PCG 2019/8EC - Compendium

Australian Government
Australian Taxation Office

Public advice and guidance compendium – PCG 2019/8

Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Practical Compliance Guideline PCG 2019/D7 *ATO compliance approach to GST apportionment of acquisitions that relate to certain financial supplies*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

Issue number	Issue raised	ATO response
1	**GST-free percentage – red zone** The first dot point in the red zone should be dropped. This point creates a red flag if a taxpayer does not apportion to GST-free supplies of credit. As claiming such a percentage would only advantage a taxpayer, if there are taxpayers that take the view that the time, effort and/or documentation for such an apportionment is not justified then it would seem odd that such a conservative position would put them in the red zone (if they are also over 35% weighted extent of creditable purpose (ECP)). Certainly it would seem inappropriate to consider such a taxpayer 'high risk' if that were the only red flag that existed. Perhaps such a taxpayer is a good example of someone that would be in the yellow zone.	The final Guideline has been clarified so that this red zone feature is only relevant where in fact a taxpayer's apportionment method does recognise the extent to which the supply of the credit card facility is GST-free, but does not utilise the method in the blue zone.
2	**Analysis of acquisitions – red zone** The second dot point in the red zone, as drafted, will be hard to apply (the other dot points are a lot more specific as to what is the element of an apportionment model that is causing the red flag). Is this second dot point aimed at the concern that a single ECP rate is determined without considering any weighting – or more specifically, that there has been no consideration/analysis of whether certain acquisitions in the credit card issuing business relate solely to credit.	We have made changes to make the application of this red zone feature more certain. The final Guideline has been clarified to provide that a method will be in the red zone where it does not have regard to the acquisitions that only relate to the financial supply of the credit card facility, in accordance with GSTR 2019/2 *Goods and services tax: determining the creditable purpose of acquisitions in a credit card issuing business*.

Issue number	Issue raised	ATO response
	If so, perhaps it can be redrafted along those lines.	
3	**ATO's approach in issuing a Guideline** The submitter recommends the ATO agree to delay finalisation of the draft Guideline and commit to alternative approaches to resolve the outstanding technical issues underpinning the draft Guideline (noting that the submitter does not agree with the view in Draft Goods and Services Tax Determination GSTD 2018/D1 *Goods and services tax: determining the creditable purpose of acquisitions in a credit card issuing business).* The ATO's perception that a Guideline is an appropriate mechanism for providing compliance certainty and confidence to the inherently complex, dynamic and fluctuating nature of Australia's financial services industry is misplaced.	We have consulted extensively on our views in GSTR 2019/2 and on the risk assessment framework set out in this Guideline, and have taken the submitters' views into account. Schedule 1 of the final Guideline is intended to work together with GSTR 2019/2 to provide a clear expression of our technical views and our expectations for how they are applied in practice. It provides certainty on the compliance approach we will take given the risk associated with particular apportionment methods. We encourage taxpayers to contact us to discuss their circumstances if they would like additional certainty in relation to their arrangements.
4	**Green zone rate** The submitter considers the 35% rate in the green zone is significantly below what is a fair and reasonable rate. It is not clear how this rate was derived by the ATO and the data that was used to calculate the rate.	In calculating the green zone rate, we had regard to the application of the method in the blue zone to available information on the typical acquisitions and supplies in a credit card issuing business. We recognise that some taxpayers may have different business arrangements such that it may be more appropriate in their circumstances to instead apply the approach outlined in the blue zone. As stated in paragraph 24 of the final Guideline, the green zone rate will be reviewed regularly in line with industry developments.
5	**Credit card issuers in a three-party (closed loop) system** The draft Guideline in relation to open loop systems shows the Commissioner is showing disregard to the potential distorted GST outcomes as between the open and closed loop payment systems.	Given the small number of entities operating a closed loop system, we do not consider that this Guideline is the appropriate product for these entities. One-on-one engagement with these entities is more appropriate.

Issue number	Issue raised	ATO response
6	**Reliance on public rulings** The submitter queries why reliance on one or more relevant ATO public rulings is not a risk mitigating factor or even a qualifying condition for white zone status. This undermines the Commissioner's stated intention to improve certainty and instil confidence for self - assessment.	The final Guideline provides a specific framework for how we assess risk associated with apportionment methods for these acquisitions. The framework does incorporate references to those ATO public rulings that are specific to credit card issuing businesses (GSTR 2019/2 and Goods and Service Tax Determination GSTD 2017/1 *Goods and services tax: when is the supply of a credit card facility GST-free under paragraph (a) of Item 4 in subsection 38-190(1) of the A New Tax System (Goods and Services Tax) Act 1999 (GST Act)?*). Goods and Services Tax Ruling GSTR 2006/3 *Goods and services tax: determining the extent of creditable purpose for providers of financial supplies* provides general guidance on apportionment for financial supply providers. It does not provide specific guidance on the design of an apportionment method for acquisitions in a credit card issuing business.
7	**Green zone limitations** In relation to paragraph 26 of the draft Guideline, the following should be clarified: • The basis at law or administrative policy for preventing taxpayers from adopting the green zone rate, where their current rate is below 35%. • The submitter is unable to reconcile the application of a 35% rate in accordance with the green zone with the statement in the second bullet point. The submitter does not understand the green zone to be predicated on any specific requirement to adopt a method.	The final Guideline sets out our compliance approach for GST apportionment. The final Guideline and the green zone in particular is our assessment of the likelihood that a taxpayer has correctly applied the law and therefore our compliance approach. It does not absolve taxpayers from applying the relevant GST provisions in determining their ECP rate, nor does it create a safe harbour rate for credit card issuers. Therefore, if a taxpayer determines that their ECP rate is below 35%, this Guideline does not allow them to increase the rate to the 35% green zone rate. Specifically, the first bullet point in paragraph 26 of the final Guideline recognises that taxpayers may have specific circumstances that result in an ECP rate for acquisitions in their credit card issuing business being below the green zone rate, which are reflected in their current position. In this situation, we may seek to understand whether a material uplift to the rate claimed is appropriate in their circumstances. The second bullet point in paragraph 26 of the final Guideline makes it clear that the fact that a taxpayer's ECP rate places them in the green zone is not an assessment of any particular method used to determine that rate. For instance, if you use an apportionment method that results in an ECP

Issue number	Issue raised	ATO response
		rate of 35% in one period as a weighted average across the relevant acquisitions, but updating the inputs in the method results in an ECP rate of 40% in a later period, the use of the higher rate would mean that you would no longer be in the green zone for that later period. You will need to reassess your risk rating.
8	**Transitional arrangements** In relation to the transitional arrangements at paragraphs 31 to 34, a number of issues arise: • Following the approach at paragraph 32 of the draft Guideline results in a taxpayer being in the white zone, but we are unclear how this designation fits within the definition of the white zone in paragraph 27 of the draft Guideline. Is the active engagement and voluntary disclosure referred to taken to be a settlement under paragraph 27, or a deemed review and low risk rating? This is currently highly unclear. It does not appear to be an ongoing settlement, as the taxpayer is deemed to be in the green zone for the remainder of the financial year. • We do not understand what the requirements for actively engaging with the ATO are. How does this interact with other engagements with the ATO, for example, for governance and justified trust, or ongoing issues related to products covered by GSTD 2018/D1? • Does the active engagement have to commence immediately from 1 January 2020, or can it commence at a later date?	Where a taxpayer meets the requirements in paragraphs 31 to 34 of the final Guideline in respect of the transitional period, they will be in the white zone for that period. We have clarified in paragraph 27 of the final Guideline that this is in addition to the other situations where a taxpayer will be in the white zone. You will be actively engaging with us if you are cooperating with us throughout the transitional period to transition your arrangements to the green zone. We will confirm with you whether you meet these requirements. Your engagement with us may occur through justified trust or another assurance product, through your client relationship manager, or by contacting FSIConsult@ato.gov.au to discuss your arrangements. In relation to Schedule 1 of the final Guideline, as discussed over the course of the consultation process that commenced in July 2019, you must have started to engage with us by 1 January 2020 to be eligible for these transitional arrangements. This has been clarified in paragraph 32 of the final Guideline.
9	**Penalties and interest** We take it that the penalties and general interest charge (GIC) remission referred to in paragraph 34 of the draft Guideline relate to the voluntary disclosure required under paragraph 32 of the draft Guideline, but point out that the implication of such a limited remission is that any taxpayer not falling within paragraph 32 will be subject to such penalties and GIC. This, in our view, provides an inappropriate impression to both taxpayers and ATO officers as to the approach to be taken to taxpayers falling outside the green zone	The transitional arrangements in paragraphs 31 to 34 of the final Guideline enable an option for taxpayers who wish to engage with us to transition their arrangements, allowing them to be in the white zone for this period (that is self-assessment of their risk zone is not required). In other situations, the imposition of penalties and interest will be considered on a case-by-case basis in line with our standard practices and procedure.

Issue number	Issue raised	ATO response
	during this period. There could be a number of reasons why a taxpayer does not (or cannot) comply with paragraph 32, and in which ATO officers would not otherwise issue assessments (and/or impose penalties and GIC).	The statement about penalties should not be construed as implying that taxpayers have failed to take reasonable care in apportioning input tax credits for financial supplies in a credit card business.
10	**Transitional period** The assumption that a taxpayer transitioning from a position other than the green zone should have to make a voluntary disclosure at the end of that transitional period, with all the implications of incorrect treatment and assumption of liability that this entails, is fundamentally unacceptable. Many taxpayers have current private rulings authorising technical positions diametrically different to those set out in GSTD 2018/D1 and the draft Guideline. Taxpayers should not be required to treat those long-held positions as invalid during any transitional period. A six-month transitional period is, in any case, entirely inadequate. In our view, transitional arrangements should be negotiated individually with different taxpayers, to take account of their unique product mix, systems, and technical positions.	The Guideline has prospective effect for tax periods starting 1 January 2020 (which aligns with the date of effect of GSTR 2019/2). The transitional period is intended to assist taxpayers to transition to the green zone in circumstances where there are difficulties with meeting the green zone requirements immediately from 1 January 2020. For example, where additional time is required for system changes to be made and come into effect. We acknowledge the submitter's comments but respectfully consider that the transitional period provided is appropriate. The transitional period is a voluntary option, and is to assist taxpayers in implementing the green zone. If taxpayers want to discuss how the transitional period will apply to their specific circumstances, we encourage them to engage with us. Your engagement with us may occur through justified trust or another assurance product, through your client relationship manager, or by contacting FSIConsult@ato.gov.au to discuss your arrangements. We have sought to minimise the compliance impact for taxpayers through extensive consultation and the practical compliance approach provided in this Guideline. We consider adopting a consistent transitional period is the best approach to ensure a level playing field across the industry. We will continue to review private rulings to ensure there is consistency across the industry. Affected taxpayers will be notified by the ATO.

Issue number	Issue raised	ATO response
11	**Transactor/revolver method** The submitter fundamentally disagrees with the ATO's insistence on dismissing the transactor/revolver methodology (which is included in the red zone) and considers that the reasons for doing so have not been articulated.	The final Guideline sets out our assessment of risk and the compliance approach that we are expected to adopt based on that risk. An apportionment method that uses a transactor/revolver method will be high risk, with the result that it will be a high priority for review. A transactor/revolver method has three steps: 1. Acquisitions are allocated between transactors (broadly, cardholders that do not pay interest) and revolvers (broadly, cardholders that do pay interest). 2. A separate revenue method is applied for acquisitions allocated to each pool of cardholders. 3. The pools are blended to determine an extent of creditable purpose (ECP) rate for all acquisitions. Our assessment is that the use of a transactor/revolver method is high risk, including because: • Where it is applied to all acquisitions in a credit card issuing business, the method assumes that all acquisitions have a relevant connection to both the supply of the credit card facility and the supply of interchange services. This is contrary to our view in GSTR 2019/2. The method does not have regard to the acquisitions that only relate to making financial supplies. • The method does not adequately reflect the extent of the relationship of acquisitions to the supply of the credit card facility. For acquisitions allocated to transactors (who are provided credit but do not pay interest), revenue fails to appropriately measure the extent of the relationship between the acquisitions and these supplies.[1] As a result, even if the method is only applied to acquisitions that

[1] Note that the ECP of an acquisition is based on its relationship to the making of particular supplies (that is, its use or intended use), and revenue is only an indirect method for approximating this relationship (see *Commissioner of Taxation v American Express Wholesale Currency Services Pty Ltd* [2010] FCAFC 122 (*Amex*) at [123–127]). A revenue-based method is fair and reasonable if the assumption holds that there is a proportionate relationship between the revenue used to measure the supplies made, and the use of the acquisitions that the revenue method applies to.

Issue number	Issue raised	ATO response
		relate to both supplies, it does not give a fair and reasonable reflection of the intended use of acquisitions. To illustrate this with an example, a credit card issuer may acquire card production services to provide plastic credit cards to cardholders (see example 12 in GSTR 2019/2). A transactor/revolver method may imply (for example) that where the cardholder is a transactor, the ECP of the acquisition is 80%, and where the cardholder is a revolver, the ECP of the acquisition is 15%. However, in both cases, the intended use of the acquisition is the same in respect of all cardholders – the physical credit card has the built-in technology to enable it to perform its function in initiating credit card transactions, which initiates the provision of credit under the supply of the credit card facility and the supply of interchange services. • In some cases the design of these methods may be underpinned by a view that there is no financial supply made to cardholders that are transactors, which is contrary to the ATO view in paragraph 13 of GSTR 2019/2.
12	**On-us transactions** The submitter fundamentally disagrees with the ATO's insistence on dismissing a methodology that treats acquisitions in the credit card issuing business as relating to taxable supplies of merchant services in the credit card acquiring business. The submitter considers that the reasons for doing so have not been articulated. Another submitter observed that the 'on-us' carve out in the blue zone methodology, and the corresponding 'red flag' in the red zone, would appear to conflict, conceptually, with other parts of the methodology that expect a taxpayer to 'look through' business units to relate acquisitions to supplies. That is, whilst acquisitions in other business units must be taken into account to the extent they relate to supplies in the credit card issuing business, there is no acknowledgment that an apportionment to 'on-us' supplies of inter-business interchange is really an apportionment to the taxable supplies made in the acquiring business unit (and so should be	We agree that the mere fact that an acquisition and a supply are made in different business units is not of itself a sufficient basis for concluding that apportionment is not appropriate. However an acquisition that has a relevant connection with the supply of interchange services in an off-us transaction will not necessarily have an equivalent connection to the supply of merchant services in the on-us context. Interchange services and merchant services are not the same and the supplies made by the entity are factually and functionally different. An objective analysis of the facts is required to determine whether the relevant connection can be established between an acquisition made in the issuing business and the supply of merchant services through the acquiring business. A similar analysis would be required to determine whether any of the acquisitions in the acquiring business have the relevant connection to the supply of the credit card facility by the entity, resulting in a requirement to apportion credits in the acquiring business. This analysis is required by

Issue number	Issue raised	ATO response
	creditable to that extent, rather than taken to rely only to the supply of credit).	paragraph 11-15(2)(a) of the *A New Tax System (Goods and Services Tax) Act 1999* and is consistent with the principles set out in Goods and Services Tax Ruling GSTR 2008/1 *Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?*, GSTR 2006/3 and GSTR 2019/2. Given the different factual matrix and relationships in the on-us context, we consider that most of the acquisitions in the issuing business identified in GSTR 2019/2 as having a relevant connection to interchange services do not have a relevant connection to the supply of merchant services in an on-us transaction. Any connection to the supply of merchant services in an on-us transaction is too remote. However, one area where the relevant connection might potentially be found to exist is for certain processing costs such as those necessary for authorising credit card transactions. In such a case, the corresponding processing acquisitions in the acquiring business would be expected to have a corresponding relevant connection with the supply of the credit card facility. Whether the relevant connection is established will depend on the particular facts and circumstances applicable to on-us transactions. The requirement to consider each acquisition from the perspective of both the acquiring and issuing businesses requires a higher level of assurance and is therefore not considered appropriate for a blue-zone methodology.
13	**Apportionment method for costs that relate to both supplies – blue zone** A number of the factors and/or requirements outlined in the blue and red zones directly conflict with the Commissioner's own public rulings. For example, in Example 10 in GSTR 2006/3 the Commissioner accepts that a range of apportionment ratios may be available to be used as to apportion the intended use of acquisitions. However, in the draft Guideline, if a taxpayer was to similarly adopt this approach and a higher than 50%proportion of intended use to taxable supplies resulted, this is considered to be high risk. This illustrates the inherent inconsistency as between the Commissioner's existing binding principles-based rulings and the arbitrary (for example, 50/50 basis) ratios which form such an integral part of the	The final Guideline sets out our assessment of risk and the compliance approach that we are likely to adopt based on that risk. As stated in the final Guideline, the apportionment methods included are for risk assessment purposes only, and should not be taken as a prescribing a specific method. Furthermore, the final Guideline is not to be taken as a statement that a method that is different to a method outlined in the blue zone will never be fair and reasonable. However, it reflects the compliance approach we will consider necessary to gain assurance as to whether an apportionment method that is not in the blue zone is in fact fair and reasonable in the circumstances.

Issue number	Issue raised	ATO response
	Commissioner's assessment of risk in the draft Guideline. The inclusion in the red zone of any methodology which results in 'some acquisitions having a closer relationship to the supply of interchange services than to the supply of the credit card facility' means that (in the ATO's view) it is never possible to demonstrate a fair and reasonable apportionment involving a recovery rate of greater than50% for any class of acquisitions. This is, with respect, clearly wrong, and should be removed.	An apportionment method that treats some acquisitions as having a closer relationship to the supply of interchange services than to the supply of the credit card facility will be a high priority for review, and is therefore in the red zone. This position is based on our analysis of common acquisitions in a credit card issuing business, which is outlined in GSTR 2019/2. For the acquisitions that are identified as relating to both supplies, we have not seen anything to suggest that there is an objective basis for considering that these acquisitions are more closely related to the supply of interchange services than to the supply of the credit card facility. Note that the final Guideline does not limit the operation of the law or replace, alter or affect our interpretation of the law in any way. We also note that it is not possible for this Guideline to address every potential variation in individual circumstances, including every potential acquisition. The aim of the final Guideline is to be transparent as to our compliance approach according to our assessment of risk in this area. It is open for a taxpayer to demonstrate that an apportionment method is fair and reasonable in their circumstances and therefore reflects the correct application of the law (even if it has features within the red zone). We do not see any inconsistency with Example 10 of GSTR 2006/3. This provides an illustrative example of the process a financial supplier may go through in comparing and then selecting a fair and reasonable method in a different factual context involving a different acquisition and different supplies.