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Financial supplies: Bundling & unbundling

Ross Stitt¹

1. INTRODUCTION

The focus of this paper is on Australia's unique 'reduced input tax credit' system and, in particular, the implications of 'bundling' within that system. Bundling is not defined in the GST legislation. It is a term used to describe the situation where a single supply of services incorporates two or more different elements, each of which could be supplied separately. Bundling is perceived by the Australian Taxation Office (the ATO) as a potential mischief because of the way in which it can, in some circumstances, result in greater reduced input tax credits than would otherwise be the case.

The first section of this paper examines the history and purpose of the reduced input tax credit system. That is followed by an analysis of the implications of bundling for arranging services and trustee services. There is then a discussion about the proposals to limit the potential for bundling in relation to trustee services. The next section of the paper looks at the reduced input tax credit implications of a special purpose in-house 'arranger' of financial supplies and the ATO's Taxpayer Alert 2010/1 GST – Interposing an Associated 'Financial Supply Facilitator' to enhance claims for reduced input tax credits for expenses incurred in the course of a company takeover. The final section discusses bundling and outsourcing.

2. THE REDUCED INPUT TAX CREDIT SYSTEM

Section 11-20 of the *A New Tax System (Goods and Services Tax) Act 1999* (the *GST Act*) dictates that an entity is only entitled to an input tax credit for the GST component of the cost of an acquisition that it makes where that acquisition is a creditable acquisition. One of the requirements for a creditable acquisition set by section 11-5 is a creditable purpose. Section 11-15(2)(a) of the *GST Act* provides that an acquisition does not have a creditable purpose where it relates to making input taxed supplies. Therefore, where an acquisition relates to making such supplies, *prima facie* the acquirer has no input tax credit entitlement.

The Government was concerned in the development of the GST regime that restrictions on the ability of financial suppliers to claim input tax credits would create

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a self-supply bias such that financial suppliers would bring in-house many of the activities that they had previously acquired from third party service providers. This was perceived as being potentially damaging to those service providers.

This problem was exacerbated by the relatively narrow application of input taxed financial supply treatment which means that arranging and facilitation type services in the financial sector are taxable supplies. This can be compared with the position in many overseas VAT jurisdictions which exempt such services. The definition of financial supplies was originally contained in a table in section 40-5(2) of the GST Act rather than Regulation 40-5.09(1) of the *A New Tax System (Goods and Services Tax) Regulation 1999* (the *GST Regulations*). The original definition included 'agreeing to make, or arranging' supplies of various securities and other financial instruments and 'a supply of anything directly in connection with' such an agreeing or arranging supply. Pursuant to the original section 40-5(3) 'a supply of advice', including a supply of advice in relation to a financial supply, was expressly excluded from the ambit of financial supplies.

However, the Government preferred a narrower scope for the financial supply definition. Its object was to avoid the problems perceived to have arisen in overseas jurisdictions in interpreting the concept of arranging. The result was the current definition in the GST Regulations. Agreeing to make and arranging other financial supplies is not included in that definition.

Participants in the financial sector realised that the combination of taxable treatment for arranging and facilitation services and the denial of input tax credits for acquisitions associated with the making of financial supplies would make GST a significant cost for them. The threat to bring services in-house was part of their response.

In a Consultation Document² issued by the Treasurer in August 1999 the self-supply bias was identified as having an adverse impact on competitiveness in the financial services sector.

*A higher effective tax burden would be faced by smaller financial supply providers who outsource proportionately more of their business inputs. Larger market participants generally have a greater ability to insource services. For example, smaller financial service providers, such as credit unions or building societies, would have less scope to insource mortgage valuation services than would a large bank. Therefore, input taxing financial supplies has important implications for the relative competitiveness of different segments of the financial sector.*³

In many jurisdictions the self-supply bias problem is dealt with by extending the application of financial supply treatment upstream to arranging services. As noted above, the Government wanted a narrow concept of financial supply because of its concerns about the difficulty of determining the parameters of arranging. The solution that the Government came up with for the self-supply bias problem was the reduced input tax credit system. The objective of that system is to reduce the GST leakage that

² 'The Application of Goods and Services Tax to Financial Services'.

³ *Id.*, p. 18.

would otherwise arise on the acquisition of a wide range of supplies from third party service providers and thereby remove the incentive for financial suppliers to self-supply. The Consultation Document commented on the system as follows.

*This approach can deliver a similar tax outcome to broader input taxation (ie. revenue neutral) but at a lower compliance cost for certain suppliers to financial institutions. The approach also reduces other potential self-supply biases as fewer suppliers are subject to input taxation.*⁴

The self-supply problem and the Government's solution were summarised in the following terms at paragraphs 5.1 and 5.2 of the Senate Further Supplementary Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998*.

Acquisitions that are made for the purpose of making financial supplies are generally input taxed. This means that generally input tax credits are not available for such acquisitions. This could create a bias towards in-sourcing in financial institutions because the effective tax burden is higher on the outsourced services than in-sourced services. ... This partial input tax credit effectively removes the bias towards in-sourcing of prescribed services.

The Explanatory Statement for the *A New Tax System (Goods and Services Tax) Regulation 1999* identified four benefits of the reduced input tax credit system at page 21 – 'reduced bias to insource, lower compliance costs for smaller entities, greater legislative certainty and a better competitive position for domestic service providers'. Greater legislative certainty was asserted on that basis that the Australian system would avoid the need to grapple with 'broad concepts such as arranging' that have caused difficulties overseas.

The reduced input tax credit system is set out in Division 70 of the GST Act and in Division 70 of the GST Regulations. It allows an entity a partial or reduced input tax credit for an acquisition where it would otherwise not be entitled to any input tax credit because of a relationship between the acquisition and the making of input taxed supplies. The level of reduced input tax credit is 75% of a full credit.

Reduced input tax credits are available for a range of acquisitions called 'reduced credit acquisitions'. These are specifically defined in Regulation 70-5.02. There is a list of 31 separate items many of which are refined further by numerous express inclusions and exclusions. The types of services encompassed by the list include transaction banking and cash management services, payment and fund transfer services, securities transaction services, loan services, debt collection services, insurance services, services remunerated by commission and franchise fees, funds management services and trustee and custodial services.

There is significant uncertainty about the scope of many of the items identified as reduced credit acquisitions. One well publicised example arose in the context of the securitisation industry. There was disagreement for many years between the ATO and participants in that industry as to the availability of reduced input tax credits to a securitisation vehicle for the acquisition of 'servicing' services. There were two

⁴ Id., p. 3.

separate points of dispute – whether the category of debt collection services in the definition of reduced credit acquisitions applies to the service of collecting all debts or only bad or delinquent debts, and whether the category of loan management services in the reduced credit acquisition definition is restricted to services acquired by actual lenders or could extend to subsequent assignees of the loans.

Another area of dispute was whether the acquisition of lenders mortgage insurance and title insurance extended to reinsurance.

Part of the problem in identifying reduced credit acquisitions is the mixed and diverse nature of the services listed in the GST Regulations and the specific terminology used to describe those services. The various items incorporate many terms that have particular meanings in the different specialist industries in which they are used and many terms that do not. The ATO has issued a comprehensive public ruling setting out its interpretation of the different categories of reduced credit acquisitions – GSTR 2004/1 Goods and Services Tax: reduced credit acquisitions. Given the binding nature of that ruling, this provides a high degree of certainty on many issues. Nevertheless there are numerous areas where there is disagreement between taxpayers and the ATO, and no doubt new issues will continue to appear.

One issue is currently emerging in the courts. Item 6 in Regulation 70-5.02 includes within the ambit of reduced credit acquisitions the acquisition of services supplied by the operator of a payment system to a participant in the system or to a third party in relation to access to the system. This item relates to item 4 in Regulation 40-5.12 which specifically excludes the supply of an interest in or under 'a payment system' from the financial supply concept. In the decision of the Full Federal Court in *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited*⁵, there was disagreement between the judges as to whether American Express provides an interest in or under a payment system to its cardholders. The majority, Kenny and Middleton JJ, held that American Express does not provide such an interest; Dowsett J, dissenting, held that it does.⁶ The High Court refused the taxpayer special leave to appeal on 5 May 2011.⁷ The Full Federal Court's conclusion on the GST implications of the nature of the relationship between American Express and its cardholders vis-à-vis the card payment system is therefore relevant to the application of item 6 in the list of reduced credit acquisitions.

⁵ (2010) 187 FCR 398; [2010] FCAFC 122.

⁶ It followed as a consequence of the majority's conclusion that the supplies made by American Express to cardholders under the charge card and credit card facilities did not fall within the express exclusion from the definition of 'financial supply' in regulation 40-5.12, which provides that the supply of an interest in or under a 'payment system' is not a financial supply. Since the majority also concluded that the supplies made by American Express were supplies of an interest in or under a 'credit arrangement or right to credit', and therefore fell within a specified category of financial supply, it followed that the supplies were financial supplies. The consequence of Dowsett J's conclusion, conversely, was that the supplies made by American Express were automatically precluded from being financial supplies.

⁷ In refusing special leave, French CJ said: "The issues that arise in these applications arise from the proper construction of a formula agreed between the applicants and the Commissioner as a means for determining the relevant operation of [A New Tax System \(Goods and Services Tax\) Act 1999](#) (Cth). Having regard to the way in which the applicants chose to conduct their cases at trial this case, in our opinion, is not a suitable vehicle in which to explore questions about the proper construction and application of regulation 40-5.12 made under the Act."

Many of the services in the reduced credit acquisition list would be input taxed or exempt financial services in other jurisdictions. Accordingly, many of the difficulties that occur in those jurisdictions in interpreting the scope of financial services occur in Australia in the context of the reduced input tax credit system.

In the absence of a control, it is very difficult to know how effective the reduced input tax credit regime has been in Australia in terms of addressing the self-supply bias. However, many of the services identified in the reduced credit acquisition list are not readily substitutable or capable of being in-sourced. Perhaps the best example of this is investment banking services in relation to mergers and acquisitions. To the extent that such items are included in the list, the system is relatively concessionary. It allows an input tax credit even though in practice self-supply is often not a viable option for the acquirers of such services.

There are also many services that are readily substitutable and that can be in-sourced but that are not included in the list of reduced credit acquisitions. One of the best examples of this is some legal services. In relation to such services, the reduced input tax credit system does not alleviate the self-supply bias.

3. ARRANGING SERVICES AND BUNDLING

As noted above, the term bundling is used to refer to the situation where an entity acquires a single supply of services that incorporates two or more different elements, each of which could be acquired separately. There is a question whether bundling can create a potential mischief in the context of the reduced input tax credit system. This is best understood by analysing the application of one of the categories of reduced credit acquisition in two relatively simple examples.

Example 3.1

Predator Co made a successful takeover bid for Target Co. It engaged an investment bank to organise all aspects of the takeover on its behalf. It was known at the outset that a recent environmental disaster caused by Predator Co might have an adverse impact on the willingness of Target Co shareholders to accept its offer. Part of the investment bank's role in relation to the takeover included dealing with the public relations issues. It engaged a PR firm to assist it in dealing with these issues.

The investment bank charged an 'arranging' fee for its services. That fee comprised two components. The first component was based on a combination of time spent by the investment bank's employees and certain external costs incurred by the investment bank (including third party consultants). The second component was contingent on completion of the takeover and was based on the value of the deal.

The takeover involved Predator Co making only input taxed supplies.

Pursuant to section 11-15(2)(a) Predator Co is denied a full input tax credit for the acquisition of the investment bank's services because that acquisition relates to making input taxed supplies. There is therefore an issue as to Predator Co's entitlement to a reduced input tax credit for that acquisition. Item 9 in Regulation 70-5.02(2) defines a reduced credit acquisition to include the acquisition of the following.

Arrangement, by a financial supply facilitator, of the provision, acquisition or disposal of an interest in a security, including the following:

(e) arranging mergers and acquisitions;

(f) arranging takeover bids.

The term 'financial supply facilitator' is defined in Regulation 40-5.07 as 'an entity facilitating the supply of the interest for a financial supply provider'. At paragraph 31 of GSTR 2004/1 the ATO states that 'the facilitating of a supply refers to activities that help forward (assist) the supply, rather than those that simply assist the financial supply provider'.

Somewhat problematically the concepts of 'arrangement' and 'arranging' are not defined in the GST Regulations. The Macquarie Dictionary defines the term 'arrangement' as 'the act of arranging'. The only relevant definition of the verb 'to arrange' is 'to prepare or plan'. The Cambridge Dictionary defines 'to arrange' as including 'to organise'. The ordinary meaning of 'to arrange' in the context of mergers and acquisitions also incorporates the concept of to cause to occur.

At paragraph 287 of GSTR 2004/1 the ATO states that 'arrangement under this item includes activities relating to the preparation for the transaction, the planning of the transaction and the settlement of the details of the transaction'.

There has been no judicial consideration of item 9. In *Xenophou v Richani*⁸, the Supreme Court of South Australia analysed the meaning of the verb 'to arrange'. In that case the appellant agreed to transfer a residential unit to the respondent if the respondent could 'arrange' a loan for the appellant to fund a property development. The respondent introduced the appellant to a bank that was prepared to make a loan to the appellant. However, the appellant argued that to arrange a loan required more than a mere introduction.

The Court said at paragraph 73 that the meaning of the word arrange 'depends in each case on the surrounding circumstances'. It held at paragraph 79 that in this case 'the respondent clearly arranged the introduction of the appellant to the bank' and that it was that act that 'led to and caused the loan to be offered'. On that basis the respondent had arranged the loan.

The issue in *Customs & Excise Commissioners v Lloyds TSB Group Limited*⁹ (*Lloyds TSB*) was the meaning of 'the making of arrangements for' the granting of credit or the provision of instalment finance under item 5 of Group 5 of Schedule 9 to the *United Kingdom Value Added Tax Act 1994*. Lloyds assisted a finance subsidiary of the Volkswagen car manufacturer to enable it to provide finance to its customers. The functions performed by Lloyds for Volkswagen included (i) receiving hire purchase and leasing applications, (ii) obtaining credit references, (iii) accepting and rejecting applications, (iv) providing information and maintaining records, (v) making payments to dealers, (vi) calculating and paying dealers' commissions, (vii) transmitting and receiving funds, (viii) providing early settlement quotations, (vix)

⁸ [2004] SASC 30.

⁹ [1998] STC 528.

dealing with correspondence, (x) assessing recoverability of bad debts, and (xi) maintaining records.

Justice Keene of the Queen's Bench Division held that most of these services came within the category of the 'arranging' of new credit deals. Several were post-acceptance functions but he treated them as part of a package that qualified as a single supply of services.

*President's Choice Bank v The Queen*¹⁰ (*President's Choice Bank*) involved a retailer of groceries and other merchandise that entered into an arrangement with the Canadian Imperial Bank of Commerce whereby the bank provided financial products to the retailer's customers. The bank installed banking machines at the retailer's locations and the retailer installed and maintained kiosks for the sale of the bank's financial products. Both parties promoted the program. The bank paid fees to the retailer based on the products sold.

The issue before the Canadian Court was whether the service provided by the retailer to the bank was an exempt supply of 'arranging for' a financial service. The Court held that it was. It said at paragraph 39 that the retailer 'helped, assisted and was directly involved in the process of the provision of financial services'.

In example 3.1 above the activities of the investment bank, including its work on the PR issues, helped forward and assisted the acquisition by Predator Co of the shares in Target Co. Accordingly the investment bank was a financial supply facilitator of the transaction. In addition the investment bank's activities can be accurately described as involving the organisation, and the causing to occur, of the acquisition of Target Co by Predator Co. Accordingly the investment bank was an arranger of the transaction. Prima facie the requirements of item 9 are therefore satisfied and Predator Co's acquisition from the investment bank is a reduced credit acquisition in its entirety for which it is entitled to a reduced input tax credit.

Example 3.2

The facts in example 3.2 are the same as for example 3.1 with the exception that the investment bank's role did not incorporate dealing with the PR issues. Predator Co handled those issues itself. It directly engaged its own PR firm to assist it in that regard.

The analysis of Predator Co's acquisition from the investment bank is the same as in example 3.1. The investment bank was a financial supply facilitator and an arranger. Accordingly Predator Co's acquisition from it is a reduced credit acquisition.

Predator Co is not entitled to a full input tax credit for its acquisition from the PR firm because that acquisition relates to making input taxed supplies. Furthermore, it is not entitled to a reduced input tax credit for that acquisition because the acquisition does not come within the ambit of any of the categories of reduced credit acquisition in the table in Regulation 70-5.02(2). The acquisition does not meet the requirements of item 9 as it would not be correct to say that the PR firm 'arranged' the acquisition of Target Co for Predator Co.

¹⁰ 2009 TCC 170.

The essential difference between example 3.1 and example 3.2 is that in the former the 'bundling' of the PR services with the other services provided by the investment bank results in a greater reduced input tax credit entitlement for Predator Co. The PR services became arranging services by virtue of being incorporated into the services provided by the investment bank.

Is this the correct outcome? Is it consistent with the policy intent behind the reduced input tax credit regime? Is there a different analysis that gives a different result?

3.1 Policy considerations

As discussed above, the reduced input tax credit regime was designed partly to avoid input taxing a much wider range of services and partly to overcome the self-supply bias created by input taxation. The former does not provide any guidance as to the interpretation of the concept of 'arranging'. The original definition of financial supply in the GST Act encompassed the arranging of certain financial supplies. Under that definition those arranging services would themselves have been input taxed. The decision to treat those supplies as taxable but provide reduced input taxed credits for a wide range of acquisitions does not throw any light on how those acquisitions are to be interpreted. The scope of reduced credit acquisitions certainly goes well beyond the acquisition of supplies that would have been input taxed under the original definition of financial supplies.

It is interesting to note that the government adopted a narrower concept of financial supplies so as to avoid the perceived difficulties experienced in foreign jurisdictions over the interpretation of the concept of arranging. In some respects, those difficulties have simply been shifted from the financial supply definition to item 9 of the reduced credit acquisition definition.

The second key objective of the reduced input tax credit regime, namely to overcome the self-supply bias, is also of limited assistance in interpreting the various categories of reduced credit acquisition and item 9 in particular. The fact that a particular service is capable of being 'in-sourced' is clearly not determinative of its status as a reduced credit acquisition. While many of the categories of reduced credit acquisition are capable of in-sourcing, there are many more services that can be in-sourced but that cannot be acquired as reduced credit acquisitions.

An argument might be made that if the acquisition of a particular service is not specifically identified in the table in Regulation 70-5.02(2), then it should not receive 'indirect' reduced credit acquisition status by reason of being incorporated as a component of one of the other items in that table. However, this argument is circular. Either an acquisition qualifies as a reduced credit acquisition or it does not. The fact that it may incorporate components that would not qualify separately as reduced credit acquisitions should not be relevant.

The argument is further undermined by item 29 – 'trustee services'. As discussed in more detail below, it is clear that trustee services can incorporate many activities which if acquired separately would not qualify as reduced credit acquisitions. In other words, the category of trustee services is not read down by reference to other categories of reduced credit acquisition.

3.2 Identify the 'acquisition'

Regulation 70-5.02(2) simply states that 'the following acquisitions ... are reduced credit acquisitions' and then lists 31 different items. Confusingly, there is no consistency in the description of those items. Some items are specifically described in terms of acquisitions eg, item 3 – 'acquisition of transaction cards by account providers'. Some items identify different forms of insurance eg, item 12 – 'lenders mortgage and title insurance'. Most of the items contain descriptions of services rather than acquisitions. The clear implication is that an acquisition of one of these identified services constitutes a reduced credit acquisition.

The term 'acquisition' is defined in Regulation 40-5.05 of the GST Regulations but only in relation to the acquisition of interests for the purposes of Regulation 40-5.09. This is not relevant to Regulation 70-5.02. Section 70-5(1) of the GST Act states that 'acquisitions' as specified in the GST Regulations are 'reduced credit acquisitions'. Accordingly, the appropriate definition of acquisition for the purposes of Regulation 70-5.02 is the definition in section 11-10(1) of the GST Act. That provision defines an acquisition as 'any form of acquisition whatsoever'. Section 11(10)(2) specifically includes 'an acquisition of services' within the term 'acquisition'.

It follows that in order to determine the existence or otherwise of a reduced credit acquisition in a transaction, it is necessary to identify the actual acquisitions made. That may sound self evident but in some cases it can be difficult to identify the specific parameters of an acquisition. The same difficulty arises on the supply side given the mirror nature of the supply and acquisition definitions.

If a person goes to a car yard and buys five cars, is it a single acquisition of five cars or five acquisitions of one car each? If a person instructs a share broker to sell 100 shares in X Co and then use the sale proceeds to purchase 300 shares in B Co, does the person make an acquisition of a single broking service or does the person make two acquisitions, one of a selling service and one of a buying service? These are simple examples but they demonstrate some of the difficulties of determining the parameters of an acquisition. This can be highly relevant in identifying acquisitions involving services like those listed in the table in Regulation 70-5.02(2) including in particular arranging services.

3.3 Composite, mixed and multiple acquisitions

On the supply side of the analysis, the concepts of 'composite' supplies, 'mixed' supplies and 'multiple' supplies have been developed to assist in determining the nature of a transaction. Broadly speaking, a composite supply is a single supply with one dominant component. While it may involve other components, those components are ancillary or integral to the dominant one. A mixed supply is a single supply comprising several different components that are more than just ancillary to another component. Multiple supplies occur where a transaction involves two or more separate supplies. The distinction between a mixed supply and multiple supplies can be a subtle one and is not always recognised.

In GSTR 2004/1 the ATO applies the composite/mixed distinction to acquisitions in the context of the reduced input tax credit regime. Paragraph 28 of the ruling states as follows.

If something that is listed as a reduced credit acquisition is acquired together with something that is not listed as a reduced credit acquisition, those parts may need to be treated separately. This depends on whether the acquisition is a mixed acquisition or a composite acquisition. These terms are intended to be similar to the concepts of a mixed supply and a composite supply and to adopt similar principles. The difference is that these terms are used to describe an acquisition that consists of parts that are reduced credit acquisitions and parts that are not.

The ruling then cross references paragraphs 223 to 256 of GSTR 2002/2 Goods and Services Tax: GST treatment of financial supplies and related supplies and acquisitions. Those paragraphs explain the terms mixed acquisition and composite acquisition and provide guidance as to how to determine which is which. A mixed acquisition is described in paragraph 232 as an acquisition containing 'separately identifiable parts' where 'no part is dominant and each part has a separate identity'.

Paragraph 233 states that a composite acquisition 'is an acquisition of one dominant part and includes other parts that are not treated as having a separate identity as they are integral, ancillary or incidental to the dominant part of the acquisition'. A composite acquisition 'is essentially the acquisition of a single thing'.

Paragraph 236 of GSTR 2002/2 states that overseas case law illustrates that the relevant factor is 'what the acquirer in essence acquires' and 'what in substance and reality is acquired'. Citing the decision of the House of Lords in *Card Protection Claim v Customs and Excise Commissioners*¹¹, paragraph 237 states that 'you must have regard to the essential features of the transaction to see whether it has several distinct principal services or a single service'.

A number of cases since the issue of that ruling have adopted a similar approach in the context of determining the parameters of supplies. In *Beynon & Partners v Commissioners of Customs and Excise*¹² the House of Lords held that the identification of supplies should be based on 'social and economic reality'.

A similar issue was considered by the Full Federal Court in *Commissioner of Taxation v Luxottica Retail Australia Pty Limited*¹³. One of the issues in that case was whether the sale of spectacles comprising a frame with lenses fitted was a single supply or two supplies, being a supply of the frame and a supply of the lenses. Interestingly, the issue was not expressed as whether the sale of the spectacles was a composite supply or a mixed supply. The Full Federal Court reached the following conclusion.

We agree with the Tribunal that the sale of the spectacles was a single supply. While 'supply' is defined broadly, it nevertheless invites a commonsense, practical approach to characterisation. An automobile has many parts which are fitted together to make a single vehicle. Although, for instance, the motor, or indeed the tyres, might be purchased separately, there can be little doubt that the sale of the completed vehicle is a single supply. Like a motor vehicle, spectacles are customarily bought as a completed article and in such

¹¹ [2001] BVC 158.

¹² [2004] UKHL 53.

¹³ (2011) 191 FCR 561; [2011] FCAFC 20.

*circumstances are treated as such by the purchaser. The fact that either the frame or the lenses may be purchased separately is not to the point.*¹⁴

There are several financial services related examples from overseas jurisdictions where a supply that involves various activities and that is predominantly arranging in nature has been treated as a composite supply and therefore an arranging supply in its entirety – see *Lloyds TSB* and *President's Choice Bank*.

Under the approach adopted by the ATO in GSTR 2004/1 a distinction is drawn between composite acquisitions and mixed acquisitions for the purposes of determining reduced credit acquisition status. A composite acquisition either qualifies as a reduced credit acquisition in its entirety or it does not qualify at all. It is never a reduced credit acquisition in part. It qualifies as a reduced credit acquisition if its essential character comes within one of the items in the table in Regulation 70-5.02(2). By contrast the approach in GSTR 2004/1 dictates that each separate component of a mixed acquisition needs to be tested separately to determine whether it qualifies as a reduced credit acquisition. In this way different components of a single mixed acquisition can be treated differently.

Is the ATO's approach to a mixed acquisition allowed under the legislation? Is it possible to divide a single acquisition into constituent parts and then determine whether each part qualifies as a reduced credit acquisition? Regulation 70-5.02 does not use apportionment wording. However, some of the items in the table appear to contemplate apportionment. For example item 26(h) encompasses life insurance administration services provided to a life insurer to enable it to comply with industry regulatory requirements 'excluding taxation and auditing services'. This wording indicates that even when a life insurer acquires a single supply of administration services from an administrator, to the extent that the services include taxation and auditing services, the acquisition does not qualify as a reduced credit acquisition. This supports a mixed acquisition approach and different treatment for different components of a single acquisition.

Significantly, item 9 does not contain any specific exclusions. Furthermore, as noted above there is no definition of the terms 'arrangement' or 'arranging' used in item 9. In particular, there is no definition that specifically excludes items like PR services or that defines arrangement or arranging so narrowly as to exclude the possibility of the incorporation of activities like PR services in certain circumstances. In addition, neither term has an industry specific meaning that supports a narrow interpretation.

In the absence of any express exclusions from arranging services in item 9, any activity that is part of an arranging service will qualify as a reduced credit acquisition even though it would not qualify as such if it was acquired on a stand alone basis.

Nevertheless, there may be situations where a single acquisition consists of a number of components, some of which are part of an arranging service and some of which are not. However, this type of apportionment of a single mixed acquisition is not relevant to a scenario like the original example 3.1 where the PR services *are* an integral part of an arranging service that is a composite supply. Bundling can achieve creditable acquisition status for the acquisition of an activity that is part of a wider arranging

¹⁴ Id., para. 15.

service even if that activity would not qualify as a reduced credit acquisition on a stand alone basis. However, bundling cannot achieve reduced credit acquisition status for the acquisition of a component of a single acquisition if that component is not part of an arranging service.

3.4 The nature of arranging services

GSTR 2004/1 also contains some specific comments about the nature of arranging services for the purposes of item 9 in Regulation 70-5.02. Significantly, there is some commentary on bundling. Paragraph 289 states as follows.

Equally, due diligence activities, though part of the preparation for the float, are not arranging for the purposes of item 9 (d). This is because due diligence by itself, does not have sufficient connection to the 'arrangement' or preparing or planning a float. However, where an entity provides due diligence activities, as part of its services in planning or preparing a float, then it may come within item 9(d).

This paragraph is saying that a separate acquisition of due diligence services does not qualify as a reduced credit acquisition, however, where due diligence services are provided as part of a wider arranging service, the acquisition of those due diligence services may be part of a reduced credit acquisition. (This distinction is illustrated in examples 36 and 37 in the ruling.) It is implicit in this analysis that in the latter scenario the acquisition of the arranging service is a single composite acquisition incorporating the due diligence services. It does not involve a mixed acquisition or two separate acquisitions of arranging services and due diligence services. Applying the words in paragraph 233 of GSTR 2002/2, the due diligence services are 'integral, ancillary or incidental' to the arranging service. It 'is essentially the acquisition of a single thing'.

Paragraph 290 of GSTR 2004/1 describes services acquired by a financial supply facilitator in order to enable that party to make a supply of arranging services as 'inputs' into those arranging services. This is the essence of how bundling works. In example 36 in the ruling, the due diligence services acquired by the financial supply facilitator are an input into its supply of arranging services to the financial supplier and therefore are part of the acquisition of those services by the financial supplier.

The paragraphs in item 9 can apply to many different activities. Take paragraph (f), 'arranging takeover bids'. That term encompasses a very wide range of activities. That range is determined by factors such as the scale and complexity of the transaction and the requirements of the entity undertaking the transaction. For example, an entity might wish to take over a small private company with four shareholders. The entity might engage an investment bank to approach those four shareholders and arrange a sale at a non-negotiable price. The 'arranging' service provided by the investment bank would be relatively limited.

By contrast, an entity might be undertaking a contested takeover of a major public company. Necessarily, the scale and *nature* of the activities undertaken by an investment bank engaged by the entity would be very different to the activities undertaken by the investment bank in the previous paragraph. Nevertheless, both transactions involve the 'arranging' of the acquisition of securities by a financial supply facilitator.

The key point is that arranging is a relatively amorphous concept. It can take many different forms and will incorporate very different activities in different circumstances. In appropriate circumstances those activities could include broking services, advertising services, PR services, legal services, due diligence services, and accounting services. Whatever the circumstances in a given case, where the essence of the service is the organising and causing to occur of a financial supply by a financial supply facilitator, the activities that constitute that service will be part of an arranging service and the acquisition of all those activities will be a reduced credit acquisition. That will be the case even if the acquisition of one or more of those activities would not qualify as a reduced credit acquisition on a stand alone basis.

Returning to example 3.1 above there are two questions - (i) whether Predator Co makes a single composite acquisition from the investment bank including the investment bank's PR activities or makes either a mixed acquisition or two separate acquisitions, and (ii) if Predator Co makes a single composite acquisition, whether that is an acquisition of an arranging service.

The better view is that looking after the PR issues associated with the takeover bid is an integral part of the wider service that the investment bank provides in organising the transaction and causing it to occur. On that basis it is part of a single composite service acquired by Predator Co from the investment bank. Predator Co looks to the investment bank to organise all aspects of the takeover including the PR issues. In the words of paragraph 233 in GSTR 2004/1, it is 'essentially the acquisition of a single thing' by Predator Co from the investment bank.

It is clear that the investment bank can accurately be described as arranging the takeover by Predator Co of Target Co. It organises the takeover and causes it to happen. Accordingly, the composite acquisition acquired by Predator Co from the investment bank qualifies as an acquisition of an arranging service and is therefore a reduced credit acquisition.

3.5 In-house versus subcontracting

There is an issue as to whether the validity of bundling various activities into a single arranging service is influenced by whether the arranger performs those activities with its own resources or contracts out the provision of those services. Comparing the two variations may assist in interpreting the concept of an arranging service.

In example 3.1 the investment bank acquired PR services from an external PR firm in order to be able to provide its comprehensive arranging services to Predator Co. In a different scenario it might have been the case that the investment bank employed its own PR experts and was able to deal with the PR issues without consulting the PR firm. At a superficial level at least the PR services in that scenario seem to be more clearly integrated with the other parts of the service provided by the investment bank and therefore seem to be more clearly part of a single composite supply of arranging services.

However, there is no real substance to this distinction. When one party contracts to provide a service to a second party, the existence and nature of that service does not turn in any way on how the first party performs its contractual obligation ie. whether it uses its own employees, a subcontractor or a combination of the two. This can be demonstrated using a variation of example 3.1. Assume that the investment bank in

that example subcontracted with a second investment bank to perform the arranging services for Predator Co. That would not alter in any way the nature of the arranging service provided by the first investment bank to Predator Co. The acquisition of that service would still be a reduced credit acquisition to Predator Co irrespective of the subcontracting.

3.6 Pure pass through versus incorporation into arranging service

Subcontracting can take many forms. Consider two variations of example 3.1. In the first variation the investment bank simply instructs the PR firm to deal directly with Predator Co on all issues. This can be described as a pure 'pass through' of the PR services. In the second variation, the PR firm works solely with employees of the investment bank and has no contact with Predator Co. The services of the PR firm are incorporated into the work of the investment bank. In both cases the investment bank engages and pays the PR firm.

The second variation results in a more comprehensive bundling. The PR services are incorporated within the arranging service acquired by Predator Co from the investment bank. It would be very difficult to argue that there was not a single composite supply and acquisition.

In the first variation the PR services are still acquired contractually by Predator Co from the investment bank but they are not integrated with the other components of the investment bank's service. On the one hand it is still the case that the investment bank arranges all aspects of the takeover, including PR. On that basis the PR services are a component of the investment bank's single arranging service. On the other hand, the absence of any integration of the PR services with the other activities of the investment bank increases the risk that the transaction might be treated as giving rise to two separate supplies and acquisitions.

Broadly speaking, in situations like this the greater the degree to which a financial supply facilitator is a mere conduit for a service provided by a third party, the greater the risk that, in applying the reduced input tax credit regime, that service will be 'unbundled' from the other service provided by the financial supply facilitator.

The distinction between the pure passing through of a service and the incorporation of a service within a wider service is very relevant in the context of both 'in-house' arrangement services and trustee services. These are discussed in more detail below.

4. OTHER ACQUISITIONS INVOLVING BUNDLING

The analysis above focuses primarily on item 9 in the table in Regulation 70-5.02(2). Similar issues arise in relation to items 18 and 21 which refer to different forms of 'arrangement by a financial supply facilitator'. Item 11 includes 'arranging syndicated loans'.

These are not the only items in Regulation 70-5.02(2) that might be perceived as raising potential bundling issues. Item 16 refers to supplies between credit unions. Coverage by the item is determined by the nature of the supplier and the acquirer rather than the nature of the acquisition itself. The ATO accepts this in paragraphs 417-423 of GSTR 2004/1.

Item 27 covers 'supplies for which financial supply facilitators are paid commission by financial supply providers'. Once again status as a reduced credit acquisition is determined by the nature of the supplier and the acquirer, and the payment mechanism, and not by the nature of the acquisition. Provided that payment for the acquisition takes the form of a commission, bundling does not appear to be a concern. There is some discussion of the operation of item 27 in the ATO's GST Determination 2007/1.

There are specific inclusions in many of the other reduced credit acquisition items that are capable of widely differing interpretations. In some cases a broad interpretation of an inclusion can result in reduced credit acquisition treatment for a 'bundled acquisition' comprising some components that would not qualify as reduced credit acquisitions if acquired separately.

5. TRUSTEE SERVICES AND BUNDLING

Perhaps the most open ended categories of reduced credit acquisition in Regulation 70-5.02 are 'trustee services' in item 29 and 'single responsible entity services' in item 31. These are important items given the prevalence of trusts in many financial structures including in particular in securitisation and funds management. These items have been the cause of significant confusion since the GST regime was introduced. There are three primary reasons for this. First these terms are not defined in the GST Regulations or the GST Act. Second, while a trust is not a legal entity, section 184-1(1)(g) of the GST Act defines an entity as including 'a trust'. Furthermore, section 184-1(3) states as follows.

A legal person can have a number of different capacities in which the person does things. In each of those capacities, the person is taken to be a different entity.

This means that an entity that is a trustee of a trust has two different capacities – its personal capacity and its capacity as a trustee. It can act in relation to the trust of which it is trustee in both those capacities. It is these two different capacities that can create confusion in determining the parameters of 'trustee services' in relation to a trust. Similar issues arise for a single responsible entity.

The third cause for uncertainty and confusion in this area has been a wide variation of drafting in trust deeds and other documents to which trustees are party. In particular, the provisions within trust deeds pursuant to which trustees are paid, reimbursed or otherwise receive funds from a trust can create ambiguity in terms of determining whether they are consideration for trustee services. Other documents signed by an entity that is a trustee frequently do not clarify the entity's particular status as a party to the document.

Some of the uncertainty in this area was removed by paragraph 666 of GSTR 2004/1. That paragraph reads as follows.

Notwithstanding the focus on custodial functions, the reference to trustee services in item 29 is capable of applying widely to services acquired from a trustee. Where a trust has been established by a deed, the deed will normally set out the rights, duties and obligations of the relevant parties to the trust including the trustee. As such, the duties carried out by the trustee in

compliance with the terms of the deed are trustee services, the acquisition of which is a reduced credit acquisition under item 29.

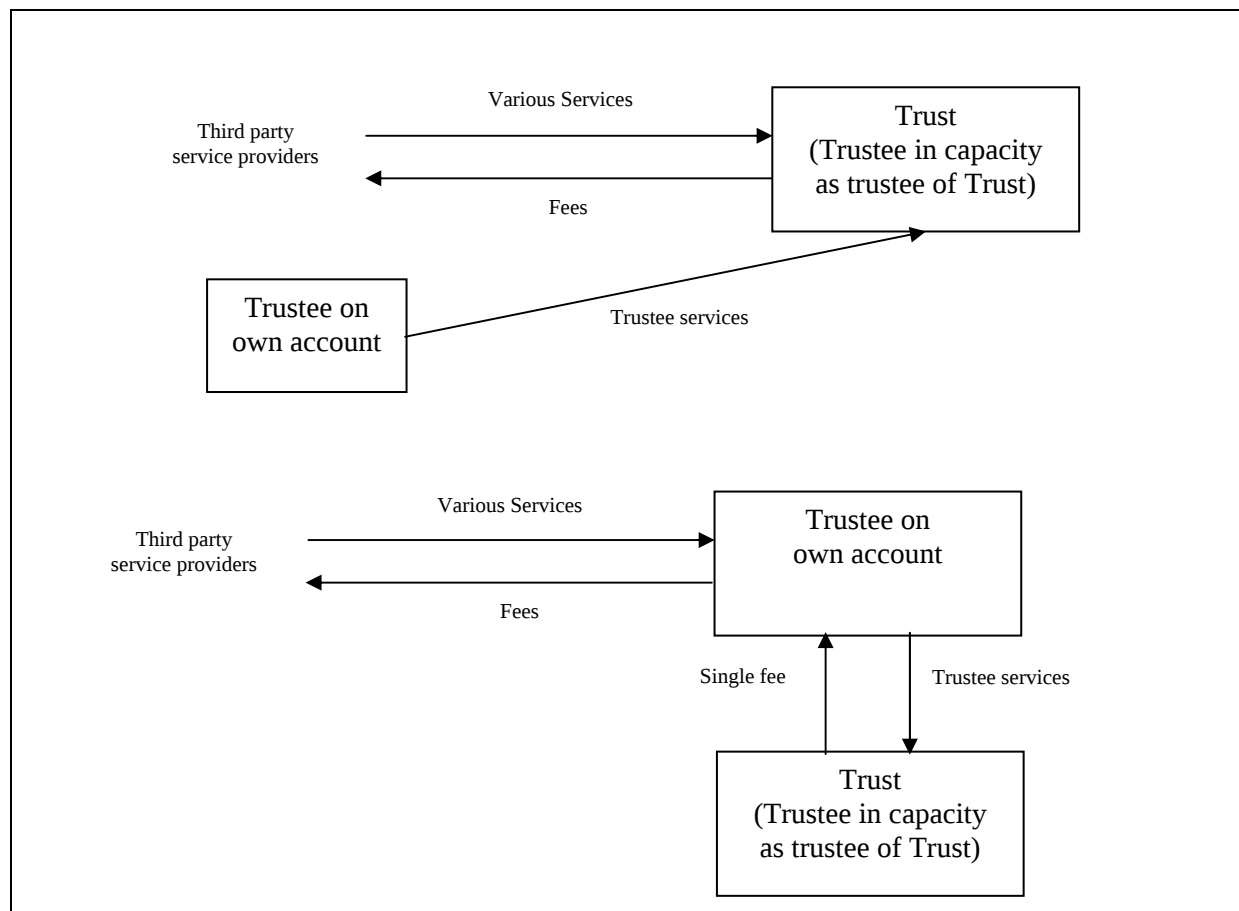
This paragraph suggests that any services that a trustee is required to provide to a trust under the terms of the relevant trust deed are trustee services. Other services provided by the trustee are not trustee services. Furthermore services acquired by the trust directly from third parties (ie. by the trustee in its capacity as trustee) are not trustee services. The significant point here is that the characterisation of services as trustee services is not determined by reference to the *nature* of the services but rather by reference to the document giving rise to the obligation to provide those services. Trustee services might have been interpreted in a more limited way such as the holding of assets, the performing of certain administrative functions, the entering into of contractual arrangements on behalf of the trust etc. However, the ATO did not seek to go down that route in GSTR 2004/1 although to be fair it may not be available given the broad wording in item 29.

When GSTR 2004/1 was issued, there was tremendous variation in the services required to be provided by trustees and the services required to be arranged by trustees under different trust deeds. Some trust deeds operated on the basis that the trustee would provide a very wide range of services albeit, in the expectation that the trustee would sub-contract many of those services to third parties. Other trust deeds did not require the trustee itself to provide a wide range of services but rather required the trustee to arrange for other third parties to provide those services to the trust. In other words, the distinction was between the trustee acquiring third party services in its own right in order to provide comprehensive trustee services to the trust and the trustee acquiring services from third party service providers in its capacity as trustee of the trust. Under the latter scenario the trustee services acquired by the trust were much more limited.

The remuneration arrangements in trust deeds reflected these two alternatives. Broadly speaking, where a trustee acquired third party services in its own right, it was entitled to be paid a single fee for its trustee services. The single fee could take one of two forms – (i) a fixed percentage of trust funds/fixed amount or (ii) a component for 'pure' trustee services plus a second component based on the cost of third party services acquired by the trustee entity in its own right. Where a trustee acquired third party services in its capacity as trustee of the trust, it was entitled to be paid a fee for its trustee services and to be reimbursed out of trust funds for the services acquired from third parties in its capacity as trustee of the trust.

These two alternatives can have very different GST implications. For example, where a trustee acquires accounting services in its own right in order to then provide accounting services itself to the trust under the terms of the trust, the accounting services are effectively bundled into the trustee services and the trust is entitled to a reduced input tax credit for the acquisition of the accounting services component of the trustee services. By contrast, where the trustee acquires the accounting services in its capacity as trustee of the trust, the result is that the trust itself acquires the accounting services. That acquisition is not a reduced credit acquisition and therefore the trust is not entitled to a reduced input tax credit.

The two alternative structures can be shown diagrammatically in figure 1 as follows.

Figure 1: Alternative structuring of trustee services

It can be seen from these examples that a trust can effectively obtain a reduced input tax credit for the acquisition of any service where that service is acquired from the trustee as trustee services pursuant to the terms of the trust deed. In other words, applying the approach in paragraph 666 in GSTR 2004/1, it seems that any service can be bundled into a trustee service seemingly without some of the uncertainties associated with bundling in relation to other categories of reduced credit acquisition such as arranging services.

Over the years there has been a perception that the very wide scope of trustee services has resulted in the availability of reduced input tax credits beyond that originally intended. In the Budget of May 2010 the Government announced measures for 'reducing opportunities for businesses to inappropriately take advantage of the reduced input tax credit concessions by bundling services'. The use of the word 'inappropriately' seems a little unfair in this context. It has often been the case that arrangements for the services and payment of trustees were in place before the reduced input tax credit regime was introduced. The Government's concern led to section 2.5 in the Government's Discussion Paper of June 2010¹⁵. The problem with

¹⁵ 'Implementation of the recommendations of Treasury's review of the GST financial supply provisions'.

trustee services was described in the following terms in paragraphs 70 and 71 of that Discussion Paper.

Different structures can be adopted in relation to the compensation of the trustee for expenses incurred in fulfilling trust obligations. The trustee may seek specific reimbursement for expenses. Alternatively, the trustee may charge a single fee which covers both the reimbursement and the remuneration for trustee services. Such a fee may take a variety of forms, such as a flat fee or a percentage of funds under management. In all cases, both the reimbursement or fee and any separate remuneration are met from trust assets.

There are many valid commercial reasons for having single fee trustee arrangements. However, the present GST treatment of such arrangements advantages them over all other entities engaged in equivalent activities, including trusts adopting different payment arrangements. There is no policy rationale for this distinction.

The Discussion Paper puts forward three possible options to remove what it identifies as a fee based problem. Those options are as follows.

Option 1 – made and provided

The consideration for a supply of trustee services should be reduced by the consideration for acquisitions the trustee has made that have been provided to the trust, except where a separate payment has been made by the trust to the trustee for it.

Option 2 – substance and character

RITCs should not be available for an acquisition of trustee services to the extent that the acquisition is the on-supply by the trustee to the trust of things the trustee has acquired without any alteration to the substance or character of the thing acquired.

Option 3 – define trustee services

RITCs should only be available for an acquisition of trustee services to the extent that the trustee service does not relate to advertising, auditing, taxation or valuation services.

There are various 'carve outs' for each of these options. The key objective of those carve outs is to ensure that input tax credits and reduced input tax credits 'should remain available to the trust to the extent that the acquisition is one for which the trust could have obtained a RITC or an input tax credit if the acquisition had been made directly by the trust from a third party'.

Paragraph 78 of the Discussion Paper describes the intention of these three options as 'to ensure neutrality in the RITC provisions by eliminating advantages associated with bundling various acquisitions into a single acquisition of trustee services'. The intention is reasonably clear. However, each of the three options put forward for achieving that intention has its problems.

It is easy to foresee interpretative difficulties arising in relation to each option. In terms of option 1, there would be many scenarios where it would be difficult to determine whether a particular service was 'provided' to the trustee or to the trust. (The made/provided distinction is often far from straightforward in the context of tripartite arrangements.) The Discussion Paper gives the example of the acquisition of investment advice from a third party and states that this advice is 'provided' to the trust because 'the benefit and substance of the advice' goes to the trust. However, if the trustee is a recognised funds manager in its own right, the terms of the trust deed require the trustee as part of its trustee function to manage the investments of the trust, and the trustee acquires the investment advice from the third party in order to assist it to perform that function, it seems difficult to argue that the investment advice is provided to the trust.

A similar issue arises in relation to option 2. The application of that option would turn on whether there was an 'on-supply' by the trustee to the trust of things acquired from third parties 'without any alteration to the substance or character' of those things acquired. The determination of whether something was on-supplied without alteration to its substance or character could well lead to disagreement. Paragraph 93 of the Discussion Paper gives an example of valuation services acquired by a trustee. It states that even though the valuation 'informs the trustee's decisions on the investment strategy for the trust', the 'substance' of the acquisition is passed on to the trust 'leaving the character of the acquisition unchanged'. Once again, if the trustee was a funds manager, it might not be correct to view the trustee as a pure conduit.

Both option 1 and option 2 would create ambiguity and complexity. In some circumstances this would lead to onerous compliance obligations on trusts. Option 3 has the potential for greater precision. The definition in item 29 already contains a specific exclusion (for certain safe custody services). Additional exclusions might assist the Government's objective. However, potentially there would still be problems in terms of determining the scope of the relationship to exclude services and in determining the activities of the trustee in dealing with the providers of those services that should qualify as true trustee services.

There could also be valuation problems. Take the situation where a trustee is paid a single fee based on a percentage of the value of trust funds and the fee is not broken down into its various components. Some kind of apportionment would be required and that often creates difficulties.

The distinction between services that a trustee entity performs with its own internal resources and services that are trustee subcontracts to a third party is also potentially relevant to the analysis in this area. The reasoning behind options 1 and 2 in the Discussion Paper assumes that most services are acquired by trustees from third parties and simply 'passed through' the trustee; ie. the trustee is a mere conduit for the services. Examples are accounting services and asset management services. However, some trustee entities have in-house resources that enable them to supply such services without subcontracting to an external party. Should the supply of accounting services by a trustee to a trust depend on whether the services are performed in-house or subcontracted? Policy considerations suggest that the determinative factor should be the nature of the services not how they arise.

The Government received submissions on the Discussion Paper. Many of those submissions were highly critical of options 1 and 2. It seems unlikely that either will eventuate. Option 3 was also identified as having problems. It remains to be seen what the eventual outcome will be. However, it is clear that there is no easy solution to overcome what the Government perceives as inappropriate bundling in the trustee context.

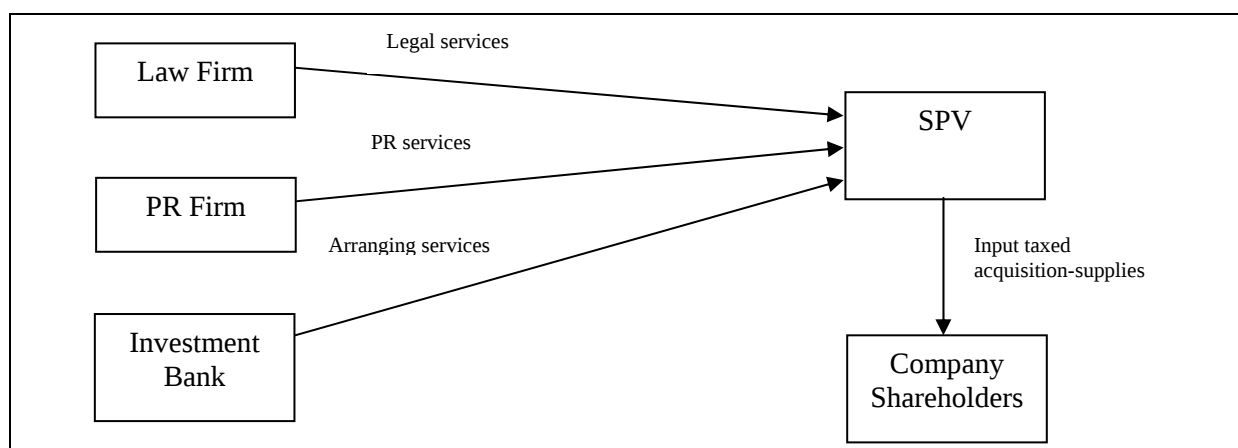
6. SPECIAL PURPOSE IN-HOUSE ARRANGER

Last year the ATO issued Taxpayer Alert TA 2010/1: GST – interposing an associated 'financial supply facilitator' to enhance claims for reduced input tax credits for expenses incurred in the course of a company takeover. That publication is directed at what the ATO perceives as a form of 'bundling' based mischief. It suggests that the activity described may have technical problems and/or fall foul of the anti-avoidance provisions in the GST Act.

To analyse TA 2010/1 it is useful to look at three different examples.

Example 6.1

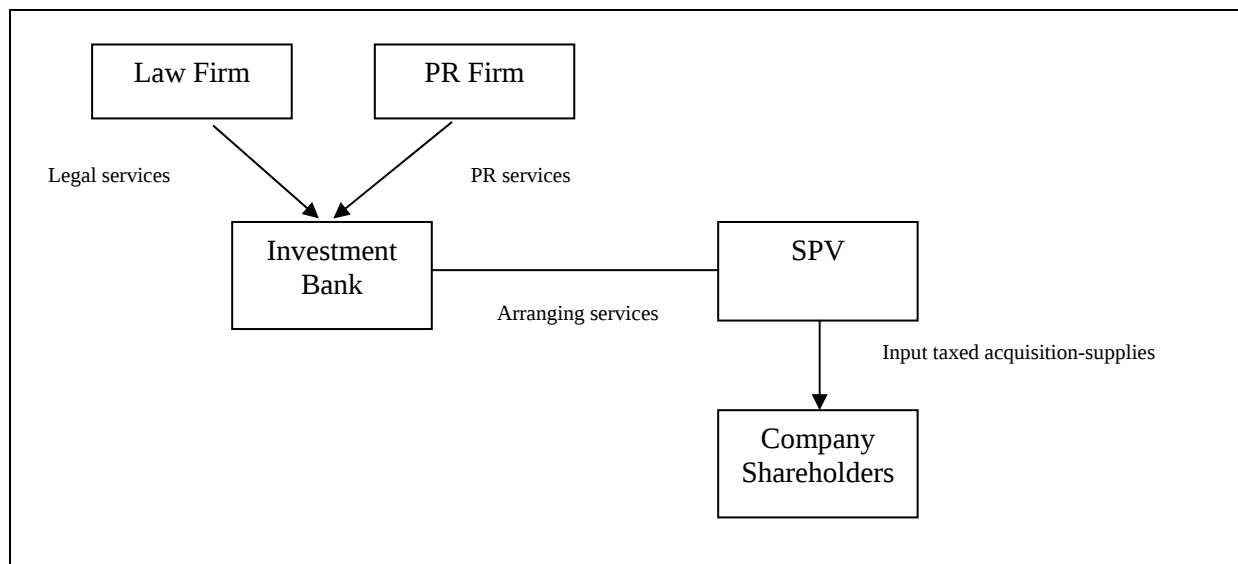
A special purpose vehicle (SPV) is established to acquire shares in a company pursuant to a takeover. It acquires a range of services from various unrelated third party service providers.



SPV cannot claim full input tax credits for any of its acquisitions because they relate to making input taxed supplies. It can claim a reduced input tax credit for the acquisition of the arranging services from the investment bank but it cannot claim a reduced input tax credit for the acquisition of either the legal services or the PR services.

Example 6.2

SPV enters into a 'package' arrangement with the investment bank whereby the investment bank agrees to arrange all aspects of SPV's takeover, including the legal and PR aspects.

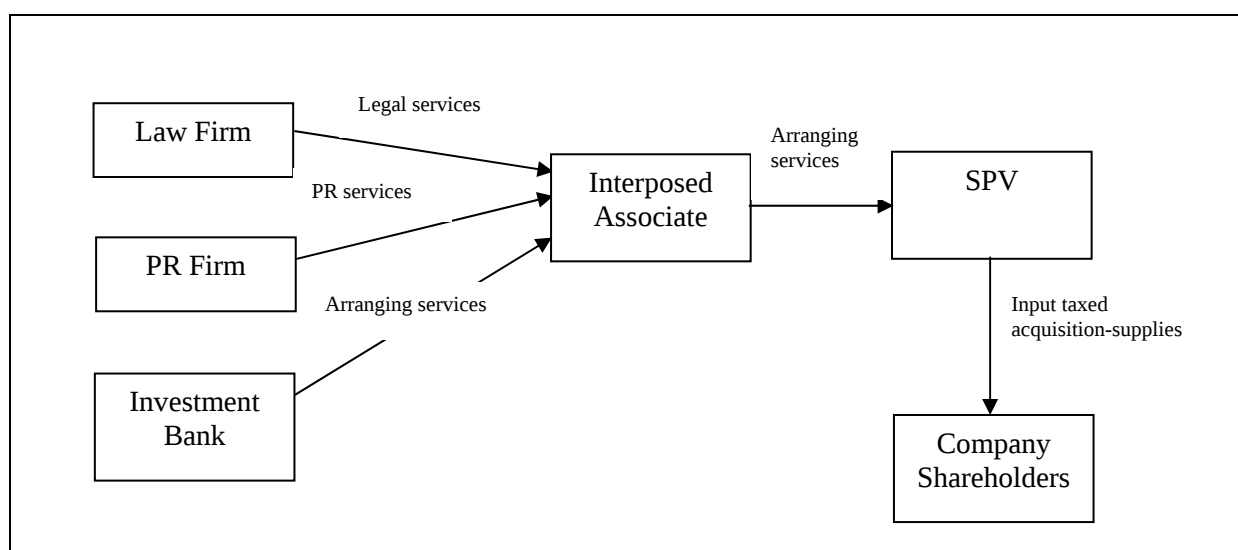


This example raises the same issues discussed earlier in relation to item 9 in Regulation 70-5.02(2) and the scope of arranging services. The key question is whether the legal services and the PR services are truly integrated into the other activities of the investment bank so that they become part of a single arranging service acquired by SPV from the investment bank.

The potential benefit of this type of structure was identified soon after the introduction of the GST regime. However, in practice, at least in relation to legal services, it has not been widely utilised. It has never been usual commercial practice for transacting entities to acquire comprehensive legal services from investment banks. Such entities prefer to acquire legal services from law firms and to have direct relationships with those law firms.

Example 6.3

SPV enters into an arrangement with an associate. The essence of the arrangement is that the associate acquires and pays for legal, PR and investment banking services supplied by third parties and then in turn supplies arranging services to SPV. SPV and its associate are not members of the same GST group.



The desired GST outcome from the perspective of SPV and its associate can be summarised as follows. The associate obtains full input tax credits for its acquisitions from the law firm, the PR firm and the investment bank. It accounts for GST in full on its supply of arranging services to SPV. SPV claims a reduced input tax credit for the entire acquisition of arranging services from the associate. The difference between example 6.1 and example 6.3 is that reduced input tax credits are effectively obtained by SPV for the acquisition of the legal services and the PR services in example 6.3 because of the way in which those services are bundled into the arranging services provided by the associate to SPV.

This structure raises the same issues discussed earlier in this paper about the nature and scope of arranging services and the efficacy of bundling. In any given situation it will depend upon the precise facts. If the associate utilises the legal services, the PR services and the arranging services in order to arrange for the SPV's acquisition of shares from the company shareholders, then SPV's acquisition from the associate may be a reduced credit acquisition in its entirety.

The example in TA 2010/1 has some additional facts that are crucial to the analysis. Point 3 in the description of the arrangement states that 'there is insufficient commercial rationale for the associate's involvement in the supply of the services'. The clear implication of these words is that the interposition of the associate serves no purpose other than to achieve a GST benefit, namely greater reduced input tax credits than would otherwise be the case.

TA 2010/1 identifies three particular concerns with this structure. First, it questions 'to what extent the services provided by the associate to the SPV' are covered by item 9. No further detail is provided however the implication is that either SPV makes separate acquisitions of each of the three different services from the associate rather than a single acquisition of arranging services, or that SPV makes a single acquisition of arranging services but that that acquisition can somehow be split into one part that constitutes a reduced credit acquisition and two parts that do not.

The second concern raised is that 'the anti-avoidance provisions of Division 165 of the GST Act may apply to the arrangement or any part of it'. Broadly speaking, Division 165 would apply if the arrangement gave rise to a GST benefit not simply attributable

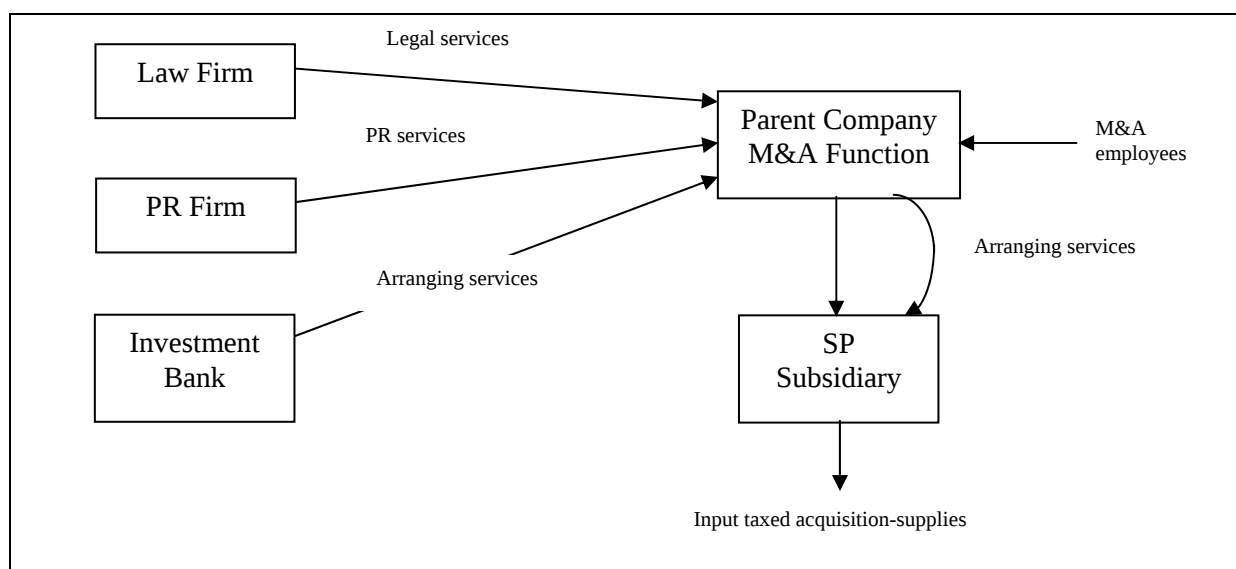
to the making of a choice, election, application or agreement expressly provided by the GST legislation and the GST benefit was either the principal effect of the scheme or the sole or dominant purpose of a party to the scheme. In the example in TA 2010/1, the key factual assumption that there was 'insufficient commercial rationale' for the associate's involvement tends to provide an automatic answer to the anti-avoidance question.

The third concern identified in TA 2010/1 is the possibility that an entity involved in the arrangement 'may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953*'.

Earlier this year the ATO followed up TA 2010/1 with the release of GSTD 2011/D2, a draft GST determination that addresses the arrangement described in TA 201/1. It provides more detail of the ATO's approach in this area. The essence of GSTD 2011/D2 is that third party services acquired by a financial supply facilitator do not become part of arranging services provided by that party if they are 'merely passed on' and are not 'integrated' into the arranging services.

In practice there are some bundling arrangements that are both more complicated and more commercial than the simple examples in TA 2010/1 and GSTR 2011/D2. Some large corporate groups have their own in-house M&A functions that are responsible for all group M&A activities. Part of that function is to acquire, co-ordinate and pay for all services provided by external parties. The other relevant factor is that many corporate groups use a special purpose subsidiary to undertake each new acquisition. This can result in the following example.

Example 6.4



It is clear in this example that there is a 'commercial rationale' for the bundling of the services of external parties within the overall arranging service provided by the parent company to its subsidiary. In particular, the parent company is more than just a pure conduit. It does not simply pass through to its subsidiary the services provided by the external parties. It has its own employees with relevant expertise who are charged with managing all aspects of the transaction, including dealing with third parties.

Significantly, the acquisition of services from the third parties assists the parent company in providing its arranging services to the subsidiary ie. the acquired services are 'integrated' into the arranging services. It is not merely a case of the subsidiary acquiring the third party services via the parent company ie. the parent company providing the third party services 'in conjunction with' the arranging services. .

In many cases like this the subsidiary is a shelf company with no employees of its own. Often the subsidiary is not formed until close to the date of the actual transaction and after the time at which the third party service providers are engaged. This demonstrates that the parent company acquires the services of those third parties on its own account and that the arrangement does not involve a pure pass through of those services to the subsidiary.

If the parent company and its subsidiary in this example were members of the same GST group, those two companies would be treated pursuant to Division 48 as a notional single entity for the purposes of determining the entitlement to input tax credits and reduced input tax credits. Under that scenario the GST group would make three separate acquisitions from the external service providers. Similar to the position in example 6.1, it would be entitled to a reduced input tax credit for the acquisition of the arranging services from the investment bank but it would not be entitled to a reduced input tax credit for the acquisition of either the legal services or the PR services. Accordingly, any GST benefit arising from the bundling of the external services into the single arranging service provided by the parent company to its subsidiary would only be available if the two were not in the same GST group.

That raises the question as to whether Division 165 could apply merely because the parent company and its subsidiary did not elect to form a GST group or, if the parent company was already in a GST group, the parties did not elect to have the subsidiary join that group. It is difficult to see how Division 165 could be applied to require entities to form or join a GST group. In this case, failure of the subsidiary to become a member of a GST group with the parent company should not be interpreted as a scheme having the principal effect of, or the sole or dominant purpose of, obtaining a GST benefit.

Section 165-5(1)(b) states that Division 165 does not apply if a GST benefit is attributable to the making of a choice that is expressly provided for by the GST law. Division 48 provides choices as to the formation of a GST group or the adding of a new member to a GST group. Choosing not to form a GST group or not to add a new member is therefore arguably a choice expressly provided for by the GST legislation.

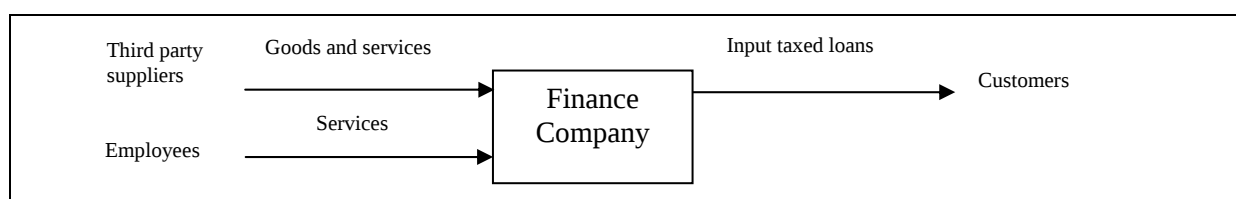
It is important to recognise that in example 6.4, any GST benefit from greater reduced input tax credits is offset by two elements of GST 'leakage'. Division 72 of the GST Act effectively requires the charging of market value consideration for supplies to an associate that is not entitled to full input tax credits. Accordingly, the parent company in this example must charge 'market value' to its subsidiary for the supply of the arranging services. That market value will reflect the salary and wages of the employees of the parent company involved in the transaction. In this way an additional GST liability will arise for the parent company. That liability will only be recoverable as to 75% by the subsidiary. The additional 25% will constitute GST leakage.

The requirement for a market value charge for the parent company's arranging services may also necessitate a mark-up on the cost to the parent company of the services acquired from third parties and its employees. That mark-up will be subject to GST and only 75% of that GST will be recoverable as a reduced input tax credit by the subsidiary. Accordingly, there will be 25% GST leakage on the mark-up.

7. OTHER FORMS OF BUNDLING

Bundling can arise in a wide range of circumstances for a wide range of reasons. Compare the following two examples.

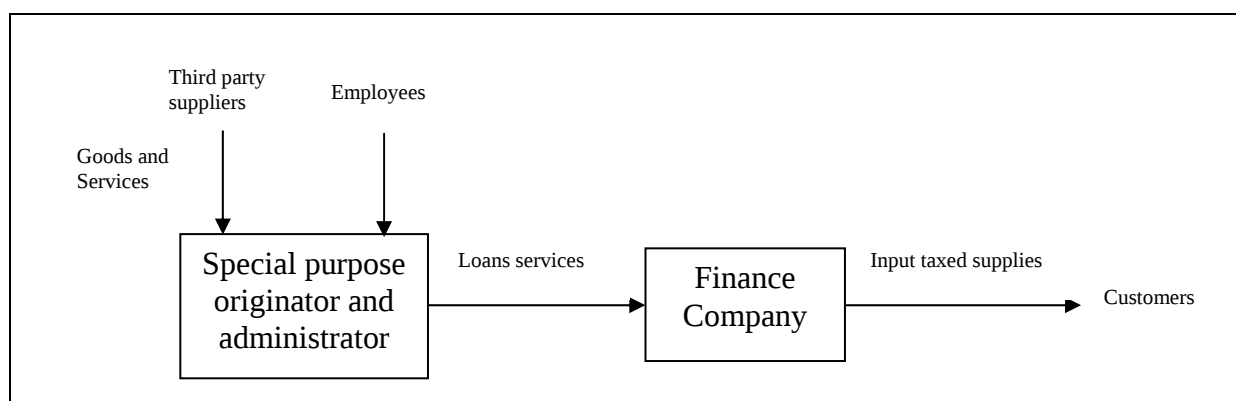
Example 7.1



The finance company makes input taxed loans to its customers. It acquires a wide range of goods and services from third party suppliers in order to carry on its loan making business. It also has employees.

The goods and services acquired from third party suppliers include items like the lease of premises, the purchase of computing equipment, and the acquisition of computing support services. None of these acquisitions qualifies as a reduced credit acquisition. Accordingly, the finance company is not entitled to any input tax credits.

Example 7.2



In this example, a special purpose originator and administrator is established. It makes many of the acquisitions previously made by the finance company. It leases premises, purchases computing equipment, acquires computer support services etc. It also has employees. The special purpose entity is able to provide a range of 'loans services' to the finance company including 'introducing and broking' and 'loan application, management and processing services'. Those services all come within item 11 or item 14 in the table in Regulation 70-5.02(2).

The special purpose entity is entitled to full input tax credits for the acquisition of goods and services from the third party suppliers and is liable for GST on its supply of

loans services to the finance company. The finance company is entitled to a reduced input tax credit for its acquisition from the special purpose entity.

The GST benefit in example 2 is that the finance company is effectively entitled to reduced input tax credits in relation to indirect acquisitions from third party suppliers for which it previously received no input tax credits or reduced input tax credits. However, that GST benefit is offset by GST leakage on the cost of the employees built into the fees for the loans services and on the mark-up charged by the special purpose entity to the finance company. Any net benefit is obviously driven by the cost of the employees relative to the cost of third party acquisitions and the size of the mark-up.

The special purpose entity in example 2 might or might not be an associate of the finance company. It could be an unrelated service provider. That would occur for example if the finance company in example 1 decided to outsource its loan origination and loan administration activities. GST might or might not be a relevant factor in that decision. The GST implications of bundling arise whenever an entity making input taxed supplies outsources part of its activities. Issues such as the status of particular acquisitions as reduced credit acquisitions and the potential application of Division 165 will depend on the precise facts of any given arrangement.