

***GSTB 2003/1 - How to calculate input tax credits and bad debt adjustments when a dividend is paid to creditors***

# GST Bulletin

GSTB 2003/1

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## How to calculate input tax credits and bad debt adjustments when a dividend is paid to creditors

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**Date of issue:** 19 February 2003

### *Preamble*

This document is a ruling for the purposes of section 37 of 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.]

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### About this Bulletin

This Bulletin applies to representatives of an incapacitated entity who pay a dividend of less than 100 cents in the dollar to creditors towards satisfaction of debts owed by the incapacitated entity. The payment of such a dividend may create either an increasing adjustment as a consequence of the creditor writing off the remainder of the debt, or an input tax credit entitlement, depending on the incapacitated entity's accounting basis for GST purposes. This Bulletin discusses how you may determine the increasing adjustment (which we refer to as a 'bad debt increasing adjustment')<sup>1</sup> or the input tax credit and its impact upon the dividend, if any, payable by the representative to the Tax Office.

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<sup>1</sup> This expression refers to increasing adjustments under section 21-15, in relation to creditable acquisitions, as a consequence of debts being written off by the supplier or overdue for 12 months or more.

This Bulletin does *not* consider the GST consequences for creditors who receive a dividend from the representative of an incapacitated entity.

All legislative references are to the *A New Tax System (Goods and Services Tax) Act 1999* unless otherwise indicated.

## Background

A representative of an incapacitated entity is required to be registered for GST if the incapacitated entity was registered or required to be registered for GST. A representative is:<sup>2</sup>

- a trustee in bankruptcy;
- a liquidator;
- a receiver;
- an administrator appointed under Division 2 of Part 5.3A of the *Corporations Act 2001*;
- a person appointed, or authorised, under an Australian Law<sup>3</sup> to manage the affairs of an entity because it is unable to pay all of its debts as and when they become due and payable; or
- an administrator of a deed of company arrangement executed by the incapacitated entity.

An incapacitated entity is:<sup>4</sup>

- an individual who is bankrupt;
- an entity that is in liquidation or receivership; or
- an entity that has a representative.

A representative, in the course of their representation duties, may pay a dividend to unsecured creditors of the incapacitated entity. At the time that an entity becomes incapacitated it may have a number of creditors, including the Tax Office.

The dividend is calculated by dividing the pool of funds available for distribution to unsecured creditors by the total amount of the admitted proofs of debt. This Bulletin assumes the dividend is less than the amount owed to the creditors, that is, less than 100 cents in the dollar. It should be noted that a dividend that pays 100 cents in the dollar does not give rise to an adjustment.

## Incapacitated entities accounting on a non cash basis

### Bad debt increasing adjustments

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<sup>2</sup> Representative is defined in section 195-1.

<sup>3</sup> An Australian Law is a law of the Commonwealth, a State or a Territory.

<sup>4</sup> Incapacitated entity is defined in section 195-1.

A dividend payment of less than 100 cents in the dollar may result in the creditors writing off as bad the parts of their debts which remain unpaid (that is, the debt minus the dividend payment).

An entity that accounts for GST on a non cash basis is entitled to attribute an input tax credit for a creditable acquisition to the tax period in which an invoice is issued or any of the consideration is paid, provided that, where required, a tax invoice is held when the entity's business activity statement for the period is lodged.<sup>5</sup> The entity has a bad debt increasing adjustment<sup>6</sup> in respect of the acquisition when the supplier (creditor) writes all or part of the debt off as bad.<sup>7</sup>

It is reasonable to assume that creditors will have written off the remainder of the debts as bad by the time the final dividend is paid. However, the incapacitated entity and the representative will not usually be aware if individual creditors have previously written off all or part of the debt as bad. In those circumstances, if the dividend payment to a creditor is for a creditable acquisition that the incapacitated entity had made before the appointment, but not fully paid for, the bad debt increasing adjustment may be attributed wholly to the tax period in which the representative pays the final dividend.

The amount of the increasing adjustment in respect of an acquisition which was fully creditable is equal to 1/11<sup>th</sup> of the amount written off.<sup>8</sup> However, if the acquisition by the incapacitated entity was only partly creditable, the increasing adjustment is calculated in proportion to the extent of the creditable purpose and/or extent of the consideration.<sup>9</sup>

### ***How is the bad debt increasing adjustment calculated?***

The Tax Office will accept the use of the following method for calculating the bad debt increasing adjustment arising from a final dividend payment. It is referred to as the 'bad debt increasing adjustment formula'.

#### **Bad Debt Increasing Adjustment Formula**

$$\text{Bad debt increasing adjustment (B)} = A \left[ 1 - \left( \frac{Y}{X} \right) \right]$$

$$\text{Dividend rate} = \frac{Y}{X + B}$$

Where:

- **B** is the total bad debt increasing adjustment to be notified to the Tax Office.
- **A** is the amount of input tax credits the incapacitated entity was entitled to in relation to the unsecured creditors' admitted debts. This figure takes into account fully and partly creditable acquisitions made by the incapacitated entity.
- **Y** is the total funds that are available to be paid as distributions to the unsecured creditors.

<sup>5</sup> Section 29-10.

<sup>6</sup> Section 21-15.

<sup>7</sup> For further discussion on when a debt is 'bad' refer to Goods and Services Tax Ruling GSTR 2000/2 which is about adjustments for bad debts and Taxation Ruling TR 92/18 which is about bad debts.

<sup>8</sup> Section 21-15.

<sup>9</sup> Section 136-10.

- **X** is the total admitted unsecured debts, before any bad debt increasing adjustments that arise as a consequence of creditors writing off part of the debts as bad.

*Example 1*

*Mark, the representative of Fabulous Fabrics Pty Ltd (the incapacitated entity), has admitted unsecured creditors' claims of \$5,152,991. Input tax credits of \$294,368, for acquisitions from these creditors included in the admitted claims, were attributed by Fabulous Fabrics Pty Ltd prior to Mark's appointment. The admitted unsecured creditors' claims include a debt to the Tax Office of \$493,587. Mark has funds of \$1,405,646 available to pay unsecured creditors.*

*Accordingly, applying the bad debt increasing adjustment formula<sup>10</sup>:*

$$A = \$294,368$$

$$Y = \$1,405,646$$

$$X = \$5,152,991$$

$$B = 294,368 \left[ 1 - \left( \frac{1,405,646}{5,152,991} \right) \right]$$

$$B = \$214,069.55$$

*The total bad debt increasing adjustment (i.e., the amount by which the Tax Office would increase its proof of debt) is \$214,069.55. As the bad debt increasing adjustment increases the Tax Office claim, the total admitted unsecured debts (X) will also increase by this amount. The dividend must be calculated on this new amount. The Tax Office dividend is based on the increased proof of debt of \$707,656.55.*

$$\text{Dividend rate} = \frac{1,405,646}{5,152,991 + 214,069.55}$$

$$\text{Dividend rate} = 0.26190$$

$$= 26.190 \text{ cents in the dollar}$$

*The dividend payable to the Tax Office is calculated as follows:*

$$\begin{aligned} \text{Tax Office dividend} &= 0.26190 \times \$707,656.55 \\ &= \$185,335.25 \end{aligned}$$

The bad debt increasing adjustment formula assumes that bad debt increasing adjustments relating to acquisitions referable to the unsecured creditors' admitted claims have not previously been claimed. It is not to be used to the extent that bad debt increasing adjustments in relation to debts outstanding for 12 months or more or previously written off have already been claimed in a business activity statement of the entity prior to the appointment of the representative or of the incapacitated entity or the representative.

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<sup>10</sup> Please note for calculation accuracy, figures should only be rounded at the final stage of the calculation, to the nearest cent.

### ***Is it the incapacitated entity or the representative that has the adjustment?***

In relation to pre-appointment acquisitions, the representative is personally liable for bad debt increasing adjustments which arise after the appointment, unless he or she notifies the Commissioner of the amount and circumstances in which they arose.<sup>11</sup> Following notification, the incapacitated entity has the bad debt increasing adjustment. The representative must notify the Commissioner of these adjustments and the amounts in order to remove his or her personal liability for the adjustment.<sup>12</sup>

The representative can provide notification of the total of the bad debt increasing adjustments to the Tax Office prior to the payment of the final dividend. The representative can request an amended proof of debt from the Tax Office when he or she notifies the Commissioner of the adjustment.

### **Interim Dividends**

A bad debt increasing adjustment does not necessarily arise as a result of an interim dividend payment. This is because creditors may not write off the whole or part of a debt owed by the incapacitated entity as bad until it is certain that no further payments will be received. In any case, representatives will not usually know whether creditors have written off any part of the debt as bad at that point. The Tax Office therefore accepts that payment of an interim dividend does not in itself trigger an increasing adjustment.

When a representative makes a final dividend payment, creditors will generally make a bona fide commercial decision that the unpaid portion of the debt is unlikely to be recovered and therefore write off the remainder of the debt.<sup>13</sup> Thus, a bad debt increasing adjustment potentially arises for the representative when a final dividend is paid and at this point the bad debt increasing adjustment formula may be used to calculate it.<sup>14</sup> However, it should be noted that, if the representative notifies the Tax Office, then it is the incapacitated entity, and not the representative, that has the adjustment.<sup>15</sup>

Where a representative pays interim dividends to unsecured creditors, those payments are based on the admitted claims of the creditors. In the case of the Tax Office, the interim dividends may be based on the admitted claim, prior to any bad debt increasing adjustments as a consequence of the remainder of the debts being written off after dividend payments.

The interim dividend(s) to the Tax Office may not have taken bad debt increasing adjustments into account because the interim dividend(s) will usually be based on the Tax Office's original proof of debt, which will not have taken into account increasing adjustments that do not arise until creditors write off the remainder of the debts owed by the incapacitated entity. Consequently, in addition to the bad debt increasing adjustment, an equalisation payment to the Tax Office is required.<sup>16</sup> The equalisation payment may be made at the time the final dividend is paid. The representative will need to ensure that sufficient funds are set aside for this equalisation payment and may wish to make an estimate of the amount of the equalisation payment, at the time of paying the interim dividend.

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<sup>11</sup> Section 147-20.

<sup>12</sup> Paragraph 147-20(1)(c).

<sup>13</sup> Goods and Services Tax Ruling GSTR 2000/2 paragraphs 37 and Taxation Ruling TR 92/18 paragraphs 3 & 4.

<sup>14</sup> Section 21-15. See below for a discussion of debts overdue for 12 months or more.

<sup>15</sup> Paragraph 147-20(1)(c).

<sup>16</sup> This assumes that the Tax Office has amended its proof of debt to claim the increase in its debt due to the bad debt increasing adjustments. A creditor's entitlement to equalisation payments arises under regulation 5.6.55 & 5.6.68 of the Corporations Regulations 2001 and section 144 of the *Bankruptcy Act 1966*.

If there is more than one interim dividend, the bad debt increasing adjustment formula is applied only at the time of the expected final dividend. The equalisation payment, that takes into account the interim dividends, is also required at the time of the final dividend. If the bad debt increasing adjustment formula is applied at the time of the expected final dividend, but there is a later dividend, the bad debt decreasing adjustment formula must also be applied in respect of the later dividend. This is discussed further below.

### *Example 2*

*Paul, the representative of Stunning Services Pty Ltd (the incapacitated entity), has admitted unsecured creditors' claims of \$5,250,000. Input tax credits of \$300,000, from acquisitions from these creditors included in the admitted claims were attributed by Stunning Services Pty Ltd prior to Paul's appointment. The admitted unsecured creditors' claims include a Tax Office claim of \$400,000. Paul pays an interim dividend to unsecured creditors of 20 cents (\$1,050,000).*

*There is no bad debt increasing adjustment at this time. The Tax Office receives an interim dividend based on a debt of \$400,000 (i.e., \$80,000). Paul may wish to make an estimate of the equalisation payment that will be due to the Tax Office and set these funds aside.*

*Paul then declares a final dividend and has \$787,500 (including the amount set aside as the equalisation payment) available for this payment.*

*Accordingly, applying the bad debt increasing adjustment formula:*

$$A = \$300,000$$

$$Y = \$1,837,500 \text{ (i.e., } \$1,050,000 + \$787,500)$$

$$X = \$5,250,000$$

$$B = 300,000 \left[ 1 - \left( \frac{1,837,500}{5,250,000} \right) \right]$$

$$B = \$195,000$$

*Y is the total funds that are paid as a dividend (i.e., interim dividend plus final dividend). The total amount of the bad debt increasing adjustment (i.e., the amount by which the Tax Office will increase its proof of debt) is \$195,000. As the adjustment increases the Tax Office claim, the total admitted unsecured debts (X) also increases by this amount. The dividend rate must be calculated on this new amount.*

$$\text{Dividend rate} = \frac{1,837,500}{5,250,000 + 195,000}$$

$$\text{Dividend rate} = 0.33747$$

$$= 33.747 \text{ cents in the dollar.}$$

*The Tax Office claim is now \$595,000 (i.e., \$400,000 + \$195,000) and the final dividend rate is calculated to be 13.747 cents in the dollar (i.e., 0.33747 – 0.20). Based on this figure, the final dividend payment to the Tax Office would be \$81,794.65. However, the first dividend payment to the Tax Office was based on the lesser debt and therefore the Tax Office is entitled to an equalisation payment. The equalisation payment is calculated as:*

$$\text{Equalisation payment} = (595,000 \times 0.20) - 80,000$$

$$\text{Equalisation payment} = \$39,000$$

The final payment to the Tax Office consists of \$81,794.65 for the final dividend and \$39,000 for the equalisation payment. The total payments made to the Tax Office by the representative are \$200,794.65 (that is, \$80,000 + \$39,000 + \$81,794.65).

### **Bad debt increasing adjustments - debts overdue for 12 months or more**

A bad debt increasing adjustment also arises when a debt has been overdue for 12 months or more, if it has not already been written off.<sup>17</sup> This may occur prior to the appointment of the representative or during the period of representation, prior to the payment of the final dividend. Adjustments are attributable to the tax period in which you become aware of them.<sup>18</sup> This could require a series of bad debt increasing adjustments to be attributed as the representative becomes aware of each adjustment.

However, the representative does not have the increasing adjustments as they occur if the representative notifies the Tax Office of the adjustments. Provided the representative notifies the Tax Office, the incapacitated entity has the increasing adjustments and not the representative.<sup>19</sup>

The notification of the increasing adjustments may be made at the time of the final dividend payment. The total of the adjustments may be calculated using the bad debt increasing adjustment formula.

### **Bad debt decreasing adjustments**

In situations where a dividend was expected to be the final dividend, but a subsequent dividend is paid, the incapacitated entity has a bad debt decreasing adjustment.<sup>20</sup> The incapacitated entity will have a decreasing adjustment if an increasing adjustment<sup>21</sup> arose when the earlier dividend, which was expected to be the final, was paid. Where a subsequent dividend is paid, which results in a decreasing adjustment, the Tax Office's admitted debt will decrease. This is because the previous dividend payment was based on the admitted debt, which included the bad debt increasing adjustment, but did not take into account the subsequent decreasing adjustment.

The amount effectively overpaid may be deducted from the final dividend payment to the Tax Office, or the Tax Office may be required to repay the overpaid amount.

Where the representative applied the bad debt increasing adjustment formula to calculate the increasing adjustment, the bad debt decreasing adjustment formula given below must be used to calculate the decreasing adjustment.

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<sup>17</sup> Paragraph 21-15(1)(c).

<sup>18</sup> Subsection 29-20(1).

<sup>19</sup> Section 147-20.

<sup>20</sup> Section 21-20.

<sup>21</sup> Section 21-15.

**Bad Debt Decreasing Adjustment Formula**

$$\text{Decreasing adjustment (D)} = A \left( \frac{Y}{X} \right)$$

$$\text{Dividend Rate} = \frac{Y}{X - D}$$

Where:

- **D** is the decreasing adjustment of the incapacitated entity.
- **A** is the amount of input tax credits the incapacitated entity was entitled to in relation to the unsecured creditors' admitted debts. This figure takes into account fully and partly creditable acquisitions made by the incapacitated entity and is the same as that used in originally applying the bad debt increasing adjustment formula.
- **Y** is the extra funds that are available for distribution to the unsecured creditors.
- **X** is the total admitted unsecured debts. This figure includes the bad debt increasing adjustment calculated previously.

*Example 3*

*Mark, the representative of Fabulous Fabrics Pty Ltd (the incapacitated entity), has previously paid what was expected to be the final dividend. Fabulous Fabrics Pty Ltd had an increasing adjustment for the bad debt amount written off using the final bad debt increasing adjustment formula as provided in Example 1 above.*

*Mark has now become aware of an asset that was not previously included in the records of Fabulous Fabrics Pty Ltd. The asset is sold by Mark who now has available additional funds of \$400,222 (net of costs and GST on the sale) to pay a further dividend to the unsecured creditors. The amount of input tax credits previously attributed by the incapacitated entity that relate to acquisitions for which there was a bad debt increasing adjustment remains unchanged at \$294,368. The total of the admitted unsecured debts is now \$5,367,060.55 (which includes the increasing adjustment of \$214,069.55).*

*Accordingly, applying the bad debt increasing adjustment formula:*

$$Y = \$400,222$$

$$X = \$5,367,060.55$$

$$A = \$294,368$$

$$\text{ATO Debt} = \$707,656.55$$

*As Fabulous Fabrics Pty Ltd has a decreasing adjustment in relation to amounts previously written off by creditors when Mark pays the dividend, the dividend rate will increase.*

*The decreasing adjustment of Fabulous Fabrics Pty Ltd is calculated as follows:*

$$D = A \left( \frac{Y}{X} \right)$$

$$= 294,368 \times (400,222 \div 5,367,060.55)$$

$$= \$21,951.04$$

*The decreasing adjustment is \$21,951.04. This decreasing adjustment is offset against the outstanding Tax Office claim. The total of the unsecured creditors' debts is reduced by the amount of the decreasing adjustment and the dividend rate is calculated as follows:*

$$\begin{aligned} \text{Dividend rate} &= \frac{Y}{X - D} \\ &= 400,222 \div (5,367,060.55 - 21,951.04) \\ &= 0.07488 \\ &= 7.488 \text{ cents in the dollar} \end{aligned}$$

*As the Tax Office claim is reduced by the amount of the decreasing adjustment, the total unsecured creditors' amount (X) is reduced by this amount. The Tax Office is still entitled to a dividend payment, although this will be calculated on the reduced debt of \$685,705.51.<sup>22</sup>*

*Also, as the previous dividend payment to the Tax Office was based on the admitted debt of \$707,656.55 (including the bad debt increasing adjustment) and the final Tax Office claim is \$685,705.51 (taking into account the decreasing adjustment), the ATO effectively has been overpaid by the initial dividend payment. Therefore, a calculation of the overpayment must be made.*

*The total dividend rate paid to unsecured creditors is 33.678 cents in the dollar (i.e., 26.190 + 7.488). The total dividend payment to the Tax Office is calculated on the final debt:*

$$\begin{aligned} &= \$685,705.51 \times 0.33678 \\ &= \$230,931.90 \end{aligned}$$

*Therefore, the final dividend paid to the Tax Office is:*

$$\begin{aligned} &= \$230,931.90 - \$185,335.25^{23} \\ &= \$45,596.65. \end{aligned}$$

## **Incapacitated entities accounting on a cash basis**

### **Input tax credits as a result of a first and final dividend to creditors**

Entities that account for GST on a cash basis are entitled to attribute input tax credits to the tax period in which they provide the consideration for the acquisition.<sup>24</sup> For example, if the consideration for a creditable acquisition is \$220 and the entity pays \$110 of that amount in a given tax period, it is entitled to attribute an input tax credit of \$10 to that tax period.<sup>25</sup> This means that, to the extent that the purchases of an incapacitated entity (which accounts for GST on a cash basis) referable to the unsecured creditors' admitted claims were creditable acquisitions, input tax credits

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<sup>22</sup> Refer to Example 1 for the Tax Office proof of debt.

<sup>23</sup> This is the amount of the interim dividend paid to the Tax Office – refer to Example 1.

<sup>24</sup> Subsection 29-10(2); provided that, where required, they hold a tax invoice at the time of lodging their business activity statement: subsection 29-10(3).

<sup>25</sup> See previous footnote.

in proportion to the rate of the dividend paid by the representative are attributed when the dividend is paid.<sup>26</sup>

When the representative pays a dividend to unsecured creditors for acquisitions made by the incapacitated entity prior to the appointment of the representative, the entitlement to input tax credits remains with the incapacitated entity.

### ***How is the amount of the input tax credit calculated?***

The Tax Office will accept the following method for calculating the input tax credit entitlement which arises where there is a payment of a first and final dividend.<sup>27</sup> This is referred to as the 'input tax credit formula'. A representative may use the input tax credit formula upon payment of a first and final dividend to calculate the input tax credit entitlement.

*Note: Section 8AAZL of the Taxation Administration Act 1953 provides that these input tax credits will be offset against the outstanding tax debt on the running balance account of the incapacitated entity before any refund is issued.*

Where the input tax credit amount is larger than the debt owed by the incapacitated entity to the Tax Office, the incapacitated entity is entitled to a refund of the excess amount. This refund will be included in the funds available for distribution by the representative. If, however, the input tax credit amount is less than the debt owed to the Tax Office, there is no refund to the incapacitated entity. The debt owed to the Tax Office is merely reduced by this amount.

#### **Input Tax Credit Formula**

**Step 1:** *Input tax credit (ITC)* =  $A \left( \frac{Y}{X} \right)$

If the ITC is greater than the debt to the Tax Office, go to Step 2.

If the ITC is less than or equal to the debt to the Tax Office, go to Step 3.

**Step 2:** *Dividend rate* =  $\frac{Y + ITC - ATO Debt}{X - ATO Debt}$

Do not go to step 3. This is the **end** of the calculation.

**Step 3:** *Dividend Rate* =  $\frac{Y}{X - ITC}$

Where:

- **ITC** is the input tax credit entitlement of the incapacitated entity referable to the unsecured creditors' admitted claims.
- **A** is the GST component included in the admitted unsecured debts of the incapacitated entity to the extent that the incapacitated entity is entitled to an input tax credit. This figure takes into account fully creditable and partly creditable acquisitions made by the incapacitated entity.

<sup>26</sup> See previous footnote.

<sup>27</sup> That is, where only one dividend is anticipated.

- **Y** is the total funds that are available to be paid as distributions to the unsecured creditors.
- **X** is the total admitted unsecured debts.
- **ATO Debt** is the total debt owed to the Tax Office by the incapacitated entity.

*Example 4*

*Tan, the representative of Kerry Club Pty Ltd (the incapacitated entity) has admitted unsecured creditors claims of \$525,000 and has funds available of \$164,249 to pay these debts. The GST component of the total admitted unsecured creditors' claims is \$38,674 and the debt that Kerry Club Pty Ltd owes to the Tax Office is \$74,007.*

*Accordingly, applying the input tax credit formula:*

$$Y = \$164,249$$

$$X = \$525,000$$

$$A = \$38,674$$

$$ATO Debt = \$74,007$$

*As Kerry Club Pty Ltd is entitled to input tax credits when Tan makes the dividend payment, the dividend rate will increase. The input tax credit of Kerry Club Pty Ltd is calculated as follows:*

**Step 1:**

*Calculate the amount of input tax credits.*

$$\begin{aligned} ITC &= A \left( \frac{Y}{X} \right) \\ &= 38,674 \times (164,249 \div 525,000) \\ &= \$12,099.36 \end{aligned}$$

*As the amount of the ITC is less than the tax debt to the Tax Office, Step 3 is applied.*

**Step 3:**

*The amount of the input tax credits to which Kerry Club Pty Ltd is entitled is \$12,099.36. These input tax credits are offset against the outstanding Tax Office claim with the result that the total of the unsecured creditors' debts is also reduced by the amount of the input tax credits and the dividend rate is calculated as follows:*

$$\begin{aligned} \text{Dividend Rate} &= \frac{Y}{X - ITC} \\ &= 164,249 \div (525,000 - 12,099.36) \\ &= 0.32024 \\ &= 32.024 \text{ cents in the dollar} \end{aligned}$$

*The Tax Office is still entitled to a dividend payment, although this will be calculated on the reduced debt. As the Tax Office claim is not cleared by the input tax credits, there is no refund. The amount of money that is available for distribution (Y) remains unchanged.*

**Interim dividends**

A representative may pay interim dividends to creditors which result in input tax credits being attributed at the time each dividend is paid. However, the input tax credit formula can not be applied at the time of the interim dividend as this will result in an inaccurate calculation of the input tax credit amount.

A representative may apply the input tax credit formula at the time of the final dividend to calculate the total amount of the input tax credits. However, at the time of the final dividend, the Tax Office effectively will have been overpaid on the previous dividend(s) if the interim dividends were based on the admitted debt before taking into account the input tax credits attributable as a result of the part payment of the creditors.

The amount may be deducted from the final dividend payment to the Tax Office, or the Tax Office may be required to repay the overpaid amount.<sup>28</sup>

*Example 5*

*Marius, the representative of Norved Pty Ltd (the incapacitated entity), has admitted unsecured creditors claims of \$780,000 and has declared an interim dividend of 20 cents in the dollar to the unsecured creditors (i.e., Marius is distributing \$156,000). The GST component of the total admitted unsecured creditors' claims is \$54,003 and the debt owed to the Tax Office by Norved Pty Ltd (the incapacitated entity) is \$103,000. Marius pays the interim dividend to the Tax Office based on the admitted proof of debt (without any adjustments to the Tax Office claim for input tax credits that result from the interim dividend payment). The interim dividend payment to the ATO is  $\$103,000 \times 0.20 = \$20,600$ .*

*Marius has funds available of \$186,050 for the final dividend making the total funds distributed to the unsecured creditors \$342,050. The example illustrates how the input tax credit entitlement of Norved Pty Ltd is able to be attributed at the time of the final dividend is calculated using the formula.*

*Accordingly, applying the input tax credit formula:*

$$Y = \$342,050$$

$$X = \$780,000$$

$$A = \$54,003$$

$$ATO Debt = \$103,000$$

**Step 1:**

*Calculate the amount of input tax credits.*

$$\begin{aligned} ITC &= A \left( \frac{Y}{X} \right) \\ &= 54,003 \times (342,050 \div 780,000) \\ &= \$23,681.70 \end{aligned}$$

*As the amount of the ITC is less than the tax debt to the Tax Office, Marius applies Step 3.*

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<sup>28</sup> Under regulation 5.6.55 of the Corporations Regulations 2001 and section 144 of the *Bankruptcy Act 1966*.

**Step 3:**

*The amount of the input tax credits to which Norved Pty Ltd is entitled is \$23,681.70. These input tax credits are offset against the outstanding Tax Office claim with the result that the total of the unsecured creditors' debts is also reduced by the amount of the input tax credits.*

$$\begin{aligned} \text{Dividend rate} &= \frac{Y}{X - \text{ITC}} \\ &= 342,050 \div (780,000 - 23,681.70) \\ &= 0.45226 \\ &= 45.226 \text{ cents in the dollar} \end{aligned}$$

*The Tax Office is still entitled to a dividend payment, although this will be calculated on the reduced debt of \$79,318.30. As the Tax Office claim is not cleared by the input tax credits, there is no refund. The amount of money that is available for distribution (Y) remains unchanged. The ATO received its interim dividend payment based on the admitted debt of \$103,000. However, the final ATO debt, after taking into account the input tax credits available to Norved Pty Ltd, is reduced to \$79,318.30. Therefore, the ATO effectively has been overpaid by the interim dividend and when Marius pays the final dividend to the ATO, this overpayment is taken into account so that the ATO receives a total dividend based on the reduced debt (i.e., \$79,318.30 x 0.45226 = \$35,872.49). Marius pays the ATO a final dividend of \$15,272.49 (i.e., \$35,872.49 - \$20,600).*

**Date of Effect**

This Determination explains our view of the law as it applied from 1 July 2000. You can rely upon this Determination as and from its date of issue for the purposes of section 37 of the *Taxation Administration Act 1953*. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and our view of when you can rely on our interpretation of the law in GST public and private rulings.

If this Determination conflicts with a previous private ruling that you have obtained, this public ruling prevails. However, if you have relied on a private ruling, you are protected in respect of what you have done up to the date of issue of this ruling. This means if you have underpaid an amount of GST, you are not for the shortfall prior to the later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

**Do you need more information**

If you have any questions or need more information on GST and the New Tax System, you can:

- phone the business Tax Reform Infoline on **13 24 78**; or
- download information from our website at **www.ato.gov.au**; or
- obtain *A Fax From Tax* on **13 28 60**; or
- write to us at PO Box 9935 in your capital city.

If you do not speak English and need help from the Tax Office, phone the Translating and Interpreting Service (TIS) on **13 14 50**.

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### ATO References

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