not traded on SFE that, upon exercise, result in the taker receiving the actual commodity rather than a futures contract over a commodity).

SFE has made representations seeking an overturning of any implication from the explanatory part of the regulations that GST might be payable on premiums paid on options over futures contracts.