THE TAX INSTITUTE

THE MARK OF EXPERTISE

28 February 2014

Ms Kate Preston
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The Treasury
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By email: GSTPolicyConsultations@treasury.gov.au

Dear Ms Preston,

Refunding Excess GST

The Tax Institute welcomes the opportunity to make a submission to the Treasury in relation to the *Tax and Superannuation Laws Amendment (2014 Measures No. 2) Bill 2014: Refunding Excess GST Exposure Draft* (**Exposure Draft**).

We welcome the amendments of the provision to restore the rights of taxpayers to seek review of the Commissioner's decisions under section 105-65 of the *Taxation Administration Act 1953* (Cth) (**TAA**) following the decision in *Naidoo v Commissioner of Taxation* [2013] AATA 443.

However, we consider the following issues need to be addressed as part of those amendments:

1. The amendments contained in the Exposure Draft leave open the question of what is the decision which would be reviewed under objection or by the Administrative Appeals Tribunal (**AAT**). Specifically:

    (a) the express words within section 105-65 contemplate that the "decision" by the Commissioner is a decision by the Commissioner not to give a refund. It would follow that if the Commissioner makes a decision not to give a taxpayer a refund, under the proposed amendments the taxpayer would now have a right to seek a review of the decision not to provide that refund. If this view is correct, the amendments should preserve the objection and review rights of taxpayers;

(b) notwithstanding the express words of the provision, the Commissioner's long held position is that section 105-65 merely gives him a discretion to pay a refund. In other words, to the extent the Commissioner makes a decision under section 105-65, that decision is a decision to pay a refund. If the Commissioner is correct in his view, the amendments may fail to achieve their intended aim, as absent an exercise by the Commissioner of his discretion (and the making of a decision to pay a refund), there is no decision which can be reviewed. The Commissioner has simply failed to make a decision.

We are concerned that if the provisions are passed in their current form and the Commissioner's view is maintained, the AAT may again find itself without jurisdiction to review any decision (or non-decision) made under section 105-65 – such significant uncertainty is undesirable and could be avoided by:

(i) the inclusion of a note confirming that the Commissioner is otherwise required to pay a refund where he does not exercise his discretion to withhold a refund; or

(ii) amending section 105-65(1) so that it provides that inter alia "The Commissioner may give a refund of an amount to which this section applies, ..., except where: ..." (i.e. to clarify that section 105-65 provides the Commissioner with a discretion to make a refund). Further, there would need to be a new subsection deeming the Commissioner to have made a reviewable decision where the Commissioner refuses to provide a refund, or otherwise fails to make a refund following a request by the taxpayer for a refund.

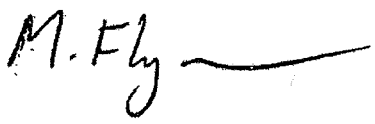
2. Item 17 of the Exposure Draft (namely the amendments to paragraph 14ZW(1)(bg)) contemplate the issue of a notice of the taxation decision under section 105-65. However, neither the amendments nor the current law provide for or require the Commissioner to issue a notice of his decision under section 105-65. Accordingly, we would recommend further amendments be introduced, requiring the Commissioner to issue a notice of decision under section 105-65. Further, the amendments should require the Commissioner to provide such a notice as soon as possible after a decision is made and / or give the taxpayer review rights where the Commissioner does not make a decision or provide any notice of that decision.

We also refer Treasury to our previous submissions on earlier iterations of proposed Division 142 attached in the appendices which identified other areas of concern with the proposed amendments:

- Appendix A – 2012 submission
- Appendix B – 2013 submission

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely



Michael Flynn
President

THE TAX INSTITUTE

19 September 2012

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Attn: Mr Michael Harms

By email: gstpolicyconsultations@treasury.gov.au

Dear Mr Harms,

Exposure Draft – Refunding Excess GST

The Tax Institute is pleased to have the opportunity to make a submission to the Treasury in relation to the Exposure Draft on Refunding Excess GST (**Exposure Draft**).

Summary

Our submission below addresses the following issues:

1. Concerns regarding the introduction of proposed Division 36 into the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (**GST Act**) as contained in the Exposure Draft;

2. Suggested amendments to section 105-65 of Schedule 1 to the *Taxation Administration Act 1953* (Cth) (**TAA**) to improve its operation in preference to the introduction of proposed Division 36 into the GST Act;

3. The likely impact of proposed Division 36 on the operation of other parts of the GST Act and the interaction with other parts of the tax laws; and

4. Amendments required to proposed Division 36 to ensure that it will operate satisfactorily in the existing GST system in the event our proposal to amend section 105-65 is not accepted.

References are to the GST Act unless otherwise stated.

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Discussion

1. Concerns of the profession in response to proposed Division 36

The original policy intent behind section 105-65 of Schedule 1 to the TAA was that

> "Ordinarily, if GST has been overpaid or entitlements to credits have been understated the Commissioner is obliged to refund the amount overpaid or credit understated"[1].

Section 105-65[2] operates as an exception to the general rules to ensure that the Commissioner is not required to refund GST in circumstances where a supplier has passed on the GST and receives a "windfall gain". In such circumstances, it is contemplated that the supplier would be required to refund the overpaid GST to the consumer of the goods and services prior to a refund being payable[3].

In this respect, section 105-65 reflects similar provisions that had previously operated under the *Sales Tax Assessment Act,* which limited the Commissioner's obligation to refund tax overpaid

> "unless the Commissioner is satisfied that the tax has not been passed on by the person to another person or, if passed on by the person to another person, has been refunded by the person to the other person"[4].

The provisions specifically allowed for the payment of a refund where sales tax had not been passed on or where the sales tax had been refunded. The provisions now found in section 105-65 were intended to introduce an equivalent regime in respect of GST. However, unlike the equivalent sales tax provisions, the GST administrative provisions do not codify the taxpayer's entitlement to a refund of tax overpaid. Therefore, in the context of section 105-65, it is unclear whether the section operates to give the Commissioner a discretion to pay refunds or is merely a discretion to withhold refunds of overpaid tax.

In addition, emanating from recent case law, a question of policy has arisen as to whether a section such as section 105-65 should be able to deal with the circumstances where an incorrect amount of GST has been remitted to the Commissioner either as a result of a mischaracterisation of a transaction or a miscalculation of the amount of GST that should have been remitted on the taxable supply made.

It is understood draft Division 36 is intended address these issues. However, in our view, Division 36 does not appear to achieve the policy intent behind the existence

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[1] See paragraph 3.39 of the Explanatory Memorandum to *the GST Administration Bill 1998* (Cth).
[2] Originally enacted as s. 39(3) of the TAA.
[3] See paragraph 3.40 and 3.41 of the Explanatory Memorandum to *the GST Administration Bill 1998* (Cth).
[4] S. 11 of the *Sales Tax Assessment Act (*No. 6) 1930 (Cth) as it applied historically.

of such a provision in the GST law (i.e. avoiding windfall gains) and goes well beyond addressing the issues identified with section 105-65.

We set out below some general concerns with the proposed Division 36.

1. *The proposed amendments attempt to supersede the substantive provisions of the GST Act.*

   The GST Act is determinative of whether supplies are to be treated as taxable, input taxed or GST-free. It undermines the integrity of the GST Act to apparently render those provisions meaningless and to have the legal status of a supply altered as a consequence of a taxpayer's error by operation of a division such as Division 36.

2. *Board of Taxation Recommendation and Issues arising out of the Sportsbet*[5] *case*

   The Board of Taxation (**Board**) in its "Review of the Legal Framework for the Administration of the Goods and Services Tax" Report recommended that section 105-65 be clarified to confirm the Commissioner has a discretion to refund GST in appropriate circumstances.

   In addition, the *Sportsbet* case highlighted the fact that section 105-65 only applied to mischaracterisations and did not apply to miscalculations, which was different to what the Commissioner had thought. Reference is made to this in the Explanatory Memorandum to the Exposure Draft (**EM**) where it is noted that taxpayers may be able to obtain a refund, and therefore a windfall gain, if an overpayment arises as a result of a miscalculation, which is inconsistent with the policy intent that taxpayers should not be able to obtain a windfall gain regardless of how the overpayment of GST arises (ie either by a mischaracterisation or miscalculation).

   In our view, the amendments contained in Division 36 do not implement the Board's recommendation nor do the amendments address the issue highlighted by the *Sportsbet* case. It would be useful if some context could be provided around how and why Division 36 was developed to explain why it has been drafted in the way that it has. We note below how the two issues raised by the Board and the *Sportsbet* case could adequately be addressed by straightforward amendments to section 105-65.

[5] *International All Sports v Commissioner of Taxation* [2011] FCA 824 (***Sportsbet***)

2. Section 105-65 – Issues and Proposed Amendments

Proposed Amendments to Section 105-65

As noted above, the Board recommended that section 105-65 should be amended to clarify that the Commissioner of Taxation has a discretion to refund GST where appropriate pursuant to this provision. We note that the Government agreed to adopt the recommendation in May 2009. A straightforward amendment to section 105-65 could be easily drafted and implemented.

In relation to the *Sportsbet* case, the issue that a refund of GST resulting from a miscalculation is not limited by the operation of section 105-65 was identified. The only amendment that is warranted to rectify this is an insertion into section 105-65 to the effect that "this section applies to miscalculations of GST payable," or words to that effect.

In this regard, The Tax Institute's preferred view is to make amendments to existing section 105-65 which incorporates the Board's recommendation, rectifies the issue identified by the *Sportsbet* case and satisfies the concerns that the profession has raised for some time in relation to the operation of this provision.

In addition, if Treasury is concerned that section 105-65 in its current form allows taxpayers (suppliers) to obtain refunds in circumstances where they have not borne the economic burden of the GST, the language in section 105-65 should be strengthened to reflect that the Commissioner may refuse to exercise his discretion to pay refunds in those circumstances. In our view, this is preferential to the outcomes likely to arise under Division 36.

We have included in the Attachment some suggested changes to section 105-65 for Treasury's consideration addressing the issues we have noted above which we believe would assist to resolve the issues identified above and make section 105-65 operate more effectively.

Provision should remain in the TAA and not be moved to the GST Act

The GST is a tax that is and was always intended to be payable in respect of taxable supplies. In imposing an amount of "GST payable" in respect of mischaracterisations and miscalculations, even in circumstances where there was no taxable supply or no supply of any kind, the proposed amendments under Division 36 will deviate considerably from this most fundamental principle of the GST. For this reason, we submit that any provision that limits refunds of overpaid GST should be contained in the TAA and not the GST Act. Such a provision would be administrative in nature (like the timing provisions in Subdivision 105-C of Schedule 1 the TAA and the restriction on refunds at

section 8AAZLGA of the TAA) and should not be confused with the substantive provisions that set out when GST is payable on supplies.

We also invite Treasury to consider whether an unintended consequence of the proposed amendments would be to impose tax on more than one subject matter for the purposes of section 55 of the *Commonwealth of Australia Constitution Act*. The question of whether the GST Act imposes tax on more than one subject was considered in *O'Meara v Federal Commissioner of Taxation* 2003 ATC 4406. In that case, Hely J found as follows:

> "In the present case, Parliament has according to "common understanding and general conceptions" imposed a tax on a single subject of taxation, namely on final private consumption in Australia. That is one subject of taxation for the purposes of s 55 of the *Constitution*."

The proposed amendments result in a windfall gain to the Commissioner in circumstances where a supplier has erred in characterising a supply or calculating an amount of GST payable. This cannot be described as a tax on final private consumption in Australia.

In this regard, The Tax Institute would prefer to see amendments made to the section 105-65 (such as those contained in the Attachment) in lieu of the introduction of the proposed Division 36 and that this provision remain in the TAA rather than be imported into the GST Act.

3. Potential impact of Division 36 on the operation of other parts of the GST Act and other parts of the tax laws

While as noted above, our preferred position is for specific amendments to be made to existing section 105-65, should Treasury still intend to introduce new provisions, we have identified several specific issues where proper consideration needs to be given to the intended operation of Division 36 and its potential impact on other areas of the tax law. We have set these out below.

(a) Amendments remove the ability of taxpayers to object to assessments

By deeming any excess GST to have always been payable, section 36-5 will, in many cases, remove the taxpayer's rights to object to an assessment for GST and/or contest the Commissioner's position (this is because even if a taxpayer can show a supply is not a taxable supply, the relevant assessment will not be excessive as section 36-5 will deem the GST to have been payable). Operating in this manner, the proposed introduction of section 36-5 will create constitutional issues, as it effectively results in GST becoming an incontestable tax. It also creates issues of public policy, as it will mean that where taxpayers are uncertain as to their tax position, to preserve their appeal rights they will need to treat the supply as non-taxable and ensure they do not pass on any GST. This should be

contrasted with the current regime under which a taxpayer is more likely to adopt a conservative position, initially accounting for the GST to the ATO, and seeking a refund if they are successful in challenging the ATO's position. We provide an example of this below.

Example

Deli Co is selling a bread product. The sale of bread is GST-free, but due to some characteristics of this product, the ATO has issued a private ruling confirming that the product is taxable. Deli Co, consistent with most retailers, determines their price by reference to the market price of equivalent products. Deli Co issues tax invoices to all customers.

If Deli Co accounts for GST on the sale of the bread, by operation of proposed Division 36, it will be unable to contest the ATO's position. Even if they objected to an assessment, and the supply of bread was found to be GST-free, the objection would not be allowed as the assessment would not be regarded as excessive. This is because, by operation of section 36-5, any GST incorrectly paid by Deli Co would be taken to have always have been payable (by operation of section 36-5(2)), irrespective of the correct GST treatment of the bread. In practice, it is unlikely that Deli Co will be able to satisfy the exceptions in section 36-5(2) and be able to treat the GST previously accounted for and remitted as not being "payable" as:

(i) it will have issued a tax invoice for the sale of the bread (and therefore will be deemed to have "passed on" the GST); and
(ii) some of its customers will be registered for GST.

Therefore, to succeed on an objection, Deli Co must not only show that the sale of the product is GST-free but also that it did not pass on any GST to another entity. The decision in *Avon*[6] illustrates how difficult, if not impossible, it is for an entity to satisfy the second test.

The alternative is for Deli Co to continue to sell the bread product GST-free. This is likely to result in the ATO issuing an assessment to Deli Co for additional GST (and penalties) that would be payable as the sale of the product has been determined to be taxable pursuant to the private ruling issued. Only in this scenario is Deli Co able to appeal and argue that the sale of bread is GST-free.

As a result, Deli Co is more likely to adopt this second more aggressive position as it preserves the possibility of an entitlement to a refund if it is ultimately correct in its technical position. Previously, a taxpayer was more likely to adopt the first more conservative position. From a policy perspective, such a change in behaviour is undesirable, as it exposes the Commissioner to credit risk (i.e. the risk it will not be able to recover the GST ultimately found to be payable) and increases compliance

[6] *Avon Products Pty Ltd v FCT* [2006] HCA 29

risk (as taxpayers are encouraged to adopt a more aggressive position to avoid the risk of being unable to recover GST that may be found not to be payable and therefore not likely to comply with their GST obligations).

(b) Amendments do not entitle the recipient to an input tax credit

Despite Note 2 to section 36-5(2), and paragraphs 1.36 to 1.38 of the EM, a recipient of a supply will not be entitled to an input tax credit for any excess GST. A recipient will only be entitled to an input tax credit under section 11-20 where it has made a creditable acquisition. The amount of the input tax credit is the amount equal to the GST payable on the supply of the creditable acquisition (section 11-25). Pursuant to section 11-5, a creditable acquisition only arises where:

(i) the recipient has acquired something for a creditable purpose; and
(ii) that acquisition is of a supply that is a taxable supply for consideration and the recipient is registered or required to be registered for GST.

Section 36-5(2) deems the excess GST to have always been payable "for the purposes of [the GST] Act". It does not deem the GST to have been payable on a taxable supply, unless this is intended to be inferred, in which case there is inherent uncertainty in relation to this in the current drafting of Division 36. Pursuant to section 11-5, whether a recipient of a supply has made a creditable acquisition turns on whether they have acquired a "taxable supply", not whether they have simply paid GST.

There is therefore doubt as to whether a recipient who has made an acquisition would in fact be eligible to an input tax credit for the excess GST component.

Where GST is incorrectly paid by a supplier to the Commissioner on a supply which is not a taxable supply, section 11-5 will not be satisfied, and hence the recipient will not be entitled to an input tax credit as the supply cannot be regarded as a creditable acquisition. Where there is in fact no supply (i.e. the scenario covered by *KAP Motors*[7]), section 11-5 also cannot be satisfied as there is no acquisition.

(c) *Amendments will result in a double windfall gain for the Commissioner*

For similar reasons as set out in (b) above, as section 36-5 does not deem the excess GST to have been payable on a taxable supply, where a supplier incorrectly treats an input taxed supply as a taxable supply, the Commissioner will receive a double windfall. The supplier will not be entitled to a refund from the Commissioner of GST incorrectly paid on the input taxed supply, thus Division 36 has a punitive effect on the supplier. At the same time, the supplier will be (correctly) denied any input tax credits on acquisitions made in making the input taxed supply. Hence, the supplier's legal rights and entitlements will be diminished

[7] *KAP Motors Pty Ltd & Anor v FCT* [2008] FCA 159

because they have made an error in, for example, characterising the supply for GST purposes. We illustrate this in the example below.

Example

A taxpayer treats a supply of accommodation to contractors on its mine site as being taxable and has issued tax invoices to the contractors. The contractors are registered for GST. The taxpayer has claimed input tax credits related to the construction and operation of the accommodation. On audit, the Commissioner concludes that the supply of the accommodation is input taxed. As the taxpayer has passed on the GST and the recipient of the supply is registered, the taxpayer will not be entitled to a refund of the excess GST paid (section 36-5(2), in particular subsection (ii)). As the supply made by the taxpayer is input taxed, the taxpayer was not entitled to the input tax credits claimed on the construction and operating costs. The Commissioner assesses the taxpayer for the input tax credits incorrectly claimed by the taxpayer. Should the taxpayer wish to reimburse the GST incorrectly charged to the contractors for the supply of the accommodation, the taxpayer will be unable to claim a refund of the excess GST as the recipients they are refunding are registered for GST.

Similarly, as the acquisition of the accommodation was input taxed, the recipients (the contractors) have not made a creditable acquisition. The Commissioner assesses the recipients for input tax credits incorrectly claimed on the acquisition of the accommodation.

The Commissioner has received a double windfall. This is similar to the windfall that can arise under section 105-65 and therefore this remains a live issue under proposed Division 36.

(d) Interaction with adjustment events

It appears evident from Example 1.7 included in the EM that the Commissioner intends to override the specific provisions dealing with adjustment events found in Division 19 of the GST Act. We note that section 105-65 has never applied to adjustment events, and the application of Division 36 to adjustment events will have significant impacts on commerce and systems.

Example 1.7 is an example of a change to the consideration for the supply which is an adjustment event (section 19-10(1)(b)). Under the current law, upon discovering that Robb had been overcharged, Mormont would issue Robb with an adjustment note for $220 and claim a decreasing adjustment. There would not be any need to regard the "excess" $20 of GST charged under the original price of $440 as "excess GST" to which section 105-65 would have applied on the basis that the character of the supply has not changed, nor was there a miscalculation of the GST owing on the taxable supply made. This is simply a case of a change to the consideration for the supply which consequently requires an adjustment to be made to the original amount of GST remitted.

Division 36 would appear to make it impossible for a decreasing adjustment to ever arise for a supplier under Division 19 if the recipient of the supply was registered for GST, even if the recipient was refunded, as the initial GST amount is deemed to have always been payable.

Rebates, discounts and other pricing adjustments, and partial or full cancellation of supplies, are then examples of transactions in which the Commissioner will receive windfall gains at the expense of taxpayers.

(e) Interaction with other taxes – Income Tax and FBT

The provisions create issues for the operation of income tax and fringe benefits tax provisions. For example, as section 36-5 does not deem the excess GST component to have been paid on a taxable supply, any excess amount passed on would appear to be assessable for income tax purposes. Section 17-5 of the *Income Tax Assessment Act 1997* (Cth) only exempts from "assessable income" the GST payable on taxable supplies. As the excess GST is not GST payable on a taxable supply, it does not appear to be exempt from income tax. Other issues arise such as whether the "excess GST" component is included or excluded from the cost base of a CGT asset and what impact the "excess GST" component might have on the FBT liability for a fringe benefit provided by an employer liable to FBT.

(f) Reliance on Tax Invoices

Reliance on the issue of a tax invoice (either supplier-created or recipient-created in relevant circumstances) is not sufficient evidence that the excess GST component has been passed on to the recipient.

The notion of "passing on" is not defined in the Exposure Draft. However, it is discussed at length in the EM and relies upon the issue of a tax invoice as evidence that the GST has been passed on to the recipient. The analysis in paragraphs 1.46 – 1.51 suggests the GST will have been passed on even where a mischaracterisation of a supply as a taxable supply or a miscalculation of the GST has occurred, even in the absence of the issue of a tax invoice. This is not necessarily proof that the economic burden of the GST has been borne by the recipient of the supply.

There is an imputed inference in the GST system that an unregistered recipient of a taxable supply always bears the economic burden and a registered recipient does not on the basis that ordinarily the registered recipient should be able to claim an input tax credit for GST paid. This is supported by the references to the Explanatory Memorandum to the GST Act made in the EM at paragraphs 1.44 and 1.45. However, this explanation supports the general application of the GST Act to suppliers who are effectively "tax collectors" and who are required to pay GST whether or not they are able to "pass it on" to (ie recover it from) persons to whom they have made taxable supplies. It is not evidence of the notion that the economic

burden of the GST is always passed on nor direct support for the inference that the burden of the GST is always borne by unregistered recipients only.

In the circumstances where customarily prices are expressed on a GST-inclusive basis, for example prices expressed under the margin scheme in the property sectors or prices expressed in the retail sector where ordinarily a consumer is not concerned with the calculation or application of GST because they are not entitled to claim an input tax credit, this assumption cannot be fairly made. This is because the consumer in this case generally accepts the price and pays it willingly and the supplier remits the relevant amount of GST and takes the risk (vis-à-vis the ATO) on that amount being correct.

Example 1.4 in the EM is an example applying the margin scheme. In this case, to suggest that a purchaser in these circumstances should be reimbursed the "excess GST" amount so that the supplier may obtain a refund of the excess GST, completely disregards the commercial reality of the transaction, being that the purchaser would have paid the agreed price whether the margin scheme had been applied to calculate the GST on the supply or not. The price of housing and apartments is driven by the market and does not increase or decrease due to the vendor's GST liability – an increased liability could not be passed on, so a decreased liability should not have to be refunded.

The notion that GST should be taken to be "passed on", simply because, for example, a tax invoice was issued, does not fairly apply in all the circumstances where a tax invoice has been issued. It is clearly not "passed on" where it can be reasonably demonstrated that the recipient of the supply would have paid the same amount for the supply regardless of the amount of GST stated in the tax invoice.

A further issue is whether the issue of an adjustment note is sufficient evidence of the refund of the excess GST paid by the recipient of the supply from the supplier to the recipient. This issue does not seem to have been addressed by Division 36.

(g) Attribution Issues

It is unclear how the amendments contained in Division 36 will impact the circumstance where a supplier attributes the GST to an incorrect tax period. It appears arguable that where a taxpayer has paid GST in an incorrect tax period, the taxpayer may not be entitled to a refund of the "excess GST" as it will have been passed on to the customer. This being the case, the amendments could produce absurd results where GST is paid in the incorrect tax period as an entity's assessed net amount for a tax period will include an amount that exceeds what is payable where it attributes GST to an incorrect tax period. Assuming this GST has been passed onto the recipient, the supplier may be unable to recover that GST from the Commissioner. However there is nothing to stop the Commissioner from reassessing the taxpayer for the GST in the correct period, as would normally be

the case where an entity accounts for the GST in the incorrect tax period. We illustrate with an example below.

Example

Big Co has, albeit incorrectly, accounted for GST on a cash basis (i.e. the GST has been included in the tax period in which payment is received). The relevant GST has been passed on to Big Co's customers and tax invoices have been issued. During an audit, the ATO identifies that Big Co should have been accounting for GST in earlier tax periods, when it issued the tax invoices. The Commissioner amends Big Co's assessments to include the GST in the earlier tax periods.

If this occurs, Big Co will essentially be taxed twice as it is not entitled to a refund of GST incorrectly paid in the later tax period because there has been no reimbursement of this GST to customers.

(h) Implications for a taxpayer accounting for GST on an accruals basis

For a taxpayer who accounts for GST on an accruals basis, it is unclear what is meant by whether the GST has been "passed on" to another entity. It appears apparent from section 36-5(3), that GST is "passed on" whether or not a tax invoice is issued. Payment of consideration (including GST) appears not to be relevant. Assuming this to be the case, it may produce absurd results for taxpayers who account for GST on an accruals basis, where there is opportunity for the taxpayer to detect the error following the issue of a tax invoice, but prior to receiving payment. This is because the taxpayer has opportunity to obtain the correct amount of GST from the recipient of the supply and issue a revised tax invoice and will not need to reimburse the recipient for the excess GST component.

Turning again to Example 1.7, assume that Mormont accounts for GST on an accruals basis and lodges its BAS on 21 April 2013. Assume also that Robb does not pay the invoice of $440 (e.g. because he considers he has been overcharged). On 25 May 2013, when Mormont realises he has overcharged Robb, Mormont issues a revised invoice for the correct amount. Robb pays the invoice. In this example, there has been no reimbursement as Robb pays the correct amount of GST. However, because there has been no reimbursement it appears that Mormont is not entitled to a refund of the additional $20 incorrectly remitted to the Commissioner.

(i) Interactions with GST payable in other circumstances

Section 36-5 appears to be focused on the GST payable on taxable supplies, however GST may also be payable in the context of taxable importations, where there is a reverse charge liability, or under a Subdivision153-B agency agreement. Each of these scenarios also creates problems for the operation of section 36-5.

(j) Inability to self-assess GST refunds

Having regard to Treasury's comments that GST refunds should be brought into line with the self-assessment regime for indirect taxes, we note that in all cases where section 105-65 doesn't apply, the current default position is that a taxpayer can self-assess a refund. However, in some circumstances it is necessary for the Commissioner to consider GST refund claims on a case by case basis, for example, in determining whether the economic burden of the GST has been passed on to a recipient (e.g. where a GST-inclusive price is agreed, notwithstanding that a tax invoice has issued).

The answer to this is not to deny all refunds in circumstances where a refund claim should not be automatic, but would warrant an exercise of the Commissioner's discretion, taking into account the relevant facts and circumstances. The unfair and inconsistent outcomes that are likely to arise under Division 36 with a removal of both a taxpayer's ability to self-assess a refund and the absence of the Commissioner's discretion are not justified by the objective.

(k) No protection against incorrect rulings and advantages for taxpayers who do not follow rulings

One scenario in which GST is likely to be overpaid is where the Commissioner issues a public ruling which is found to be incorrect. Taxpayers following the ruling will pay GST that is not payable, however upon the ruling being shown to be incorrect, those taxpayers will not be entitled to a refund of the GST incorrectly paid.

In contrast, a taxpayer who acts contrary to the ruling will have never borne the cost of the GST and therefore is better off than the taxpayer who has paid the GST. This will be particularly relevant in business to consumer markets, where both suppliers will receive the same price. Therefore, the taxpayer who adopted the conservative position and followed the Commissioner's ruling is left worse off.

The fact that the position is set out in a public ruling does not protect the taxpayer, as Division 357 of the TAA only stops the Commissioner from seeking to recover a shortfall. In that context, Division 36 is likely to encourage taxpayers to adopt contrary positions to those set out in rulings (where the issue is contentious) and provide windfalls for taxpayers who do not follow the Commissioner's rulings.

The situation does not presently arise, as the Commissioner could exercise his discretion where the GST has been overpaid as a consequence of the Commissioner's error (i.e. the issue of an incorrect ruling).

4. Division 36 – Proposed Amendments

In our view, Division 36 goes well beyond the recommendations made by the Board of Taxation. We have already suggested that in lieu of the introduction of this new Division into the GST Act, there should be amendments made to section 105-65, such as those contained in the Attachment, which may better deal with the Board's recommendation and other issues identified above in relation to GST refunds.

However, should Treasury form the view as a result of this consultation on the Exposure Draft that the operation of a provision in respect of the refund of excess GST should be pursued in this form, we recommend the following amendments be made to Division 36:

a) A specific provision deeming that the "excess GST" component has been paid for a taxable supply or an arrangement that is treated as having given rise to a taxable supply for the purposes of the GST Act be included in Division 36;

b) Remove the requirement in section 36-5(2)(b)(ii) that the excess GST has been passed on to an entity that is neither registered nor required to be registered for GST in order to be able to gain a refund of the excess GST for the relevant supply that has already been remitted to the Commissioner;

c) If the notion of "passing on" is to be retained, in the context of refunds, it is only appropriate to deny the refund to a supplier where the recipient paid more than it otherwise would have on account of GST. Accordingly, Division 36 would need to be amended to reflect this;

d) Retain a limited discretion for the Commissioner - GST applies in a vast number of scenarios where the economic burden may or may not be passed on or may be paid in an incorrect period or by the wrong entity. It will be impossible to ensure appropriate outcomes unless the Commissioner retains his discretion to look at the facts and circumstances on a case by case basis to determine whether excess GST should be refunded in particular circumstances where the requirements of section 36-5 are not met. The AAT has shown the capacity to tell the difference between a case where the economic burden has been passed on to the customer[8] and when it has not been passed on[9] evidencing the need for such a discretion to be retained and applied in these types of circumstances; and

e) Compliance issues for taxpayers - Taxpayers dealing with Division 36 will face the following compliance issues:

[8] See *National Jet Systems Pty Ltd v FCT* [2011] AATA 766 and see para [71] in relation to the notion of "passing on" of GST and para [78] which states that in applying the discretion under 105-65 , the prevention of windfall gains is the primary issue to be addressed before exercising the discretion.
[9] See the decision in *Luxottica Retail Australia Pty Ltd v FCT* [2010] AATA 22.

- The provision will apply from the date of announcement (17 August 2012) rather than the date of Royal Assent (or first tax period starting on or after Royal Assent);
- Difficulties in trying to understand and apply undefined, ambiguous terms such as "passing on";
- The onus of proving where GST has or has not been "passed on"; and
- Self-assessment of the appropriate amount of the refund.

Given the uncertainties and burdens noted above, we would anticipate the potential for much dispute arising between taxpayers and the ATO in respect of the correct application and results that should arise under Division 36. This could potentially cause the Commissioner to have to consider refund requests in many instances on a case by case basis (and therefore at much cost to the Revenue) rather than be able to rely on the operation of the self-assessment system for the collection and refund of GST.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0011.

Yours sincerely

Ken Schurgott
President

Attachment

105-65 Restriction on GST refunds

(1) The Commissioner may decide not to refund or apply an amount that he or she would otherwise have to refund ~~need not give you a refund of an amount to which this section applies,~~ or apply (under Division 3 or 3A of Part IIB) ~~an amount to which this section applies~~, if:

(a) you overpaid the amount, or the amount was not refunded to you, because a * supply was incorrectly treated as a * taxable supply, or an * arrangement was incorrectly treated as giving rise to a taxable supply~~,~~ to any extent, or you miscalculated the amount of GST payable in respect of a taxable supply or arrangement; and

~~(b) the supply is not a taxable supply, or the arrangement does not give rise to a taxable supply, to that extent (for example, because it is * GST-free); and~~

(~~c~~b) one of the following applies:

(i) the Commissioner is not satisfied that you have reimbursed a corresponding amount to the recipient of the supply or (in the case of an arrangement treated as giving rise to a taxable supply) to an entity treated as the recipient;

(ii) the recipient of the supply, or (in the case of an arrangement treated as giving rise to a taxable supply) the entity treated as the recipient, is * registered or * required to be registered.

Note: Divisions 3 and 3A of Part IIB deal with payments, credits and RBA surpluses.

(2) In deciding whether to not refund the amount under this section, the Commissioner must have regard to whether you have passed on the economic burden of the GST to the recipient of the supply or, (in the case of an arrangement treated as giving rise to a taxable supply) to an entity treated as the recipient and any other relevant factor.

(3~~2~~) This section applies to the following amounts:

(a) in the case of a * supply:

(i) so much of any * net amount or amount of * GST as you have overpaid (as mentioned in paragraph (1)(a)); or

(ii) so much of any net amount that is payable to you under section 35-5 of the * GST Act as the Commissioner has not refunded to you (as mentioned in paragraph (1)(a)), either by paying it to you or by applying it under Division 3 of Part IIB of this Act;

(b) in the case of an * arrangement:

(i) so much of any net amount or amount of GST to which subparagraph (a)(i) would apply if the arrangement were a supply; or

(ii) so much of any net amount to which subparagraph (a)(ii) would apply if the arrangement were a supply.

Note: Division 3 of Part IIB deals with payments, credits and RBA surpluses.

Objecting to the decision to not refund the amount

(4) You may object to a decision of the Commissioner not to refund or apply an amount under this section in the manner set out in Part IVC, if you are dissatisfied with the decision.

THE TAX INSTITUTE

26 March 2013

Ms Brenda Berkeley
General Manager
Indirect, Philanthropy and Resource Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attn: Mr Rob Dalla-Costa

By email: gstpolicyconsultations@treasury.gov.au

Dear Ms Berkeley,

Refunding Excess GST – Exposure Draft

The Tax Institute is pleased to have the opportunity to make a submission to the Treasury in relation to the *Refunding Excess GST – Exposure Draft* (**Exposure Draft**).

Summary

Our submission below addresses issues arising in respect of the Exposure Draft. Much improvement has been made to these draft provisions since they were first released in exposure draft form on 17 August 2012.Though much closer to the policy intent behind these draft provisions, the current Exposure Draft still poses some concerns. In particular:

- Some suggested amendments to the operative provisions have been included in Appendix A to ensure the provisions will operate consistently with the rest of the GST law and not give rise to unintended outcomes;
- We have suggested some amendments to clarify the ambit of the Commissioner's discretion; and
- To avoid compliance issues for taxpayers, we suggest a start date coinciding with Royal Assent rather than the date of the announcement.

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Discussion

1. Original Policy Intent of an "excess refunds" provision

The original policy intent behind section 105-65 of Schedule 1 to the *Taxation Administration Act 1953* (Cth) (TAA) was that

> "Ordinarily, if GST has been overpaid or entitlements to credits have been understated the Commissioner is obliged to refund the amount overpaid or credit understated"[1].

Section 105-65[2] operates as an exception to the general rules to ensure that the Commissioner is not required to refund GST in circumstances where a supplier has passed on the GST and receives a "windfall gain". In such circumstances, it is contemplated that the supplier would be required to refund the overpaid GST to the consumer of the goods and services prior to a refund being payable[3].

In this respect, section 105-65 reflects similar provisions that had previously operated under the *Sales Tax Assessment Act,* which limited the Commissioner's obligation to refund tax overpaid

> "unless the Commissioner is satisfied that the tax has not been passed on by the person to another person or, if passed on by the person to another person, has been refunded by the person to the other person"[4].

The provisions specifically allowed for the payment of a refund where sales tax had not been passed on or where the sales tax had been refunded. The provisions now found in section 105-65 were intended to introduce an equivalent regime in respect of GST. However, unlike the equivalent sales tax provisions, the GST administrative provisions do not codify the taxpayer's entitlement to a refund of tax overpaid. Therefore, in the context of section 105-65, it is unclear whether the section operates to give the Commissioner discretion to pay refunds or discretion to withhold refunds of overpaid tax.

In addition, emanating from recent case law[5], a question of policy has arisen as to whether a section such as section 105-65 should be able to deal with the circumstances where an incorrect amount of GST has been remitted to the Commissioner either as a result of a mischaracterisation of a transaction or a miscalculation of the amount of GST that should have been remitted on the taxable supply made.

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[1] See paragraph 3.39 of the Explanatory Memorandum to *the GST Administration Bill 1998* (Cth).
[2] Originally enacted as s. 39(3) of the TAA.
[3] See paragraph 3.40 and 3.41 of the Explanatory Memorandum to *the GST Administration Bill 1998* (Cth).
[4] S. 11 of the *Sales Tax Assessment Act (*No. 6) 1930 (Cth) as it applied historically.
[5] *International All Sports v Commissioner of Taxation* [2011] FCA 824 identified the fact that section 105-65 only applied to mischaracterisations and had no application to miscalculations.

The Assistant Treasurer's announcement[6] on 17 August 2012 stated that the draft legislation would clarify the circumstances in which the restriction on GST refunds would apply to overpayments of GST "...and allows taxpayers to self-assess their entitlement to a GST refund by reference to ascertainable criteria". These same ascertainable criteria are also to apply to refunds of GST where there has been a miscalculation of the GST.

Proposed Division 36 issued in exposure draft form at the same time contained the first iteration of the rules intended to replace section 105-65 and bring the rules into the *A New Tax System (Goods and Services Tax) Act* 1999 (Cth) (**GST Act**). Many concerns were highlighted with Division 36, particularly that it did not address the stated policy intent behind having such a provision and went well beyond addressing the issues that have been identified with section 105-65.

Proposed Division 142 is a second iteration of the rules to replace section 105-65 and bring this provision into the GST Act. The policy intent behind Division 142 is to ensure that taxpayers do not obtain a windfall gain, irrespective of how the overpayment of GST arises[7].

Division 142 comes much closer to meeting the stated policy intent and addressing the issues identified with section 105-65. It mostly succeeds in ensuring the provision can operate in the context of a self-assessment system. However, it presents its own set of concerns.

2. Operative provisions of proposed Division 142

a) When Division 142 applies

Draft section 142-5 sets out when Division 142 will apply and defines a new term, "extra GST", that is the crux of this division. There is confusion between the "amount" referred to in subsection 142-5(1) and subsection 142-5(2) and whether these are intended to be the same amount or different amounts. An interpretation of these subsections suggests these amounts are different. That is, the "amount" in subsection 142-5(1) refers to all GST in excess of what should have been payable by the taxpayer. The "amount" in subsection 142-5(2) refers to the new term "extra GST" which, by definition, is an amount less than the excess GST referred to in subsection 142-5(1).

We suggest Treasury clarify these subsections by ensuring the use of the term "amount" is clarified. We have attached in Appendix A some suggested mark-ups to clarify what may be intended here for Treasury's consideration.

In addition, subsections 142-5(2)(a) and (b) restrict the application of Division 142 where the extra GST amount is covered by a decreasing GST adjustment attributable

[6] *Assistant Treasurer Media Release* No. 86, 17 August 2012
[7] Paragraphs 1.17 and 1.19 in the EM

to a later period or is correctly attributable to a different tax period (i.e. a timing difference).

This leaves in question what happens when the extra GST is identified and adjusted for in the same tax period in which it first arose. The Commissioner's view, as set out at paragraph 15 of GSTR 2000/19, is that no adjustment arises, where the adjustment event occurs in the same period.

For example, a taxpayer agrees with a recipient to make a taxable supply for a price of $1,100. The taxpayer accounts for GST of $100 and issues a tax invoice to the recipient. In the same tax period, an event arises which causes the supply to stop being a taxable supply. The price remains the same. No refund is given to the recipient because the price has remained the same. There is no corresponding decreasing adjustment and the GST is not attributable to any other tax period. Provided the taxpayer identifies the adjustment in the current tax period, it will not be required to account for GST.

Similarly, if the adjustment event occurs in a different period, the taxpayer will also be entitled to a decreasing adjustment for the GST. However, in the event that the adjustment happens in the same tax period (meaning there is no decreasing adjustment), and the taxpayer incorrectly accounts for the GST (for example, because it is unaware of the event which caused the supply to stop being taxable), section 142-5 has the effect of denying the taxpayer a refund of the GST that it would otherwise be entitled to.

The Tax Institute is of the view that a taxpayer should be able to self-assess a refund under Division 142 even where the mischaracterisation occurs within the same tax period. Section 142-5(2) should be amended to reflect this.

b) Refunding extra GST

(i) Subsection 142-10(1)

General operation

Subsection142-10(1) deems that extra GST has always been payable on a taxable supply until the extra GST that has been passed-on is reimbursed to the entity to whom the GST was passed on.

There is a clear attempt to deem the extra GST as always having been payable by the taxpayer for the purpose of the GST law (regardless of whether it actually was payable or not) and remains so until the taxpayer can show the extra GST has been reimbursed. After this, the taxpayer is then eligible to obtain a refund. The subsection works fairly well as far as it applies to taxpayers (suppliers) with GST liabilities as it contains objective criteria and therefore, at first instance, allows a taxpayer to self-assess entitlement to a refund.

However, the position is not clear for the other entity (recipient) referred to in the provision to whom the GST has been passed on. Though this may be intended, on the face of the draft provision, it is not clear if the recipient is also deemed to have made an acquisition for which they may be entitled to claim an input tax credit on account of having paid GST on the acquisition.

We have suggested wording in Appendix A to clarify that the other entity, the recipient, is making an acquisition in respect of which they are entitled to an input tax credit subject to satisfying the normal rules for an input tax credit. We also suggest inclusion of some examples in the Explanatory Memorandum (**EM**), or perhaps building on the existing examples in the EM (for example, Example 1.8) to illustrate how section 142-10(1) will affect when the recipient is entitled to claim input tax credits.

Timing

The timing as to when the GST has or has not been passed on is also unclear on the face of the draft provision. It would be useful if Treasury could include some guidance in the EM regarding when the GST is taken to have been passed on (or not).

For example, is GST passed on when the tax invoice is issued or is it when the tax invoice is paid? If it is when the tax invoice is issued, issues arise under section 142-20, as the taxpayer may not be in a position to reimburse the recipient for GST, as no amount of GST has been paid by the customer.

(ii) Subsection 142-10(2)

If a taxpayer incorrectly treats a supply as taxable, passes on the GST, realises the supply should have been treated as input taxed and is unable to refund the GST to the recipient, the Commissioner will receive a double windfall. The supplier will not be entitled to a refund from the Commissioner of GST incorrectly paid on what would have been, in the absence of Division 142, the input taxed supply as they have no cause to refund the GST to the recipient of the supply. At the same time, the supplier will be denied input tax credits on acquisitions made in making what would have been an input taxed supply.

If the supply is taken to be taxable for the payment of GST, then it should be also be taxable for the purposes of the related input tax credits. This is a fundamental premise on which the GST Act is based – as noted in paragraphs 1.4 and 1.5 of the draft EM, which state:

> 1.4 The scheme of the GST Act is premised on the following principles (see Chapter 1 of the Executive Summary in the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998:
>
> - GST is remitted by suppliers who make supplies in carrying on their enterprise. Suppliers do not bear the GST because the tax is included in the price of what they supply;
> - GST is effectively borne by private consumers when they acquire anything to consume; and

- To ensure that GST is effectively borne by consumers, anyone who is registered is generally entitled to an input tax credit for the GST on what they acquire or import for the purpose of their enterprise.

1.5 Accordingly, the scheme of the GST Act envisages that the supplier 'passes on' the GST to the recipient of the supply and there should not be a refund where it may result in a windfall gain. Symmetry is also maintained between the GST payable and the corresponding input tax credit which may be claimed by a GST registered recipient.

The Tax Institute is of the view that inclusion of subsection 142-10(2) is unwarranted and contradictory to the premise on which Division 142 is based.

(iii) Subsection 142-10(4)

Subsection 142-10(4) appears to operate as an integrity measure to deny a recipient input tax credits in certain circumstances. The provision may be aimed at preventing the claim of input tax credits by entities who have received tax invoices from related parties, but the other party has not remitted any GST (for example, they are not actually carrying on an enterprise).

The provision suggests that a recipient should know whether the supplier has or has not paid extra GST to the Commissioner. It is not clear what Treasury intends here. Is Treasury, for example, expecting recipients to make enquiries of their suppliers to determine whether the suppliers have remitted the GST to the Commissioner? If a recipient is always expected to find out whether the supplier has or has not remitted the GST to the Commissioner on the supply made to the recipient, this creates an unacceptable administrative burden on both recipients and suppliers.

The Tax Institute also raises concerns about the use of the phrase "and while" in this subsection. Some clarification should be provided as to how this is intended to apply in practice. Is it intended that the recipient may claim the input tax credits if it doesn't know and cannot be reasonably expected to know that the supplier has not remitted the GST, but must then repay the input tax credits if it comes to know that the supplier has not remitted the GST (e.g. because it reads about a dispute between the supplier and the Commissioner in the tax press)? Is it also possible that a recipient may know that a supplier has not remitted the GST and is therefore not entitled to claim input tax credits, but later ceases to be informed of the supplier's actions and so becomes entitled to make a claim?

We illustrate with an example below:

(A) A recipient, who accounts for GST on a monthly basis, purchases goods from a small business which accounts for GST on a quarterly basis. In preparing its BAS for January 2013, the recipient discovers that GST has been incorrectly charged by the small business. The small business will not have paid the GST to the Commissioner as it accounts for GST on a quarterly basis. Is it reasonable for the recipient to have expected that the small business has not remitted the GST to the Commissioner as it is a small business which is likely to

account for GST on a quarterly basis? What enquiries does the recipient need to make in order to ascertain that it acted reasonably?

(B) In the same scenario, the recipient claims the input tax credits assuming, incorrectly that the small business has paid the GST on to the Commissioner. In March 2013, the recipient discovers that the small business went into liquidation at the end of January 2013, and it is likely it did not pay any GST onto the Commissioner. Does the recipient now need to go back and amend its BAS for January 2013, as it now knows the small business did not pay the GST to the Commissioner? Should the recipient be reasonably expected to know the small business did not pay the GST as it went into liquidation in January 2013?

In our view, Division 165 of the GST Act may already work sufficiently to - despite the GST amount having been passed on – guard against contrived arrangements that Treasury may be concerned about and will significantly increase the cost of GST administration for business, as it will now require a recipient to ascertain whether the supplier has in fact paid its GST liability. However, if subsection 142-10(4) is to be retained, we request that Treasury include an example in the EM of the kind of situation to which this provision is intended to apply and make clear the mischief that the provision is intended to address.

3. Commissioner discretion – section 142-10(3)

We understand that section 142-10(3) is intended to provide the Commissioner with limited discretion to deem an amount of extra GST not to be payable where the Commissioner is satisfied that a refund of the extra GST would flow through to the entity who has borne the cost of the GST and there would not be any windfall gain to the taxpayer (supplier).

We have suggested some amendments to this subsection (contained in Appendix A) to clarify that the extra GST is not deemed to be payable where the Commissioner is satisfied of the elements in subsections (3)(a) and (b).

Subsection 142-10(3)(a) also appears to require that the GST flow through a chain of entities to the final consumer. We query the necessity of including this subsection as it is not clear. It would be useful if examples of the circumstances to which this subsection is intended to apply were included in the EM.

We query what the term "flow" is intended to mean in this circumstance. Does it relate to passing on GST between two parties only, or through a chain involving intermediaries until it rests with the final consumer? In practical terms, how is a supplier meant to prove the extra GST has flowed through a chain of intermediaries to the final consumer?

Example 1.12 in the EM that is intended to illustrate the circumstances where the Commissioner's discretion has been applied is not a very useful example as Entity A who has remitted the GST to the Commissioner has not passed the GST on to anyone.

It is Entity B that passed the GST on to Eric Pty Ltd. Therefore there is no real need for the Commissioner to exercise discretion in this case. We suggest an example properly demonstrating when the Commissioner has had to exercise discretion be included in the EM. Perhaps existing Example 1.12 might be a good example of how the discretion might apply if Entities A and B are grouped for GST (instead of not being grouped per the facts in the example). Though, we note we are unsure how this provision is intended to apply to GST groups either. Treasury should give some consideration to this issue; perhaps inclusion of a simple amendment to Division 48 may be enough to clarify this.

The provision also has the potential to cause hardship for an intermediary. Take an example where Entity A sells crackers to Supermarket Co who in turn sells the crackers to consumers. Entity A and Supermarket Co incorrectly treat the supplies as taxable, but a large court decision clarifies that the supply is GST-free. Consequently Entity A offers to refund consumers for the GST incorrectly charged. As Entity A has paid the GST refund to the end consumer, subsection 142-10(3) should operate, meaning that subsection 142-10(1) will not apply. This means Entity A will be entitled to a refund of the GST. However, it will also mean that Supermarket Co is no longer entitled to an input tax credit, as the supply to it is no longer a taxable supply.

We also raise concerns regarding the situation where a supply is not taxable and the Commissioner treats the supply as taxable. The Commissioner can make a mistake in assessing the taxpayer and cause an amount of extra GST to be included in the taxpayer's assessed net amount. Even if the Commissioner is overturned on objection or appeal, Division 142 may still apply so as to make the taxpayer liable to pay that excess GST assessed by the Commissioner. This is confirmed by Example 1.11 of the EM.

Treasury dealt with this issue previously in its 2009 Discussion Paper, "*Implementation of the recommendations of the Board of Taxation's review of the legal framework for the administration of the GST*". In that Discussion Paper, Treasury stated that it would be appropriate for the Commissioner to exercise his discretion to pay a refund where:

> "... the overpayment of GST has directly resulted from actions of the Commissioner. In particular, where the supply was originally treated as non-taxable, the Commissioner has assessed the supplier on the basis that it is taxable, but the assessment is overturned on objection or appeal".

This view was manifestly reasonable. It would be a harsh and arbitrary outcome for taxpayers who take the correct view of the law to be required to pay more GST because of an error on the Commissioner's part. However, this will be a consequence of Division 142, which does not provide the Commissioner with discretion to pay a refund in those circumstances. We submit that Treasury's initial view was the correct one, and that Division 142 should not apply so as to deny a refund to a taxpayer where the extra GST arises as a result of the actions of the Commissioner.

4. Passing on of GST and reliance on tax invoices – section 142-15

Subsection 142-15 is an attempt to define when the extra GST has been passed on to the recipient of the supply. There is still heavy reliance on the issue of a tax invoice being prima facie evidence that GST has been passed on. We query whether documentation able to be treated as a tax invoice by the Commissioner under section 29-70(1B) should be excluded from this provision and only documentation that meets the requirements of being a tax invoice, independent of any determination by the Commissioner, be included.

Though the EM talks about all kinds of evidence to indicate whether GST has been passed on (for example, referring to the supplier's pricing policies[8]), there is no indication in the legislation that this kind of circumstantial evidence is evidence of GST being passed on in accordance with section 142-15.

Also, for section 142-15 to operate effectively, reference should be made to other kinds of evidence besides tax invoices to prove that GST has been passed on.

In addition, this provision should also make reference to the fact that the recipient has paid an amount of GST (or what would be regarded as GST).

5. Cancelled supplies – 142-20

The intention behind and operation of this provision is unclear. On its face, the provision operates to deny a decreasing adjustment where the GST has been passed on to the recipient of the supply and has not been reimbursed. Paragraph 1.37 in the EM makes reference to the *Qantas*[9] case though we note that no reference was made to decreasing adjustments in this case. The provision also appears to apply in all circumstances, that is, it is not limited to a circumstance where GST has been incorrectly paid initially.

If enacted, the provision will give rise to unintended consequences and double taxation. For example, where a supply is cancelled, it is common for the supplier to provide the customer with a voucher of equal value. The cancellation of the original supply would give rise to an adjustment event. Pursuant to section 142-20, the supplier will no longer be entitled to a decreasing GST adjustment, as the GST has not been reimbursed to the customer. The customer has instead been provided with a voucher for a value equal to the price of the original supply. The supply of the voucher is not subject to GST under Division 100. However, a second set of GST liability will arise when the voucher is redeemed for taxable supplies.

If the purpose of this provision is to say that where a supply was a taxable supply and is no longer a taxable supply, a taxpayer is unable to obtain a decreasing adjustment, then a mirror provision should be included to ensure that there is no increasing

[8] Paragraph 1.50 of the EM

[9] *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA 41

adjustment to a recipient of the supply that has been re-characterised from taxable to non-taxable.

Finally, we note that the provision will only apply where the supply is cancelled in a different tax period. The provision will not apply where the supply is cancelled in the same tax period, as there is no decreasing adjustment. It is odd that the GST outcome for the same transaction would depend so heavily upon whether the cancellation spanned two tax periods.

6. Commencement date

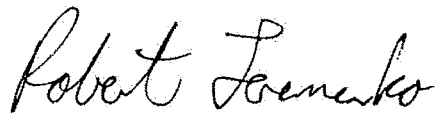
There will be compliance issues for taxpayers having to comply with new Division 142 on the basis that, according to the Exposure Draft[10], it will start to apply to the first tax period commencing after the date of the original announcement by the Assistant Treasurer, 17 August 2012, and not from Royal Assent. In particular, section142-20, which was not previously announced, may have a significant impact on the retail sector, and will result in double taxation. It is difficult to see what basis there could be for justifying retrospective introduction of an announced measure giving rise to double taxation on a sector which is already facing significant pressure.

In our view, commencement of Division 142 from the date of Royal Assent would be more appropriate, so to minimise the compliance burden on taxpayers arising from the amendments.

Also, while we appreciate that the Australian Taxation Office has provided guidance on how it will treat GST refunds during the interim period where the existing legislation is in place and before any (new) retrospective legislation is potentially passed, we note that there is only a 28 day window for taxpayers to re-visit their GST refund compliance free of penalties or interest. Given that the announcement occurred on 17 August 2012, proposed Division 36 came and went, and now a proposed Division 142 has been issued with no indication of when it will be considered by Parliament, we suggest that it would be reasonable for the 28 day window to be extended. We take the view, in these circumstances, that the remission period for penalties and interest under retrospective legislation, should be 90 days.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0011.

Yours sincerely



Robert Jeremenko
Senior Tax Counsel

[10] Item 14

Inserts for

Tax Laws Amendment (2013 Measures No. 2) Bill 2013: Refunding excess GST

EXPOSURE DRAFT

Commencement information

Column 1	Column 2	Column 3
Provision(s)	**Commencement**	**Date/Details**
1.		
2. Schedule ??	The day this Act receives the Royal Assent.	
3.		

Schedule ??—Refunding excess GST

A New Tax System (Goods and Services Tax) Act 1999

1 Subsection 17-5(1) (note)

Repeal the note, substitute:

Note 1: For the basic rules on what is attributable to a particular period, see Division 29.

Note 2: For further rules if you have excess GST for the period, see Division 142.

2 Section 19-99 (after table item 1AA)

Insert:

1AB	Excess GST and cancelled supplies	Division 142

3 Subsection 35-5(1) (note 1)

Omit ", and section 105-65 in Schedule 1 to,".

4 Section 35-99 (after table item 1)

Insert:

1A	Excess GST	Division 142

5 Section 35-99 (note)

Repeal the note.

6 Section 37-1 (after table item 10A)

Insert:

10B	Excess GST	Division 142

7 At the end of Part 4-4

Add:

Division 142—Excess GST

Table of Subdivisions

142-1 What this Division is about

Amounts of excess GST will not be refunded if this would give an entity a windfall gain.

Note: Refunding excess GST to a supplier will give it a windfall gain if it has already passed on the excess GST in the price of the supply (and not reimbursed the recipient).

Subdivision 142-A—Excess GST unrelated to adjustments

142-5 When this Subdivision applies

(1) This Subdivision applies in relation to the *extra GST amount in subsection (2) if your *assessed net amount for a tax period takes into account an amount of GST ***(excess GST)*** exceeding the ~~at which~~ amount of GST which is payable.

Note: This Subdivision can apply whether or not you have paid, or been refunded, the assessed net amount.

(2) The amount (the ***extra GST***) is the excess GST less any of it that:

(a) is covered by a *decreasing adjustment attributable to a later tax period; or

(b) is correctly attributable to a different tax period.

Example: Sunny Co mistakenly reports a negative net amount of $4,000 made up of GST of $10,000 less input tax credits of $14,000. In fact, Sunny Co's GST should have been $8,000 making its negative net amount $6,000. Sunny Co has extra GST of $2,000.

142-10 Refunding extra GST

(1) For the purposes of each *taxation law, so much of the extra GST as you have passed on to another entity is taken to have always been:

(a) payable; and

(b) on a *taxable supply made to the other entity;

until you reimburse the other entity for the passed-on GST.

Note 1: If you reimburse the passed-on GST so that this subsection ceases to apply, you may have a decreasing adjustment (see section 19-55) and the other entity may have an increasing adjustment (see section 19-80).

Note 2: The rest of the extra GST will be refunded as described in section 155-75 in Schedule 1 to the *Taxation Administration Act 1953*.

Note 3: The other entity is taken to have made an acquisition from you (see section 11-5).

~~(2) Subsection (1) does not apply for the purposes of how subsection 11-15(2) (about creditable purpose) applies to you.~~

(23) Subsection (1) does not apply to ~~deny the refund to~~deem the extra GST to be payable on a taxable supply to the extent that the Commissioner is satisfied that a refund of the extra GST:

(a) would flow to the entity that has effectively borne the cost of the extra GST; or~~and~~

(b) would not give an entity a windfall gain.

(34) Subsection (1) does not apply for the purposes of applying a *taxation law to the other entity if, and while, that other entity knows, or could reasonably be expected to have known, that you have not paid the extra GST to the Commissioner.

Note: Subsection (1) still applies for the purposes of applying taxation laws to you.

142-15 Working out if the extra GST has been passed on

For the purposes of section 142-10:

(a) some or all of the extra GST may pass on to the other entity even if:

(i) a *tax invoice is not issued to or by that other entity; or

(ii) a tax invoice issued to or by that other entity relates to that extra GST, but does not contain enough information to enable that extra GST to be clearly ascertained; and

(b) if:

(i) a tax invoice is issued to or by the other entity; and

(ii) it contains enough information to enable some or all of the extra GST to be clearly ascertained;

the tax invoice is prima facie evidence of that part of the extra GST having passed on to that other entity.

Subdivision 142-B—Excess GST related to cancelled supplies

142-20 Refunding excess GST relating to cancelled supplies

(1) If:

(a) your *assessed net amount for a tax period takes into account an amount of GST on a supply; and

(b) you have a *decreasing adjustment attributable to a later tax period as a result of the cancellation of the supply;

the decreasing adjustment is reduced to the extent that you have passed on that GST to the *recipient of the supply, but not reimbursed the recipient for the passed-on GST.

(2) Subsection (1) has effect despite section 19-55 (which is about decreasing adjustments for supplies).

8 Section 51-60 (note 1)

Omit ", and section 105-65 in Schedule 1 to,".

9 Section 54-65 (note 1)

Omit ", and section 105-65 in Schedule 1 to,".

10 Section 195-1 (note at the end of the definition of *taxable supply*)

Omit "and 113-5", substitute ", 113-5 and 142-10".

Income Tax Assessment Act 1936

11 Subsection 98A(2) (note)

Omit ", and section 105-65 in Schedule 1 to,".

12 Subsection 98B(4) (note)

Omit ", and section 105-65 in Schedule 1 to,".

Taxation Administration Act 1953

13 Section 105-65 in Schedule 1

Repeal the section.

14 Application of amendments

The amendments made by this Schedule apply in relation to working out your net amount for a tax period starting on or after 17 August 2012.