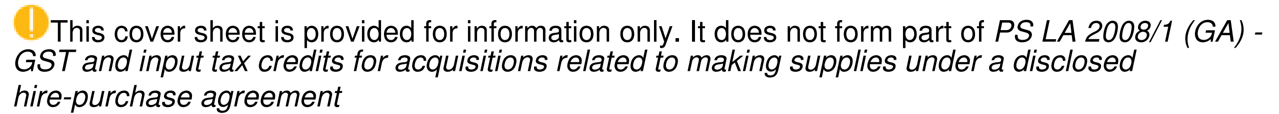
PS LA 2008/1 (GA) - GST and input tax credits for acquisitions related to making supplies under a disclosed hire-purchase agreement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This document has changed over time. This version was published on *1 April 2008*

Practice Statement Law Administration (General Administration)

PS LA 2008/1 (GA)

FOI status: may be released

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SUBJECT: **GST and input tax credits for acquisitions related to making supplies under a disclosed hire-purchase agreement**

PURPOSE: **To outline the Commissioner's approach to calculating the input tax credit entitlement for acquisitions that relate to the making of supplies under disclosed hire-purchase agreements**

Table of contents **Paragraph**

BACKGROUND	**1**
STATEMENT	**5**
Our approach to arrangements pre 1 April 2008	8
Our approach to arrangements from 1 April 2008	10
EXPLANATION	**13**
Previous position	24
Current position	26
The use of the 'revenue' method for products other than disclosed hire-purchase agreements	38
Examples	39

(1) Partly creditable acquisition – no entitlement to reduced input tax credits 39
Tax periods up to and including the tax period ending 31 March 2008 39
Example 1 – acquisition of overheads on or before 31 March 2008 40
Tax periods from 1 April 2008 41
Example 2 – acquisition of overheads on or after 1 April 2008 42
(2) Partly creditable acquisition – entitlement to reduced input tax credits 43
Tax periods up to and including the tax period ending 31 March 2008 43
Example 3 – acquisition of 'introductory services' on or before 31 March 2008 44
Tax periods from 1 April 2008 45
Example 4 – acquisition of 'introductory services' on or after 1 April 2008 46
(3) Partly creditable acquisition - no entitlement to reduced input tax credits (acquisition allocated to a dedicated 'asset finance cost centre' – no floor plan finance activities) 47
Tax periods up to and including the tax period ending 31 March 2008 47
Example 5 – acquisition of 'overheads' on or before 31 March 2008 48
Example 6 – acquisition of 'overheads' on or before 31 March 2008 49
Example 7 – acceptable use of a revenue based formula 51
Tax periods from 1 April 2008 52
Example 8 – acquisition of 'overheads' on or after 1 April 2008 53
(4) Partly creditable acquisition - no entitlement to reduced input tax credits (acquisition allocated to a dedicated asset finance cost centre - floor plan finance activities) 54
Tax periods up to and including the tax period ending 31 March 2008 54
Example 9 – acquisition of 'overheads' on or before 31 March 2008 55
Example 10 – acceptable use of a revenue based formula 56
Tax periods from 1 April 2008 57
Example 11 – acquisition of 'overheads' on or after 1 April 2008 58

BACKGROUND

1. This practice statement explains a method for the calculation of input tax credits for acquisitions related to supplies made under a disclosed hire-purchase agreement that will be accepted by the Commissioner as complying with the relevant provisions of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

2. A hire-purchase agreement is a 'disclosed' hire-purchase agreement if the credit for the goods supplied under the arrangement is provided as a separate charge that is disclosed to the recipient of the goods.

3. The practice statement applies only to those acquisitions that relate both to the supply of the goods and to the supply of the credit. These acquisitions are partly creditable acquisitions necessitating the need for a fair and reasonable apportionment of acquisitions between creditable and non-creditable parts.

4. The practice statement does not apply to the acquisition of goods (for example motor vehicles) for supply under a disclosed hire-purchase agreement.

STATEMENT

5. Applying the law to determine the extent of creditable purpose in relation to disclosed hire-purchase agreements is inherently uncertain and can give rise to practical difficulties and disproportionately high compliance costs for taxpayers. It is also unlikely to be cost effective in most cases for the Tax Office to undertake compliance action in this area in an attempt to find a precise extent of creditable purpose.

6. Given that level of uncertainty, it is appropriate for the Commissioner to accept as complying with the law an approach to determining the extent of creditable purpose for a partly creditable acquisition that is in line with those set out in this practice statement.

7. The practice statement outlines a range of scenarios in which the extent of creditable purpose for a partly creditable acquisition is required to be determined. These scenarios include circumstances where:

- there is no entitlement to reduced input tax credits
- there is entitlement to reduced input tax credits
- there is no entitlement to reduced input tax credits and the acquisition is allocated to a dedicated asset finance cost centre – no floor plan finance[1] activities, and
- there is no entitlement to reduced input tax credits and the acquisition is allocated to a dedicated asset finance cost centre – floor plan finance activities.

Our approach to arrangements pre 1 April 2008

8. For a tax period up to and including a tax period ending 31 March 2008,[2] the Commissioner will accept an approach that applies a revenue based formula (incorporating consistent values for both financial supplies and non-financial supplies) to determine the extent of creditable purpose for partly creditable acquisitions.

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[1] Schedule 1 to Goods and Services Tax Ruling GSTR 2002/2 defines 'floor plan finance' as an agreement under which a financier purchases capital goods from a manufacturer or distributor for the purposes of display and sale by a wholesaler or retailer. The financier retains legal title to the goods, while possession and limited rights over the goods (and the obligation to return goods if unsold) are granted to the dealer. Floor plan finance is a form of bailment.

[2] Subject to the application of section 105-50 of the *Tax Administration Act 1953* (TAA).

9. However, the Commissioner may commence an audit on a BAS period up to and including 31 March 2008[3] where the taxpayer has applied a revenue based formula that includes:

   (a) the value of 'floor plan payouts' as non-financial supply revenue in both the numerator and denominator of the formula, and/or

   (b) gross revenues for non-financial supplies in both the numerator and the denominator, and net revenues for financial supplies in the denominator of the formula.

Our approach to arrangements from 1 April 2008

10. For a tax period ending on or after 1 April 2008, the Commissioner will accept as being fair and reasonable an apportionment method (including a set-rate method) that achieves an extent of creditable purpose for partly creditable acquisitions of less than or equal to 15%.

11. The Commissioner considers that an extent of creditable purpose of 15% is likely to be at the top end of the range of the proportions that could be expected in disclosed hire purchase agreements and in most cases, therefore, is likely to be a fair reflection of the apportionment required by the law.

12. However, there is no requirement for a taxpayer to adopt an extent of creditable purpose of 15% where a proportion in excess of 15% is fair and reasonable on a proper application of the law to the taxpayer's particular circumstances. Taxpayers may wish to seek a GST private ruling before applying a higher percentage, and are encouraged to do so.

EXPLANATION

13. For the purposes of the GST Act, two separate and distinct supplies are made under a disclosed hire-purchase agreement. These are the taxable (or GST-free) supply of the goods and the input taxed (financial) supply of an interest in or under a credit arrangement.

14. A taxpayer is entitled to an input tax credit for any creditable acquisitions that it makes. Under section 11-15 of the GST Act, a thing is acquired for a creditable purpose to the extent that it is acquired in carrying on the taxpayer's enterprise. However a thing is not acquired for a creditable purpose to the extent that the acquisition relates to making supplies that would be input taxed.

15. Under subsection 11-30(1) of the GST Act, an acquisition is partly creditable where, amongst other things, the acquisition is made partly for a creditable purpose.

16. Therefore, an acquisition which relates to both the taxable (or GST-free) activity and the input taxed activity of the entity under a disclosed hire-purchase agreement is a partly creditable acquisition.

17. An example of a type of acquisition which relates to both activities under the arrangement is an introductory / arrangement service. This service may be acquired from an entity that facilitates the supply of a disclosed hire-purchase agreement for the taxpayer. A retail motor vehicle dealership may be such an entity.

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[3] Subject to the application of section 105-50 of the *Tax Administration Act 1953*.

18. Overheads are another example of the type of acquisitions which are partly creditable because they relate to both activities under the arrangement. These acquisitions such as leased premises, utilities and stationery may also relate to other activities of the entity.

19. Where a taxpayer makes a partly creditable acquisition, the amount of input tax credit is determined by applying the following formula set out in subsection 11-30(3) of the GST Act:

Full input tax credit × Extent of creditable purpose × Extent of consideration

where:

Extent of creditable purpose is the extent to which the creditable acquisition is for a creditable purpose, expressed as a percentage of the total purpose of the acquisition.

20. Some partly creditable acquisitions may also be subject to the application of Division 70 of the GST Act. Division 70 provides for a reduced input tax credit for certain acquisitions, where credit has been denied (either wholly or partly) because the acquisition relates to some extent to making financial supplies. Reduced credit acquisitions are listed in subregulation 70-5.02(2) of the A New Tax System (Goods and Services Tax) Regulations 1999 (GST Regulations).

21. For example, the acquisition of introductory/arrangement services discussed in paragraph 17 of this practice statement, qualifies as a reduced credit acquisition under item 18 of subregulation 70-5.02(2) of the GST Regulations.

22. Division 70 of the GST Act makes a reduced credit acquisition creditable to the extent it relates to making financial supplies. Regulation 70-5.03 of the GST Regulations specifies the percentage of input tax credit for each kind of reduced credit acquisition as 75%.

23. Where a reduced credit acquisition is partly for a creditable purpose because of Division 11 of the GST Act, and partly for a creditable purpose because of Division 70 of the GST Act, the extent to which the acquisition is acquired for a creditable purpose is worked out using the formula in subsection 70-20(2).

Previous position

24. The Commissioner, on 28 October 2002, set out his views (via the Tax Office website – *Financial Services – Questions and Answers, Question 14. Hire-purchase arrangements and apportionment methodology*) on disclosed hire-purchase arrangements and the treatment of related acquisitions. This advice has since been amended to clarify its application.

25. The Commissioner in this advice, amongst other things, expressed the view that:

- the use of a general formula approach incorporating gross revenues for non-financial supplies (for example bailment and the supply of vehicles), and net revenues for financial supplies under hire-purchase agreements is not a fair and reasonable method of determining the extent of creditable purpose for overheads. This inconsistent treatment of financial supplies and taxable supplies in the general formula gives a weighting to taxable supplies which is out of proportion to the input taxed activities carried out, and

- a method that reflects the extent of input taxed activities is preferred. Whilst no particular approach was advocated, the Commissioner suggested that a method based on current contracts modified to reflect the extent of taxable activities associated with a hire-purchase contract may be a more appropriate method of determining the extent of creditable purpose of overheads.

Current position

26. Goods and Services Tax Ruling GSTR 2006/3 calls for a fair and reasonable approach to determining extent of creditable purpose and apportioning input tax credits. In practical terms, the 'fair and reasonable' concept is merely a way of saying that the method chosen to determine 'use' of an acquisition must be justifiable.

27. A justifiable apportionment methodology in this context is one that takes into account the level of enterprise activities or business effort devoted to the taxable and input taxed elements of a disclosed hire-purchase agreement. In this regard, the Commissioner considers that the main activity of such an enterprise predominantly involves the provision of credit and consequently the majority of expenditure would be related to the making of input taxed supplies.

28. Whilst the making of a taxable supply by the taxpayer to the customer is an integral part of the arrangement, the nature of the surrounding commercial circumstances to the arrangement establishes that the taxpayer typically employs little in the way of business effort in making such a supply. Consequently, a justifiable apportionment methodology in this context should reflect that acquisitions are predominantly used by the taxpayer in the carrying out its financial intermediary role and to a much lesser extent in the making of taxable supplies.

29. On this basis, the Commissioner maintains the view that the use of a revenue based formula approach is not a fair and reasonable method of determining the creditable purpose of partly creditable acquisitions because it allocates a disproportionate amount of expenditure to the taxable activity which is contrary to the fundamental nature of the typical enterprise offering this type of credit arrangement.

30. The Commissioner's view that the appropriate proportion of expenditure to be allocated to the taxable activity ought to be a small percentage has lead to consideration of practices in other jurisdictions in order to arrive at an acceptable practical approach to the problem. Both the United Kingdom and New Zealand use a set rate for apportioning credit on overheads under hire-purchase agreements.

31. The United Kingdom, under the *HM Customs & Excise Agreement with the Finance Houses Association Ltd about finance houses and partial exemption (September 1984)*, accepted a rate of 15% based upon research and negotiation. The Agreement expired in 2000, and advice received is that any new rate agreed will not be greater than 15%.[4]

32. New Zealand accepted a rate of 10% which was a compromise between the (then) United Kingdom rate of 15% and the 5% rate arrived at through empirical testing undertaken in the field.

33. As international precedent suggests that a set rate method is acceptable to most industry participants, and also suggests that a maximum rate of 15% is appropriate, the Commissioner therefore considers that 15% is a reasonable percentage to apply in determining extent of creditable purpose for Division 11 of the GST Act under a disclosed hire-purchase agreement.

34. Notwithstanding this view, for a tax period up to and including a tax period ending on 31 March 2008, the Commissioner will accept the application of a revenue based method of apportionment (incorporating consistent values to values for both financial supplies and non-financial supplies) to determine the extent of creditable purpose for partly creditable acquisitions. The Commissioner takes this approach in view of the particular circumstances which have surrounded the implementation of GST to disclosed hire-purchase agreement transactions.

35. However, for the abovementioned BAS periods, a taxpayer will be at a risk of audit in circumstances where they have applied a revenue based formula incorporating bailment payouts and / or gross revenues for non-financial supplies and net revenues for financial supplies. This is due to the ATO view on such practices being clearly outlined in GST public rulings.[5]

36. For a tax period ending on or after 1 April 2008, the Commissioner will accept an apportionment method (including a set-rate method) that achieves an extent of creditable purpose for partly creditable acquisitions of less than or equal to 15%.

37. Taxpayers that consider a proper application of the law to their circumstances warrants a higher percentage may if they wish seek a private ruling and are encouraged to do so prior to applying a higher rate.

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[4] The Commissioner notes the decision in the UK Value Added Tax (VAT) Tribunal case *Royal Bank of Scotland Group PLC* [2007] BVC 19983 (where HMRC argued for a 0% rate). The unique features of this case make it unreliable as a precedent for Australian GST purposes. For example, conflicting evidence in the way in which the case was presented ultimately led to the VAT Tribunal adopting the application of a 'transaction count' apportionment method which we consider provides a doubtful proxy for the measurement of use to which expenditure is applied in these arrangements. Additionally, the VAT Tribunal provided little in the way of clarification as to why this method was considered fair and reasonable.

[5] See the abovementioned *Financial Services – Questions and Answers, Question 14. Hire purchase arrangements and apportionment methodology*) and paragraph 109 of GSTR 2006/3.

The use of the 'revenue' method for products other than disclosed hire-purchase agreements

38. Notwithstanding that the Commissioner considers that the revenue based method is inappropriate in typical cases, it is open for a taxpayer to apply a revenue based method of apportionment to their circumstances where the use of such an approach achieves an accurate reflection of the input tax credits available for acquisitions acquired in carrying on the taxpayer's enterprise. Accordingly, while it is open for a taxpayer to adopt a revenue based approach to apportionment, the decision to do so must be based on fair and reasonable principles,[6] rather than a belief that resort to such method is available on a default basis (where no other method is available or practical).

Examples

(1) Partly creditable acquisition – no entitlement to reduced input tax credits

Tax periods up to and including the tax period ending 31 March 2008

39. Under subsection 11-30(3) of the GST Act, the amount of the input tax credit for a partly creditable acquisition that does not give rise to reduced input tax credits is calculated by applying the formula:

Full input tax credit × Revenue formula%[7] × Extent of consideration[8]

where the revenue formula includes:

$$\frac{\text{GST- exclusive value of gross disclosed hire-purchase principal receipts}}{\text{GST- exclusive value of total gross disclosed hire-purchase receipts}} \times \frac{100}{1}$$

40. *Example 1 – acquisition of overheads on or before 31 March 2008*

EasyCredit Financial Services (EasyCredit) carries on an enterprise of providing motor vehicle finance to customers on disclosed hire-purchase terms. In the September 2006 tax period, EasyCredit is invoiced for 'overheads' worth $55,000 (inclusive of $5,000 GST). To determine its entitlement to input tax credits, EasyCredit applies a revenue based formula. This formula uses the previous month's gross receipts from the hire-purchase activities as follows: the GST exclusive value of principal repayments ($830,000) is divided by the total GST exclusive value of both principal and interest repayments ($1,000,000) and multiplied by 100.

Using this formula EasyCredit determines an extent of creditable purpose of 83% for its 'overhead' acquisitions. The amount of input tax credit is $4,150 ($5,000 × 83%).

In this circumstance, based on the application of the abovementioned methodology, the Commissioner will accept the input tax credit claim determined by EasyCredit.

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[6] As stated in paragraph 73 of Goods & Services Tax Ruling (GSTR) 2006/3 Goods and services tax: determining the extent of creditable purpose for providers of financial supplies.

[7] As required by subsection 11-30(3) of the GST Act, in this circumstance, the extent of creditable purpose% is determined by application of the revenue based formula approach outlined in paragraph 8 of this practice statement.

[8] In each of the associated examples, the assumption has been made that the extent of consideration is 100% (and has therefore not been depicted).

Tax periods from 1 April 2008

41. Under subsection 11-30(3) of the GST Act, the amount of the input tax credit for a partly creditable acquisition that does not give rise to reduced input tax credits is calculated by applying the formula:

    Full input tax credit × 15%[9] × Extent of consideration[10]

42. *Example 2 – acquisition of overheads on or after 1 April 2008*

    In the November 2008 tax period, EasyCredit is invoiced for 'overheads' to the value of $66,000 (inclusive of $6,000 GST). To determine its entitlement to input tax credits, EasyCredit applies the 15% set-rate. The amount of input tax credit for its 'overhead' acquisitions is $900 ($6,000 × 15%).

    In this circumstance, based on the application of the 15% set-rate method, the Commissioner will accept the input tax credit claim determined by EasyCredit.

(2) Partly creditable acquisition – entitlement to reduced input tax credits

Tax periods up to and including the tax period ending 31 March 2008

43. Subsection 11-30(3) of the GST Act is modified by applying the formula set out in subsection 70-20(2) of the GST Act in relation to the 'extent of creditable purpose' component. The amount of input tax credit, for a partly creditable acquisition that includes an entitlement to reduced input tax credits, is calculated by applying the formula:

    Extent of creditable purpose + [Extent of Division 70 creditable purpose × Percentage credit reduction]

    where:

    the *extent of creditable purpose* is calculated as follows:

    Full input tax credit × Revenue formula%[11] × Extent of consideration[12]

    where the revenue formula includes:

    $$\frac{\text{GST- exclusive value of gross disclosed hire-purchase principal receipts}}{\text{GST- exclusive value of total gross disclosed hire-purchase receipts}} \times \frac{100}{1}$$

    the *extent of Division 70 creditable purpose* is the extent expressed as a percentage, to which the purpose for which the entity makes the acquisition was a creditable purpose, because of Division 70.

    the *percentage credit reduction* is 75%[13]

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[9] As required by subsection 11-30(3) of the GST Act, in this circumstance, the extent of creditable purpose% is determined by application of the 15% set-rate approach (or such other percentage agreed to with the Commissioner) outlined in paragraph 10 of this practice statement.

[10] In each of the associated examples, the assumption has been made that the extent of consideration is 100% (and has therefore not been depicted).

[11] As required by subsection 11-30(3) of the GST Act, in this circumstance, the extent of creditable purpose% is determined by application of the revenue based formula approach outlined in paragraph 8 of this practice statement.

[12] In each of the associated examples, the assumption has been made that the extent of consideration is 100% (and has therefore not been depicted).

[13] See paragraph 22 of this practice statement.

44. *Example 3 – acquisition of 'introductory services' on or before 31 March 2008*

In the June 2006 tax period, Hybrid Motor Vehicle Dealerships (Hybrid) invoices EasyCredit for 'introductory services' to the value of $82,500 (inclusive of $7,500 GST). These services are reduced credit acquisitions under item 18 of regulation 70-5.02. EasyCredit calculates its extent of creditable purpose using the revenue based formula described in Example 1 (83%). It then applies this in the subsection 70-20(2) formula as follows: extent of creditable purpose (83%) plus (the extent of Division 70 creditable purpose (17%) times the percentage credit reduction (75%)). That is 83% plus 12.75% giving an extent of creditable purpose of 95.75% The amount of input tax credit for the acquisition of introductory services is $7,181 ($7,500 × 95.75%).

In this situation, based on the application of the abovementioned methodology, the Commissioner will accept the input tax credit claim determined by EasyCredit.

Tax periods from 1 April 2008

45. Subsection 11-30(3) of the GST Act is modified by applying the formula set out in subsection 70-20(2) of the GST Act in relation to the 'extent of creditable purpose' component. The amount of input tax credit, for a partly creditable acquisition that includes an entitlement to reduced input tax credits, is calculated by applying the formula:

Extent of creditable purpose + [Extent of Division 70 creditable purpose × Percentage credit reduction]

where:

the *extent of creditable purpose* is 15%

the *extent of Division 70 creditable purpose* is 85%

the *percentage credit reduction* is 75%

46. *Example 4 – acquisition of 'introductory services' on or after 1 April 2008*

In the April 2008 tax period, Hybrid invoices EasyCredit for 'introductory services' to the value of $124,875 (inclusive of $11,352 GST). These services are reduced credit acquisitions under item 18 of regulation 70-5.02. Using the 15% set-rate in the subsection 70-20(2) formula EasyCredit determines the extent of creditable purpose for the acquisition of 'introductory services' from Hybrid as follows: 15% + [85% × 75%] giving an extent of creditable purpose of 78.75%. The amount of input tax credit for the acquisition of 'introductory services' is $8,939 ($11,352 × 78.75%).

In this situation, based on the application of the 15% set-rate method, the Commissioner will accept the input tax credit claim determined by EasyCredit.

(3) Partly creditable acquisition - no entitlement to reduced input tax credits (acquisition allocated to a dedicated 'asset finance cost centre' – no floor plan finance activities)

Tax periods up to and including the tax period ending 31 March 2008

47. A taxpayer that has a dedicated asset finance cost centre or apportions expenses at an overall enterprise level, and provides only retail finance products (that is, no floor plan wholesale finance products), can calculate the extent of creditable purpose under subsection 11-30(3) of the GST Act for partly creditable overheads using the formula:

Full input tax credit × Revenue formula%[14] × Extent of consideration[15]

where the revenue formula includes gross (GST exclusive) revenues for non-financial supplies in both the numerator and the denominator, and gross revenues for financial supplies in the denominator of the formula.

48. *Example 5 – acquisition of 'overheads' on or before 31 March 2008*

CarFinance Financial Services (CarFinance) supplies a range of asset finance products including finance and operating leases, chattel mortgages and disclosed hire-purchase agreements to customers. In carrying on its enterprise, CarFinance allocates its 'overhead' acquisitions to a central cost centre which services all of its asset finance activities, and applies a revenue based formula to determine the extent of creditable purpose for these acquisitions. The revenue based formula applied by CarFinance uses:

(a) gross (GST exclusive) finance and operating lease revenue – this product represents 25% of active contracts, and historically generates gross annual revenue of $77 million

(b) gross chattel mortgage revenue (including principal and interest repayments) – this product represents 25% of active contracts, and historically generates gross annual revenue of $77 million ($66 million principal repayments and $11 million interest repayments/credit charges), and

(c) gross (GST exclusive) disclosed hire-purchase revenue (including both principal and interest repayments) - this product represents 50% of the active contracts, and historically generates gross annual revenue of $193 million ($165 million principal repayments and $28 million interest repayments/credit charges).

Using the gross annual revenues, CarFinance determines that its overhead acquisitions are made 69% for a creditable purpose as follows; $242 million (which is made up of $165 million disclosed hire-purchase principal repayments and $77 million leasing payments) divided by $347 million (calculated by adding $193 million disclosed hire-purchase repayments, $77 million leasing payments and $77 million chattel mortgage principal and interest repayments) and multiplied by 100.

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[14] As required by subsection 11-30(3) of the GST Act, in this circumstance, the extent of creditable purpose% is determined by application of the revenue based formula approach outlined in paragraph 8 of this practice statement.

[15] In each of the associated examples, the assumption has been made that the extent of consideration is 100% (and has therefore not been depicted).

In the September 2007 tax period, CarFinance is invoiced for 'overheads' worth $1.1 million (inclusive of $100,000 GST). By application of the 69% extent of creditable purpose, CarFinance calculates that the amount of input tax credit entitlement for these acquisitions is $69,000 ($100,000 × 69%).

In this scenario, based on the application of the abovementioned methodology, the Commissioner will accept the input tax credit claim determined by CarFinance for its 'overhead' acquisitions.

49. *Example 6 – acquisition of 'overheads' on or before 31 March 2008*

Mobile Financial Solutions (Mobile) supplies a range of asset finance products to customers including finance and operating leases, chattel mortgages and disclosed hire-purchase agreements. Mobile allocates its 'overhead' acquisitions to a central cost centre which services all of its asset finance activities. Mobile also uses a revenue based formula to determine the extent of creditable purpose for its overhead acquisitions. However, the revenue based formula applied by Mobile uses:

(a) gross (GST exclusive) finance and operating lease revenue – this product represents 20% of active contracts, and historically generates gross annual revenue of $50 million

(b) net chattel mortgage interest revenue – this product represents 30% of active contracts, and historically net annual revenue of $3 million. This net figure is calculated as $18 million gross interest repayments/credit charges minus $15 million being the annual cost of funding the chattel mortgages. Gross annual principal repayments are not included in the calculation but generate $89 million, and

(c) gross (GST exclusive) disclosed hire-purchase principal repayments and net disclosed hire-purchase interest revenue – this product represents 50% of active contracts, and historically generates $165 million in gross annual principal repayments and $6 million net annual interest revenue This is calculated as $28 million gross interest repayments/credit charges minus $22 million being the annual cost of funding the disclosed hire-purchase products.

Using the gross revenues, Mobile determines that its overhead acquisitions are made 95.99% for a creditable purpose as follows; $215 million (which is made up of $165 million disclosed hire-purchase principal repayments and $50 million leasing revenue) divided by $224 million (calculated by adding $165 million disclosed hire-purchase principal repayments, $6 million net disclosed hire-purchase interest revenue, $50 million leasing revenue and $3 million net chattel mortgage interest revenue) and multiplied by 100.

In the November 2006 tax period, Mobile is invoiced for 'overheads' worth $1.1 million (inclusive of $100,000 GST). Using 95.99% extent of creditable purpose, Mobile calculates that the amount of input tax credit entitlement for these acquisitions is $95,990 ($100,000 × 95.99%).

Mobile has applied a revenue based formula to work out the extent of creditable purposes for 'overhead' acquisitions that are attributable to a tax period which ends on or before 31 March 2008.

However, in this circumstance, the Commissioner is likely to challenge the input tax credits determined by Mobile for its 'overhead' acquisitions because the revenue based formula applied incorporates inconsistent values for input taxed and non-input taxed activities.

50. Had Mobile included gross (GST exclusive) revenues for non-financial supplies in both the numerator and the denominator, and gross revenues for financial supplies in the denominator of the formula, the Commissioner would have accepted the amount of input tax credits determined on that basis.[16]

51. *Example 7 – acceptable use of a revenue based formula*

Using Mobile's gross revenues, the extent of creditable purpose is 61% as follows: $215 million (made up of $50 million gross leasing revenue and $165 million gross disclosed hire-purchase principal revenue) divided by $350 million (calculated by adding $50 million gross leasing revenue, $165 million gross disclosed hire-purchase principal revenue, $28 million gross disclosed hire-purchase interest revenue, $89 million gross chattel mortgage principal revenue and $18 million gross chattel mortgage interest/credit charges revenue) and multiplied by 100.

Had Mobile used the 61% extent of creditable purpose figure, its input tax credit entitlement for its acquisition of 'overheads' would be $61,000 ($100,000 × 61%). This calculation of the entitlement to input tax credits would have been accepted by the Commissioner.

Tax periods from 1 April 2008

52. A taxpayer that has a dedicated asset finance cost centre or apportions expenses at an overall enterprise level, and provides only retail finance products (that is, no floor plan wholesale finance products), can calculate the extent of creditable purpose under subsection 11-30(3) of the GST Act for partly creditable overheads in the following manner:

Step 1 by a fair and reasonable method, determine the ratio of each retail finance product (for example disclosed hire-purchase agreements, chattel mortgages, finance lease and operating leases) to all retail finance products

Step 2 allocate overheads to each retail finance product according to the ratio of that product to all retail finance products

Step 3 overheads allocated to finance and operating lease products are acquired solely for a creditable purpose

overheads allocated to chattel mortgage products are acquired not at all for a creditable purpose

overheads allocated to disclosed hire-purchase products, go to step 4

[16] Equally, the Commissioner would have accepted the amount of input tax credits calculated by use of a revenue based formula inclusive wholly of net values for both financial supplies and non-financial supplies.

Step 4 apply the formula:

Full input tax credit $\times$ 15%[17] $\times$ Extent of consideration[18]

53. *Example 8 – acquisition of 'overheads' on or after 1 April 2008*

In the June 2008 tax period, CarFinance acquires 'overheads' for $2.2 million (inclusive of $200,000 GST). In determining its entitlement to input tax credits, CarFinance uses:

(a) gross (GST exclusive) finance and operating lease revenue – this product represents 25% of active contracts, and, historically generates gross annual revenue of $77 million

(b) gross chattel mortgage revenue (including principal and interest repayments) – this product represents 25% of active contracts, and, historically generates gross annual revenue of $77 million ($66 million principal repayments and $11 million interest repayments/credit charges), and

(c) gross (GST exclusive) disclosed hire-purchase revenue (including both principal and interest repayments) - this product represents 50% of the active contracts, and, historically generates gross annual revenue of $193 million ($165 million principal repayments and $28 million interest repayments/credit charges).

CarFinance adopts the following approach:

Step 1 CarFinance uses 'active contracts[19] to determine the ratio of each retail finance product to all finance products. Using historical benchmarks the ratios are:

Leasing (finance and operating)	-	25%
Chattel Mortgages	-	25%
Disclosed hire-purchase	-	50%

Step 2 CarFinance allocates the GST component of the $2.2 million 'overheads' ($200,000) to each retail finance product according to the ratio worked out in step 1, that is:

Leasing	$50,000 ($200,000 $\times$ 25%)
Chattel Mortgages	$50,000 ($200,000 $\times$ 25%)
Disclosed hire-purchase	$100,000 ($200,000 $\times$ 50%)

[17] As required by subsection 11-30(3) of the GST Act, in this circumstance, the extent of creditable purpose% is determined by application of the 15% set-rate approach (or such other percentage agreed to with the Commissioner) outlined in paragraph 10 of this practice statement.

[18] In each of the associated examples, the assumption has been made that the extent of consideration is 100% (and has therefore not been depicted).

[19] The use of 'active contracts' for 'portfolio' apportionment purposes is intended to be illustrative and is not prescriptive of the way in which 'portfolio' apportionment is to be carried out in all circumstances. The Commissioner will accept the use of other methods of 'portfolio' apportionment providing that the method selected delivers a fair and reasonable outcome.

Step 3 For overheads allocated to each retail finance product, CarFinance determines that:

overheads allocated to Leasing products are wholly for a creditable purpose giving an input tax credit entitlement of $50,000

overheads allocated to Chattel Mortgage products are not at all for a creditable purpose and do not give rise to any input tax credits, and

overheads allocated to disclosed hire-purchase products are partly for a creditable purpose, with the amount of input tax credit determined by applying the formula set out in step 4.

Step 4 CarFinance determines the amount of input tax credit for overheads allocated to disclosed hire-purchase products by applying the formula:

$100,000 × 15% = $15,000

By adding up the results from steps 3 & 4, CarFinance determines that it is entitled to an input tax credit of $65,000 (that is, $50,000 relating to leasing activities plus $15,000 determined to relate to the taxable supplies made under disclosed hire-purchase agreements).

In this circumstance, based on the application of the abovementioned approach, the Commissioner would accept the input tax credit claim determined by CarFinance.

(4) Partly creditable acquisition – no entitlement to reduced input tax credits (acquisition allocated to a dedicated asset finance cost centre – floor plan finance activities)

Tax periods up to and including the tax period ending 31 March 2008

54. A taxpayer that has a dedicated asset finance cost centre or apportions expenses at an overall enterprise level, and provides both floor plan wholesale finance products and retail finance products, can calculate the extent of creditable purpose under subsection 11-30(3) of the GST Act for partly creditable overheads in the following manner:

Full input tax credit × Revenue formula%[20] × Extent of consideration[21]

where the revenue formula:

(a) excludes the value of 'floor plan payouts'[22] as non-financial supply revenue in both the numerator and denominator of the formula, and/or

(b) and includes gross (GST exclusive) revenues for non-financial supplies in both the numerator and the denominator, and gross revenues for financial supplies in the denominator of the formula.

[20] As required by subsection 11-30(3) of the GST Act, in this circumstance, the extent of creditable purpose% is determined by application of the revenue based formula approach outlined in paragraph 8 of this practice statement.

[21] In each of the associated examples, the assumption has been made that the extent of consideration is 100% (and has therefore not been depicted).

[22] 'Floor plan payout' is the consideration received by the 'floor plan financier' for the supply of goods to the wholesaler/retailer, when the wholesaler/retailer sells the goods.

55. *Example 9 – acquisition of 'overheads' on or before 31 March 2008*

Mendarosa Financial Services (Mendarosa) is the wholly owned (non-GST grouped) finance arm of Mendarosa Motors. Mendarosa provides both wholesale (floor plan finance) and retail finance products (finance and operating leases, chattel mortgages, and disclosed hire-purchase agreements) to customers. Mendarosa allocates its 'overhead' acquisitions to a central cost centre which services all of its wholesale and retail asset finance activities. Mendarosa uses a revenue based formula to determine the extent of creditable purpose for its 'overhead' acquisitions. The revenue based formula applied by Mendarosa includes:

(a) the (GST exclusive) value of floor plan payouts – historically the annual amount of floor plan payouts is $750 million

(b) the (GST exclusive) value of floor plan fees – historically, floor plan fees generate $15 million in annual gross revenue

(c) gross (GST exclusive) finance and operating lease revenue – these products represent 30% of active contracts, and, historically generate annual gross revenue of $118 million

(d) net chattel mortgage interest revenue – this product represents 30% of active contracts, and, historically, annual net revenue of $3 million ($18 million gross interest repayments/credit charges minus $15 million annual cost of funding the chattel mortgages). Gross principal repayments are not included but generate $100 million annually, and

(e) gross (GST exclusive) disclosed hire-purchase principal repayments and net disclosed hire-purchase interest revenue – this product represents 40% of active contracts, and, historically, generates $135 million in annual gross principal repayments and $7 million annual net interest revenue ($22 million gross interest repayments/credit charges minus $15 million annual cost of funding the disclosed hire-purchase products).

Using these historical revenues, Mendarosa determines that its 'overhead' acquisitions are made 99.02% for a creditable purpose as follows: $1,018 million (made up of $750 million floor plan payouts plus $15 million floor plan fees plus $135 million disclosed hire-purchase principal repayments plus $118 million leasing revenue) divided by $1,028 million (calculated by adding $750 million floor plan payouts, $15 million floor plan fees, $135 million disclosed hire-purchase principal repayments, $118 million leasing revenue, $7 million net disclosed hire-purchase interest revenue and $3 million net chattel mortgage interest revenue) and multiplied by 100.

In the November 2006 tax period, Mendarosa acquires 'overheads' for $3.3 million (including GST). Applying 99.02% extent of creditable purpose Mendarosa calculates that the amount of input tax credit entitlement for these acquisitions is $297,060 ($300,000 × 99.02%).

Mendarosa has applied a revenue based formula to work out the extent of creditable purpose for 'overhead' acquisitions that are attributable to a tax period which ends on or before 31 March 2008.

However, in this circumstance, the Commissioner is likely to challenge the input tax credits determined by Mendarosa for its 'overhead' acquisitions because the revenue based formula applied incorporates floor plan payout amounts and inconsistent values for input taxed and non-input taxed activities.

Had Mendarosa excluded the value of floor plan payouts, and included gross revenues for non-financial supplies in both the numerator and the denominator, and gross revenues for financial supplies in the denominator of the formula, the Commissioner would have accepted the amount of input tax credits determined on that basis.[23]

56. *Example 10 – acceptable use of a revenue based formula*

Using Mendarosa's gross revenues the extent of creditable purpose is 65.68% as follows: $268 million (made up of $15 million floor plan finance fees plus $135 million gross disclosed hire-purchase principal revenue plus $118 million gross leasing revenue) divided by $408 million (calculated by adding $15 million floor plan finance fees, $135 million gross disclosed hire-purchase principal revenue, $118 million gross leasing revenue, $22 million gross disclosed hire-purchase interest revenue, $100 million gross chattel mortgage principal revenue and $18 million gross chattel mortgage interest/credit charges revenue) and multiplied by 100.

Had Mendarosa used the 65.68% extent of creditable purpose figure, its input tax credit entitlement for its 'overheads' would be $197,040 ($300,000 × 65.68%). This calculation of the entitlement to input tax credits for the 'overhead' acquisitions would have been accepted by the Commissioner.

Tax periods from 1 April 2008

57. A taxpayer that has a dedicated asset finance cost centre or apportions expenses at an overall enterprise level, and provides both floor plan wholesale finance products and retail finance products, can calculate the extent of creditable purpose under subsection 11-30(3) of the GST Act for partly creditable overheads in the following manner:

Step 1 by a fair and reasonable method apportion overhead acquisitions between 'wholesale' and 'retail' finance products

overheads allocated to wholesale finance products are acquired wholly for a creditable purpose

overheads allocated to retail finance products, go to step 2

Step 2 by a fair and reasonable method determine the ratio of each retail finance product (for example, disclosed hire-purchase agreements, chattel mortgages, finance and operating leases) to all retail finance products

Step 3 allocate overheads to each retail finance product according to the ratio of that product to all retail finance products

Step 4 overheads allocated to finance and operating lease products are acquired solely for a creditable purpose

overheads allocated to chattel mortgage products are acquired not at all for a creditable purpose

[23] As previously mentioned, the Commissioner would have equally accepted the amount of input tax credits calculated by use of a revenue based formula inclusive wholly of net values for both financial supplies and non-financial supplies.

overheads allocated to disclosed hire-purchase products, go to step 5

Step 5 apply the formula:

Full input tax credit × 15%[24] × Extent of consideration[25]

58. *Example 11 – acquisition of 'overheads' on or after 1 April 2008*

In the April 2008 tax period, Mendarosa acquires 'overheads' for $2.2 million (inclusive of $200,000 GST). In determining its entitlement to input tax credits, Mendarosa uses:

(a) the (GST exclusive) value of floor plan payouts – historically the annual amount of floor plan payouts is $750 million

(b) the (GST exclusive) value of floor plan fees – historically, floor plan fees generate $15 million in annual gross revenue

(c) gross (GST exclusive) finance and operating lease revenue – these products represent 30% of active contracts, and, historically generate annual gross revenue of $118 million

(d) net chattel mortgage interest revenue – this product represents 30% of active contracts, and, historically, annual net revenue of $3 million ($18 million gross interest repayments/credit charges minus $15 million annual cost of funding the chattel mortgages). Gross principal repayments are not included but generate $100 million annually, and

(e) gross (GST exclusive) disclosed hire-purchase principal repayments and net disclosed hire-purchase interest revenue – this product represents 40% of active contracts, and, historically, generates $135 million in annual gross principal repayments and $7 million annual net interest revenue ($22 million gross interest repayments/credit charges minus $15 million annual cost of funding the disclosed hire-purchase products).

Mendarosa adopts the following approach:

Step 1 Mendarosa allocates the GST component of the $2.2 million 'overheads' ($200,000) between its wholesale and retail finance products. It does this by applying the ratio of gross wholesale product revenue (excluding floor plan payouts) to total asset finance product revenue[26] (including gross wholesale and retail product revenue, but excluding floor plan payouts) to the $200,000 amount.

Using historical benchmarks, Mendarosa determines that 3.67% (calculated as $15 million annual gross floor plan fees divided by $408 million total annual gross asset finance revenues multiplied by 100) of the $200,000 should be allocated to its taxable wholesale finance products.

[24] As required by subsection 11-30(3) of the GST Act, in this circumstance, the extent of creditable purpose% is determined by application of the 15% set-rate approach (or such other percentage agreed to with the Commissioner) outlined in paragraph 10 of this practice statement.

[25] In each of the associated examples, the assumption has been made that the extent of consideration is 100% (and has therefore not been depicted).

[26] In the context of steps 1 & 2, the respective use of 'revenue' and 'active contracts' for 'portfolio' apportionment purposes is intended to be illustrative and is not prescriptive of the way in which 'portfolio' apportionment is to be carried out in all circumstances. The Commissioner will accept the use of other methods of 'portfolio' apportionment providing that the method selected delivers a fair and reasonable outcome.

The acquisition of the overheads allocated to Mendarosa's wholesale finance products is solely for a creditable purpose giving an input tax credit entitlement of $7,340 ($200,000 × 3.67%).

Step 2 Mendarosa uses 'active contracts'[27] to determine the ratio of each retail finance product to all finance products. Using historical benchmarks the ratios are:

Leasing (finance and operating)	-	30%
Chattel Mortgages	-	30%
Disclosed hire-purchase	-	40%

Step 3 Mendarosa allocates the remaining overheads ($192,660) to each retail finance product according to the ratio worked out in step 2, that is:

Leasing	$57,798 ($192,660 × 30%)
Chattel Mortgages	$57,798 ($192,660 × 30%)
Disclosed hire-purchase	$77,064 ($192,660 × 40%)

Step 4 For overheads allocated to each retail finance product, Mendarosa determines that:

overheads allocated to Leasing products are solely for a creditable purpose and give rise to an input tax credit entitlement of $57,798

overheads allocated to Chattel Mortgage products are not at all for a creditable purpose and do not give rise to any input tax credits

overheads allocated to disclosed hire-purchase products are partly for a creditable purpose. The amount of input tax credit is determined by applying the formula set out in step 5

Step 5. Mendarosa determines the amount of input tax credit for overheads allocated to disclosed hire-purchase products by application of the formula:

$77,064 × 15% = $11,559

By adding up the results from steps 1, 4 & 5, Mendarosa determines that it is entitled to an input tax credit of $76,697 (that is, $7,340 relating to wholesale finance activities plus $57,798 relating to leasing activities plus $11,559 determined to relate to the taxable supplies made under disclosed hire-purchase agreements).

In this circumstance, based on the application of the abovementioned approach, the Commissioner would accept the input tax credit claim determined by Mendarosa.

[27] In each of the associated examples, the assumption has been made that the extent of consideration is 100% (and has therefore not been depicted).

Subject references	acquisition creditable acquisition creditable purpose extent of creditable purpose GST hire-purchase input tax credit input taxed supply partly creditable reduced credit acquisition reduced input tax credit taxable supply
Legislative references	ANTS(GST)A 1999 Div 11 ANTS(GST)A 1999 11-15 ANTS(GST)A 1999 11-30(1) ANTS(GST)A 1999 11-30(3) ANTS(GST)A 1999 Div 70 ANTS(GST)A 1999 70-20(2) ANTS(GST)R 1999 70-5.02(2) ANTS(GST)R 1999 70-5.03 TAA 1953 Sch 1 105-60
Related public rulings	GSTR 2002/2; GSTR 2006/3
Related practice statements	
Other references	Financial Services – Questions and Answers, Question 14. Hire-purchase arrangements and apportionment methodology; HM Customs & Excise Agreement with the Finance Houses Association Ltd about finance houses and partial exemption (September 1984)
Case references	Royal Bank of Scotland Group PLC [2007] BVC 19983
File references	06/3806
Date issued	30 January 2008
Date of effect	1 April 2008
Other Business Lines consulted	**All**