GSTD 2011/D3 - Goods and services tax: does an adjustment for a change in extent of creditable purpose necessarily arise for services acquired in relation to a proposed merger and acquisition transaction that does not eventuate, or that does not proceed in the manner contemplated at the time the services were acquired?

This cover sheet is provided for information only. It does not form part of *GSTD 2011/D3 - Goods and services tax: does an adjustment for a change in extent of creditable purpose necessarily arise for services acquired in relation to a proposed merger and acquisition transaction that does not eventuate, or that does not proceed in the manner contemplated at the time the services were acquired?*

This document has been finalised.

Draft Goods and Services Tax Determination

Goods and services tax: does an adjustment for a change in extent of creditable purpose necessarily arise for services acquired in relation to a proposed merger and acquisition transaction that does not eventuate, or that does not proceed in the manner contemplated at the time the services were acquired?

This publication provides you with the following level of protection:

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. No.

2. Section 129-40[1] can give rise to an adjustment in relation to services that have been acquired in certain circumstances. However, there can only be an adjustment under section 129-40 where there is a change in the extent of creditable purpose of an acquisition. If a service is acquired and applied in carrying on your enterprise, and is not of a private or domestic nature, an adjustment can only arise under section 129-40 if there is a difference between the extent that the service relates to input taxed supplies at the time it is acquired, and the extent that it relates to input taxed supplies when it is actually applied in carrying on your enterprise (whether those supplies occur at the time of application or are merely proposed at that time).

[1] All references are to the *A New Tax System (Goods and Services Tax) Act 1999* unless otherwise stated.

3. Services acquired in the context of proposed mergers and acquisitions (M&A) typically include due diligence and other advisory services. In many cases, the only application of these services occurs at or about the time they are acquired. In such a case no adjustment arises under Division 129. When services are acquired and applied at or about the same time , the intended use of the services and their actual use are the same, and there is no change in the extent of creditable purpose of the services.

4. On the other hand, there may be a change in creditable purpose if the services are applied or reapplied at a later time. Whether this is the case needs to be determined in the context of the particular proposed M&A; having regard to how the services are used.

5. The **mere** fact that services involve the provision of advice and that advice contributes to an overall body of knowledge that is relevant to whether the proposed M&A proceeds, and/or the manner in which the M&A is conducted, does not mean that the services are applied or reapplied over that period of time.

Examples

Example one – Application of advice, where advice is used immediately, but the proposed transaction changes: no Division 129 adjustment

6. *Bid Co is considering acquiring the business of Target Co by acquiring shares in Target Co. Both are Australian companies. Bid Co acquires the services of lawyers in drafting a share sale agreement. It also acquires advice about how it could address the implications of Target Co's known, poor regulatory compliance.*

7. *The intended purchase of the shares of Target Co would be an input taxed financial supply.*[2] *Accordingly, Bid Co claims no input tax credits, because its acquisitions are solely related to a supply that would be input taxed and are not made for a creditable purpose to any extent.*

8. *In the course of due diligence, Bid Co receives advice that Target Co has had very poor compliance with trade practices and health and safety regulations, and concludes that there would be a material exposure in purchasing Target Co by way of share acquisition. However, Bid Co considers that Target Co's business is very valuable and decides to acquire the assets of Target Co instead.*

The acquisitions of the services referred to (drafting of agreement and advice about regulatory compliance) related to the intended acquisition of shares and were therefore not for a creditable purpose. The services were also applied in relation to the proposed acquisition of the shares, at the time that they were acquired.[3] *The services were not reapplied when, as a result of the issues revealed during due diligence, Bid Co decided to acquire the assets of Target Co instead of its shares. Therefore the actual application of the services reflected their intended application and no adjustment arises under Division 129. This is the case even though the transaction undertaken is different to the transaction that was contemplated at the time the services were acquired.*

[2] Refer to paragraph 23 of this draft Determination.
[3] Although the share agreement was never executed, the services acquired in having the agreement drafted were applied for the purpose of contemplating the proposed input taxed supply.

Example two – Application of advice where transaction does not eventuate: no Division 129 adjustment

9. *As part of its national expansion strategy, Flash Co intends to make a takeover bid for the shares of Lightening Co. Flash Co acquires the services of an investment bank with industry expertise for the specific purpose of organising the best takeover strategy and providing guidance on the appropriate bid price to pay for the shares. Both companies make only taxable supplies (excluding any M&A transactions).*

10. *The investment bank services are acquired for the purpose of acquiring shares; that would be an input taxed financial supply.*[4] *The acquisition of investment services is not for a creditable purpose and Flash Co does not claim input tax credits on this acquisition.*

11. *The board of Lightening Co rejects the 'friendly' takeover proposal made by Flash Co. Following further advice from the investment bank, Flash Co decides not to pursue the transaction any further.*

The merchant bank services were applied at the time they were acquired. They were not reapplied when the transaction was discontinued. Accordingly, no adjustment arises under Division 129.

Example three – Application of advice where the advice is subsequently applied for a purpose that is different from what is intended: adjustment required under Division 129

12. *Big Digger Inc is a mining company which plans to expand. It has been assessing Barren Ground Co which operates several mines in another State and has made a public offer to purchase 100% of the shares of Sub Co, a wholly owned subsidiary of Barren Ground Co. The acquisition of Sub Co shares will be an input taxed financial supply by Big Digger.*[5]

13. *As well as making its own internal assessment, Big Digger engages a firm of consulting geologists to provide a report on the mineral reserves controlled by Sub Co. When received, the geologist's report is used to make a decision to go ahead with the share purchase.*

14. *The acquisition of the geologist's report is related to an intended input taxed supply and is not for a creditable purpose. Big Digger Inc does not claim input credits on this acquisition.*

15. *Legal due diligence by another service provider indicates that Sub Co previously operated a now disused mine; a litigation search reveals that a nearby resident is commencing litigation about contamination arising from the mine. To avoid any potential exposure to any liabilities arising from the claims made in relation to the activities of the disused mine, Big Digger decides that it will not purchase the Sub Co shares but will offer to purchase the assets of the operating mine as a going concern.*

16. *The consulting geologist's report provides a valuation of the key asset being the expected future production of the mine. This was previously used to inform the valuation of Sub Co's shares and this was the intended use at the time the valuation report was acquired.*

[4] Refer to paragraph 23 of this draft Determination.
[5] Refer to paragraph 23 of this draft Determination.

17. *When the decision was made that the final bid structure should be acquisition of the assets, the valuation was reused to determine the price for this bid. In this case, the consulting geologist's service is incorporated into, and reflected by, the final report provided. There was no need for further advice to be provided, or for any revision of the advice set out in the report, by the consulting geologist.*

18. *This is a circumstance where a service has been applied as intended but is then subsequently applied for a different purpose. In this case an adjustment arises under Division 129.*

Date of effect

19. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
28 September 2011

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Explanation

Background to M&A

20. References to M&A transactions include takeovers and mergers of companies, and the sale and purchase of business assets (including goodwill). M&A activities include the steps that lead up to an M&A transaction, including where the intended M&A transaction does not proceed. M&A may consist of several different supplies for GST purposes. For example, in addition to the sale of shares or business assets, there may be supplies associated with corporate restructuring, capital raising, divestments or share buy-backs.[6]

Relevantly, acquisitions of financial supplies, including acquisitions of shares, are treated as input taxed financial supplies. These supplies are referred to as 'acquisition-supplies'.[7]

Creditable purpose

21. Under section 11-20 an entity is entitled to input tax credits for creditable acquisitions that it makes. To make a creditable acquisition, the entity must, among other things, acquire the thing solely or partly for a creditable purpose.[8] 'Creditable purpose' is defined in section 11-15. Under paragraph 11-15(2)(a) you do not acquire a thing for a creditable purpose to the extent that the acquisition relates to making supplies that would be input taxed.

22. The Commissioner's view on the application of paragraph 11-15(2)(a) is set out in *Goods and Services Tax Ruling GSTR 2008/1: Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?*[9] Under that view, 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 input taxed supplies. In the context of M&A this includes making input taxed acquisition-supplies, such as the purchase of shares.

23. Under Division 129 an adjustment may arise if the actual application of a 'thing' (that is an acquisition) is different from the intended application. Adjustments under Division 129:

- arise only for acquisitions above a certain value,
- arise for 'adjustment periods', and
- are calculated by use of a 'method statement'.

---

[6] Further background information on the GST treatment of mergers and acquisitions can be found in the *GST guide – claiming input tax credits on acquisitions made in connection with a merger and acquisition activity* at www.ato.gov.au.
[7] This is further explained in GSTR 2002/2 at paragraph 22.
[8] Paragraph 11-5(a).
[9] See paragraphs 149 to 161 for passages particularly relevant to M&A transactions.

24. The method statement in subsection 129-40(1) requires a comparison between the **actual application of the thing** and the **intended or former application of the thing**. If these two differ, there is an adjustment.[10]

25. Under section 129-55 the term 'apply' in relation to a thing acquired or imported, includes:

(a) supply the thing; and

(b) consume, dispose of or destroy the thing; and

(c) allow another entity to consume, dispose of or destroy the thing.

26. The meaning of 'apply' is central to determining actual application.[11] The relevant thing will have been applied in the entity's enterprise if an objective assessment of the facts and circumstances demonstrates that the thing has been allocated or dedicated to a particular use (or uses) in the enterprise.[12]

27. After an acquisition or importation is made, the extent to which it is actually applied or used for a creditable purpose may be different from the intended use, in which case an adjustment may arise. If an acquisition is applied when it is acquired, the actual application should reflect the intended use and no adjustment will arise.

28. In the context of M&A transactions, many acquisitions will be applied leading up to a critical event such as:

- making a decision on the transaction,
- making a bid, or
- concluding the transaction and making a supply.

Application of Division 129 to services in M& A context

29. Common acquisitions during M&A transactions are services, such as the provision of advice and due diligence. The acquisition of a service is a 'thing' that can be subject to the application of a section 129-40 adjustment. For example, in the case of real property transactions, the Commissioner's view is that services are capable of being incorporated into a broader thing (for example, a physical asset) which may be applied for different purposes over time.[13]

30. In the M&A context, however, services are usually applied when they are obtained, rather than being applied over time. Advice services and due diligence services will contribute to the overall body of knowledge of the acquirer that will be drawn upon when making decisions. However, these services may not have an enduring use in their own right, and are not incorporated into another asset.

---

[10] The detailed operation of Division 129 is not explained in this draft GSTD. For a fuller explanation of the Commissioner's view of the application of Division 129 refer to GSTR 2000/24 and GSTR 2009/4. For the purposes of this determination, we assume that the other requirements for making adjustments are met and the only issue is whether there has been a change in extent of creditable purpose of relevant acquisitions.

[11] When we use the term 'apply' or 'application' this includes a reference to the actual application of the thing in Step 1 of the method statement in subsection 129-40(1). The Commissioner's views on the meaning of 'apply' are explained in more detail in paragraphs 30 to 35 of GSTR 2009/4.

[12] See also paragraph 35 of GSTR 2009/4.

[13] See GSTR 2009/4 at paragraph 63.

31. There may be cases where advice received and used for one purpose is subsequently specifically used for a different purpose, in which case an adjustment may arise. For example, a valuation of a target entity could be acquired with an intended share acquisition in mind, but later applied in an asset purchase. Advice, such as a valuation, that is not specifically directed to the form of a proposed transaction can be reapplied without referring to the service provider, even if the structure of the proposed transaction changes.

32. In these situations, a careful assessment of the particular advice and services should be made to distinguish what may appear to be a further application of the acquisitions from the immediate application of those things. We do not consider that the **mere** fact that advice contributes to a body of knowledge which is taken into account over the course of the M&A in itself means that the advice is applied over time.

Application of Division 129 where the intended M& A transaction doesn't proceed

33. Paragraph 129-50(2)(a) states that you do not apply a thing for a creditable purpose to the extent that the application relates to making supplies that **are** input taxed. Under paragraph 11-15(2)(a), you do not acquire a thing for a creditable purpose to the extent that the acquisition relates to making supplies that **would be** input taxed (emphasis added).

34. The Division 129 test uses the term 'are' and Division 11 the term 'would be', but in other respects the provisions are the same. Despite the difference in terminology, the Commissioner takes the view that the connection to input taxed supplies for the purpose of Division 129 is determined in the same way as for Division 11.[14] The difference between the two is that for Division 11 the connection is judged at the time of acquisition and for Division 129 at the time of application. For the purposes of Division 129, there is a sufficient connection to input taxed supplies to deny creditable purpose to the extent that, on an objective assessment of the surrounding facts and circumstances, the acquisition is allocated or dedicated to the making of actual or intended input taxed supplies as part of an entity's enterprise.

35. In some cases an M&A transaction will not be completed at all. This may be due to a decision by the entity (for example to abandon the transaction) or to circumstances outside the entity's control (for example, a bid is unsuccessful). The fact that an actual supply doesn't eventuate does not, in itself give rise to a change in the extent of creditable purpose of related acquisitions.[15] Where an acquisition is used in preparing for an intended supply or in the process of making a decision whether to proceed with the supply, that acquisition is applied in contemplation of the supply under consideration. If the intended supply is an input taxed supply, the application of the acquisition is not for a creditable purpose. The fact that the transaction does not eventuate will not affect this conclusion.

36. For example, an entity intends to make an input taxed supply by way of acquiring shares and obtains due diligence advice prior to making a final commitment. The advice is used in making a decision not to proceed with the transaction. Notwithstanding that the transaction is abandoned, the acquisition still retains its relationship to supplies that are input taxed for the purposes of determining the actual application of the advice.

---

[14] The Commissioner's view of determining a connection between an acquisition and the making of input taxed supplies is found in GSTR 2008/1, especially from paragraph 101-119.

[15] This is illustrated by Example 40 in GSTR 2002/2 at paragraph 270-271, where no Division 129 adjustment arises when an intended share acquisition doesn't occur due to the actions of the other entity's shareholders.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.

37. An alternative view is that Division 129 is concerned with judging creditable purpose by reference to supplies that are actually made, rather than by the use to which an acquisition is put. On this view:

- where an intended input taxed supply is not in fact made, there has been no application of the thing for a non-creditable purpose, and Division 129 may operate to produce a decreasing adjustment; and
- where the acquisition is used in contemplation of a taxable supply or a GST-free supply, but an input taxed supply is ultimately made, Division 129 may operate to produce an increasing adjustment.

38. This view is based on the difference in wording of the 'creditable purpose' test in paragraph 129-50(2)(a) (which uses the term 'are input taxed') compared to the test in paragraph 11-15(2)(a) (which uses the term 'would be input taxed' and incorporates a nexus to intended supplies). The difference in terminology is treated as significant and an ordinary reading of the words of paragraph 129-50(2)(a) is said to lead to a conclusion that it must refer to supplies that are in fact made. It can be argued that whilst Division 11 is concerned with the hypothetical, Division 129 is concerned with what has actually happened. In addition, it can be argued that if the tests in the two divisions were meant to be the same, the same words would have been used.

39. We think that the better view is that the tests in Division 11 and Division 129 are not intended to be inherently different, but merely that one is judged at the time of acquisition, and the other at the time of application. Although the definition of creditable purpose in Division 129 refers to supplies that **are** input taxed, in our view this merely reflects the fact that application of a thing will typically be contemporaneous with supplies made using the thing.

40. In our view paragraph 129-50(2)(a) will be invoked where the application of the thing relates to the making of an intended input taxed supply regardless of whether such a supply has occurred in the relevant adjustment period. This view is illustrated by paragraphs 47A and 47C of GSTR 2009/4 where, in the context of input taxed supplies of residential premises, creditable purpose is denied where the things in question are applied in relation to future intended input taxed supplies that have not occurred as at the end of the relevant adjustment period.[16]

[16] This view is also consistent with Example 40 at paragraphs 270 and 271 of GSTR 2002/2.

41. We do not think that the choice of the term 'are' is particularly significant in this context.[17] For example, the term 'would be' is used in subsection 129-50(3) to qualify the operation of paragraph 129-50(2)(a). Similarly, paragraph 11-15(5)(b), in modifying the operation of paragraph 11-15(2)(a), refers to supplies that 'are not input taxed'. In our view the choice of connecting word between 'making' and 'input taxed' merely reflects a connection with past, present or future supplies as the context requires. It could equally be argued that if 129-50(2)(a) was intended to refer to actual supplies that have in fact been made (past tense) then the term 'were input taxed' might be more appropriate. In the context, we think that the use of the word 'making' is a neutral term that does not convey past, present or future tense.

42. Although not decisive because made in the context of Division 11, we note the following comments of Hill J in *HP Mercantile* which are consistent with the approach adopted in this Draft Determination:

> [W]hile it is true that the GST Act does not mandate a system of tracing acquisitions to actual supplies, it does not follow that an entity which has embarked upon 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 upon whether the acquisitions are related to supplies which, if made, would be input taxed…
>
> Since a person will be taken to be carrying on an enterprise if the taxpayer does anything in the course of the commencement of an enterprise, there will always be the possibility that the enterprise might fail before there has been any supply made. It is difficult to see why the legislative policy would be to give a taxpayer a full input tax credit in such a case, while not giving it a credit if the enterprise in fact did not fail but thereafter operated to make a supply.[18]

[17] See by way of comparison, in the context of Division 11, *HP Mercantile Pty Limited* [2005] FCAFC 126; 2005 ATC 4571; (2005) 60 ATR 106 (*HP Mercentile*), per Hill J at [40] to [43].
[18] *HP Mercantile* at [46] and [48].

Appendix 3 – Your comments

43. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

44. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Australian Taxation Office website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **26 October 2011**

Contact officer: **Simon Jukes**
Email address: **Simon.Jukes@ato.gov.au**
Telephone: **(07) 3213 6036**
Facsimile: **(07) 3212 5061**
Address: **Terrica Place**
140 Creek Street
Brisbane Queensland 4000

Contact officer: **Melissa Harrison**
Email address: **Melissa.Harrison@ato.gov.au**
Telephone: **(08) 8218 9296**
Facsimile: **(08) 8218 9233**
Address: **91 Waymouth Street**
Adelaide South Australia 5000

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; GSTR 2000/24; GSTR 2002/2; GSTR 2008/1; GSTR 2009/4

Subject references:

- adjustments
- creditable acquisition
- creditable purpose
- GST financial supplies
- GST input tax credits & creditable acquisitions
- GST supplies & acquisitions
- input taxed supplies
- takeovers & mergers

Legislative references:

- A New Tax System (Goods and Services Tax) Act 1999
- ANTS(GST)A 1999 Div 11
  ANTS(GST)A 1999 11-5(a)
- ANTS(GST)A 1999 11-15
- ANTS(GST)A 1999 11-15(2)(a)
- ANTS(GST)A 1999 11-15(5)(b)
- ANTS(GST)A 1999 11-20
- ANTS(GST)A 1999 Div 129
- ANTS(GST)A 1999 129-40
- ANTS(GST)A 1999 129-40(1)
- ANTS(GST)A 1999 129-50(2)(a)
- ANTS(GST)A 1999 129-50(3)
  ANTS(GST)A 1999 129-55

Case references:

- *HP Mercantile Pty Limited v. Federal Commissioner of Taxation* [2005] FCAFC 126; 2005 ATC 4571; (2005) 60 ATR 106

ATO references

NO:	1-3GDQ6KS
ISSN:	1443-5179
ATOlaw topic:	Goods and Services Tax ~~ Financial supplies ~~ financial supplies and acquisitions