Mergers and acquisitions – claiming input tax credits

The entitlement of an entity to claim input tax credits for acquisitions associated with merger and acquisitions activity.

Last updated 12 April 2017

This information explains how entities can claim input tax credits for acquisitions associated with merger and acquisition (M&A) activity.

It is designed primarily for tax managers and tax practitioners who have a working knowledge of GST.

What we mean by M&A

References to M&A in this information include takeovers and mergers of companies, as well as the sale and purchase of business assets (including goodwill). M&A activity refers to any of the steps that lead up to an M&A transaction. This includes activities where the intended M&A transaction does not eventuate.

M&A may consist of several different supplies for GST purposes. For example, in addition to the sale of shares or business assets, there may be supplies associated with corporate restructuring, capital raising, divestments or share buy-backs.

Assumptions we have made

For the purpose of this information, it is assumed that apart from determining if the acquisition relates to input taxed supplies, all the other requirements for creditable purpose and claiming input tax credits are met. It is also assumed that the entity incurring the cost of the acquisition is the entity making the acquisition and the entity undertaking the M&A activity.

This information does not address reduced input tax credits for acquisitions that relate to making financial supplies, and, unless specifically mentioned, it does not address circumstances where GST-free financial supplies may occur.

See also

- Apply for a private ruling
- GSTR 2008/1:*Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?* - paragraphs 149 to 196 may be of particular assistance in the context of M&A
- GSTR 2002/2: *Goods and services tax: GST treatment of financial supplies and related supplies and acquisitions* - paragraphs 266-274 may be of particular assistance in the context of M&A
- GSTD 2012/3: *Goods and services tax: does an adjustment for a change in extent of creditable purpose necessarily arise for services acquired in relation to a proposed merger and acquisition transaction that does not eventuate, or that does not proceed in the manner contemplated at the time the services were acquired?*

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Difficulties in determining input tax credit entitlements

Understand the difficulties of determining the extent of creditable purpose on related acquisitions.

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Input tax credits can be claimed for creditable acquisitions. An acquisition will not be creditable to the extent that it relates to making supplies that would be input taxed. M&A frequently involves both the purchaser and seller making input taxed financial supplies. In particular, both the sale and the purchase of shares are input taxed financial supplies, with the purchase of the shares being referred to as an acquisition-supply. Input tax credits may not be claimed on things acquired to the extent that they relate to making any input taxed financial supplies.

However, during the course of M&A it can sometimes be difficult to assess to what extent the acquisitions relate to making such input taxed supplies. Hence, it can be difficult for a prospective purchaser or seller to determine the extent to which they can claim input tax credits.

For example, there might be ongoing negotiations between a corporate group that owns a manufacturing operation and a prospective purchaser of that operation. Substantial costs may be incurred by both parties to undertake due diligence, conduct negotiations, consult lawyers, attend to regulatory requirements and so on. However, it may not be determined until late in this process whether a sale will occur at all and, if it does, whether it will take the form of either, say:

- an input taxed sale of shares
- a taxable supply of assets.

Because M&A transactions are often complex, and frequently involve a high degree of uncertainty and commercial sensitivity, we have developed guidelines to assist in determining the extent of creditable purpose on related acquisitions.

Instead of applying the advice provided here, you may choose to defer claiming any available input tax credits until after the M&A transaction is complete. If you adopt this approach, you may quarantine acquisitions related to an M&A activity. For example, if you set up a cost centre for the M&A activity, the creditable purpose for acquisitions needs to be judged by reference to your intention at the time of acquisition, even if input tax credit claims are delayed until after the M&A is completed. In effect, you may consider it easier to ascertain the purpose of an acquisition with the benefit of hindsight.

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Phases in M&A activity

Information on the 3 broad phases in mergers and acquisitions activity.

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To help you understand your entitlement to input tax credits, we will discuss M&A activity as comprising three broad phases. However, every transaction is different, and will not necessarily follow a sequential pattern from phase one to phase two, then phase three, nor will it always include all identified phases.

Phase one – preliminary phase/exploration of possibilities

Phase one encompasses preliminary activities that occur at different levels within an organisation looking at new business opportunities, restructuring and expansion plans, internal review of strategic objectives and divestment opportunities.

Phase two – project established but form of transaction not yet determined

Relevant activities during this phase may include due diligence, transaction planning, financial modelling and preparing an information memorandum for potential bidders.

Phase three (final phase) – form of transaction known and completion of transaction

The final phase commences when the proposed manner in which the M&A will occur has been decided and extends through to the conclusion of the transaction.

This phase includes:

- activities where the form of the transaction has been determined, but the deal has not yet been struck – for example, continuing due diligence, drafting of legal agreements, establishing necessary legal and regulatory approvals, and the timing and negotiation of terms
- activities between the signing of the agreement and settlement – for example, regulatory approvals, shareholder approval, financing arrangements and preparation of settlement accounts
- post-completion activities relating to the M&A transaction – for example, updating the share registry, debriefing and further regulatory compliance.

M&A activity may not necessarily include all phases

Not all phases will occur in each transaction – for example, in some instances an entity may establish a preferred option (phase three) but the other party may reject this option, or a more preferable option may emerge. In some instances, the transaction may revert to phase one.

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If acquisitions are for a creditable purpose

Factors that determine whether an acquisition is for a creditable purpose and an input tax credit can be claimed.

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There are a number of factors that determine whether an acquisition is for a creditable purpose and is one for which an input tax credit can be claimed.

The practical guidance provided here focuses on whether the acquisition relates to making supplies that would be input taxed. For this purpose, a sufficient connection is established between acquisitions and supplies that would be input taxed if, on an objective assessment of the surrounding facts and circumstances, the acquisition is used, or is intended to be used, solely or to some extent for the making of supplies that would be input taxed.

In the context of M&A, not all of the possible transactions that might arise would be input taxed financial supplies. You will need to assess the character of the relevant supplies on a case-by-case basis. For example, if you are planning to buy shares in a target entity, this is an input taxed acquisition-supply. To the extent that an acquisition relates to buying those shares, it would not be for a creditable purpose. This is so regardless of whether or not you are committed to proceeding with the purchase of shares or ultimately do purchase the shares.

On the other hand, if you are planning to buy the assets of an enterprise and do not intend to use the assets to make input taxed supplies, to the extent your acquisitions relate to the purchase of those assets, they will be for a creditable purpose.

When an acquisition is considered too remote

Acquisitions made in phase one may be so remote that they do not have a sufficient connection with any future M&A related input taxed supply. Such acquisitions may be for a creditable purpose.

We consider that the factors listed below are indicative of an M&A activity where the related acquisitions are too remote from a potential input taxed supply. No single factor is necessarily decisive, and weight must be given to each factor, depending on the circumstances of the M&A transaction:

- the work being conducted is exploratory and high-level
- no business case or board paper/purchase recommendation paper has been prepared for senior management's consideration
- there has been no commitment at the level of the board or senior management that the M&A will proceed, that an offer will be made, or that extensive due diligence be conducted
- there is no dedicated project team
- a potential bidder in a sale process (for example, a tender) is considering the target entity, but has not yet determined whether it will make an indicative offer or put forward an expression of interest to commence due diligence
- the work being conducted might be equally relevant to gaining a better understanding of the business's competitors or market – that is, while an M&A is a possible outcome, a significant purpose is to build knowledge that is generally helpful to the business.

When an acquisition is no longer considered too remote

There is no single factor to indicate when an acquisition associated with a proposed M&A is no longer too remote from a proposed input taxed supply. The following is a non-exhaustive list of indicators that the M&A transaction, regardless of whatever form it might eventually take, has ceased to be a remote possibility and has become a planned course of action:

- the work being conducted is no longer exploratory and high-level, but specific and detailed
- the board or senior management have committed to pursuing the M&A, or extensive due diligence is being conducted
- a specific project relating to the transaction has started and a dedicated project team has been set up
- for a possible acquisition, the prospective purchaser has prepared or started to prepare an indicative offer or expression of interest
- services have been acquired that specifically relate to M&A activity, such as (but not limited to) investment banking/corporate advice, valuation services, specialist legal and accounting services, or due diligence services.

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Claiming input tax credits

How to claim input tax credits.

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Claiming input tax credits for an acquisition that is remote from a potential M&A transaction

Acquisitions made at an early stage with respect to a possible M&A activity may be too remote from any intended input taxed financial supply for input tax credits to be denied by reference to the possible final supply.

Because the acquisition is so remote from any possible M&A activity, it may be appropriate to claim input tax credits on a basis which is consistent with how input tax credits are claimed on overheads or enterprise costs – that is, to treat the acquisitions as relating to all of the enterprise activities, rather than any particular supplies, and to apportion input tax credits accordingly.

If the expenses are incurred as part of a unit or business area that has the specific function of engaging in M&A, it may be more appropriate to assess creditable purpose by reference to the activities of that unit or business area and treat the expenses as overheads of that unit. For example, if the work is done by a unit which solely engages in the input taxed acquisition and supply of shares, input tax credits would be denied.

If M&A activity is not part of the usual business, creditable purpose might be assessed by reference to the supplies made by the business as a whole. The expenses would be treated as enterprise costs. In this context, by 'usual business' we mean that such M&A activity is not, in itself, a focus of the entity's core business activity.

Claiming input tax credits for an acquisition that is no longer remote from a potential M&A transaction

If an acquisition has a sufficient connection with potential supplies made under the M&A, its creditable purpose depends on both the nature of the acquisition and the intention of the business at the time of the acquisition.

Acquisitions that are related solely to the pursuit of a particular option need to have creditable purpose assessed by reference to that option. For example, advice on the availability of the GST-free going concern concession obtained by a purchaser of business assets would relate to the supplies that are intended to be made by the purchaser using those business assets and not to an input taxed acquisition-supply of shares. Therefore, if those assets are not intended to be used to make input taxed supplies, input tax credits would be allowed.

Acquisitions of services such as the provision of advice on taxation, regulatory, contractual or other matters in the context of an M&A activity need to be examined to determine whether or not they relate to a specific form of M&A transaction or a number of different forms indifferently. There are services such as taxation advice that in some contexts may be described as general overheads. As a general proposition, however, we do not consider that taxation advice relating to the M&A activity constitutes a general overhead cost of the business. Rather, that advice may be specifically related to the M&A. The creditable purpose of such advice will need to be determined on the basis of the nature of that advice and the particular purpose or purposes to which it is directed.

Where acquisitions relate indifferently to the alternative forms an M&A transaction may take, in determining creditable purpose you will need to assess the degree of relatedness to any potential input taxed supply. This should be assessed by reference to the current preferences or decision of the enterprise (for example, senior management or the board) in conducting the M&A, as at the time of acquisition.

If this is not possible because no sufficiently defined approach to the proposed transaction has been developed, there might be other objective factors that could be used to establish creditable purpose. For example, for a business that engages in M&As regularly, this might be done by reference to the business's track record of successful M&A transactions.

On the other hand, there may be no particular objective factors that indicate the form in which the M&A is likely to occur. If it is reasonable to consider that it is about as likely as not that the M&A will be conducted in a manner that gives rise to an input taxed supply as a non-input taxed supply, a fair and reasonable approach may be to claim 50% of the input tax credits.

Where success fees are consideration for a supply that is properly construed as the provision of the ongoing services of an advisor in connection with a particular M&A, creditable purpose for those services should be determined by reference to the intended use of the acquirer over the period in which those services were being acquired.

The potential that the M&A activity may not culminate in a completed deal (for example, the parties may walk away) is not relevant in assessing the extent of creditable purpose. That is, where the probability of being successful in any M&A activity is 10% (because of the number of bidders etc), it does not mean that you are entitled to claim 90% input tax credits for the acquisition as an overhead and are only required to assess creditable purpose in respect of 10% of the relevant acquisitions relating to that potential M&A.

When an M&A is in phase three, the GST character of the intended transaction will generally be known and creditable purpose can be determined based upon the GST character of the intended transaction. That is, acquisitions made in this phase will typically be related to the intended supply that will conclude the M&A transaction.

Example one – company decides to sell part of its business by either selling shares or assets depending on which is more commercially attractive

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Vendor Ltd is in financial difficulty and, after having a strategic review undertaken (phase one), is seeking to divest some of its operations. It is open to all offers for all the group's assets or selling shares in its operating subsidiaries. Vendor Ltd establishes a project team and engages external expertise (an investment bank, an accounting firm and a legal firm). Vendor Ltd issues an information memorandum to Australian entities and also establishes a data room that allows prospective buyers to access the group's confidential business data and records so that they can perform due diligence before making a final bid under the offer process (phase two).

When objectively viewed, Vendor Ltd does not have a preference about whether the bidders offer to buy business units, assets or shares in operating subsidiaries. This is evidenced by the information memorandum provided to potential bidders and the advice provided to the accounting provider by Vendor Ltd that information on all aspects of the corporate group be included. It will consider each bid individually. Objectively viewed, Vendor Ltd intends to sell assets or shares (subject to bidders providing an attractive offer), but there is no basis on which to assess the relative likelihood of the form the transaction will take before bidders put in their bids. For acquisitions that relate to this period of time, it is reasonable for Vendor Ltd to determine that creditable purpose is 50%, as it is considered about as likely as not that a transaction will proceed by way of an input taxed share sale or a taxable (or GST-free) asset sale.

Example two – planned takeover where decision to make acquisition by way of share purchase is made at an early stage

Cat Ltd is a listed entity and has identified Mouse Ltd (another listed entity) as a potential takeover target that could be restructured and integrated into Cat Ltd's operations (phase one and two are already completed at this point).

Cat Ltd determines that the only realistic means to proceed with a takeover is by purchasing the shares in Mouse Ltd and engages Investment Bank (IB) to advise on a takeover strategy. On IB's advice, Cat Ltd proceeds to acquire Mouse Ltd shares on market and then later announces an off-market takeover bid for the remaining shares (phase three).

In this scenario, it was apparent that at the time Cat Ltd engaged IB it had determined that the only means realistically available to effect the takeover was by a share purchase.

In this case, there is an objective basis to determine that there was only ever one option available, being the acquisition of shares. IB's services only relate to the purchase of shares and therefore Cat Ltd cannot claim input tax credits.

Example three – planned M&A: assessing creditable purpose of services remunerated by way of a success fee

MinCo has been assessing its capacity to expand and evaluating market conditions (phase one).

MinCo decides that it wishes to expand its mining interests by making a significant acquisition and engages IBank (an investment bank) to assist in identifying a suitable target and in all aspects of effecting the acquisition. IBank is to be paid a retainer and is to receive a significant payment upon successful completion of any deal. At the time IBank is initially engaged, MinCo has no particular preference for how best to proceed with any deal, as IBank's mandate is to canvass all possible options. Over a period of three months, IBank undertakes research into suitable targets and, having formed a view about a particular target entity, recommends that MinCo acquire Digger Co by way of share acquisition (phase two).

MinCo accepts the recommendation, subject to the necessary checks. Over the next four months, IBank, with the assistance of several other service providers, undertakes due diligence into Digger Co. All due diligence proves satisfactory and MinCo approaches Digger Co with a proposal that they merge by way of MinCo acquiring all of Digger Co's shares using a scheme of arrangement (phase three).

The scheme of arrangement to execute the takeover is accepted four months later, and MinCo acquires all shares in Digger Co. MinCo pays IBank a success fee of 3% of the capital value of Digger Co (phase three).

In working out the input tax credits to claim on IBank's services, MinCo applies the following analysis:

- Phase two: No preference is established but there is an intention to proceed – the options IBank is looking at could involve asset or share acquisitions, and there are no other objective measures that can be ascertained to determine the likelihood of one option or another. For acquisitions that are not specific to a particular option, input tax credits are claimed based on 50% creditable purpose.
- Phase three: During this period the company is pursuing the acquisition of shares. As such, it is considered that no input tax credits can be claimed for acquisitions related to the potential share acquisition.
- For the payment that is made at the conclusion of the transaction relating to services performed by IBank during the different phases, a reasonable assessment needs to be made as to what extent the services related to work in the different phases.

Example four – company decides to sell part of its business - several different options

Indigo Co has decided to refocus on its core activity of manufacturing electrical appliances and has decided to sell off a part of its non-core business, which is operated by way of a wholly owned subsidiary. Due to the nature of the non-core business, it is considered that there is a real likelihood of interest from a particular non-resident entity in acquiring the business by way of share acquisition. There are also two resident entities interested in acquiring the business – one has indicated that it is interested in purchasing the key business assets, and the other has indicated it is only interested in a share acquisition. Indigo Co is keen to sell the business for the right price and has no preference as to how the transaction will proceed.

From the point at which Indigo Co determines it will sell off part of its business, Indigo Co moves out of phase one and into phase two. During phase two, some denial of input tax credits on acquisitions related to supplies that would be input taxed is required.

Indigo Co undertakes various planning, financial modelling and preparation of information to provide to potential bidders and engages investment banking, valuation, and specialist accounting and legal services to assist in the sale.

Indigo Co is aware that there needs to be some level of denial of input tax credits in regard to acquisitions made that relate to the sale. There are three potential bidders, each having a different preference for the form of the transaction. It can't be predicted which bidder is likely to be successful. Therefore, Indigo Co decides, in the absence of other factors, to apportion input tax credits taking into account the respective preferences of each bidder.

Potential bidder	Possible GST character of supply
Entity A (non-resident)	GST-free sale of shares
Entity B (resident)	Taxable sale of assets
Entity C (resident)	Input taxed sale of shares

There are three equally likely forms that the transaction could take, one of which is input taxed. Indigo Co concludes that it is fair and reasonable to claim input tax credits on the basis of two-thirds (66%).

When the M&A activity progresses to phase three (for example, when negotiation with a preferred bidder commences), Indigo Co will be able to determine a revised input tax credit percentage for services acquired from that point onwards.

Integration costs

Services or things which are related to the operation of the newly merged business and not to the transaction itself.

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In the course of an M&A activity, you may acquire services or things which are related to the operation of the newly merged business and not to the M&A transaction itself. Such services may include those which relate to integrating the entities engaged in a merger or acquisition such that they operate effectively as a single business after the transaction is completed. Examples of such services include human resource consultancy services designed to deal with cultural issues and staff retention in the new business, or marketing services dealing with new branding.

Acquisitions which fall into this category could be described as integration costs rather than transaction related costs. Where such acquisitions are able to be identified clearly, it may be appropriate to treat the acquisitions as enterprise costs which relate to all the supplies made by the merged entity, rather than relating to any particular supplies, and apportion input tax credits accordingly. However, careful consideration will need to be given to such acquisitions in light of the facts and circumstances in each case to properly determine whether or not they are integration costs or are more properly to be considered as acquisitions that relate to an M&A activity.

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Penalties

Penalties may apply for incorrectly claiming input tax credits.

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If you incorrectly claim input tax credits on things acquired in the course of M&A activity, you may be liable to a penalty for making a false or misleading statement.

If reasonable care was taken to prepare your activity statement, a penalty for making a false or misleading statement will not apply. A lack of awareness by those preparing the activity statement, about matters which are relevant to completing that activity statement, does not excuse you from taking reasonable care.

We expect that an entity engaged in M&A will, to the fullest extent possible, make relevant information available to those involved in preparing an activity statement to enable a reasonable assessment to be made about:

- the nature of the M&A being undertaken
- the extent to which acquisitions are related to particular options.

However, we recognise that determining creditable purpose in the context of unfolding M&A activity provides some practical difficulties, and that there may be some uncertainty in determining the correct amount of input tax credits at the date an activity statement is due. Some of these difficulties include:

- confidentiality considerations necessarily limiting the sharing of information within an organisation, particularly where listed public companies are involved
- frequent changes in direction and purpose as due diligence unfolds
- difficulty in analysing the particulars of work provided by certain advisors in time for preparing activity statements.

Having regard to these practical difficulties, and as part of your overall compliance management approach, you may decide to establish a process which involves reviewing input tax credit claims. This review should take place within a reasonable period after the completion of the M&A transaction to identify and correct any errors made in the original input tax credit claims.

When considering whether reasonable care has been taken, we will take into account the way you sought to manage your compliance obligation in response to these practical difficulties. Moreover, if we conclude that you did not take reasonable care and are therefore liable to a penalty, we will consider whether remission of any penalty is appropriate, having regard to such things as:

- whether it would be fair and reasonable to remit, having regard to the practical difficulties faced by you in initially determining creditable purpose
- whether you are making a genuine attempt to comply – which might be supported, for example, by a process that you have in place to review input tax credit claims within a reasonable period after the M&A expenses were incurred, with a view to correcting any error in the original activity statement.

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Adjustments

Some acquisitions made in the course of M&A may be used for a different purpose than intended.

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This information does not deal with adjustments that you may need to make under Division 129 of the *A New Tax System (Goods and Services Tax) Act 1999*, where you use something for a purpose which is different to its intended use.

Some acquisitions made in the course of M&A may be used for a different purpose than intended – for example, where the proposed structure of a transaction changes or does not proceed. GSTD 2012/3 provides our views on the application of Division 129 in the M&A context, particularly where the proposed M&A transaction doesn't proceed or proceeds in a manner different from that contemplated at the time of acquisition.

See also

- GSTD 2012/3 *Goods and services tax: does an adjustment for a change in extent of creditable purpose necessarily arise for services acquired in relation to a proposed merger and acquisition transaction that does not eventuate, or that does not proceed in the manner contemplated at the time the services were acquired?*
- GSTR 2000/24 *Goods and services tax: Division 129 - making adjustments for changes in extent of creditable purpose*

- GSTR 2002/2 *Goods and services tax: GST treatment of financial supplies and related supplies and acquisitions* – paragraphs 270-271

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