

***GSTD 2007/D1 - Goods and services tax: is a credit card provider entitled to a reduced input tax credit under item 27 of the table in subregulation 70-5.02(2) of the A New Tax System (Goods and Services Tax) Regulations 1999 for the acquisition of services from a co-branding partner where it pays commission for those services?***

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This document has been finalised.



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# Draft Goods and Services Tax Determination

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Goods and services tax: is a credit card provider entitled to a reduced input tax credit under item 27 of the table in subregulation 70-5.02(2) of the A New Tax System (Goods and Services Tax) Regulations 1999 for the acquisition of services from a co-branding partner where it pays commission for those services?

## **Preamble**

*This document is a draft for public comment. As such, it represents the preliminary, though considered, views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling or advice for the purposes of section 105-60 of Schedule 1 to the **Taxation Administration Act 1953**. The final Determination will be a public ruling for the purposes of section 105-60 and may be relied upon by any entity to which it applies.*

1. Yes. A credit card provider (financial supply provider) is entitled to a reduced input tax credit under item 27 of the table in subregulation 70-5.02(2) (item 27) of the A New Tax System (Goods and Services Tax) Regulations 1999 (GST Regulations) for the acquisition of services from a co-branding partner, where it pays commission for those services and the nature of the services acquired means the partner is a financial supply facilitator as defined in regulation 40-5.07 of the GST Regulations in relation to the supply of an interest in or under a credit arrangement.

## **Background**

### **Co-branded credit card arrangements**

2. A co-branded credit card arrangement is an arrangement entered into between a credit card provider (for example, a bank) and another entity having a strong brand presence for the purpose of introducing a credit card product into the market. The credit card product is known as a co-branded credit card because it bears the names of both the credit card provider and the co-branding partner.<sup>1</sup>

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<sup>1</sup> Although both names appear on the co-branded credit card, it is common for only one name to be displayed prominently.

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3. The credit card provider has the legal responsibility for issuing the credit card product to customers. The co-branding partner provides services to the credit card provider in relation to the issue of the credit card product. The types of services provided by the co-branding partner vary between arrangements. Under some arrangements the co-branding partner may continue to provide services after the credit card has been issued to the customer.

4. The services that a co-branding partner provides in accordance with the terms of its agreement with the credit card provider may include the following:

- allowing access to its existing client base;
- sourcing and introducing customers;
- retaining customers;
- offering, promoting and supporting the credit card product;
- encouraging the acceptance and use of the credit card at agreed locations;
- advertising the credit card product by means of electronic media and newspapers, direct mail, door drops and shopping centre booths;
- assisting applicants to complete the application for the credit card;
- validating completed application forms to ensure they have been correctly completed;
- processing the completed application forms or forwarding them to the credit card provider for processing;
- issuing temporary cards where on-the-spot approval is obtained;
- operating a call centre to assist customers; or
- operating a reward/incentive program linked to the credit card.

5. The co-branded credit card arrangement provides for the co-branding partner to be paid commission for the services it provides. The form the commission takes will depend on the arrangement.

## Explanation

### ***GST legislation and GST Regulations***

6. Under paragraph 11-15(2)(a) of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), a thing acquired in carrying on an enterprise is not acquired for a creditable purpose to the extent that the acquisition relates to making supplies that would be input taxed.<sup>2</sup> Section 40-5 of the GST Act provides that a financial supply, as defined in the GST Regulations, is input taxed.

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<sup>2</sup> Unless the entity does not exceed the financial acquisitions threshold (subsection 11-15(4) of the GST Act) or the acquisition relates to a financial supply consisting of a borrowing and the borrowing relates to supplies that are not input taxed (subsection 11-15(5) of the GST Act).

7. The supply of an interest in or under a matter mentioned in any of the items listed in the table in subregulation 40-5.09(3) of the GST Regulations is a financial supply provided the conditions in subregulation 40-5.09(1) are all satisfied, and provided the interest is not excluded because it is mentioned in regulation 40-5.12 of the GST Regulations.<sup>3</sup> Issuing a credit card is the provision of an interest in<sup>4</sup> a credit arrangement, which falls within item 2 of the table in subregulation 40-5.09(3). The credit card provider typically makes acquisitions related to the financial supply of the interest in a credit arrangement. Therefore, acquisitions made by the credit card provider are not for a creditable purpose under section 11-15 of the GST Act because they relate to making a supply that would be input taxed.
8. Subsection 70-5(1) of the GST Act states that the GST Regulations may provide that acquisitions of a specified kind that relate to making financial supplies can give rise to an entitlement to a reduced input tax credit. Subregulation 70-5.02(1) of the GST Regulations indicates that acquisitions mentioned in subregulation 70-5.02(2) are those which give rise to this entitlement. The expression *an acquisition ... that relates to making financial supplies* used in subregulation 70-5.02(1) identifies a class of acquisitions that are denied input tax credits because of the operation of paragraph 11-15(2)(a) and subsection 40-5(1) of the GST Act.<sup>5</sup>
9. Subregulation 70-5.02(1) of the GST Regulations does not impose any further test once credit has been denied under these provisions. That is, an acquisition that does not have a creditable purpose because it relates (solely or partly) to making supplies that would be input taxed financial supplies, is taken to relate, to that extent, to making financial supplies for the purposes of regulation 70-5.02. Individual items within the table in subregulation 70-5.02(2), however, may impose a more stringent nexus test than paragraph 11-15(2)(a) of the GST Act.<sup>6</sup>
10. Division 70 of the GST Regulations provides an exhaustive list of items which have the status of reduced credit acquisitions. While many of the terms within these items may describe acquisitions made by a financial supply provider (and are therefore denied credit) regard must be had to the qualifications imposed in each item in determining whether a reduced input tax credit is available for a particular acquisition. The item which is sought to be applied must be read as a whole, and the acquisition must fulfil all of the conditions stated in the item.<sup>7</sup>
11. Under item 27, 'Supplies for which financial supply facilitators are paid commission by financial supply providers' are reduced credit acquisitions.
12. Therefore, for item 27 to be met there must be:
- a financial supply provider;
  - a financial supply facilitator; and
  - commission.

<sup>3</sup> Regulation 40-5.12 sets out an itemised list of supplies that are not financial supplies.

<sup>4</sup> In the context of regulation 40-5.09, we do not ascribe any specific technical significance to establishing whether something is covered as an interest in or an interest under an item in the table. See paragraph 82 of Goods and Services Tax Ruling GSTR 2002/2 Goods and services tax: GST treatment of financial supplies and related supplies and acquisitions.

<sup>5</sup> See paragraph 47 of Goods and Services Tax Ruling GSTR 2004/1 Goods and services tax: reduced credit acquisitions.

<sup>6</sup> See paragraph 48 of GSTR 2004/1.

<sup>7</sup> See paragraph 19 of GSTR 2004/1.

## Financial supply provider

13. Under a co-branded credit card arrangement, the credit card provider is the entity that creates the interest in a credit arrangement and supplies it to its customers. It is therefore the financial supply provider<sup>8</sup> of the interest.

## Financial supply facilitator

14. A financial supply facilitator is defined in the GST Regulations as an entity facilitating the supply of an interest for a financial supply provider.<sup>9</sup>

15. The Commissioner, in GSTR 2002/2<sup>10</sup> and GSTR 2004/1,<sup>11</sup> has set out principles for determining whether an entity is a 'financial supply facilitator' for the purposes of subregulation 70-5.02(2) of the GST Regulations. These rulings discuss the characteristics of a financial supply facilitator. A summary of these characteristics is as follows:

- being a financial supply facilitator describes the role that the entity plays in a particular transaction and is not a characteristic inherent of the entity itself;
- an entity can be a financial supply facilitator in relation to some transactions but not in relation to others;
- the activities of the entity must have an identifiable association with the supply that goes beyond a mere general association for the entity to be a financial supply facilitator;
- an identifiable association requires there to be a substantial connection so as to exclude activities that are only generally related;
- in the absence of this identifiable association, an entity will not be a financial supply facilitator of the supply of an interest for the purposes of Division 70 of the GST Regulations; and
- the particular supply may be an actual financial supply or it may be a supply that the entity intends to make.

## ***Supplies that an entity intends to make***

16. An intended supply is a particular supply which is intended to be made but which, for some reason, is not actually made. An example of an intended supply is where a mortgage broker introduces a borrower and a lender, but the loan does not take place because the parties cannot reach agreement on the terms.

17. If the activities of an entity were clearly directed towards assisting in the making of a financial supply and that supply is not made, the entity will still retain the character of a financial supply facilitator.<sup>12</sup>

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<sup>8</sup> The term 'financial supply provider' is defined in regulation 40-5.06 of the GST Regulations.

<sup>9</sup> Regulation 40-5.07 of the GST Regulations.

<sup>10</sup> At paragraphs 257 to 265.

<sup>11</sup> At paragraphs 30 to 35.

<sup>12</sup> See paragraphs 32 and 39 of GSTR 2004/1.

***A substantial connection with provision of co-branded credit cards***

18. Examples of the types of services provided by a co-branding partner under a co-branding credit card arrangement are listed at paragraph 4 of this Determination. Arrangements vary, and co-branding partners may supply different services. The documents that constitute the co-branding arrangement will typically detail which services the co-branding partner is to provide.

19. It is not necessary that all of the services listed in paragraph 4 of this Determination are provided for a co-branding partner to be a financial supply facilitator. However, to have a sufficient nexus, the services provided must have an identifiable association with the financial supply of the interest in or under the credit arrangement that goes beyond a mere general association. An identifiable association does not mean that the services have to be directly linked to the supply; however, it does require that there be a substantial connection so as to exclude activities that are only generally related (for example, promotion, advertising, product design, market research or similar types of activities).<sup>13</sup> This is an objective test and should be determined on a case by case basis taking into account all the facts and circumstances.

20. In determining whether services provided by a co-branding partner have a substantial connection to the supply of the interest in or under the credit arrangement, consideration is to be given to the services provided as a whole because none of the individual services listed in paragraph 4 of this Determination is determinant.

21. Where the co-branding partner's involvement in the supply of the cards involves activities such as, for example, merely providing a list of names, or access to a customer data base, there is not considered to be a substantial connection with the supply of the interest in the credit arrangement, therefore the co-branding partner is not a financial supply facilitator.

22. Further, the supply by a co-branding partner of credit card marketing and promotional services, in isolation, is not considered to have a substantial connection to the supply of the interest in the credit arrangement. Similarly, an isolated supply by a co-branding partner of processing credit card applications is not considered to have a substantial connection to the supply of the interest in the credit arrangement.

23. However, these activities may be provided as part of a package which includes for example, sourcing and introducing customers, providing a telephone application facility and follow up activities where application forms have not been correctly completed. Such a package of services when looked at as a whole, is indicative of the co-branding partner playing an active role in forwarding and assisting the supply of the interest in the credit arrangement. The acquisition of such a package of services would be considered to have a substantial connection with the supply of the credit cards and as such the co-branding partner would be considered a financial supply facilitator in relation to that supply.

**Commission**

24. Under the co-branding arrangement, the co-branding partner is paid a commission for the services it provides. Item 27 only applies to supplies by a financial supply facilitator for which it is paid a commission by a financial supply provider.

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<sup>13</sup> See paragraph 32 of GSTR 2004/1.

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25. The term ‘commission’ is defined in GSTR 2002/2<sup>14</sup> as:  
Payment to an agent or similar entity, or to an employee for particular services rendered.  
The payment may be made on a fixed sum or fixed percentage basis, or on a sliding scale based on the value of the transaction.
26. The term commission may include corpus commission, income commission, trailing commission, and brokerage. However, not all of these are necessarily payments to a financial supply facilitator. Other fees, including those calculated on the value of work done, rather than a per-transaction or percentage of value based calculation, and retainers, are not commission.<sup>15</sup>
27. Supplies of services by employees in return for the payment of a commission do not qualify as reduced credit acquisitions under item 27.<sup>16</sup>

## Examples

### **Example 1 – substantial connection**

28. *Rockmelon Pty Ltd (a company with a strong brand presence) signs an agreement with Contour Bank to operate a co-branded credit card product. Under the agreement, Contour Bank is responsible for launching a co-branded credit card product into the market. It will have the legal relationship with customers and the ensuing operational responsibilities. Rockmelon Pty Ltd is responsible for sourcing, introducing and retaining customers and will undertake its own marketing activities. Both entities are jointly responsible for the design and pricing of the product. If a customer sourced by Rockmelon Pty Ltd is accepted as a customer of Contour Bank, Contour Bank will pay Rockmelon Pty Ltd a commission.*
29. *The sourcing and introduction obligations owed by Rockmelon Pty Ltd to Contour Bank are carried out at its own cost by Rockmelon Pty Ltd. It directly markets and promotes the credit card program to both the world at large and its existing customer base. This involves advertising through its own outlets, electronic media and newspapers, direct mail, door drops and booths in shopping centres.*
30. *Paper applications are mailed directly to Rockmelon Pty Ltd who outsources the processing of the applications to a third party, Tiburon & Co. Online applications are hosted on a Contour Bank server and processed by Tiburon & Co. Rockmelon Pty Ltd is constructively involved in this process by being the entity responsible for the operation of the call centre (the provision of which has been outsourced to Tiburon & Co). Telephone applications are handled by a third party engaged by Rockmelon Pty Ltd, which has the responsibility for this function.*
31. *Rockmelon Pty Ltd is also responsible for following up those applicants who have failed to complete checks in the credit approval process. Rockmelon Pty Ltd provides incentives to applicants to complete this process. Where an application is successful and a supply of an interest in or under a credit arrangement is made by Contour Bank, Rockmelon Pty Ltd encourages the use of the credit card by paying an amount into the cardholder’s account.*

<sup>14</sup> Schedule 1.

<sup>15</sup> Paragraph 653 of GSTR 2004/1.

<sup>16</sup> Paragraph 652 of GSTR 2004/1.

32. *The retention obligations owed by Rockmelon Pty Ltd to Contour Bank are carried out primarily by Rockmelon Pty Ltd operating a 'reward program' linked to the credit card program. Rockmelon Pty Ltd is also involved in encouraging the use of the credit card after periods of inactivity and training 'retention teams' controlled and funded by Contour Bank.*
33. *The payment of a commission by Contour Bank to Rockmelon Pty Ltd is calculated by reference to customers introduced during a particular period. Where performance goals (in relation to the economic performance of the entire credit card program) are met, Rockmelon Pty Ltd is entitled to a trailing commission from Contour Bank.*
34. *Rockmelon Pty Ltd is a financial supply facilitator in relation to the supply of the interest in the credit arrangement provided by Contour Bank to the co-branded credit card customers. This is because there is a substantial connection between Rockmelon Pty Ltd's supplies to Contour Bank and the supply of the interest in or under the credit arrangement. The services provided by Rockmelon Pty Ltd are supplies for which a financial supply facilitator is paid a commission by a financial supply provider. Therefore, the acquisition of Rockmelon Pty Ltd's services by Contour Bank is a reduced credit acquisition under item 27.*

**Example 2 – substantial connection**

35. *High Finance identifies Dominion Pty Ltd as a suitable partner in the establishment of a co-branded credit card product because Dominion Pty Ltd has access to an existing customer base and has the capacity to influence its customers. Dominion Pty Ltd and High Finance contract with each other with the terms and conditions set out in the relevant agreement.*
36. *Under the agreement, High Finance is responsible for introducing a co-branded credit card product into the Australian market. It will have the legal relationship with customers and the ensuing operational responsibilities. Dominion Pty Ltd is responsible for offering, promoting, supporting and distributing the credit card product and encouraging its acceptance and use at distribution channels covered by the agreement.*
37. *The co-branded credit card is for use by cardholders in making credit purchases with merchants in general, but provides incentives (in the form of a rebate off the card balance) where the credit card is used with Dominion Pty Ltd merchants. The incentives are partly funded by Dominion Pty Ltd.*
38. *Under the terms of the agreement, a committee consisting of representatives from both parties is set up to determine the creative style of the credit card product and develop a plan for card distribution and promotion initiatives for the following year. As part of this process, the committee engages an advertising agency to market the credit card. The costs are shared equally by High Finance and Dominion Pty Ltd.*
39. *Dominion Pty Ltd is responsible for displaying point of sale promotional materials and application forms and placement of posters at participating Dominion Pty Ltd merchants. The staff of participating Dominion Pty Ltd merchants will promote the credit card by explaining its features and providing other information.*
40. *Dominion Pty Ltd will also provide High Finance with access to its existing and future customer data and will give High Finance access to its merchant's premises to conduct its own promotional campaigns.*



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41. *Dominion Pty Ltd is not responsible for collating and dispatching application forms filled out at its participating merchant's premises. This is done by a third party under contract with High Finance. Dominion Pty Ltd is not responsible for the processing of the application forms or for handling any enquiries resulting from these applications. Apart from partially funding the rebate paid by High Finance to cardholders, Dominion Pty Ltd plays no part in the retention of such cardholders.*

42. *Under the agreement, High Finance will pay Dominion Pty Ltd the following commissions:*

- *new account commission (for each new approved credit card account acquired through a participating Dominion Pty Ltd merchant);*
- *trailing commission (based on a percentage of the customer net revenue for the total credit card portfolio);*
- *cross sell commission (where a customer introduced by Dominion Pty Ltd goes on to acquire another financial product, for example a personal loan) offered by High Finance).*

43. *Despite the fact that Dominion Pty Ltd is not responsible in any way for the processing of application forms, does not handle enquiries in relation to the applications and plays only a small part in retaining cardholders, there is still a substantial connection between the activities of Dominion Pty Ltd and the supply of the interest in the credit arrangement by High Finance. Dominion Pty Ltd is therefore a financial supply facilitator in relation to the supply of the interest in the credit arrangement to the cardholders. Dominion Pty Ltd is paid commission for its services. The acquisition of Dominion Pty Ltd's services by High Finance is therefore a reduced credit acquisition under item 27.*

### **Example 3 – not a substantial connection**

44. *Tesoro Bank decides to release a new credit card product. It enters into an arrangement with Mercado Pty Ltd, a high profile company with a strong brand image, to undertake the marketing of the credit card product by means of direct mail, television and radio commercials and newspaper advertisements. The arrangement also provides for Mercado Pty Ltd to lend its name to the credit card product as a means of encouraging customer acceptance of the product. Mercado Pty Ltd agrees to accept payment by way of commission based upon the number of customers who take up the offer of the interest in the credit arrangement. Mercado Pty Ltd is not involved in the processing of the applications for the credit card product or in responding to cardholder enquiries in relation to the applications. Mercado Pty Ltd does not play any part in retaining cardholders as customers.*

45. *The activities of Mercado Pty Ltd in providing marketing services and lending its name and image to the credit card product do not have a substantial connection to the supply of the interest in the credit arrangement by Tesoro Bank. Mercado Pty Ltd is not a financial supply facilitator in relation to the supply Tesoro Bank because there is insufficient nexus between the promotional services it provides and the supply of the interest in the credit arrangement by Tesoro Bank. The acquisition of Mercado Pty Ltd's services is not a reduced credit acquisition under item 27.*

**Example 4 – not a substantial connection**

46. *Gorgon Pty Ltd is an entertainment company whose enterprise includes the operation of theme parks, the production of motion pictures and television shows, and the sale of merchandise. Gorgon Pty Ltd is the owner of a well known cartoon character called Sassy Suzy. Gorgon Pty Ltd enters into an agreement with Dinero Bank under which it grants Dinero Bank the licence to use the image of Sassy Suzy on a new credit card product. The consideration for the grant of the licence is paid to Gorgon Pty Ltd as a commission based on the number of customers who take up the new credit card product.*

47. *Dinero Bank promotes the credit card by direct mail and the launch of a national television and print advertising campaign. The campaign highlights the competitive benefits of the card together with the ability to accumulate rewards points which can be redeemed at Gorgon Pty Ltd theme parks or for Gorgon Pty Ltd merchandise.*

48. *Gorgon Pty Ltd has not undertaken sufficient activities to be regarded as assisting the provision of the interest in a credit arrangement. There is not a substantial connection between the mere grant of the licence by Gorgon Pty Ltd and the supply of the interest in the credit arrangement by Dinero Bank. Gorgon Pty Ltd is not a financial supply facilitator in relation to the supply of the co-branded credit card to the cardholders. Although Gorgon Pty Ltd is paid by way of commission for the grant of the licence, the acquisition of the licence by Dinero Bank is not a reduced credit acquisition under item 27.*

**Date of effect**

49. This draft Determination represents the preliminary, though considered view of the Australian Taxation Office. This draft may not be relied on by taxpayers or practitioners. When the final Determination is officially released, it will explain our view of the law as it applies both before and after its date of issue.

50. The final Determination will be a public ruling for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953* and may be relied upon, after it is issued, by any entity to which it applies. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and our view of when you can rely on our interpretation of the law in GST public and private rulings.

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## Your comments

51. We invite you to comment on this draft Goods and Service Tax Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel or relevant Tax officers. The Tax Office may use a version (names and identifying information removed) of the compendium in providing responses to persons providing comments. Please advise if you do not want your comments included in the latter version of the compendium.)

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## Commissioner of Taxation

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<i>Previous draft:</i>	- ANTS(GST)A 1999 11-15(4)
Not previously issued in draft form	- ANTS(GST)A 1999 11-15(5)
	- ANTS(GST)A 1999 40-5
	- ANTS(GST)A 1999 40-5(1)
<i>Related Rulings/Determinations:</i>	- ANTS(GST)A 1999 70-5(1)
GSTR 2002/2; GSTR 2004/1	- ANTS(GST)R 1999 40-5.06
	- ANTS(GST)R 1999 40-5.07
	- ANTS(GST)R 1999 40-5.09
<i>Subject references:</i>	- ANTS(GST)R 1999 40-5.09(1)
- credit cards	- ANTS(GST)R 1999 40-5.09(3)
- Goods and services tax	- ANTS(GST)R 1999 40-5.12
- GST financial supplies	- ANTS(GST)R 1999 Div 70
- input tax credit entitlement	- ANTS(GST)R 1999 70-5.02
- reduced credit acquisitions	- ANTS(GST)R 1999 70-5.02(1)
	- ANTS(GST)R 1999 70-5.02(2)
<i>Legislative references:</i>	- TAA 1953 Sch 1 105-60
- ANTS(GST)A 1999 11-15	
- ANTS(GST)A 1999 11-15(2)(a)	

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## ATO references

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