

GST alert

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on Goods and Services Tax issues
for clients in business.

Whilst the input **tax credit system** may appear simple and straightforward, there are many complications and the Courts are now beginning to see the first cases concerning deductions.

Creditable Acquisition

GST incurred on supplies received is claimable as a credit where:

- it is acquired solely or partly for a creditable purpose
- the supply is a taxable supply
- consideration is provided for the supply
- you are registered or required to be registered

A creditable purpose is defined by section 11-15 GST Act 1999 as the acquisition of a thing to the extent that it is acquired for the carrying on of an enterprise. It is not, however, a creditable purpose where the acquisition relates to the making of input taxed supplies or where it is acquired for a private or domestic purpose.

Input Taxed supplies

GST incurred on expenditure is not available for credit where it relates to input taxed supplies, such as financial supplies. This includes GST incurred on expenditure that relates directly to the input taxed supplies and also to overhead or 'enterprise' expenditure. The GST incurred on enterprise expenditure will relate partly to the taxable and GST-free supplies made and partly to the input tax supplies made. An apportionment of this input tax is necessary and any credits claimed may need to be adjusted over time if the creditable extent alters. This requires complex and detailed record keeping as well as judgement in determining what is a fair and reasonable apportionment of costs.

Determining the extent of the credit, or whether a credit can be claimed at all is one of the most complex issues that needs to be considered in GST. This matter was examined in the decision *Re*

The Recoveries Trust and FCT [2004] AATA 1075. This held that GST incurred that related to the acquisition of financial supplies (debts) was not claimable to any extent. GST incurred on a due diligence exercise that was undertaken prior to any decision to acquire such supplies was creditable in full. This decision, however, was based upon an example in a ruling (GST 2002/2) that stated that services rendered to the taxpayer prior to the intention to make or receive financial supplies was fully creditable, whilst services received after the date that an intention was formed is not creditable. Thus, it is clear that it is essential that detailed records are kept including the reasons for making decisions, board minutes etc. that can support the claims for GST credits as well as demonstrate that the credit is claimed in reliance of this ruling.

Issue costs

It should be noted, however, that the GST legislation would not appear to support the claim made by *The Recoveries Trust*. Section 11-15 allows a credit where the acquisition is for the carrying on of the enterprise unless the acquisition relates to making supplies that would be input taxed. It might, therefore, be thought that this would prevent the claiming of credits on the acquisition of the due diligence costs as it relates to the future acquisition of the input taxed financial supply. It is possible to consider



that if the due diligence was such that it was decided that the financial supplies were not to be received that as no input taxed supplies were to be made that the credits were claimable. However, this view was thought by the Tribunal not to be determinative. Thus, without the existence of the example in the Ruling, the claim for credit may have been disallowed.

Unless it relates to an input taxed supply

It is noted, however, that the legislation allows credits for all acquisitions that are made to the extent that they are acquired in carrying on the enterprise unless it relates to input taxed supplies or private or domestic acquisitions. This would appear to suggest that GST on costs can be claimed as a credit as long as there is no input taxed supply (or private use). This may be of importance when considering the raising of capital such as the issue of shares. The current view would be that the raising of capital by shares is an input taxed supply as it is the provision, acquisition or disposal of an interest in securities (Regulation 40-5.09 GST Regulations 1999). An alternative view has, however, been put forward in the European Court of Justice in a number of recent EU cases concerning holding companies and share issues. In the UK the issue transfer or receipt or any dealing in a security is input taxed, and the overriding European VAT Directive states that transactions in shares are input taxed. The European Court, however, has held in *Kretztechnik AG v Finanzamt Linz* (ECJ C-465/03) that the mere exercise of the right of ownership by its holder couldn't, in itself, be regarded as constituting an economic activity (the making of supplies). Also, if such activities do not in themselves constitute an economic activity within the meaning of the VAT Directive, the same must be true of activities consisting in the sale of such holdings (see also *Wellcome Trust* [1996] ECJ C-155/94, paras. 32-33).

Ownership, not supplies

This was confirmed in the *Kretztechnik* decision (para. 19) and it further stated at paras. 22 - 26 that a supply of goods involves the transfer of the right to dispose of tangible property as owner. The issue of new shares cannot be regarded as a supply of goods as it is intangible property. Thus, for this to be a supply for VAT purposes would depend on whether that transaction constituted a supply of services or not. It was held that the issue of shares for the purpose of raising capital was not a supply of services. The aim of the company in issuing shares was to expand its capital and that through the issue of shares there was a change in ownership of the company rather than any supply of services. The mere acquisition of a financial holding in another company does not represent exploitation of property for the purpose of obtaining income on a continuing basis. Any dividend yielded by that holding is the result of ownership of the property and is not the product of economic activity for VAT purposes. Thus, the acquisition and holding of shares is not a supply for VAT purposes, unless it is undertaken in the course of a business trading in securities.

Conclusion

Whether this principle can be transferred to the GST system is a matter for debate. It does, however, give considerable food for thought and offers the opportunity to increase the value of credits. This allied to ensuring that the correct evidence is held and that credits are claimed before any decision is taken to acquire or make financial supplies can increase the credits available to a business.

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