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Abstract
This case note examines the Federal Court decision in *Qantas Airways Limited v Commissioner of Taxation*, which considered what the 'taxable supply' is, if any, in relation to domestic air travel, where the passenger cancels or does not show up for a flight, and does not obtain a refund. The case note examines how, despite a potentially absurd outcome, the decision is sound and, if upheld by the High Court, may catalyse a change in the law.

Keywords
goods and services tax (GST), taxable supply, airfare refund

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CASE NOTE

NO FLIGHT, NO SUPPLY – *QANTAS AIRWAYS LIMITED v COMMISSIONER OF TAXATION*

KRISTEN ZORNADA*

This case note examines the Federal Court decision in *Qantas Airways Limited v Commissioner of Taxation*, which considered what the 'taxable supply' is, if any, in relation to domestic air travel, where the passenger cancels or does not show up for a flight, and does not obtain a refund. The case note examines how, despite a potentially absurd outcome, the decision is sound and, if upheld by the High Court, may catalyse a change in the law.

INTRODUCTION

In determining liability for goods and services tax (GST), a 'taxable supply' must first be identified.[1] An inability to identify a taxable supply, or the identification of a taxable supply that ultimately fails, will nullify GST liability. *Qantas Airways Limited v Commissioner of Taxation ('Qantas Airways')*[2] considered what is the 'taxable supply', if anything, where a passenger purchases a fully refundable airline fare, but cancels or does not otherwise board the flight, and does not claim a refund.

This case emphasises the inherent difficulties in interpreting some of the most fundamental provisions of GST legislation. Characterisation of a 'taxable supply' is a vital element in the determination of GST liability, yet not entirely straightforward, as evidenced by the *Travelex Ltd v Commissioner of Taxation* (*'Travelex'*)[3] decision.[4] In

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1 See *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 7-1, s 9-5.

2 [2011] FCAFC 113.

3 (2010) 241 CLR 510.

4 The case of *Travelex Ltd v Commissioner of Taxation* (2010) 241 CLR 510 concerned whether a sale by Travelex of 400 Fijian dollars beyond the customs barrier at Sydney Airport constituted a supply of (or in relation to) rights, and therefore whether it was GST-free. At first instance, the Full Federal Court held that it was not a supply of (or in relation to) rights and was therefore not GST-free. Travelex appealed to the High Court, where the majority (French CJ, Hayne and Heydon JJ) upheld the appeal, noting that currency has little value

Qantas Airways, the Court appeared to be indirectly influenced by *Travelex*, favouring an approach to characterisation of the taxable supply that focused on the 'purpose' and 'substance' of the supply, rather than some anterior supply.[5]

FACTS

This case was an appeal from *Qantas Airways Limited v Commissioner of Taxation*,[6] heard by the Administrative Appeals Tribunal ('Tribunal'). The issue before the Tribunal was whether GST was payable where a person books and pays for a fully refundable flight, but either cancels it or does not turn up, and does not seek a refund. Qantas Airways Limited ('Qantas') contended the taxable supply was the failed flight; the Commissioner of Taxation ('Commissioner') contended it was the reservation itself.

The Tribunal had to consider, first, whether the arrangement between the passenger and the airline prior to flight was contractual in nature and, if so, what the relevant terms of the contract were. On this point, it found the Conditions of Carriage gave rise to an enforceable contract between Qantas and each passenger.

The second question before the Tribunal was whether there had been a 'supply' for the purpose of assessing GST. The Tribunal considered 'supply' within the ordinary meaning of the word, and found a supply existed when the reservation was made between the passenger and Qantas. It reasoned the airline 'holding itself ready' for carriage in respect to the passenger was a sufficient service to constitute a 'supply' and attract the imposition of GST. Therefore, the Tribunal held Qantas was still liable to pay GST on cancelled flights or 'no-shows' where the passenger did not pursue a refund.

Qantas appealed the decision to the Full Federal Court, on the grounds that the Tribunal misconstrued s 9-5 of *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ('GST Act') by failing to correctly identify the relevant supply.

DECISION

On appeal, the Full Court of the Federal Court (Stone, Edmonds and Perram JJ) had regard to s 7-1 of the GST Act, which provides GST is payable on 'taxable supplies', and s 9-5, which states 'You make a ***taxable supply*** if… (a) you make the supply for

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without the rights attached to it. However, the minority (Bell and Crennan JJ) would have denied the appeal.

5 *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113 [47].

6 [2010] AATA 977.

consideration…'. 'Supply' is defined in s 9-10 to include 'a supply of services'[7] for which consideration is given.[8]

The Full Federal Court noted the Tribunal's approach to the issue of supply was 'not easy to understand' and seemed 'back to front'.[9] This criticism was directed mainly at the Tribunal determining the 'ordinary meaning' of the term 'supply', an approach based on the United Kingdom's VAT legislation, without providing a clear explanation for why this particular legislation was relevant.

The Court then turned to the Conditions of Carriage of both Qantas and its subsidiary, JetStar, to determine the nature of the 'supply' for which the passenger was providing consideration. The Court concluded that, while a person can only fly if they have entered into a contract for a flight, the person would not be carried unless the fare has been paid.[10] Its analysis of what constituted the taxable supply proceeded on the basis that there was a contract with Qantas at the time of making the booking.

The Court agreed with the parties in their contention that there was only one, rather than multiple taxable supplies. It went further and stated that, simply because the supply fails, it does not provide a warrant (unless mandated by statute) to identify some other anterior supply as the relevant supply.[11] The Court claimed this was exactly what the Tribunal did, in reliance on the decision of the High Court of Australia ('High Court') in *Commissioner of Taxation v Reliance Carpet* ('*Reliance Carpet*').[12] However, the Federal Court distinguished that case on the basis that the legislation explicitly stated a deposit for real property was to be treated as a supply only if and when it was forfeited.[13] There was no such statutory mandate in the present case. The Court also noted that the High Court was prepared to accept the forfeited deposit as the supply, but, absent the statutory provision, it would not have been the relevant supply.[14]

The Court further noted that even the Tribunal identified 'the actual carriage of the passenger [was] obviously the purpose of each reservation'.[15] Accordingly, the Court concluded the relevant supply in the present case was the contemplated flight, not the reservation; since the contemplated flight failed to occur, there was no taxable supply, and no GST was payable. The appeal was allowed with costs.

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7 *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-10 (2)(b).
8 *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-10.
9 *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113 [5].
10 *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113 [38].
11 Ibid [42].
12 (2008) 236 CLR 342.
13 *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113 [43].
14 Ibid [45].
15 Ibid [47].

On 10 February 2012, the Commissioner appealed the case to the High Court. Justices Gummow and Hayne granted Special Leave in the matter.[16]

DETERMINING WHAT CONSTITUTES A 'TAXABLE SUPPLY'

Characterisation of the supply

The *Qantas Airways* characterisation of the 'taxable supply' followed a reasoned methodology well supported by authority. Although *Travelex* was not strictly followed, it is evident the Federal Court in *Qantas Airways* was influenced by the approaches to characterisation adopted in *Travelex* – namely, identification of the obvious 'purpose' and 'substance' of the supply.[17] Notwithstanding similar approaches to determination ('the purpose of the transaction' compared to 'direct object of the supply'), conclusions may differ.[18] The Federal Court in *Qantas Airways* did not elaborate especially as to how it, in particular, arrived at the conclusion 'the relevant supply in the present case is the contemplated flight'.[19] Rather, it was implied by analogy with the case law.

Nonetheless, closer examination of the Court's discussion of authority and resulting conclusion reveals the reasoning in *Qantas Airways* to be sound. Naturally, the Court's starting position was to analyse the characterisation of the supply as held by the Tribunal, namely that '[a] way of describing what Qantas has done … is *holding itself ready to carry the passenger*' (emphasis added).[20] In the italicised passage, the Tribunal seems to imply the passenger is not acquiring the service of the flight per se, but the *right* to fly. Prima facie, this argument is not without merit: Qantas Conditions of Carriage do not guarantee a passenger a particular seat on a particular flight (ie, the passenger may get 'bumped' due to delays, cancellations, overbooking, etc.) but rather the right to redeem their ticket for a seat on some flight.

Indeed, in light of the decision in *Travelex*, there certainly seems to have been scope for the Court in *Qantas Airways* to find the relevant supply to be a supply of rights, rather than the flight itself. However, *Qantas Airways* steered away from this, and sensibly directed its inquiry towards identifying the primary and obvious purpose of

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16 Transcript of Proceedings, *Commissioner of Taxation v Qantas Limited* (High Court of Australia, Gummow and Hayne JJ, 10 February 2012).

17 *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113 [47]-[48]; see *Travelex Limited v Commissioner of Taxation* (2010) 241 CLR 510, [32] (French CJ and Hayne J); [47] (Heydon J).

18 *Travelex Limited v Commissioner of Taxation* (2010) 241 CLR 510, compare [32] (French CJ and Hayne J), [47] (Heydon J) with [99] (Crennan and Bell JJ).

19 *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113 [49].

20 Ibid [24].

the supply. When characterising the supply, it distinguished *Reliance Carpet* and did not apply *Travelex*, thereby avoiding an incongruous comparison. In *Travelex,* a 'right' as the object of supply could be more readily inferred because the supply (the exchange of foreign money) was neither a good, nor service – it was either a supply in relation to rights, or not. Further, the nature of the supply in that case was different, as it concerned a 'financial supply'.

Instead, the Court in *Qantas Airways* applied the analogous *Saga Holidays Limited v Commissioner of Taxation* ('Saga Holidays'),[21] where the supply in question was a hotel room. In that case, Conti J held although 'the supply may involve the creation of any right… the mutually intended subject matter is not a chose [in action] … but provision of accommodation.'[22] Indeed, in the case of choses, it would seem appropriate to characterise the provision of 'rights' as the supply, given their intangible nature. But in light of such authority as *Saga Holidays*, the only sensible option open to the Court in *Qantas Airways* was to characterise the supply as being the contemplated flight, and 'nothing more or less'.[23]

A principled approach despite a potentially absurd result

The Court's finding in *Qantas Airways* that the contemplated flight was the supply might be seen to potentially lead to an absurd situation. That is, it gives the company the ability to retain unrefunded fares and not pay GST on said collection.

However, it is argued that when determining what constitutes a 'taxable supply', and the resultant tax obligations, the decision in *Qantas Airways* represents a principled approach. This is evident when two situations are compared: (1) passengers who book fully-refundable fares, cancel or do not show up for the flight, then obtain a refund; (2) passengers who book fully-refundable fares, cancel or do not show up for the flight, then through their own actions, fail to obtain a refund.

In the first situation, Qantas is permitted to (and does) make GST adjustments - it applies for a refund of the GST it paid to the Australian Tax Office (ATO) when cancelled reservations are refunded.[24] The second, however, situation is the event that gave rise to the proceedings. The Commissioner (with whom the Tribunal agreed) argued Qantas should have no right to a refund in GST where nothing is repaid to the passenger.[25] From a policy perspective, this is a logical approach:

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21 (2005) 149 FCR 41.

22 *Saga Holidays Limited v Commissioner of Taxation* (2005) 149 FCR 41 [112].

23 *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113 [56], quoting *Commissioner of Taxation v Reliance Carpet Co Pty Limited* (2008) 236 CLR 342 [13].

24 *Qantas Airways Limited v Commissioner of Taxation* [2010] AATA 977 [17].

25 See *Qantas Airways Limited v Commissioner of Taxation* [2010] AATA 977 [18].

Qantas retains unrefunded fares as a windfall. It does not seem fair it should also be exempt from paying tax on this windfall.

However, it is important to remember that, in the first situation, when a passenger obtains a refund, Qantas does not receive a GST refund because it no longer holds the passenger's money in its hands. Rather, it receives a refund because, legally, the supply has failed. In the second situation, the supply has also failed. From a legal perspective, there is no distinction between the two situations. The fact that, in the second situation, the passenger failed to exercise his or her right to a full refund, should not affect the determination of what constitutes the failed supply.

Such an approach would suffer from being retrospective. Indeed, this was supported by the Court in their reasoning that 'simply because an outcome, which is the supply paid for, fails, does not provide some warrant, statutory mandate aside, to search for and identify some other anterior supply as the "taxable supply"'.[26] Accordingly, and as the Court's decision ultimately supports, the legal consequences of both situations should be the same: a GST refund should be permitted.

Looking forward: questions for the High Court

Despite the seemingly well-reasoned decision in *Qantas Airways* on the nature of supply, questions were still raised at the Special Leave hearing for appeal to the High Court. In particular, Justice Hayne queried, '[is Qantas's compliance with GST payments] premised on there being taxable supply at the time of payment…?'[27]

This line of questioning seems to imply that, if Qantas is paying GST at the time of the passenger booking, then, at that stage, there is a taxable supply for the purposes of calculating GST. However, this concern can be simply addressed: payment at the time of booking does not necessarily mean a taxable supply exists, as 'assessable income may be conceivably derived by a taxpayer at the point of time of entry into an executory contract',[28] without necessarily resulting in actual tax liability for the taxpayer. Further, given the legislation's provision for refunds and 'adjustments',[29] it contemplates that, from time to time, taxpayers will pay GST on a supply that ultimately fails, and therefore are entitled to a refund.

With a decision that affects such a fundamental provision of the GST legislation and which results in an undesirable outcome for the ATO, it is unsurprising the Commissioner appealed the case to the High Court. The decision of the High Court is

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26 *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113 [42].

27 Transcript of Proceedings, *Commissioner of Taxation v Qantas Limited* (HCA, Gummow and Hayne JJ, 10 February 2012).

28 See *Saga Holidays Limited v Commissioner of Taxation* (2005) 149 FCR 41 [112].

29 See *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 19-10, s 19-40.

highly anticipated, because of the policy implications of the finding in *Qantas Airways.* If the Full Federal Court is upheld and there is no taxable supply, then, in the case of fares paid well in advance, the taxpayer may not know at the end of the tax period (in which the fare was purchased) what its liability for GST is. This leads to uncertainty to the extent of its reporting and payment obligations. The scope of the decision means it may affect not only the flight industry, but other industries where full payment is made upfront with the right of refund. Possible industries include tourism, accommodation and telecommunications. However, while the uncertainty regarding tax obligations is a valid concern, it can (at least in part) be addressed by s 19-10 of the GST Act, which provides for the making of adjustments regarding GST liability paid in other tax periods.

CONCLUSION

The decision in *Qantas Airways* demonstrates a principled approach towards interpreting a fundamental provision of the GST Act regarding characterisation. This approach of identifying the direct, obvious purpose of the supply is a victory for straightforward interpretation of GST legislation. It is not, of course, a victory for the ATO, who may now be unable to claim GST on failed flights even where the airline retains the collected fare as a windfall. From this policy perspective, the decision has potentially controversial implications. Nevertheless, courts cannot make decisions based on policy. Rather, decisions should be based on legal principle. The Court's reasoning in *Qantas Airways* is well supported by authority and a logical line of reasoning regarding an area of law often fraught with confusion and ambiguity. If the High Court upholds the Full Federal Court's decision, it would be unsurprising if there followed a change in the law allowing companies to retain tax-free windfalls.