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Ruling Compendium – GSTD 2012/3

This is a compendium of responses to the issues raised by external parties to draft GSTD 2011/D3: *Goods and services tax: does an adjustment for a change in extent of creditable purpose necessarily arise for services acquired in relation to a proposed merger and acquisition transaction that does not eventuate, or that does not proceed in the manner contemplated at the time the services were acquired?*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1	<i>Binding status</i> 1.1 The related <i>GST guide - claiming input tax credits on acquisitions made in connection with a merger and acquisition activity</i> (GST Guide) is not binding on the Commissioner. However, the draft Determination will be a public ruling when finalised. As these products are addressing some of the same issues, we consider that these ATO products should be consistent and should work together.	1.1 To ensure consistency, further information from the GST Guide has been added to the final Determination. Phase 2 expenses (as classified in the GST Guide) have been included in example one and example two. Phase 1 expenses are considered to be preliminary and not within the scope of the Determination question. The ATO has published binding advice about input tax credit entitlements for acquisitions associated with mergers and acquisitions (M&A) in public rulings, GSTR 2008/1 and GSTR 2002/2. Public feedback highlighted that more practical guidance would assist with taxpayer compliance; therefore the ATO issued the guide as a supplementary product to the binding ruling products. Changes made to the Determination should provide practical guidance for taxpayer's and ensure that the GST Guide and the

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		Determination can be used as complementary products. Although the GST Guide does not have the same status as a ruling, PS LA 2008/3 provides that where a taxpayer relies on written advice they will be protected against the false or misleading statement penalty that might otherwise arise. If a taxpayer wants the Commissioner to provide binding advice about the applicability of the law to their individual circumstances, a private ruling may be the best option.
2	<i>Change from addendum to GSTD product</i> 2.1 We also note that the Commissioner originally intended to issue an addendum to GSTR 2002/2 or GSTR 2000/24 (Refer to the NTLG GST Subcommittee Minutes from 15 June 2011.) We consider that the right approach has been taken to issue a stand-alone publication that deals with the issues for M&A transactions.	2.1 It was considered that a Determination could more accurately address the issue and provide greater context around the issue.
3	<i>Examples</i> 3.1 The three examples set out in the draft Determination are very much black and white scenarios and too simplistic. There are many complicated issues which taxpayers need guidance on and the examples just don't deal with these issues. The simplistic nature of the examples may mean that the draft Determination has little use for taxpayers.	3.1 The examples are designed to illustrate the broad principles relevant to the specific Determination question. However, they have been updated based on specific comments made to provide greater guidance to taxpayers. For instance, example 1 has been expanded to include some other types of expenses. An example of when an acquisition is reapplied has also been added to paragraph 45 in the

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		explanation section.
4	<i>Example: Common scenario</i> 4.1 The draft Determination provides no specific comment about the common scenario where costs are incurred before it is known whether the proposed transaction will be a share or asset transaction, for example investment bank advice, valuation or due diligence services. According to the GST guide the costs should generally be apportioned when incurred (for example on a 50/50 basis), but given that (unlike the costs specifically relating to the aborted share acquisition in the examples) the costs would remain relevant to the ultimate form of the transaction. Does Division 129 of the <i>A New Tax System Goods and Services Tax Act 1999</i> (GST Act) then allow or require a partial true-up of the input tax credit claim once the form of transaction is known?	4.1 The examples have been updated to included situations where costs are incurred before the outcome of the transaction is known. Paragraph 7 in example one and paragraphs 15 - 16 in example two have been updated to explain the extent of creditable purpose of costs where there is no particular objective factors that indicate the form in which the M&A is likely to take and as such the fair and reasonable approach is to claim 50% input tax credits. The examples also provide guidance on when Division 129 needs to be applied. Paragraph 44 in the explanation section has also been added to explain the application of Division 129 to phase 2 type expenses that are incurred in evaluating or preparing to carry out the transaction. The application of Division 129 does not turn on whether the form of the ultimate transaction is different from the one initially intended, but will depend on whether the acquisition is in fact applied for a different purpose from the intended purpose.
5	<i>Example – Assets to shares</i> 5.1 The examples do not deal with a situation	5.1 We acknowledge that the examples given in the draft only

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	where it is proposed to acquire assets and then there is a later change to acquire shares.	dealt with situations where it is proposed to acquire shares and then the entity later acquires assets. In order to provide guidance to taxpayers, example 3 has been updated to include the application of Division 129 where it is proposed to acquire assets and the entity later acquires shares.
6	<i>Examples – Acquisitions relevant to both transactions</i> 6.1 The draft Determination talks about services being applied or reapplied at a later time. If the services acquired are relevant to both potential types of transaction they are (unlike Examples one and two) still relevant to the ultimate transaction, so a Division 129 adjustment arises? This should be canvassed in the draft Determination.	6.1 The examples in the draft Determination only dealt with services classified in the GST Guide as phase 3 acquisitions. In order to provide more practical guidance, examples one and two have been updated to include phase 2 acquisitions (as classified in the GST Guide). Paragraph 46 has been added to indicate that such acquisitions may give rise to an adjustment if the circumstances in paragraph 45 arise. The examples illustrate that an adjustment will only arise under Division 129 when there is a change in the extent of application for a creditable purpose.
7	<i>Example One</i> 7.1 In <i>Example One</i> (paragraph 6-8) does Division 129 apply in a situation where there is a need to seek further services from the lawyer to draft agreements where it is decided to go ahead with the asset sale.	7.1 This will depend on the factual situation. Where there is an application of the acquired services for a different purpose such as in <i>example one</i> (paragraph 14) and <i>three</i> (paragraph 27) Division 129 may apply. Where there is an acquisition of new services this may be a creditable acquisition under Division 11 of

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		the GST Act.
8	<i>Example One</i> 8.1 This example is not very helpful. This is because such services do not only relate to the share acquisition, the ongoing compliance with occupational, health and safety issues etcetera is an issue that would impact the business operations as much as its ownership. Only if the advice is on an historic liability that exists for the company owners will it be quarantined to the share acquisition. We suggest using such an example where the liability is quarantined would be better in illustrating the issue and the position the Commissioner wishes to take. Even then, to what extent does an advice on an historic liability, say tax exposure, later give rise to a Division 129 adjustment if it is used in relation to a creditable purpose (as a general enterprise cost) when the acquirer of the company uses the advice as the basis for a disclosure to the ATO?	8.1 It is acknowledged that the facts in the example are unclear and therefore the advice could be of a general nature and applicable to either the purchase of assets or shares. The facts in example one have been updated to improve clarity and to illustrate the application of Division 129 in the M&A context. For example due diligence in relation to intellectual property has been added to illustrate later application of the due diligence services. While the example provided in this comment has not been incorporated into the example, the same principles under Division 129 would apply. The acquisitions would need to be assessed against the commentary set out in paragraphs 42 to 45, to determine if such acquisitions have been reapplied.
9	<i>Paragraph 10</i> 9.1 This is not a correct reflection of the GST Act.	9.1 It is acknowledged that the Determination does not deal with reduced input tax credits. However, the application of Division

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	The draft Determination sets out: The acquisition of the investment services is not for a creditable purpose and Flash Co does not claim input tax credits on this acquisition. This statement appears to disregard section 70-10 of the GST Act and the reduced input tax credit regime. The draft Determination should address the extended meaning of creditable purpose and reduced credit acquisitions.	70 of the GST Act is outside the scope of the determination. To avoid confusion, footnote 6 has been added to example two to provide that the Determination assumes that acquisitions to the extent that they relate to the making of input taxed supplies, are not for a creditable purpose. Also, a new footnote 2 at the start of the examples states that it is assumed that the relevant entity has exceeded the financial acquisitions threshold (Division 189 of the GST Act), and that the examples don't deal with any potential reduced input tax credits under Division 70.
10	<i>Example Three</i> 10.1 In relation to example three where a Division 129 adjustment is required, do the various thresholds under Division 129 apply which that any acquisition that related to the acquisition of the shares that is below \$10,000 cannot be adjusted because of subsection 129-10(1) of the GST Act?	10.1 Footnote 10 in the draft Determination explains that the detailed operation of Division 129, which includes the operation of the various thresholds, is not explained in the draft Determination. In order to provide clarity this footnote has been moved to the explanation section of the final Determination in paragraph 40 and provides that the detailed operation of Division 129 has not been explained in the Determination and it is assumed that the other requirements in Division 129 have been met. The question of apportionment under Division 129 is fact specific and has been addressed in GSTR 2000/24 and GSTR 2009/4. Footnote 7 has also been added to the example.

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11	<i>Appendix Two – Alternative view</i> 11.1 The Commissioner notes that there is an alternative view and addresses the differences as an issue in relation to terminology in Division 11 and Division 129 of the GST Act. However we consider that a more fundamental point in relation to the alternative view and that is the question of whether an entity that does not make input taxed supplies should bear the burden of GST. That is, the Division 129 adjustments when a proposed input taxed acquisition does not eventuate ensure that an otherwise taxable business does not incur irrecoverable GST that needs to be factored in as a cost to its taxable supplies – giving rise to cascading tax which the GST system is designed to avoid. This is the Alternative view that should be reflected in the draft Determination.	11.1 We acknowledge that there are further competing views in regards to the operation of the GST Act where an entity does not make an input supply otherwise than in the M&A transaction. The basis for this competing view is not confined to M&A transactions and is not dealt with in the Determination. However, the Commissioner's view is explained in GSTR 2008/1 at paragraphs 184-196 in the context of capital raising. However, the Alternative view and Commissioner's view has been slightly expanded and clarified..