

**Circular To: All Members**

**317/99**

**Impact of GST on Pricing of Deliverable Wheat and Wool Futures Contracts**

The Exchange's Wheat Committee has recommended that the membership and clients be invited to comment on a proposal that deliverable contracts be priced on a "GST-exclusive" basis for new contract months.

The proposal would apply only to contract months after the last month in which there are open positions at the time of any changeover announcement. It would apply to both the wheat and greasy wool futures contracts. (All other futures contracts, including the cash settled 19 and 23 micron wool contracts, already trade at GST-exclusive prices, because there is no GST payable in respect of these contracts).

Anyone with an interest in this issue is invited to make their comments in writing to the undersigned by Friday 3 December 1999 (to enable a decision to be taken at the mid-December 1999 Board meeting). Contact details: [mstarr@sfe.com.au](mailto:mstarr@sfe.com.au), phone: 02 9256 0400, fax: 02 9256 0666

The attached paper outlines factors relevant to the proposal from the Wheat Committee and details of further indications received from the Treasury Department and Australian Taxation Office as to how the GST regulations will be administered.

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**17 November 1999**

## **IMPACT OF GST ON PRICING OF DELIVERABLE WHEAT AND WOOL FUTURES CONTRACTS**

### **Background**

By late August/early September 1999, it had become reasonably clear – notwithstanding some mixed messages from the relevant Government authorities – that GST would be payable on deliveries pursuant to wheat and wool futures contracts.

As a result, market participants called on the Exchange to clarify whether GST should be factored into the prices quoted for futures contracts for post-July 2000 delivery.

Consultations undertaken by the Exchange at that stage revealed fairly evenly divided preferences for “GST-inclusive” versus “GST-exclusive” pricing for contract months that had already been listed. The Exchange opted for “GST-inclusive” pricing. It issued Circular 268/99 of 22 September 1999 indicating that the Exchange did not propose to vary its by-laws (so as to enable parties making a delivery to require the buyer to pay any amount, additional to the settlement price, on account of GST).

At the same time, the Exchange foreshadowed that it would be willing to adopt a different approach for new contract months, if this became appropriate in the light of new information.

### **New Information**

Subsequent to the Exchange’s September 1999 decision, the following information relevant to pricing of commodity contracts has emerged:

- the Government has made regulations, accompanied by an explanatory statement indicating that when a delivery takes place pursuant to a futures contract, GST is payable on the basis of the daily *settlement price* at expiry (not the price at which either party to the delivery originally agreed to buy or sell, as the case may be);
- the Australian Wool Exchange has announced that the hammer price at wool auctions will be “GST-exclusive” (i.e. buyers will be invoiced 10% more than the hammer price, and the seller will be liable to pay GST on one eleventh of that higher invoice price);

### **Impact of GST Being Payable on Settlement Price**

GST being based on settlement price will present some difficulties for pricing under a “GST-inclusive” regime.<sup>1</sup>

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<sup>1</sup> GST payable on settlement price means that, at the time that they are making bids and offers, market participants cannot precisely quantify their eventual GST liability, (in the event they go to delivery). They would be forced, instead, to price the GST component on the basis of contract price even though any ultimate GST liability would be calculated by reference to settlement price.

But the alternative of GST being payable on the basis of original contract price would also have presented difficulties.<sup>2</sup>

In any event, the clarification that GST is to be payable on the basis of settlement price is seen by many as tilting the balance of convenience in favour of “GST-exclusive” pricing. Under this approach, market users would not need to make any assumptions about the likely cost of GST when entering futures contracts. They would know that it will be one eleventh of whatever turns out to be the daily settlement price at expiry of the contract.

Of course, market users entering contracts for currently listed contract months (i.e. “GST-inclusive” contracts) would only have the contract price to serve as a guide to how much GST would ultimately be payable. Where the settlement price varies significantly from the original contract price, the seller will face a considerably larger or smaller GST liability than had been factored into the pricing.

Any changeover to “GST-exclusive” pricing should, therefore, occur at the earliest possible time that is consistent with not adversely affecting the position of parties to existing contracts.

The following proposal, upon which market users’ comments are sought, has been developed on this basis.

### **Proposal for Comment**

1. That the Sydney Futures Exchange make an announcement of intention to change its by-laws so that prices quoted for a particular class of futures contracts would be deemed not to include GST.
2. That the class of futures contracts that would be deemed to be “GST-exclusive” would be all contracts entered in respect of a delivery month that is after the last month in which there are open positions at the time of the changeover announcement, e.g. if the changeover announcement were made any day in December 1999 and, on that day, there were open positions in the wheat futures contracts for July 2000 and January 2001 (but not the intervening contract months), the first contract month for which wheat futures contracts would trade on a “GST-exclusive” basis would be March 2001. On this same principle, the first “GST-exclusive” greasy wool futures contract could be, say, October 2000.

Comments are sought by 3 December 1999 as to whether market users consider that there is now enough certainty – e.g. as to likely pricing practices in underlying markets – to make a decision to change over to a “GST-exclusive” pricing regime.

### **Examples**

The following examples indicate how settlement procedures / invoicing would vary under “GST-inclusive” versus “GST-exclusive” approaches:

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<sup>2</sup> Had GST been payable on the basis of original contract price, one of the following unsatisfactory outcomes is likely to have eventuated: either a buyer would still be unable to price their GST liability if their eventual liability were to be based on the price originally contracted by an unknown seller, who had not at that stage been allocated to deliver to that buyer. Alternatively, the buyer would be invoiced by the clearing house for GST based on the buyer’s original contract price, the seller would be invoiced on the basis of its own different original contract price and the clearing house would be the party left with the mismatch.

GST Inclusive

Contract Date:	October 1999 (prior to changeover announcement)
Contracts:	8 Wheat Futures Contracts for delivery in July 2000 (or other contract month in the "GST-inclusive" period).
Daily Settlement Price at Expiry:	\$174 per tonne
Location Discount:	\$25.50 per tonne
Net Receipt by Seller:	\$148.50 per tonne X 8 contracts (at 50 tonnes per contract) = \$59,400
Invoicing:	Clearing House to issue invoices to the clearers for each party indicating that the final settlement amount includes GST of \$5,400, being one eleventh of \$59,400

GST Exclusive

Contract Date:	February 2000 (or other date after changeover announcement)
Contract:	1 Greasy Wool Futures Contract for delivery in February 2001
Daily Settlement Price at Expiry:	790 cents per kg
Total of Premiums and Discounts:	40 cents per kg discount
Net Receipt by Seller:	750 cents per kg plus 75 cents GST per kg multiplied by , say, 2580 kg = \$21,285 <sup>3</sup>
Invoicing:	Clearing House to issue invoices to the Clearers for each party indicating that the final settlement amount includes GST of \$1,935, being 75 cents X 2580 kg.

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<sup>3</sup>

In the event that wool tax were payable by the seller, being the first time that that wool has been sold, the clearing house would deduct wool tax of 4% of the settlement amount *before* GST, i.e. 4% of 750 cents per kg, in the above example.

### **Further Clarifications from Government Authorities**

As a result of discussions held between representatives of SFE, the Treasury Department and the Australian Taxation Office on 15 November 1999, we now anticipate the following outcomes:

- the issue of a ruling by the Commissioner of Taxation to the effect that GST is not payable on premiums payable under options over futures contracts traded on the SFE; and
- a decision by the Commissioner of Taxation that brokers and clearers involved in making a delivery on behalf of a seller of a futures contract can *issue* invoices to their clients (“recipient-created tax invoices”), rather than needing to *receive* a “tax invoice” from their client, before being entitled to claim input tax credits.

Neither of these outcomes can be guaranteed. However, Treasury and ATO informally acknowledged that both outcomes would be consistent with the broad policy intent and encouraged the Exchange to make the necessary formal applications to the ATO. Further details on these issues are set out below.

#### **Options Over Futures Contracts**

The regulations determine that most derivatives are “financial supplies” rather than “taxable supplies” for GST purposes. But there is an exception for options over supplies which are, themselves, taxable. These options are taxable. Hence, if exercise of an option entitles the taker to delivery of a commodity like wool or wheat, then GST is payable on the premiums.

In determining whether an option over a futures contract is treated the same as an option directly over the underlying commodity, one must distinguish the core provision from the various descriptions in the regulations as to what the core provision was designed to achieve. Some of the descriptive material would give the impression that the options over commodity futures contracts that are traded at SFE will be subject to GST (in the same way that OTC commodity options would be subject to GST). However, the Treasury and ATO representatives now appear to accept that the core provisions may not actually have this effect. Furthermore, they do not have any policy difficulty with this outcome: the policy intention was only to prevent low exercise price options or other variants being created as a way of avoiding GST on the full value of the commodity upon exercise of the option.

Against this background, Treasury / ATO encouraged the Exchange to seek a formal ruling from ATO to the effect that the class of options traded on SFE do not constitute options, rights or obligations to make or receive taxable supplies (because the taker acquires a position under a futures contract rather than the commodity) and, therefore, no GST would be payable on the premiums.

## Invoicing

At present, the clearing house issues invoices to clearing members acting for buyers and sellers. Each of these clearers, in turn, invoices its client.

In the absence of a determination from the ATO – that invoices could continue to flow out from the clearing house in this manner – the direction of invoices from clearing house to the sell side would need to be reversed: as the ultimate seller is the first “supplier” of the commodity to the next person in the delivery chain (either the broker or clearer for the seller to whom title passes fleetingly), the seller would have needed to issue a tax invoice to its broker or clearer, in order that the broker or clearer could obtain an input tax credit for the GST payable by them (when they transferred title to the commodity over to the clearing house).

The Exchange indicated that reversing the current flow of invoices would be counterproductive: before a seller could invoice the clearer to whom it delivered a commodity (as part of the process of delivering it to the ultimate buyer), the seller would need information from their clearer as to the net settlement price. Since this information is sourced from the clearing house, it would make more sense to allow the clearing house to invoice the seller’s clearer and for this clearer, in turn, to invoice the broker or seller from whom it took title.

ATO representatives indicated that they did not foresee any difficulties in them exercising their discretion to sanction a continuation of the current flow of invoices. (The “seller’s advice” currently issued to the clearer for the seller would be headed “recipient-created tax invoice”. Clearers would need to make a similar change to the heading of any invoices they issued to clients *making* deliveries. The invoices issued by clearers to clients *taking* deliveries would be headed “tax invoice”).

The Exchange will now formally seek an exercise by the Commissioner of Taxation of his discretion to sanction the issue of recipient-created tax invoices in respect of any “supply” occurring in the delivery chain between ultimate seller and the clearing house.

The direction in which invoices flow does not alter the liability for GST. Whether a clearer for the ultimate seller issues a “recipient-created tax invoice” to the seller or the seller had issued a “tax invoice” to its clearer, it is the “supplier” that bears the ultimate GST liability. Any obligation of a clearer to pay GST, as a result of having title to the commodity pass through its hands, will be entirely offset in the same GST return by claiming an input tax credit for the same amount of GST that it was effectively “charged” by the person from whom the clearer took title.

It is only the ultimate seller that does not receive an input tax credit for exactly the same amount of GST as they are liable to pay to the ATO. The seller can only claim an input tax credit (assuming it is registered for GST purposes) for any GST incorporated into its purchases of goods and services that are used in the business (that results in delivering pursuant to a futures contract).