GSTR 2008/1 - Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?

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Goods and Services Tax Ruling

Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?

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Preamble

This document is a ruling for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953*. You can rely on the information presented in this document which provides advice on the operation of the GST system.

[**Note:** This is a consolidated version of this document. Refer to the ATO Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]

What this Ruling is about

1. To claim an input tax credit you must make a creditable acquisition[1] or importation.[2] To make a creditable acquisition or importation you need to make the acquisition or importation solely or partly for a creditable purpose. This Ruling considers the creditable purpose requirement. The meaning of creditable purpose is set out in section 11-15 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) for acquisitions and section 15-10 of the GST Act for importations.

2. This Ruling explains some factors that provide guidance in determining whether an acquisition or importation is for a creditable purpose. It addresses:

- whether the acquisition or importation is made in carrying on an enterprise or whether it is of a private or domestic nature; and
- whether the acquisition or importation relates to making supplies that would be input taxed.

3. This Ruling does not address every issue that could arise in ascertaining whether an acquisition or importation is made for a creditable purpose. Instead, this Ruling makes some general observations about the nature of this enquiry and explains some factors that, in the Commissioner's view, would be relevant to the enquiry in various specific situations.

[1] Section 11-5 of the GST Act.
[2] Section 15-5 of the GST Act.

4. Although this Ruling deals primarily with entities carrying on an enterprise that results in the entities making supplies, the principles outlined are also applicable to entities carrying on an enterprise where the entities do not make supplies.

5. The Ruling briefly describes the interaction of paragraph 11-15(2)(a) with subsections 11-15(3), (4) and (5) of the GST Act, but it does not discuss the operation of those subsections in detail.

6. This Ruling does not explain the operation of Division 129 of the GST Act.[3]

7. The extent of creditable purpose of an acquisition or an importation is the subject of two separate GST Rulings, and is not dealt with in detail in this Ruling.[4]

8. This Ruling does not discuss Division 70 of the GST Act, which is about reduced credit acquisitions. Division 70 contains an extended definition of creditable purpose which is based on the definition of creditable purpose in section 11-15 of the GST Act. Division 70 is discussed in GSTR 2004/1.[5]

9. Unless otherwise stated, all legislative references in this Ruling are to the GST Act.

Date of effect

10. This Ruling explains the Commissioner's view of the law as it applies both before and after its date of issue. You can rely upon this Ruling on and from its date of issue for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953*. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and the Commissioner's view of when you can rely on this interpretation of the law in GST public and private rulings.

11. If this Ruling conflicts with a previous private ruling that you have obtained or a previous public ruling, this public ruling prevails.

12. However, if you have relied on a previous ruling, you are protected in respect of what you have done up to the date of issue of this public ruling or, if there is a change to the legislation, you are protected in respect of what you have done up to the date the legislative change takes effect.

[3] See Goods and Services Tax Ruling GSTR 2000/24 Goods and services tax: Division 129 – making adjustments for changes in extent of creditable purpose.
[4] See Goods and Services Tax Ruling GSTR 2006/3 Goods and services tax: determining the extent of creditable purpose for providers of financial supplies; and Goods and Services Tax Ruling GSTR 2006/4 Goods and services tax: determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose.
[5] Goods and Services Tax Ruling 2004/1 Goods and services tax: reduced credit acquisitions.

13. This means that if you have relied on the earlier ruling and have underpaid an amount of GST, you are not liable for the shortfall prior to either the issue date of this Ruling or the date the legislative change takes effect, as appropriate. Similarly, if you have relied on the earlier ruling you are not liable to repay an amount overpaid by the Commissioner as a refund.

Background

A New Tax System (Goods and Services Tax) Act 1999

14. The general entitlement to input tax credits arises from the making of creditable acquisitions and creditable importations.[6] Division 11 deals with creditable acquisitions, while Division 15 deals with creditable importations. This Ruling is concerned with the creditable purpose requirement in paragraphs 11-5(a) and 15-10(a), and the meaning of creditable purpose, as set out in sections 11-15 and 15-10 for acquisitions and importations respectively.

15. The term 'creditable acquisition' is defined in section 11-5 as follows:

> You make a ***creditable acquisition*** if:
>
> (a) you acquire anything solely or partly for a creditable purpose; and
>
> (b) the supply of the thing to you is a taxable supply; and
>
> (c) you provide, or are liable to provide, consideration for the supply; and
>
> (d) you are registered, or required to be registered.

16. 'Creditable purpose' is defined in section 11-15 as follows:

> (1) You acquire a thing for a ***creditable purpose*** to the extent that you acquire it in carrying on your enterprise.
>
> (2) However, you do not acquire the thing for a creditable purpose to the extent that:
>
> (a) the acquisition relates to making supplies that would be input taxed; or
>
> (b) the acquisition is of a private or domestic nature.
>
> (3) An acquisition is not treated, for the purposes of paragraph (2)(a), as relating to making supplies that would be input taxed to the extent that the supply is made through an enterprise, or part of an enterprise, that you carry on outside Australia.

[6] Subsection 7-1(2).

(4) An acquisition is not treated, for the purposes of paragraph (2)(a), as relating to making supplies that would be input taxed if:

(a) the only reason it would (apart from this subsection) be so treated is because it relates to making financial supplies; and

(b) you do not exceed the financial acquisitions threshold.

(5) An acquisition is not treated, for the purposes of paragraph (2)(a), as relating to making supplies that would be input taxed to the extent that:

(a) the acquisition relates to making a financial supply consisting of a borrowing; and

(b) the borrowing relates to you making supplies that are not input taxed.

17. If you have made an importation you will need to establish whether it is a creditable importation. The term 'creditable importation' is defined in section 15-5 as follows:

You make a ***creditable importation*** if:

(a) you import goods solely or partly for a creditable purpose; and

(b) the importation is a taxable importation; and

(c) you are registered, or required to be registered.

18. 'Creditable purpose' is defined in section 15-10 as follows:

(1) You import goods for a ***creditable purpose*** to the extent that you import the goods in carrying on your enterprise.

(2) However, you do not import the goods for a creditable purpose to the extent that:

(a) the importation relates to making supplies that would be input taxed; or

(b) the importation is of a private or domestic nature.

(3) An importation is not treated, for the purposes of paragraph (2)(a), as relating to making supplies that would be input taxed to the extent that the supply is made through an enterprise, or part of an enterprise, that you carry on outside Australia.

(4) An importation is not treated, for the purposes of paragraph (2)(a), as relating to making supplies that would be input taxed if:

(a) the only reason it would (apart from this subsection) be so treated is because it relates to making financial supplies; and

(b) you do not exceed the financial acquisitions threshold.

(5) An importation is not treated, for the purposes of paragraph (2)(a), as relating to making supplies that would be input taxed to the extent that:

(a) the importation relates to making a financial supply consisting of a borrowing; and

(b) the borrowing relates to you making supplies that are not input taxed.

19. As the creditable purpose tests in Divisions 11 and 15 are similarly structured, using the same words, the Commissioner considers that the tests are intended to be similarly applied. Consequently, where a discussion in this Ruling refers to provisions in Division 11, the discussion is also applicable to Division 15. For this purpose, references to 'acquisitions' can be read as references to 'acquisitions and importations'.

The context of GST

20. The Australian GST is a multi-stage value added tax, borne at the point of final consumption of goods and services, and calculated with reference to supplies. A fundamental aspect of any value added tax is that tax is charged at every point at which value is added prior to final consumption, with credit available for GST charged at earlier stages. This credit results in each entity that is registered for GST paying a net amount at each stage, being the difference between the GST on their outputs (taxable supplies) and the GST on their inputs (creditable acquisitions).

21. Hill J, in delivering the main judgment of the Full Federal Court decision in *HP Mercantile Pty Limited v. Commissioner of Taxation*[7] (*HP Mercantile*), noted the following with respect to the GST:

> The language of the GST Act, as seen in the context of value added taxation generally, makes it clear that the legislative scheme is that a taxpayer will be entitled to an input tax credit where it is necessary that a credit be given to ensure that output tax payable by the taxpayer is not imposed upon an amount which already includes tax payable at some early stage in the commercial cycle. Where possible, GST is not to be found embedded in the price or consideration on which output tax is calculated when taxable supplies are made. However, in the case of a taxpayer which makes input taxed supplies, while that taxpayer will not be liable to output tax on the supplies it makes which satisfy the description of input taxed supplies, that taxpayer will be denied an input tax credit for the tax payable on acquisitions it makes where the necessary relationship exists.[8]

[7] (2005) 143 FCR 553; [2005] FCAFC 126; 2005 ATC 4571; (2005) 60 ATR 106.
[8] (2005) 143 FCR 553 at 564; [2005] FCAFC 126 at paragraph 45; 2005 ATC 4571 at 4579; (2005) 60 ATR 106 at 116.

22. In relation to the availability of input tax credits, Hill J said:

> The genius of a system of value added taxation, of which the GST is an example, is that while tax is generally payable at each stage of commercial dealings (supplies) with goods, services or other 'things', there is allowed to an entity which acquires those goods, services or other things as a result of a taxable supply made to it, a credit for the tax borne by that entity by reference to the output tax payable as a result of the taxable supply. That credit, known as an input tax credit, will be available, generally speaking, so long as the acquirer and the supply to it (assuming it was a 'taxable supply') satisfied certain conditions, the most important of which, for present purposes, is that the acquirer make the acquisition in the course of carrying on an enterprise and thus, not as a consumer. The system of input tax credits thus ensures that while GST is a multi-stage tax, there will ordinarily be no cascading of tax. It ensures also that the tax will be payable, by each supplier in a chain, only upon the value added by that supplier.[9]

23. Hill J's comments reinforce the policy intent expressed in the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998 (Explanatory Memorandum) which describes the scheme of the GST as follows:

> 3.24 Input tax credits are intended to offset the GST included in the price you paid for an acquisition if the acquisition is for use in your enterprise. If you are going to use a thing in your enterprise, for example by selling it on to someone else, GST will be included in that sale. Therefore, to avoid double taxing that thing, you receive a credit for the GST included in the price you paid for the thing. You therefore have a creditable purpose if you acquire a thing for the purpose of your enterprise.
>
> 3.26 However, you are not entitled to an input tax credit for acquiring a thing if your acquisition of the thing relates to an input taxed supply you are going to make. No tax will be charged on that supply. Therefore, you do not have a creditable purpose if your acquisition of a thing relates, either <u>directly or indirectly</u>, to a supply you make that is input taxed (emphasis added).

24. A supplier that makes taxable supplies is liable for GST on those supplies. The supplier is entitled to claim input tax credits for acquisitions it makes that relate to making those supplies. This ensures that the price the supplier charges reflects the value of the supply (including the cost of inputs net of GST and the value added by the supplier) and the GST levied on the value of that supply. That is, the price charged does not reflect any embedded GST.

[9] (2005) 143 FCR 553 at 557; [2005] FCAFC 126 at paragraph 13; 2005 ATC 4571 at 4574; (2005) 60 ATR 106 at 109.

25. A supplier that makes input taxed supplies is not liable for GST on those supplies. The supplier is not, however, entitled to input tax credits for acquisitions it makes that relate to making those supplies. The price the supplier charges will reflect the cost of its inputs (including any GST it has borne) and the value added by the supplier.[10] The term 'input taxed', rather than the more usual term 'exempt' as used in other jurisdictions,[11] reflects that tax is included in the inputs to the supply rather than levied on the supply.

26. For taxable and input taxed supplies made from business to consumer the price includes GST. For input taxed supplies the GST is embedded and so the supplies are partially taxed even though there is no explicit charging of GST on such supplies.

27. Where taxable supplies are made in business to business transactions, cascading of tax does not occur. This is because the tax passed on in the price of the taxable supply can give rise to input tax credits for the recipient of the supply if the acquisition is used by the recipient to make taxable supplies (or GST-free supplies).

28. In contrast, cascading can occur when there are business to business input taxed supplies. This is because the embedded tax passed on in the price of the input taxed supply cannot give rise to input tax credits for the recipient of the supply, even if the acquisition is used by the recipient to make taxable supplies.

29. As a general proposition, we consider that Division 11 should be interpreted in a way that will not ordinarily lead to a cascade of tax. However this is not the sole principle for determining whether an acquisition is made for a creditable purpose. That task requires application of the actual language of the GST Act in light of the contextual considerations mentioned above.

Relevance of income tax law

30. There is some similarity between section 11-15 of the GST Act and section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997). For instance, under section 8-1 of the ITAA 1997 relevant considerations include whether a loss or outgoing was incurred in carrying on your business and whether it is of a private or domestic nature.

31. Section 8-1 of the ITAA 1997 is as follows:

> 8-1(1) You can ***deduct*** from your assessable income any loss or outgoing to the extent that:
>
> (a) it is incurred in gaining or producing your assessable income; or
>
> (b) it is necessarily incurred in carrying on a *business for the purpose of gaining or producing your assessable income.

[10] See paragraph 5.4 of the Explanatory Memorandum.
[11] See paragraph 5.5 of the Explanatory Memorandum.

> 8-1(2) However, you cannot deduct a loss or outgoing under this section to the extent that:
>
> (a) it is a loss or outgoing of capital, or of a capital nature; or
>
> (b) it is a loss or outgoing of a private or domestic nature; or
>
> (c) it is incurred in relation to gaining or producing your exempt income or your non-assessable non-exempt income; or
>
> (d) a provision of this Act prevents you from deducting it.

32. When the GST legislation was enacted, there was a well known history of connection tests in income tax law. The similarity in the structure and wording of section 11-15 when compared with section 8-1 of the ITAA 1997 and the former provision subsection 51(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) was commented on by Hill J in *HP Mercantile:*[12]

> It is, perhaps, not unremarkable that s 11-15 of the GST Act bears, in its structure, some similarity to the general business deduction provisions of the Australian income tax law, that is, s 51(1) of the *Income Tax Assessment Act 1936* (Cth) (the ITAA 1936) and s 8-1 of the *Income Tax Assessment Act 1997* (Cth). In both the GST provision and the income tax provisions, there is a need to pass first through a positive test. In the case of GST, the positive test is the requirement that the acquisition has been in whole or in part acquired in carrying on an enterprise. In the income tax context, there is the need to find that the loss or outgoing be incurred in gaining or producing assessable income, or in carrying on a business. In both cases apportionment arises where the positive test is only partly satisfied. Next, both require consideration of negative tests which exclude the allowance of a credit in the GST context or the allowance of a deduction in the income tax context. In the GST context the negative tests are those set out in s 11-15(2) of acquisitions relating to supplies that would be input taxed or acquisitions of a private and domestic nature. In the income tax context, the negative tests also involve the case where the loss or outgoing is of a private and domestic nature as well as where it is capital or of a capital nature. In both cases, a question of apportionment arises where the negative tests only partly apply.

[12] (2005) 143 FCR 553 at 559; [2005] FCAFC 126 at paragraph 21; 2005 ATC 4571 at 4576; (2005) 60 ATR 106 at 111.

33. Notwithstanding the similarities in the respective provisions it is worth commenting on how the negative limbs of section 8-1 of the ITAA 1997 operate in practice. A loss or outgoing incurred in gaining or producing exempt income is not denied deductibility through the operation of the negative limb. Such a loss or outgoing will not satisfy the positive limbs. Similarly a loss or outgoing that is of a private or domestic nature would be unlikely to satisfy the positive tests in section 8-1 of the ITAA 1997. There is also some basis for arguing that the exclusion from deductibility because a loss or outgoing is of a capital nature is not a true exception and again such a loss or outgoing would not pass the positive tests of the provision. The negative tests in section 8-1 of the ITAA 1997 are essentially contradistinctions to the positive tests.

34. This stands in contrast to section 11-15 where it is possible that an acquisition may pass through the broad threshold test in subsection 11-15(1) only to be denied a creditable purpose because of its relationship to the making of supplies that would be input taxed.

35. The structure of the GST provisions has a significant difference in that the negative test in paragraph 11-15(2)(a) uses different words from the positive test to describe the required connection. The positive test in subsection 11-15(1) uses the expression 'in carrying on your enterprise', whereas the negative test in paragraph 11-15(2)(a) has 'relates to making supplies that would be input taxed'.

36. The negative limb of paragraph 11-15(2)(a) has an independent operation. As such, the treatment of acquisitions is essentially governed by their relationship (if any) to the making of supplies that would be input taxed.

Relevance of overseas VAT and GST law

37. The drafting of the Australian input tax credit provisions differs from that of most overseas VAT and GST legislation in that the availability of input tax credits under the Australian law is based on a broad enterprise connection test and the further requirement that there be no relationship with making supplies that would be input taxed.

38. By contrast, input tax deductibility (which is the term commonly used overseas for the availability of input tax credits) under, for example, the European VAT legislation is primarily based on an enterprise connection test and requires a sufficient positive connection with taxable supplies.

39. Interpretation of the VAT legislation by the European Court of Justice is governed and informed by European Union directives on VAT harmonisation between the member states. In respect of the deductibility of input tax, Article 2 in the former First Directive and Article 17 in the former Sixth Directive have been relevant in numerous court decisions.[13] These Articles relevantly provide:

> Article 2, First Directive – On each transaction, value added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable **after deduction of the amount of value added tax borne directly by the various cost components**. [emphasis added]
>
> Article 17(2), Sixth Directive – In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay: … value added tax due or paid …

40. In light of the above Directives, a view has evolved in the UK and European courts that entitlement to deduct input tax on an acquisition depends on a 'direct and immediate link' between the acquisition and taxable transactions being established and the amount to be deducted as input tax having been borne directly by the various cost components of the taxable transaction.

41. In the Australian context the general scheme of the legislation provides for the desire to restrict cascades of input tax into taxable outputs (see paragraph 22 of this Ruling). This much the Australian law has in common with all GST and VAT systems.

42. However, unlike the UK and European VAT regimes the Australian GST law has no requirement to 'link' an acquisition to the making of a taxable or GST-free supply for the acquisition to have a creditable purpose. If the acquisition is made in carrying on an entity's enterprise it is for a creditable purpose, subject to the negative test in paragraph 11-15(2)(a).

43. The 'cost component' analysis in the UK and European law results from the requirement of Article 2 of the First Directive that VAT is to be charged after deduction of the VAT borne directly by the various cost components. The Australian GST legislation has no equivalent of this requirement. The Commissioner considers that whether an acquisition is a cost component of a particular output may be a relevant consideration in determining whether the acquisition has been made for a creditable purpose in that this would tend to help establish whether the input 'relates to' the output. However, there is no legislative basis for viewing this consideration as a special or decisive factor.

[13] The First and Sixth VAT Directives have recently been repealed and the Articles have been recast into a new principal VAT Directive.

44. In the Commissioner's view, you do not acquire a thing for a creditable purpose if the acquisition relates *directly or indirectly* to making supplies that would be input taxed (see paragraph 23 of this Ruling). Therefore, a conclusion that an acquisition has, in terms of the UK and European case law, a direct and immediate link with the making of taxable supplies is not decisive for Australian purposes because the acquisition may nevertheless also relate, directly or indirectly, to the making of other supplies that would be input taxed.

45. Despite this, from a consideration of whether an acquisition has (perhaps by analogy with the overseas case law) a direct and immediate link with the making of particular supplies, two conclusions could follow. Firstly, it is very likely that an acquisition that has that link would also 'relate to' the making of those supplies. Secondly this might, depending on the circumstances, be a relevant consideration to take into account in deciding whether the acquisition has a real and substantial (though indirect) relationship to the making of other supplies, if those other supplies would be input taxed.

Ruling with explanation

46. Entities that are registered for GST are entitled to claim input tax credits for creditable acquisitions they make.[14] Section 11-5 sets out what is a creditable acquisition. A creditable acquisition is made if an entity makes an acquisition solely or partly for a creditable purpose[15] and the other requirements of section 11-5 are met.[16] This Ruling only deals with the creditable purpose requirement, the meaning of which is set out in section 11-15.

47. Under section 11-15, an entity acquires a thing for a creditable purpose to the extent that the entity acquires the thing in carrying on its enterprise. However, an acquisition is not for a creditable purpose to the extent that the acquisition is of a private or domestic nature.[17]

48. An acquisition is also not for a creditable purpose to the extent that the acquisition relates to making supplies that would be input taxed,[18] unless either subsection 11-15(3), (4) or (5) applies.[19] If none of these subsections are satisfied, and the acquisition relates to a financial supply, the entity may still have an entitlement to a reduced input tax credit, if the acquisition it makes is a reduced credit acquisition for the purposes of Division 70.[20]

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[14] Section 11-20.
[15] Paragraph 11-5(a).
[16] The other requirements are that the supply to the entity is a taxable supply; the entity provides or is liable to provide consideration for the supply; and the entity is registered or required to be registered for GST.
[17] Paragraph 11-15(2)(b).
[18] Paragraph 11-15(2)(a).
[19] Subsections 11-15(3), (4) and (5) are discussed at paragraphs 197 to 214 of this Ruling.
[20] See GSTR 2004/1.

49. An entity is often required to determine the extent to which an acquisition is for a creditable purpose, based on the entity's intended use of the acquisition.

50. If an entity determines the extent of creditable purpose based on intended use, the entity may be required to make adjustments if its actual use of the thing differs to its intended use.[21]

51. Similarly, if an entity acquires goods solely for a creditable purpose and later applies those goods solely to private or domestic use, the entity may have to make an increasing adjustment.[22]

52. This Ruling does not address the adjustment provisions. The need to make adjustments for change in use of an acquisition is explained in GSTR 2000/24.[23] The need to make an adjustment because an acquisition becomes or stops being a creditable acquisition is explained in GSTR 2000/19.[24] You should refer to these Rulings for further information.

Structure of the 'Ruling with explanation' section

53. This section of the Ruling is divided into three parts as follows:

Part	Content
Part A (paragraphs 54 to 100)	Determining whether an acquisition is made in carrying on an enterprise, including whether the acquisition is of a private or domestic nature
Part B (paragraphs 101 to 196)	Determining a connection between an acquisition and the making of supplies that would be input taxed.
Part C (paragraphs 197 to 214)	The interaction of subsections 11-15(3), (4) and (5) with paragraph 11-15(2)(a)

Part A – Determining whether an acquisition is made in carrying on an enterprise

54. This section discusses the Commissioner's approach to determining whether you acquire a thing in carrying on your enterprise, including whether the thing you acquire is of a private or domestic nature.

[21] See Division 129 (which is about adjustments for change in use of an acquisition).
[22] See Division 130 (which is about goods applied solely to private or domestic use).
[23] Goods and Services Tax: Division 129 – making adjustments for changes in extent of creditable purpose.
[24] Goods and Services Tax Ruling GSTR 2000/19 Goods and services tax: making adjustments under Division 19 for adjustment events.

55. Subsection 11-15(1) requires that you acquire a thing in carrying on your enterprise. It is therefore necessary firstly to identify the enterprise that is being carried on and secondly to determine whether there is a connection between the acquisition and the enterprise being carried on.

Determining the enterprise that is being carried on

56. The definition of 'enterprise' refers to an activity or series of activities that is done in the form of a business, an adventure or concern in the nature of trade or the regular or continuous leasing, licensing or granting of an interest in property. It also includes an activity or series of activities done by a trustee of a trust or complying superannuation fund, a charitable institution or charitable fund, a religious institution or a government or an entity established for a public purpose.[25]

57. Additionally 'carrying on' an enterprise is defined[26] to include doing anything in the course of the commencement or termination of the enterprise and therefore it is also relevant to have regard to those activities. If an entity is not carrying on an enterprise (and does not intend to carry on an enterprise) the entity cannot register[27] and therefore cannot make a creditable acquisition and is not entitled to any input tax credits.[28]

58. Miscellaneous Taxation Ruling MT 2006/1[29] provides guidance as to activities typically undertaken in the course of commencing or terminating an enterprise. For further information on whether activities form part of commencing an enterprise refer to paragraphs 122 to 139 of MT 2006/1 and for terminating an enterprise refer to paragraphs 140 to 148 of MT 2006/1.

59. Section 9-20 sets out the meaning of enterprise. Subsection 9-20(1) commences by stating that 'an enterprise is an activity, or series of activities'. Consequently, it is necessary to identify the activity or series of activities that constitute the enterprise to determine whether the acquisition is acquired in carrying on that enterprise.

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[25] Section 9-20.
[26] Section 195-1.
[27] Division 23.
[28] Section 11-5.
[29] Miscellaneous Taxation Ruling MT 2006/1 The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number. This Ruling applies equally to the meaning of enterprise for the purposes of the GST Act: Goods and Services Tax Determination GSTD 2006/6 Goods and services tax: does MT 2006/1 have equal application to the meaning of 'entity' and 'enterprise' for the purposes of the A New Tax system (Goods and Services Tax) Act 1999?

60. In determining the enterprise that is being carried on relevant indicators include:

- the activities that generate income for the entity;
- formation documents;
- contracts;
- business records such as receipts and invoices;
- business plans; and
- minutes of meetings.

Determining a connection between the thing acquired and the enterprise

61. In many cases it is clear that there is a connection between the thing acquired and the enterprise being carried on. For example, if an entity operating a shoe shop acquires shoes to on-sell through his or her shoe shop it is clear that the acquisition is made in carrying on the enterprise. However, if the entity acquires the shoes to give as a gift to his or her daughter, it is equally clear that the acquisition is not made in carrying on the enterprise.

62. There is also a connection between acquisitions of a capital nature and the enterprise being carried on if the acquisitions are, for example, used by the entity in making supplies. Although acquisitions of a capital nature are denied a deduction[30] for income tax purposes, there is no similar denial of an input tax credit under section 11-15 and so acquisitions that are of a capital nature are treated in the same manner as other acquisitions. For example, if a car manufacturing company purchases new spray painting machinery for use on its production line, the acquisition is made in carrying on its enterprise and is for a creditable purpose.

63. However, situations may arise where it is not clear whether the acquisition is made in carrying on the enterprise. For example the entity may have acquired the thing but it may not be clear whether it can be said that the thing was acquired in carrying on the enterprise, or whether it is private or domestic in nature.

Was the thing acquired in carrying on an enterprise?

64. Whether something is acquired in carrying on an enterprise requires a connection or link between the thing acquired and the enterprise.

[30] Paragraph 8-1(2)(a) of the ITAA 1997.

65. As remarked on by Hill J in *HP Mercantile*[31] there is some similarity between section 11-15 of the GST Act and section 8-1 of the ITAA 1997. Hill J noted[32] that for both income tax and GST purposes there is a need to pass through a positive test. For income tax purposes, the positive test is that the loss or outgoing has been incurred in gaining or producing assessable income (1st limb) or in carrying on a business for the purpose of gaining or producing assessable income (2nd limb) and for GST purposes the positive test is that the acquisition has been acquired in carrying on an enterprise.

66. Common to both is an exclusion of a loss or outgoing (for income tax purposes) or an acquisition (for GST purposes) that is private or domestic in nature. However, it is only for income tax purposes that a loss or outgoing of a capital nature is excluded.

67. In the income tax context the connection required if either the first or second limb of subsection 8-1(1) of the ITAA 1997 is to be satisfied has been the subject of much judicial consideration. In *Macquarie Finance Ltd v. Commissioner of Taxation*[33], which broadly concerned whether interest payments were of a capital nature or were deductible, French J gave a summary of previous income tax cases that had considered issues such as the connection between a loss or outgoing and the gaining or producing of assessable income; or the carrying on of a business for the purpose of gaining or producing assessable income. As summarised by French J, the tests that have variously been applied include:

- whether the loss or outgoing was incidental or relevant or desirable or appropriate;
- the objectively assessed purpose of the entity, which may be assessed by reference to the results that the loss or outgoing or the particular agreement or transaction is designed to achieve; and
- the assessment of the objective purpose of the entity in incurring the expenditure, or inferences as to a connection may be assisted by reference to the subjective purpose of a relevant individual (for example, in the case of a company, the directors or its agents).

68. In the Full Federal Court decision of *Magna Alloys & Research Pty Ltd v. Federal Commissioner of Taxation*,[34] (*Magna* Alloys) Brennan J explained that both motive and subjective purpose are states of mind, whereas objective purpose is an attribute of a transaction. That is, it is attributed to a transaction by reference to all the known circumstances.

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[31] (2005) 143 FCR 553 at 559; [2005] FCAFC 126 at paragraph 21; 2005 ATC 4571 at 4576; (2005) 60 ATR 106 at 111.
[32] See extract at paragraph 32 of this Ruling.
[33] (2005) 146 FCR 77; 2005 ATC 4829; (2005) 61 ATR 1.
[34] (1980) 49 FLR 183 at 185; 80 ATC 4542 at 4544; (1980) 11 ATR 276 at 279.

69. The Commissioner considers that in the GST context it is necessary to make an objective assessment as to whether there is a connection between the thing acquired and the enterprise, based on all the facts and circumstances. Although the subjective purpose of the entity making the acquisition is relevant, it is not determinative.

70. Whether an acquisition is acquired in carrying on an enterprise is a question of fact and degree, making it impractical to provide an exhaustive list of all the factors that may be relevant to determining whether an acquisition is made in carrying on an enterprise. However, some factors that would suggest that an acquisition is made in carrying on an enterprise include that:

- the acquisition is incidental or relevant to the commencement, continuance or termination of the enterprise;
- the thing acquired is used by the enterprise in making supplies;
- the acquisition secures a real benefit or advantage for the commencement, continuance or termination of the enterprise;
- the acquisition is one which an ordinary business person in the position of the recipient would be likely to make for the enterprise;
- the acquisition does not meet the personal needs of individuals such as partners or directors;
- the acquisition helps to protect or preserve the enterprise entity, structure or organisation; and
- the acquisition is made by the entity in accordance with, or to satisfy, a statutory requirement imposed on the enterprise.

71. In some cases an acquisition can be made in carrying on an enterprise, even if the relevant outgoing is not 'necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income for income tax purposes'.[35] An example is provided by the facts in *Commissioner of Taxation v. Swan Brewery Company Limited*.[36]

[35] Paragraph 8-1(1)(b) of the ITAA 1997. Formerly contained in subsection 51(1) of the ITAA 1936.
[36] (1991) 30 FCR 553; 91 ATC 4637; (1991) 22 ATR 295.

72. The taxpayer in that case was a public company that had been the subject of a takeover offer. The case concerned the deductibility under subsection 51(1) of the ITAA 1936 of expenditure incurred on:

- obtaining an independent report from another entity on the takeover offer for the information of the company's shareholders, as required by the relevant companies legislation;
- obtaining advice from the company's solicitors in relation to the takeover offer and in relation to the preparation of a formal statement to the shareholders that was required by the legislation; and
- printing the formal statement.

73. The Full Federal Court held that the expenditure was not deductible under subsection 51(1) as it was not incidental to the gaining or producing of assessable income and it was not necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. The Court[37] said:

> With regard to 'the second positive limb of sub-section 51(1)' that the outgoings have been necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, the Tribunal rightly concluded that the necessary nexus between the expenditure and the carrying on of the business of the taxpayer was absent.
>
> To qualify as an outlay to which the second limb of s. 51 applies, it must be shown that the expenditure is characterised by the business ends to which it is directed, those ends forming part of or being truly incidental to the business. (See *FC of T* v. *Snowden & Willson Pty. Ltd.* (1958) 11 ATD 463; (1958) 99 CLR 431 per *Dixon* C.J. at ATD p. 464; CLR p. 437.)
>
> The expenditure upon aids to the consideration of the adequacy of the valuation of the capital interest of the shareholders contained in the takeover offer and of the nature of the response to that offer to be recommended to shareholders owed nothing to the conduct of the business of the taxpayer.
>
> The nature and profitability of the taxpayer's business and the assets of the corporation acquired by that business may well have dictated the worth and value of the interests of shareholders in the share capital of the taxpayer, but it did not mean that expenditure related to those interests was necessarily incurred in the carrying on of that business for the purpose of gaining or producing assessable income and, as the Tribunal found, it clearly was not.

74. For GST purposes, however, the Commissioner would, on balance, accept that acquisitions made by a company in these circumstances would be made in carrying on its enterprise, having regard to all the factors mentioned at paragraph 70 of this Ruling.

[37] (1991) 30 FCR 553 at 561; 91 ATC 4637 at 4644; (1991) 22 ATR 295 at 303.

Particular circumstances considered

75. Determining whether an acquisition is made in carrying on an enterprise is often a straight-forward exercise. For example, acquisitions of raw materials that an entity uses in manufacturing things that it supplies as part of its enterprise would almost invariably be made in carrying on an enterprise.

76. However, some situations are not so straight-forward. The next passage of the Ruling discusses the following kinds of acquisitions:

(i) acquisitions that are private or domestic in nature;

(ii) acquisitions that are commonly used for private or domestic purposes;

(iii) acquisitions that concern the business entity, structure or organisation; and

(iv) acquisitions where the thing acquired is provided to another entity.

(i) Whether the acquisition is private or domestic in nature

77. Under paragraph 11-15(2)(b), an acquisition is not acquired for a creditable purpose to the extent that the acquisition is of a private or domestic nature.

78. The Commissioner considers that an acquisition that is of a private or domestic nature would rarely, if ever, be acquired in carrying on an enterprise and that paragraph 11-15(2)(b) does not operate independently from subsection 11-15(1).[38] Further, the Commissioner considers that the income tax cases that deal with whether a loss or outgoing is private or domestic are relevant for the purposes of paragraph 11-15(2)(b).

79. Whether an acquisition is made in carrying on an enterprise or for some other purpose, depends on all the facts and circumstances. It is not enough to take into account only that an acquisition appears to be for the purposes of the enterprise, or conversely does not appear to be for the purposes of the enterprise. For example, if the owner of a book store buys a rare collector's book through the store's normal supply channels to give to his daughter for her birthday, the acquisition is not made in carrying on the enterprise, although it may appear to be so from a superficial examination of the circumstances of the purchase.

[38] This is consistent with the approach in GSTR 2006/4.

80. Whether expenditure is private or domestic in nature is to be determined according to all of the particular facts. It is not possible to offer simplistic generalisations such as, for example, that all travel undertaken between a private residence and a place of work is for private or domestic purposes.

Acquisitions that are living expenses

81. Guidance on the meaning of the term 'in carrying on an enterprise' can be found in the income tax cases dealing with whether losses and outgoings were incurred *in* gaining or producing assessable income or *in* carrying on a business. The courts have distinguished between losses and outgoings which, even though they are an essential prerequisite to the income producing activities, are not incidental or relevant to the income producing activities.

82. The issue considered in *Lunney v. FCT*; *Hayley v FCT* (1958) 100 CLR 478 (*Lunney* and *Hayley* respectively) concerned whether fares for travel to work were incurred in gaining or producing assessable income and whether they were necessarily incurred in carrying on a business for the purposes of gaining or producing assessable income.

83. In *Lunney* the fares were incurred by an employee. In *Hayley* it was a self-employed dentist. In finding that the travel to work was not incurred in gaining or producing assessable income or in carrying on a business in either case, the High Court in the joint judgment of Williams, Kitto and Taylor JJ, at 500 quoted with approval, Denning LJ' s decision in *Newsom v. Robertson* (1) [1953] 1 Ch. 7 where Denning LJ stated that:

> A distinction must be drawn between living expenses and business expenses. In order to decide into which category to put the cost of travelling, you must look to see what is the base from which the trade, profession, or occupation is carried on. In the case of a barrister, it is his chambers. Once he gets to his chambers the costs of travelling to the various courts is incurred wholly and exclusively for the purposes of his profession. But it is different with the cost of travelling from his home to chamber and back. That is incurred because he lives at a distance from his base. It is incurred for the purposes of his living there and not for the purposes of his profession, or at any rate not wholly or exclusively; and this is so, whether he has a choice in the matter or not. It is a living expense as distinct from a business expense.

84. In *Lodge v. Federal Commissioner of Taxation*,[39] the High Court took a similar view in respect of childminding expenses incurred by a law clerk whose job involved the preparation of bills of costs. Mason J stated that:

> The expenditure was incurred for the purpose of earning assessable income and it was an essential prerequisite of the derivation of that income. Nevertheless its character as nursery fees for the appellant's child was neither relevant nor incidental to the preparation of bills of cost, the activities or operations by which the appellant gained or produced assessable income. The expenditure was not incurred in, or in the course of, preparing bills of cost.[40]

85. Expenditure that is characterised as living expenses would ordinarily also be characterised as being private or domestic in nature. However, it is not possible to determine whether an acquisition is private in nature simply by considering the type of acquisition. For example, an employer may pay an employee's child minding costs as part of the remuneration package paid to the employee. This acquisition is made to provide a benefit in respect of employment in the enterprise. It is made in carrying on the enterprise and is not of a private or domestic nature for the purposes of section 11-15.

86. How GST and fringe benefits interact is discussed in GSTR 2001/3.[41]

(ii) Acquisitions that are commonly used for private or domestic purposes

87. Particular care must be exercised if the thing acquired is of a kind commonly used for private or domestic purposes and a connection to the relevant enterprise is not readily apparent. In such cases, unless a clear association between the acquisition and the enterprise can be demonstrated, it is unlikely that the acquisition is acquired in carrying on the enterprise.

88. An example of such a situation is provided by the facts in *Ian Flockton Developments Ltd v. Customs and Excise Commissioners*.[42] In this case the company made plastic mouldings and storage tanks. The company's customers were project engineers in chemical factories. The company's business was not sought through advertising, but rather through personal contact and recommendations. To gain new customers the company conceived of purchasing and running a racehorse on the basis that this would promote the company's image and be a point for discussion in initiating negotiations with potential customers.

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[39] (1972) 128 CLR 171; 72 ATC 4174; (1972) 3 ATR 254.
[40] (1972) 128 CLR 171 at 175 – 176; 72 ATC 4174 at 4176 – 4177; (1972) 3 ATR 254 at 256.
[41] Goods and Services Tax Ruling GSTR 2001/3 Goods and services tax: GST and how it applies to supplies of fringe benefits.
[42] [1987] BTC 5030.

89. In this case, the court found that the company was entitled to deduct input tax paid on the purchase and upkeep of the horse as the acquisitions were 'used or to be used for the purpose of the business'.[43] This followed from a particular finding of fact based on all the evidence.

90. The significance of this case is that it demonstrates that a connection between expenditure and the conduct of an enterprise is the critical issue. It is not the inherent nature of the expenditure that decides whether an acquisition is creditable. If facts similar to these arise in Australia it would be necessary to make an objective assessment as to whether there is a connection between the thing acquired and the enterprise based on all the facts and circumstances. This would involve the Commissioner carefully scrutinising the facts and assertions made by the business proprietors before allowing the input tax credits.

91. Note that certain acquisitions that are of a recreational or private nature are specifically precluded from being creditable acquisitions by Division 69.

(iii) Acquisitions that concern the business entity, structure or organisation

Acquisitions to defend the enterprise's reputation

92. The issue of defence of a company's reputation was considered in the income tax case of *Magna Alloys*. In *Magna Alloys*, the Federal Court considered whether legal expenses incurred by a company in defending criminal action against several of its agents, the company directors and the company itself were deductible under subsection 51(1) of the ITAA 1936. The criminal action arose from allegations that secret commissions were being paid to employees of purchasers of their products to encourage them to recommend the use of Magna's products, rather than those of its competitors.

93. The Federal Court found that while the directors of the company may have been motivated by consideration of their own position in making the payments, this did not prevent the conclusion that the outgoings were reasonably capable of being seen as desirable and appropriate from the point of view of the business ends of the taxpayer's business. The Court also concluded that the expenditure was not of a private or domestic nature as the criminal charges arose from commercial activities carried on by the relevant company officers on the taxpayer's behalf.

94. In a GST context, the acquisitions would be made in carrying on the enterprise if the acquisitions had a sufficient connection to the commercial activities of the enterprise.

[43] Subsection 14(3) of the *Value Added Tax Act 1983* (United Kingdom)

Acquisitions that provide an enduring benefit to the enterprise

95. Acquisitions that are of a capital nature that provide an enduring benefit to the business entity, structure or organisation are made in carrying on an enterprise. For example, if a company expands its business operations by acquiring a competitor's business, this acquisition provides an enduring benefit to the enterprise and is made in carrying on the enterprise.

96. Similarly, acquisitions that restrict competition from competitors are made in carrying on an enterprise. This issue was considered in *Broken Hill Theatres Pty Ltd v. FC of T* (1952) 85 CLR 423; 9 ATD 423 (*Broken Hill Theatres*). That case concerned the deductibility under subsection 51(1) of the ITAA 1936 of legal expenses that a proprietor of a cinema had incurred in successfully opposing the granting of a licence to an intending competitor. The High Court found that the legal expenditure was incurred for the purpose of preserving and protecting the taxpayer's business, but was capital in nature.

97. As the GST Act contains no restrictions on capital acquisitions, the legal services acquired in *Broken Hill Theatres* would satisfy subsection 11-15(1).

(iv) The thing acquired is provided to another entity

98. A thing may be acquired by one entity (the recipient) but be provided to another entity. This concept is discussed at paragraphs 123 to 176 of GSTR 2006/9.[44]

99. As explained in that Ruling, it is the recipient entity that acquires the thing. Consequently, it is the recipient entity that must satisfy the creditable purpose requirements in section 11-15.

100. If a thing is acquired by one entity but provided to another entity, the acquisition is not necessarily made in carrying on the first entity's enterprise. For example, if advice concerning share value is acquired by a private company and provided to its individual shareholders to enable those individuals to secure private finance, the advice provides no benefit to the company and is not acquired in carrying on its enterprise. The acquisition relates to each individual's shareholding rather than the enterprise that is being carried on. It satisfies the personal needs of the shareholders rather than the company.

[44] Goods and Services Tax Ruling GSTR 2006/9 Goods and services tax: supplies.

Part B – Determining a connection between an acquisition and the making of supplies that would be input taxed

101. In this section we explain the Commissioner's approach to determining whether an acquisition relates to the making of supplies that would be input taxed. If it is established that an acquisition is made in carrying on an enterprise, paragraph 11-15(2)(a) will preclude it being for a creditable purpose to the extent that it 'relates to' making supplies that would be input taxed. In this section of the Ruling, all of the examples assume that the acquisitions have been made in carrying on an enterprise.

102. Subject to paragraph 103 of this Ruling, if an entity does not make, has never made, and does not intend to make, supplies that would be input taxed, there is no need to consider whether paragraph 11-15(2)(a) applies. Instead, to establish whether an acquisition is for a creditable purpose, it is only necessary to ascertain whether the acquisition is made in carrying on the enterprise (see Part A at paragraph 54 of this Ruling).

103. If an entity makes, has made, or intends to make, input taxed supplies, it needs to consider whether paragraph 11-15(2)(a) applies to its acquisitions. Consideration of paragraph 11-15(2)(a) is also required if an entity acquires residential premises as defined in section 195-1 subject to an existing lease.[44A] Paragraph 11-15(2)(a) applies if acquisitions relate solely or partly to supplies that would be input taxed.

104. Unlike subsection 11-15(1), paragraph 11-15(2)(a) specifically focuses on the relationship between an acquisition and the making of supplies. The purpose of subsection 11-15(2) can be ascertained by its relationship with the other provisions of the GST Act. When viewed in the context of the adjustment provisions such as Division 129, it can be seen that the purpose of subsection 11-15(2) is to focus on the intended usage of an acquisition in so far as the acquisition relates to supplies that are to be made in the future.

105. If the acquisition relates to supplies that would be input taxed, paragraph 11-15(2)(a) precludes it from being for a creditable purpose. Division 129 then focuses on the actual usage of the acquisition and adjusts accordingly, depending on whether the actual usage relates to input taxed supplies.

106. Paragraph 11-15(2)(a) does not require tracing to a specific supply. Nevertheless, unlike subsection 11-15(1), it requires some form of connection to the supplies that the entity makes, made or intends to make.

[44A] For the Commissioner's view on the application of paragraph 11-15(2)(a) in these circumstances, see paragraphs 26 to 32 of Goods and Services Tax Determination GSTD 2012/1 *Goods and Service tax: what are the GST consequences following the sale of residential premises that are subject to a lease?*

107. Sometimes, the future supplies that the entity intends to make never eventuate. In *HP Mercantile* Hill J said that if this occurs that, 'it does not follow that an entity which has embarked on an enterprise which consists of the making of input taxed supplies, but in fact makes no supplies, will be entitled to obtain input tax credits. Whether it is will depend on whether the acquisitions are related to supplies which, if made, would be input taxed'.[45]

108. The operation of paragraph 11-15(2)(a) is not dependent on the sequence in which an acquisition and supply occur. In many instances the input taxed supply will precede the acquisition.

The decision in *HP Mercantile*

109. The judgment of Hill J in *HP Mercantile* with which Stone and Allsop JJ agreed provides some guidance on the operation of paragraph 11-15(2)(a), though the case did not deal with every aspect of the possible operation of the paragraph. Hill J considered the application of paragraph 11-15(2)(a) and the connection required between an acquisition and the making of supplies that would be input taxed.

110. HP Mercantile Pty Ltd (as trustee) acquired certain debts by way of legal assignment and set about recovering those debts. The debts were acquired in a single transaction. For GST purposes, the acquisition of the debts by HP Mercantile Pty Ltd was both an acquisition and a financial supply[46] by HP Mercantile Pty Ltd and is referred to as an acquisition-supply.[47]

111. Before acquiring the debts, HP Mercantile Pty Ltd acquired advice by way of a feasibility study as to whether it should acquire the debts. Once HP Mercantile Pty Ltd acquired the debts, it also acquired debt collection services. As the recovery of the debts is not itself a supply, the only supply made by HP Mercantile Pty Ltd to which the acquisitions could relate was the earlier single acquisition-supply of the debts.

112. For the acquisition of debt collection services, the issue was whether there existed a relevant connection between the acquisition of the debt collection services and the earlier acquisition-supply of the debt. In the course of considering this issue, Hill J considered the nature of the connection required.

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[45] Paragraph 46 of *HP Mercantile* (2005) 143 FCR 553 at 565; [2005] FCAFC 126; 2005 ATC 4571 at 4580; (2005) 60 ATR 106 at 116.

[46] Item 2 of subregulation 40-5.09(3) of the A New Tax System (Goods and Services Tax) Regulations 1999 (the GST Regulations).

[47] Acquisition-supply is not a defined term in the GST Act. It is a term used to refer to a supply which is the acquisition of a financial interest, as explained in paragraph 26 of Goods and Services Tax Ruling GSTR 2002/2 Goods and services tax: GST treatment of financial supplies and related supplies and acquisitions.

113. With regard to the requirement in paragraph 11-15(2)(a) that the acquisition 'relates to making supplies that would be input taxed', Hill J commented:

> … the words 'relates to' are wide words signifying some connection between 2 subject matters. The connection or association signified by the words may be direct or indirect, substantial or real. It must be relevant and usually a remote connection would not suffice. The sufficiency of the connection or association will be a matter for judgment which will depend, among other things, upon the subject matter of the inquiry, the legislative history, and the facts of the case. Put simply, the degree of relationship implied by the necessity to find a relationship will depend upon the context in which the words are found. So much appears from the various cases referred to by the tribunal when discussing the meaning of these words…[48]

114. In applying this approach to the acquisition of the debt collection services, Hill J stated:

> … the activities of the Trust in acquiring the debts and then collecting them were closely connected as one continuous course of conduct….To say that fees paid for assistance to collect the debts had no real relationship with the acquisition of the debts would, in this context, be remarkable.[49]

115. Thus the Court held that the acquisition of the debt collection services related to making supplies that would be input taxed even though the relevant supply (the acquisition-supply of the debts) was made before the acquisition. In making this finding, Hill J stated that there was no reason why the words 'relates to making supplies that would be input taxed' required that the connection between acquisitions and supplies be made at some future time. Instead, the connection could be between an acquisition and a supply that was made before the acquisition.[50]

116. With regard to the advice acquired by way of a feasibility study, Hill J considered whether there was a sufficient relationship between the acquisition of the advice and the making of the financial supplies (that is, the acquisition-supply of the debts).[51] The Court held that the advice related solely to the making of input taxed supplies (that is, the acquisition-supply of the debts) which if proceeded with would be input taxed.[52]

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[48] See paragraph 35 of *HP Mercantile* (2005) 143 FCR 553 at 562; [2005] FCAFC 126; 2005 ATC 4571 at 4578; (2005) 60 ATR 106 at 114.
[49] See paragraph 39 of *HP Mercantile* (2005) 143 FCR 553 at 563; [2005] FCAFC 126; 2005 ATC 4571 at 4579; (2005) 60 ATR 106 at 115.
[50] See paragraph 39 of *HP Mercantile* (2005) 143 FCR 553 at 563; [2005] FCAFC 126; 2005 ATC 4571 at 4579; (2005) 60 ATR 106 at 115.
[51] See paragraph 73 of *HP Mercantile* (2005) 143 FCR 553 at 569; [2005] FCAFC 126; 2005 ATC 4571 at 4583; (2005) 60 ATR 106 at 120.
[52] See paragraph 76 of *HP Mercantile* (2005) 143 FCR 553 at 570; [2005] FCAFC 126; 2005 ATC 4571 at 4584; (2005) 60 ATR 106 at 121.

117. Hill J also discussed the application of section 11-15 when an acquisition such as an undifferentiated general overhead has a relevant connection to a number of supplies, some of which involve the making of taxable supplies and some the making of input taxed supplies. He explained that the acquisition will not relate wholly to any one of the activities, and may require apportionment.[53]

Principles established by *HP Mercantile*

118. The decision in *HP Mercantile* established the following principles that should be applied in determining whether an acquisition relates to making supplies that would be input taxed:

- The language of section 11-15 suggests that it was not intended that there be a tracing between the acquisition and the actual supply. However, it does not follow that an entity which has embarked on an enterprise which consists of the making of input taxed supplies, but in fact makes no supplies, is entitled to input tax credits. Whether it is depends on whether the acquisitions are related to supplies which, if made, would be input taxed.[54]
- There is no requirement for an acquisition to precede a supply before it can be said that the acquisition is connected to the making of that supply.[55] Therefore an acquisition can relate to the entity making past, current or future supplies.
- The words 'relates to' are wide words signifying some connection between two subject matters. There must be a connection between an acquisition and the making of input taxed supplies. The connection or association signified by the words may be direct, or indirect, substantial or real. It must be relevant and usually a remote connection would not suffice.[56]
- The requirement of apportionment can be found in the words 'to the extent that' which indicate that an acquisition may relate to the making of supplies that are input taxed as well as supplies that are taxable as would be the case with undifferentiated general overhead outgoings of an entity making both input taxed and taxable supplies (*Ronpibon Tin NL & Tongkah Compound NL v. FC of T* (1949) 78 CLR 47 at 55-56 (*Ronpibon*)).[57]

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[53] See paragraphs 37, 49 and 76 of *HP Mercantile* (2005) 143 FCR 553; [2005] FCAFC 126; 2005 ATC 4571; (2005) 60 ATR 106.
[54] See paragraph 46 of *HP Mercantile* (2005) 143 FCR 553 at 565; [2005] FCAFC 126; 2005 ATC 4571 at 4580; (2005) 60 ATR 106 at 116.
[55] (2005) 143 FCR 553 at 566; [2005] FCAFC 126 at paragraph 52; 2005 ATC 4571 at 4581; (2005) 60 ATR 106 at 117.
[56] Paragraph 35 of *HP Mercantile* (2005) 143 FCR 553 at 562; [2005] FCAFC 126; 2005 ATC 4571 at 4578; (2005) 60 ATR 106 at 114.
[57] Paragraph 37 of *HP Mercantile* (2005) 143 FCR 553 at 563; [2005] FCAFC 126; 2005 ATC 4571 at 4578; (2005) 60 ATR 106 at 115.

Establishing a connection to input taxed supplies

119. For the purposes of paragraph 11-15(2)(a) a sufficient connection is established if, on an objective assessment of the surrounding facts and circumstances, the acquisition is used, or intended to be used, solely or to some extent for the making of supplies that would be input taxed.

120. The following table lists some situations that raise particular considerations in establishing a connection between the acquisition and the making of supplies that would be input taxed. The list is not exhaustive, but the material provided is intended as a general indication of how the Commissioner would approach the analysis of the specified situations.

Situations	GSTR 2008/1
(1) An acquisition is used or consumed in making input taxed supplies. For example, materials used in repairing residential premises that are leased.	Paragraphs 121 to 125
(2) An acquisition is used to promote, market or advertise the making of input taxed supplies. For example, a bank promoting its loan products.	Paragraphs 126 to 130
(3) An acquisition is made in the course of making an acquisition-supply.	Paragraphs 131 to 135
(4) An acquisition is an overhead of the enterprise, or segment of the enterprise, that is making supplies that would be input taxed. For example, rental of premises by a bank that provides both taxable and input taxed supplies.	Paragraphs 136 to 148
(5) An acquisition is preparatory to the making of an input taxed supply.	Paragraphs 149 to 171
(6) An acquisition is made as a consequence of an input taxed supply that has already been made (past supplies).	Paragraphs 172 to 183
(7) Acquisitions made in the course of raising capital (other than by borrowing).	Paragraphs 184 to 196

(1) Acquisitions used or consumed in making input taxed supplies

121. Subsection 11-15(2) specifically focuses on the relationship between an acquisition and particular supplies. When viewed in the context of the adjustment provisions such as Division 129, it can be seen that, when an acquisition precedes a supply, the purpose of subsection 11-15(2) is to focus on the intended usage of the acquisition.

122. If the intended usage of the acquisition relates to supplies that would be input taxed, paragraph 11-15(2)(a) precludes it from being for a creditable purpose. Division 129 then focuses on the actual usage of the acquisition and adjusts accordingly, depending on whether the actual usage relates to input taxed supplies.

123. If the acquisition is used or consumed in making an input taxed supply, there is a direct connection between the acquisition and the input taxed supply. For example, acquisitions made in constructing or maintaining residential premises that are supplied by way of an input taxed supply of a lease or licence relate to making that supply and consequently are not for a creditable purpose.

124. The following example also illustrates an acquisition that is used in the making of input taxed supplies.

Example 1 – acquisition used in making input taxed supplies

125. *Stack Trucks sells trucks to customers and also offers them finance by way of loans. Stack Trucks makes an acquisition of specialist loan management software which is used exclusively by loans staff. The acquisition is made in carrying on Stack Trucks' enterprise. The software is used wholly in making input taxed supplies. The acquisition of the software is therefore not for a creditable purpose.*

(2) Acquisition used to promote, market or advertise the making of input taxed supplies

126. An entity may make an acquisition to promote, market or advertise some particular aspect of the entity's enterprise. In some instances, the acquisitions will promote specific supplies and will relate to these supplies. In other circumstances, the acquisitions are to promote the entity as a whole, by increasing public awareness of the entity and the types of products that it supplies. If the entity makes input taxed supplies as well as taxable supplies or GST-free supplies, acquisitions must be apportioned on a fair and reasonable basis.

127. If promotional goods are given away as part of a marketing and advertising strategy, the acquisition of these goods relates to the supplies that are being marketed. In these circumstances, the relationship of the acquisition of the promotional goods to the on-supply of those goods, is not so significant that it excludes from consideration the relationship with the supplies being marketed. To the extent that the supplies that are promoted by the marketing strategy would be input taxed, the acquisition of the goods is not for a creditable purpose.

128. Similarly, if the acquisition of the goods is to increase public awareness of the entity and its products, the acquisitions relate to all of the supplies that the enterprise makes. The relationship of the acquisition to the on–supply of the goods is not the relationship that determines whether the acquisitions are creditable, to the exclusion of the relationship that the acquisition has with the enterprise as a whole.

Example 2 – promotional give-aways

129. *Gorgon Bank acquires five thousand attractively coloured pens to give away, along with information brochures concerning its banking products (input taxed and taxable supplies) to anyone who makes an inquiry about opening an account. Receiving a pen is not dependent on the person actually opening an account. The pen is stamped with the Bank's name, branch address and phone number.*

130. *The Bank acquires the pens for the purposes of promoting and advertising its products (taxable and input taxed). The acquisition relates to all supplies made by the enterprise and therefore should be apportioned on a fair and reasonable basis.*

(3) Acquisitions made in the course of making an acquisition-supply

131. Specific rules in the GST Regulations[58] mean that the acquisition of a financial supply by an entity is not merely an acquisition but is also a financial supply made by that entity. An acquisition that is also a financial supply is commonly referred to as an acquisition-supply.[59]

132. If an acquisition is for the purpose of making a financial supply of this special kind, the acquisition relates to making a supply that would be input taxed. For example, brokerage and legal services that are acquired for the purposes of acquiring shares (a financial supply) relate to making supplies that would be input taxed and are not for a creditable purpose.

133. *HP Mercantile*,[60] which is authority for this proposition, is discussed at paragraphs 109 to 118 of this Ruling.

Example 3 – acquisitions made in the course of making an acquisition-supply

134. *Juggernaut Pty Ltd acquires brokerage services in acquiring shares in a rival company, Rocky Pty Ltd.*

135. *The acquisition of the brokerage services is made in acquiring the shares in Rocky Pty Ltd (an input taxed acquisition-supply). The acquisition of the brokerage services relates to making a supply that would be input taxed and is not for a creditable purpose.*

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[58] See regulations 40-5.06 and 40-5.09 of the GST Regulations.

[59] Acquisition-supply is not a defined term in the GST Act. It is a term used to refer to a supply which is the acquisition of a financial interest as explained in paragraph 26 of GSTR 2002/2.

[60] (2005) 143 FCR 553; [2005] FCAFC 126; 2005 ATC 4571; (2005) 60 ATR 106.

(4) Acquisitions that are overheads or enterprise costs

136. Some acquisitions have a direct relationship to a particular supply. Examples of these types of acquisition are repair services and letting services acquired for leased residential premises. Other acquisitions can relate to more than one supply or type of supply. For example, a company that has a number of pawn broker shops makes input taxed supplies of loans and taxable supplies of goods. Some of its acquisitions relate to both types of supplies.

137. Similarly, acquisitions such as contracted information technology services may relate to more than one division of a bank, and require apportionment if only some of the divisions make taxable supplies.

138. Other acquisitions do not directly relate to any specific type of supplies. Instead, they have an indirect relationship to all the supplies that the entity makes in carrying on its enterprise. If an entity makes both taxable and input taxed supplies, paragraph 11-15(2)(a) precludes these types of acquisitions from being for a creditable purpose to the extent that they relate to making supplies that would be input taxed.

139. The formulation of section 11-15 has similarities to the formulation of section 8-1 of the ITAA 1997 and its predecessor subsection 51(1) of the ITAA 1936, in that these provisions both use the phrase 'to the extent' to provide for apportionment.

140. The leading income tax case on apportionment under subsection 51(1) of the ITAA 1936 is *Ronpibon.* In that case the High Court observed that there are two types of expenditure that require apportionment. One kind consists of undivided items of expenditure in respect of things or services of which distinct and severable parts are devoted to gaining or producing assessable income and distinct and severable parts to some other cause. In such cases it may be possible to divide the expenditure in accordance with the applications that have been made of the things or services. The other kind of apportionable items involve a single outlay or charge which serves both objects indifferently. Of this, directors' fees may be an example. With the latter, there must be some fair and reasonable assessment of the extent of the relationship to assessable income. It is an indiscriminate sum apportionable but hardly capable of arithmetical or rateable division because it is common to both objects.

141. Examples of the first type of expenditure described in *Ronpibon* are likely to be overheads such as rent for premises occupied by a financier from which the financier makes both taxable and input taxed supplies; or direct costs such as materials used by a builder in building houses for both sale (taxable supply) and rental (input taxed supply).

142. Examples of the second type of expenditure described in *Ronpibon* are likely to be enterprise costs such as costs in restructuring the enterprise; or rent for head office premises. These types of acquisitions are referred to as enterprise costs in GSTR 2006/3 and GSTR 2006/4.[61]

143. Enterprise costs may be apportioned on the basis of current supplies that are made by the entity in carrying on its enterprise, although this may not always be the case. The overarching principle is that apportionment should be applied on a fair and reasonable basis, having regard to the factual circumstances. GSTR 2006/3 and GSTR 2006/4 provide guidance on fair and reasonable bases for apportionment.

144. The following examples illustrate when various types of acquisitions require apportionment.

Example 4 – acquisition relates to making both taxable and input taxed supplies

145. *Round the Block Pty Ltd buys real property and leases it to tenants. Most of Round the Block's business concerns leasing residential properties (input taxed supply) although it also has a small commercial property division that leases strata titled office accommodation (taxable supply).*

146. *Round the Block acquires advertising services in promoting both its residential and commercial leasing divisions. A single advertising campaign is run for the two divisions. As the acquisition of advertising services promotes both divisions and thus promotes both the input taxed and taxable supplies, it is partly for a creditable purpose, and partly for a non-creditable purpose. The invoice provided by the supplier provides a break-up of costs between the two divisions. Consequently, apportionment can be carried out on the basis of the invoice provided. However, if the invoice did not provide a break up of costs for each division the acquisition* would *need to be apportioned on a fair and reasonable basis.*

Example 5 – acquisition used for all the supplies made in carrying on the enterprise

147. *Following on from the previous example, Round the Block acquires rental premises, gas and electricity for the office from which both divisions are operated. These acquisitions relate to both types of supplies made by Round the Block.*

148. *These overhead acquisitions are therefore partly for a creditable purpose and partly for a non-creditable purpose and need to be apportioned on a fair and reasonable basis.*

[61] Paragraphs 53 to 56 of GSTR 2006/3 and paragraphs 63 to 66 of GSTR 2006/4.

(5) Acquisitions preparatory to the making of an input taxed supply

149. If advice is sought on a range of specific options that an entity is exploring and all options involve the making of supplies that would be input taxed, the acquisition of advice relates to supplies that would be input taxed and is therefore not creditable.

Example 6 – considering a range of options

150. *Jetstream Ltd is a company listed on the Australian Securities Exchange. Within Jetstream a designated team monitors other companies and industries to identify potential investment opportunities that are only of an equity nature. The team conducts research and works up proposals for presentation to the board. The team has a relatively free reign when considering options.*

151. *Jetstream acquires online market reports to assist the team in their analysis. This acquisition is made in carrying on Jetstream's enterprise. Due to the nature of the team's activity which can only lead to the making of supplies that would be input taxed, the acquisition of the market reports are not for a creditable purpose.*

Example 7 – advice on a particular option that the acquirer is considering – input taxed

152. *Metro is a privately owned company that owns a chain of cinemas. It makes only taxable supplies. The finance officer of the company has been given approval to proceed to a public listing of the company to raise capital through a share issue. Metro acquires the services of a merchant bank to provide advice on the flotation and issue of the shares.*

153. *The acquisition of the advice is made by Metro in carrying on its enterprise. Metro is acquiring the advice in order to float the company by issuing shares to the public. The issuing of the shares is an input taxed supply. Therefore, the acquisition of the advice relates to making supplies that would be input taxed. The acquisition of the advice is not for a creditable purpose.*[62]

154. Conversely, if the proposal under consideration would, if implemented, not involve or result in the making of input taxed supplies, paragraph 11-15(2)(a) has no application and the acquisition of the advice would be for a creditable purpose.

[62] The facts in the example assume that subsection 11-15(4) does not apply. Acquisitions made in the course of raising capital are discussed at paragraphs 184 to 196 of this Ruling.

Example 8 – advice on a particular proposal under consideration

155. *Excepton Bank owns its head office premises, which are located in the Sydney CBD. The property division is considering whether to recommend to senior management that the bank move to other premises outside the CBD and find a tenant to take a lease over the valuable CBD building.*

156. *To assist in making this decision, Excepton Bank acquires the services of an agency specialising in leasing trends and demographics.*

157. *These acquisitions are made in carrying on Excepton Bank's enterprise. The content of the advice is to assist the bank in making a decision on whether to move and lease its current premises to another entity. The leasing of the premises, if carried out, would be a taxable supply. In these circumstances the advice has no relationship to the making of supplies that would be input taxed. The acquisition of advice is therefore for a creditable purpose.*

158. If advice relates to more than one option and part of that advice relates to a particular option that would involve or result in making input taxed supplies, then the advice to the extent that it relates to that option is not for a creditable purpose. It is not necessary for the entity to have selected that option, or to have formed an intention to proceed, for paragraph 11-15(2)(a) to apply.

Example 9 – considering two options – one option is making input taxed supplies – the other option is making a taxable supply

159. *Pulp Pty Ltd is carrying on an enterprise of constructing blocks of units. Prior to commencing the construction of a particular block of units, Pulp Pty Ltd commissions E-Trend, a company with experience in evaluating the property market, to advise whether the block of units, once constructed, will be more profitable if it is sold (taxable supply), or used for residential rental (input taxed supply). The decision will influence the final design of the unit block. Once the decision has been made, the construction will commence.*

160. *The acquisition of market evaluation services is made in carrying on Pulp Pty Ltd's enterprise. The advice is to evaluate two possible options; one being input taxed (residential rental), the other taxable (sale of the unit block). The acquisition is for a creditable purpose to the extent that it relates to the sale option. It is not for a creditable purpose to the extent that it relates to the residential rental option. To ascertain the extent of creditable purpose, Pulp Pty Ltd uses the bill of costing to establish the proportion relating to each option, on the basis that the bill of costing accurately reflects the division of the services.*

161. If, by contrast, the outlay on the advice is relevant to more than one of the options indifferently, and some but not all of the options would involve making input taxed supplies, then the outlay is equivalent to the second kind of expenditure identified in *Ronpibon* (see paragraph 140 of this Ruling). This means the extent of the relationship of the outlay to the making of supplies that would be input taxed must be assessed on some fair and reasonable basis. The exact means of apportionment would depend on the facts.[63]

Acquisitions made in commencing an enterprise

162. Whether an acquisition made in commencing an enterprise relates to supplies that would be input taxed is determined according to the supplies the entity intends to make.

163. An entity may be formed solely to make input taxed supplies. In this case, the Commissioner's view is that all acquisitions relate to making supplies that would be input taxed. This characterisation flows from the nature, or proposed nature, of the particular enterprise.

Example 10 – commencing an enterprise that makes input taxed supplies

164. *Core Pty Ltd is a company that is conducting activities in the commencement of an enterprise and is therefore carrying on an enterprise. It has been incorporated for the purpose of conducting a debt factoring business by purchasing debts from identified entities and undertaking debt collection activities to realise the debts. Core Pty Ltd contracts D-Rate, an agency that specialises in rating debt, to advise on the range of potential suppliers of debt chosen by Core Pty Ltd's directors as targets.*

165. *The acquisition of the debt rating services by Core Pty Ltd is made in carrying on its enterprise. However, as the only supply envisaged by Core is the acquisition of debt and it is a financial supply by Core Pty Ltd the acquisition of the debt rating service is for making input taxed supplies. Therefore the acquisition of the debt rating service is not for a creditable purpose*.

166. An enterprise may also be formed with the intention of making taxable or GST-free supplies and also input taxed supplies. In this case, acquisitions made in commencing the enterprise are not made for a creditable purpose to the extent those acquisitions are for the purposes of preparing to make supplies that would be input taxed.

[63] See paragraphs 72 and 73 of GSTR 2006/3 and paragraphs 99 and 100 of GSTR 2006/4.

Example 11 – commencing an enterprise that makes taxable and input taxed supplies

167. *Bazza has purchased land from an entity registered for GST. The supply of the land to Bazza is a taxable supply and the margin scheme was not used to calculate the GST on the supply. Bazza intends to build a stratum unit complex on the land consisting of commercial shops on the ground floor and residential premises in the remainder of the complex. It is intended that the shops and residential premises will be leased.*

168. *Bazza's acquisition of the land is to make both input taxed supplies (leasing residential premises) and taxable supplies (leasing commercial shops). To the extent that the acquisition of the land relates to the leasing of the residential premises, it is not acquired for a creditable purpose and apportionment on a fair and reasonable basis is required.*

Acquisitions made in expanding the enterprise

169. If an entity is expanding its enterprise similar issues as discussed at paragraphs 149 to 161 of this Ruling arise and therefore those principles similarly apply. The following examples reinforce those principles.

Example 12 – future activities – expanding to make supplies that would be input taxed

170. *Harvey Pty Ltd carries on an enterprise of selling boats. If Harvey's customers need finance, it can be arranged through Big T Finance Pty Ltd. Harvey Pty Ltd's customer's have complained about the service provided by Big T Finance Pty Ltd. Harvey Pty Ltd obtains advice about providing its own finance to customers. The acquisition of advice relates to future input taxed supplies. The acquisition of the advice is not for a creditable purpose even if a final decision had not been made by Harvey Pty Ltd to pursue that course of action.*

Example 13 – future activities – expanding to make other taxable supplies

171. *Following on from Example 12, Harvey Pty Ltd is interested in expanding its business into the jet ski market and acquires advice about potential markets and sales. The acquisition of the advice is for a creditable purpose because it is acquired in carrying on Harvey Pty Ltd's business and the acquisition does not relate to the making of supplies that would be input taxed. This would be so even if Harvey Pty Ltd had not made a final decision concerning whether to expand into the jet ski market.*

(6) Acquisitions that relate to past supplies

172. An entity that has made particular types of supplies in carrying on its enterprise may cease, or partially cease, making those supplies and commence making different types of supplies. While the entity is continuing to carry on an enterprise, the supplies that the entity makes have changed.

173. In these circumstances, the entity may make acquisitions that do not relate to the current supplies it is making, but relate to supplies that it has previously made. If the acquisition relates to input taxed supplies that have previously been made, paragraph 11-15(2)(a) precludes it from being for a creditable purpose.

174. Hill J specifically addressed the issue of past supplies in HP Mercantile, where he states that there is no requirement for an acquisition to precede a supply before it can be said that the acquisition is connected to the activity of making that supply.[64]

Example 14 – acquisition of legal advice relates to past input taxed supplies

175. *Pale Rider Pty Ltd (Pale Rider) is a commercial leasing and financing company which makes both taxable and input taxed supplies in carrying on its enterprise. On 1 July 2007, Pale Rider discontinues making input taxed supplies (financial supplies) and continues making only taxable supplies (commercial leasing). In November 2007, Pale Rider makes an acquisition of legal advice in relation to the recovery of a debt under a defaulted finance contract.*

176. *The acquisition of legal advice is for the purposes of Pale Rider's enterprise.*

177. *The acquisition is made to recover moneys owing under the finance contract and relates to a past input taxed supply. Therefore, the acquisition of the legal advice is not for a creditable purpose.*[65]

Acquisitions made in terminating an enterprise if the entity makes or has made supplies that are input taxed

178. An entity may continue to make its usual supplies in the course of terminating its enterprise, or it may cease to make these supplies.

179. If an entity continues making the same supplies, whether an acquisition relates to making supplies that would be input taxed is determined in the same way as it would have been prior to the entity beginning the process of termination.

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[64] (2005) 143 FCR 553 at 566; [2005] FCAFC 126 at paragraph 52; 2005 ATC 4571 at 4581; (2005) 60 ATR 106 at 117.
[65] This is subject to subsections 11-15(3) and (4).

180. If an entity ceases making its usual supplies and makes different supplies as part of terminating its enterprise, it is necessary to consider whether the acquisitions it makes relate to its past supplies or the supplies it is currently making.

Example 15 – terminating an enterprise – change of supplies that it makes

181. *Uptown Ltd has conducted an enterprise of manufacturing lifts for some years. Poor business decisions have led to a lack of contracts and its manufacturing activities being terminated. The entity is in the process of terminating its enterprise and the only supplies made are the sale of the manufacturing equipment and the disposal of its investment portfolio.*

182. *Uptown Ltd acquires the services of an agent to assist in selling its equipment. This acquisition is used in making taxable supplies of equipment. This acquisition is for a creditable purpose.*

183. *Uptown Ltd acquires the services of an investment adviser to assist in decision-making about its portfolio of investments. This acquisition is made to dispose of its investment portfolio which involves the making of input taxed financial supplies. This acquisition is not for a creditable purpose under section 11-15.*[66]

(7) Acquisitions made in the course of raising capital (other than by borrowing)

184. Acquisitions that are made in the course of raising capital other than by borrowing raise questions as to whether the most appropriate connection is to the supplies comprising the raising of capital (input taxed) or to the entity's underlying income-earning activities (which may be taxable supplies or GST-free supplies). An example is a share issue conducted by a company whose main activity is selling cars.

185. One view that has been raised is that the purpose for making such acquisitions is not the financial supply of the shares, but the supplies of the entity for which the capital is raised. It is contended that denying input tax credits for acquisitions made for the purpose of raising capital causes a cascade of tax if the business or income-earning activities of the entity is the making of taxable supplies.

[66] The facts in the example are subject to subsection 11-15(4) not applying.

186. It is said that this is contrary to the policy intent of the GST which is to have no cascade of tax, where possible. It is therefore argued that the purpose of the acquisitions should be seen as the making of taxable supplies, and not the making of input taxed supplies (for example, the issue of shares or other securities). This contention is said to be supported by the decision of the European Court of Justice in *Kretztechnik AG v. Finanzamt Linz*,[67] which held that the issue of shares is not a supply for the purposes of the VAT, thereby allowing the full recovery of input tax credits.

187. The Commissioner's view is as follows. In the context of the Australian GST, the issue of shares, as a means of capital raising, is an input taxed financial supply. Acquisitions made for the purposes of a share issue are acquisitions that relate to making supplies that would be input taxed.

188. The provision, acquisition or disposal of an interest mentioned in subregulation 40-5.09(3) of the GST Regulations is a financial supply.[68] A share fits within the definition of a security, which is an interest mentioned in item 10 of subregulation 40-5.09(3). Regulation 40-5.03 of the GST Regulations defines the provision of an interest to include the allotment, creation, grant and issue of the interest.

189. Regulation 40-5.06 of the GST Regulations provides the issue of a share as an example of an interest created by a financial supply provider in making the supply of an interest. These references in the legislation make it clear that the issue of a share is a financial supply and is consequently input taxed.

190. The policy intention to deny input tax credits for things acquired in the course of making a supply of shares by way of issue (capital raising) is supported by items in subregulation 70-5.02(2) of the GST Regulations dealing with arranging services for share floats and underwriting of share issues. That is, such acquisitions are reduced credit acquisitions for the purposes of Division 70 and the reduced input tax credits provided for under Division 70 are available only if input tax credits are denied by the application of paragraph 11-15(2)(a). To paraphrase Hill J in *HP Mercantile*,[69] the regulations proceed on the basis that various acquisitions made in relation to issuing securities, while not attracting a full input tax credit, will qualify as being entitled to a reduced credit.

[67] Case C-465/03 [2005] STC 1118.
[68] If the other requirements in paragraphs 40-5.05(1)(a) and 40-5.05(1)(b) of the GST Regulations are satisfied.
[69] (2005) 143 FCR 553 at 568; [2005] FCAFC 126 at paragraph 65; 2005 ATC 4571 at 4582; (2005) 60 ATR 106 at 119.

191. Further support for the Commissioner's view that acquisitions made for the purposes of raising capital by way of share issue relate to the share issue and not to how the subsequent funds are used is provided by subsection 11-15(5). As explained at paragraphs 203 to 214 of this Ruling, this provision ensures that an acquisition, which would otherwise not be for a creditable purpose because it relates to a financial supply being a borrowing,[70] is for a creditable purpose if the borrowing relates to making supplies that are not input taxed. This provision would be unnecessary if it were appropriate to consider the purposes for which the borrowing is used.

192. Although the policy underlying the input taxation of financial supplies in Australia is broadly comparable with that underlying equivalent VAT regimes, the Australian GST legislation diverges from international VAT models in its detail. The Australian model limits the scope of input taxation and grants a degree of input tax relief under the reduced input tax credit regime to achieve a revenue neutral result.

193. The Commissioner therefore considers it consistent with the policy intent of the legislative provisions that acquisitions such as brokerage services, which are made for the purposes of raising capital through the issue of shares (or other securities), relate to the making of supplies that would be input taxed (being the issue of shares or other securities).

Example 16 – initial placement offer – acquisition of arranging services

194. *Noddy Industries Pty Ltd is a private company that manufactures furniture for sale thereby making taxable supplies. Noddy needs to upgrade its manufacturing equipment to remain competitive with other manufacturers. To do this it needs to raise $10,000,000. The shareholders of Noddy decide to list the company and raise the necessary capital through an initial placement offer.*

195. *A merchant bank is engaged to arrange the flotation. Noddy makes supplies of interests in securities (financial supplies) when it issues the shares.*

196. *The acquisition of the arranging service is made in carrying on Noddy's enterprise and is to raise capital through the issue of securities, which are input taxed supplies. The acquisition of the arranging service relates to making supplies that would be input taxed (issue of securities) and is not for a creditable purpose under section 11-15.*[71]

[70] Goods and Service Tax Ruling GSTR 2003/9 Goods and services tax: financial acquisitions threshold, paragraphs 61 to 65.
[71] The facts in the example are subject to subsection 11-15(4) not applying.

Part C – the interaction of subsections 11-15(3), (4) and (5) with paragraph 11-15(2)(a)

197. Subsections 11-15(3), (4) and (5) treat acquisitions that would otherwise relate to making supplies that would be input taxed as not relating to the making of such supplies. They are exceptions to paragraph 11-15(2)(a). To the extent that one or more of these subsections applies to an acquisition, the acquisition is not precluded from being for a creditable purpose by paragraph 11-15(2)(a).

Subsection 11-15(3)

198. Subsection 11-15(3) states that:

> An acquisition is not treated, for the purposes of paragraph (2)(a), as relating to making supplies that would be input taxed to the extent that the supply is made through an enterprise, or a part of an enterprise, that you carry on outside Australia.

199. The policy principle of the provision is to ensure that GST is not borne on exports.

Subsection 11-15(4)

200. Subsection 11-15(4) applies to acquisitions that are not for a creditable purpose because they relate to making financial supplies.[72] Subsection 11-15(4) only applies if the entity making the acquisition does not exceed the 'financial acquisition threshold', as set out in Division 189.

201. If subsection 11-15(4) applies, an acquisition is not treated as relating to making supplies that would be input taxed and is therefore for a creditable purpose.

202. The operation of subsection 11-15(4) is discussed in GSTR 2003/9, which is about the financial acquisitions threshold.

Subsection 11-15(5)

203. The purpose of subsection 11-15(5) is to ensure that an acquisition that relates to a financial supply consisting of a borrowing is made for a creditable purpose if the borrowing relates to supplies that are not input taxed.

[72] The term 'making financial supplies' is used in subsection 11-15(4) and the term 'making supplies that would be input taxed' in paragraph 11-15(2)(a). The effect of this is to provide relief under subsection 11-15(4) to financial supplies, and not to other input taxed supplies.

204. 'Borrowing' is defined in section 195-1 of the GST Act as having the meaning given by section 995-1 of the ITAA 1997. That section defines 'borrowing' as any form of borrowing, whether secured or unsecured, and includes the raising of funds by the issue of a bond, debenture, discounted security or other document evidencing indebtedness. For the purposes of the GST Act, a borrowing must involve the existence of a debtor/creditor relationship.[73]

205. When an entity borrows money from a lender, the entity that borrows the money acquires an interest in a credit arrangement. An interest in a credit arrangement is mentioned in item 2 of subregulation 40-5.09(3) and, provided the other requirements of regulation 40-5.09 are satisfied, the borrowing entity makes an acquisition-supply of the interest which is a financial supply.[74]

206. Under paragraph 11-15(2)(a), an acquisition that is made for the purpose of a borrowing (a financial supply) is not for a creditable purpose. However, subsection 11-15(5) requires that you look to the supplies to which the borrowing relates to determine whether the acquisition is for a creditable purpose. The effect of subsection 11-15(5) is that if the borrowing is for the purpose of making supplies other than supplies that are input taxed, then acquisitions that relate to the borrowing are for a creditable purpose.

207. If the borrowing does not relate to making particular supplies, it relates to all of the supplies made by the entity and apportionment may be required.

208. Acquisitions that relate to the making of a financial supply consisting of a borrowing refer only to acquisitions made by the borrowing entity and not to acquisitions made by the entity that lends the money.[75]

Example 17 – acquisition relates to a borrowing – borrowing relates to making taxable supplies

209. *Juggernaut Pty Ltd is a truck manufacturer. It acquires legal and accounting services as part of entering into a loan agreement with Big Bank. The funds borrowed by Juggernaut Pty Ltd are used to upgrade manufacturing equipment.*

210. *The acquisition of the legal and accounting services is made in carrying on Juggernaut's enterprise, and relates to making a financial supply consisting of a borrowing (taking out the loan). Under paragraph 11-15(2)(a) the acquisition of the legal and accounting services is not for a creditable purpose. However, subsection 11-15(5) requires that you look to the purpose of the borrowing to determine if the acquisition is for a creditable purpose.*

[73] See GSTR 2003/9 paragraph 62.
[74] See paragraphs 37 to 42 of GSTR 2002/2 and paragraphs 64 of GSTR 2003/9.
[75] Paragraph 63 of GSTR 2003/9.

211. *As the borrowing relates to the making of taxable supplies of the trucks, the acquisition of the legal and accounting services is for a creditable purpose.*

Example 18 – acquisition of a borrowing where proceeds are used to pay dividends

212. *Viva Ltd is an event organiser. It has very uneven cash flows and invests surplus income in various securities. Although Viva has made a profit, at the time it is called on to pay a dividend to its parent company, it is engaged on a major project and has no cash available. It incurs legal and broker's fees in borrowing the funds required to pay the dividend.*

213. *The acquisitions of the legal and brokerage services are made in carrying on Viva Ltd's enterprise. Under paragraph 11-15(2)(a) the acquisition of the legal and broking services is not for a creditable purpose. However, subsection 11-15(5) requires that you look to the purpose of the borrowing to determine whether the acquisition in question is for a creditable purpose.*

214. *The purpose of the borrowing is to pay dividends, which is not a supply. The borrowing is not for the purposes of making any particular supplies; it is for the purposes of Viva Ltd's enterprise as a whole. Viva Ltd's activities include making both taxable and input taxed supplies, and therefore the acquisitions of the services are partly creditable and partly not creditable and apportionment on a fair and reasonable basis is required.*

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Commissioner of Taxation
5 March 2008

Previous draft:

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Related Rulings/Determinations:

GSTR 1999/1; GSTR 2000/19; GSTR 2000/24; GSTR 2001/3; GSTR 2002/2; GSTR 2003/9; GSTR 2004/1; GSTR 2006/3; GSTR 2006/4; GSTR 2006/9; GSTD 2006/6; GSTD 2012/1; MT 2006/1

Subject references:

- acquisition
- advertising and promotion expenses
- borrowing and loans
- capital
- carrying on an enterprise
- creditable acquisitions
- creditable purpose
- input taxed supplies
- private or domestic
- shares
- takeover

Legislative references:

- ANTS(GST)A 1999
- ANTS(GST)A 1999 7-1(2)
- ANTS(GST)A 1999 9-20
- ANTS(GST)A 1999 9-20(1)
- ANTS(GST)A 1999 Div 11
- ANTS(GST)A 1999 11-5
- ANTS(GST)A 1999 11-5(a)
- ANTS(GST)A 1999 11-15
- ANTS(GST)A 1999 11-15(1)
- ANTS(GST)A 1999 11-15(2)
- ANTS(GST)A 1999 11-15(2)(a)
- ANTS(GST)A 1999 11-15(2)(b)
- ANTS(GST)A 1999 11-15(3)
- ANTS(GST)A 1999 11-15(4)
- ANTS(GST)A 1999 11-15(5)
- ANTS(GST)A 1999 11-20
- ANTS(GST)A 1999 Div 15
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