

ALERT

11 July 2013

The ATO increases its scrutiny of GST recovery in mergers and acquisitions

The line between tax avoidance and tax planning is increasingly prominent as the ATO steps up its tax collection and anti-avoidance activities in an effort to curtail revenue 'leakage'. In this Alert, we consider the legitimacy of certain transaction structures that are designed to maximise GST recovery in mergers and acquisitions involving input taxed financial supplies.

Background

The Australian Goods and Services Tax (**GST**) regime in its most basic form involves a supplier of goods or services charging an additional GST amount (being 10% of the price of the goods or services) to the purchasers of its products. The supplier is entitled to claim an 'input tax credit' (**ITC**) for the GST amounts that it has outlaid on goods and services that are utilised in the course of carrying out its commercial enterprise.

Certain transactions that are integral features of mergers and acquisitions (eg transfers of shares and units) are 'input taxed financial supplies' for GST purposes. This means that while there is

no GST payable on the provision, acquisition or disposal of securities, the purchaser is not permitted to claim ITCs for the GST expended in the course of acquiring goods and services related to the M&A transaction (eg accounting advice, legal services, business valuations). This results in a net GST liability payable by the acquirer of the securities.

The general rule that ITCs are not creditable on the acquisitions of goods and services that preceded the 'financial supply' is subject to a category of acquisitions that are eligible for 'reduced input tax credits' (**RITCs**). These acquisitions are listed in regulation 70-5.02(2) of the *A New Tax System (Goods and Services Tax) Regulations 1999* (Cth) and include the provision of 'arranging services' by a 'financial supply facilitator'. Eligibility to claim an RITC results in recovery of 75% of the GST amount charged on goods and services acquired in relation to the financial supply.

The alleged scheme

While the ability of an acquirer of securities to claim an RITC for



ALERT

certain arranging services (eg investment bank services) is uncontroversial, the fees charged by other providers of services (eg accountants and lawyers) in connection with the M&A transaction generally do not give rise to an entitlement to claim an RITC. The imperative to extend the availability of RITCs to legal and accounting services has given rise to a particular transaction structure that has attracted the ATO's scrutiny in recent times.

The structure in question involves Entity A (**Acquirer**) engaging a related entity, Entity B (**Arranger**) to provide arranging services to facilitate the acquisition of shares in the target company. The Arranger organises various professional services (including accounting and legal advice) for the Acquirer in relation to the transaction. The Arranger makes a single collective 'supply' of professional services to the Acquirer in its role as 'financial supply facilitator'. The Acquirer then claims an RITC on the supply of arranging services by the Arranger (**Transaction Structure**).

The ATO issued TA 2010/1 outlining its concerns that arrangements sharing characteristics with the Transaction Structure potentially contravened the anti-avoidance provisions contained in Division 165 of *A New Tax System (Goods and Services Tax) Act 1999* (Cth). The ATO has also now expanded powers under the Promoter Penalty Regime to prosecute persons who promote tax exploitation schemes or who implement schemes in a manner that fails to accord with relevant ATO product rulings.

Implications

TA 2010/1 indicates that the Commissioner will consider the substance of the relationship between an Acquirer and Arranger when determining whether the 'sole or dominant purpose' of an Arranger's involvement in a Transaction Structure is to derive a 'GST benefit', thus contravening the anti-avoidance provisions.

Nevertheless, the provision of arranging services by a related entity may enable businesses to claim RITCs (increasing net GST recovery) for services that would not otherwise be creditable provided (among other things) that the:

- arrangement has commercial substance (eg the Arranger is remunerated on commercial terms);
- Arranger plays a meaningful role in engaging service providers (eg the Arranger oversees and monitors service delivery); and
- Arranger routinely provides arranging services to the Acquirer and/or unrelated entities.

Comment

Businesses considering implementing an arrangement that is identical or similar to the Transaction Structure described in this Alert should be adequately informed about the risk of contravening anti-avoidance provisions and carefully assess whether there are genuine commercial imperatives underpinning the arrangement. It may be advisable to obtain a private ruling from the ATO regarding a proposed transaction structure. Businesses should also consider whether engaging an *unrelated* party to provide a bundled supply of 'arranging services' would yield similar commercial benefits to those provided by the Transaction Structure.

Want to republish any of this article?

If you would like to republish any part of this article in your staff newsletter or elsewhere please contact our Marketing team on **+61 3 9608 2168**

Disclaimer

This Alert is intended to provide general information on legal issues and should not be relied upon as a substitute for specific legal or other professional advice.



For further information please contact:

Michael Kohn, Partner
Phone (direct) **+61 3 9608 2160**
Mobile **+61 408 327 805**
Email **m.kohn@cornwalls.com.au**