Institute of Chartered Accountants Australia

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Dear Rob

Refunding excess GST consultation

The Institute of Chartered Accountants in Australia (the Institute) welcomes the opportunity to make a submission in relation to the second consultation Exposure Draft legislation on refunding excess GST (the **ED**).

The Institute is the professional body for Chartered Accountants in Australia and members operating throughout the world. Representing more than 70,000 current and future professionals and business leaders, the Institute has a pivotal role in upholding financial integrity in society. Members strive to uphold the profession's commitment to ethics and quality in everything they do, alongside an unwavering dedication to act in the public interest.

The ED was released for consultation on 26 February 2013. It builds on the first consultation Exposure Draft legislation on refunding excess GST (the **first ED**), which was released for consultation on 14 August 2012.

The measure, when enacted, will apply in relation to working out net amounts for tax periods commencing on or after 17 August 2012.

General comments

The ED resolves many of the issues raised in the Institute's submission dated 14 September 2012 on the first ED. The ED is a significant improvement over the first ED and the Institute welcomes these improvements.

While not resiling from our 'in principle' objections to retrospectivity and the use of a 'passing on' test, this submission focuses on technical deficiencies in the ED.

In summary, the Institute recommends the following amendments to the ED:

- The references to 'discretion' and to refunds only being paid in 'exceptional circumstances' in the EM in respect of proposed section 142-10(3)[1] should be removed.

- Proposed section 142-10(3)(a) should be removed and the only requirement for the payment of a GST refund under proposed section 142-10(3) should be that the Commissioner is satisfied that a refund of the extra GST would not give an entity a windfall gain.

- A specific decreasing and increasing adjustment should be included in proposed Division 142 in respect of reimbursed GST. In particular, to the extent a taxpayer reimburses the recipient for the passed-on GST, it should have a decreasing adjustment that arises at the time of the reimbursement (and the recipient should have a corresponding increasing adjustment).

- The Commissioner's decision not to pay a GST refund under proposed section 142-10(3) should be included as a reviewable GST decision under section 110-50(2) of Schedule 1 to the *Taxation Administration Act 1953* (the **TAA**).

- The expression 'GST' in proposed section 142-5(1) should be defined and the definition should be aligned with the definition of 'GST' in section 17-5.

- Proposed section 142-5 should be reworded to define the concept of 'excess GST' and also to clarify the concept so as to resolve the uncertainties highlighted in our specific comments.

- The Institute questions whether proposed section 142-20 is necessary following the decision in *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA 41 and, on this basis, suggests that the proposed section should be removed from the ED. In the event the proposed section remains, a further provision should be included that reduces the recipient's increasing adjustment where GST has been passed on, but not reimbursed.

The Institute would be pleased to discuss these recommendations and issues in further detail with Treasury.

Specific comments

The Commissioner's residual 'discretion'

The Explanatory Memorandum to the ED (the **EM**) indicates that 'the Commissioner's discretion to grant a refund will be retained to cover exceptional circumstances where the Commissioner is satisfied that a refund is appropriate' (paragraph 1.18). This is purportedly achieved through proposed section 142-10(3). The Institute notes that the proposed section does not appear to contain any discretion. Rather, where the requirements of paragraphs (a) and (b) in the proposed section are satisfied, the Commissioner is obligated to pay the refund. The references to 'discretion' in the EM should be removed. Further, the references in the EM to refunds only being paid in 'exceptional circumstances' should be removed as there is nothing in proposed section 142-10(3) that suggests that any refund should only be paid in exceptional circumstances.

Proposed section 142-10(3)(a) includes the requirement that the Commissioner be satisfied that a refund of the extra GST 'would flow to the entity that has effectively borne the cost of the extra GST'. The Institute believes that this provision is uncertain and unnecessary. The clear, stated policy underpinning proposed Division 142 is to deny windfall gains to taxpayers (as per the explanatory section to proposed Division 142).

[1] All statutory references are to the *A New Tax System (Goods and Services Tax) Act 1999* (the **GST Act**), unless otherwise specified.

Where refunding GST to a taxpayer would not give rise to a windfall gain, it is fair and equitable that the GST refund is paid to the taxpayer. Imposing the additional requirement in proposed section 142-10(3)(a) is likely to lead to harsh outcomes for taxpayers and is contrary to the stated policy of the provisions. It shifts the balance too far in favour of the Commissioner.

Further, the concepts used in paragraph (a) are vague and ambiguous. When GST is 'effectively borne' is not defined and the term is not otherwise used in the GST law. The concept of borne tax arose in the context of the wholesales sales tax regime. In that context, a person was relevantly taken to have borne tax on goods where the person was liable to pay tax on an assessable dealing with the goods or the person purchased the goods for a price that included tax (refer section 11 of the *Sales Tax Assessment Act 1992*). It is not clear to the Institute what is intended by the concept of GST being effectively borne by an entity, whether this should be similar to the concept as it was used in the sales tax regime and how it differs from the concept of passing on. Further, in the context of a multi-stage tax such as GST, it can be notoriously difficult to determine which entity (if any) has effectively borne GST. In addition, the intended operation of the word 'flow' in paragraph (a) is similarly unclear and neither the ED, nor the EM explain the meaning of this concept.

Accordingly, the Institute recommends that proposed section 142-10(3)(a) is removed and that the only requirement for the payment of a GST refund under proposed section 142-10(3) is that the Commissioner is satisfied that a refund of the extra GST would not give an entity a windfall gain.

Claiming GST refunds where GST is reimbursed

Proposed section 142-10(1) effectively allows taxpayers to self-assess their entitlement to a GST refund where they reimburse the recipient with the amount of the extra GST.

The EM indicates that, where an entity does so, it may seek a refund from the Commissioner by applying for an amendment of the relevant assessment or objecting to the relevant assessment (whichever is applicable) or that the refund may give rise to adjustments for the parties to the transaction (paragraph 1.40). Absent proposed Division 142, GST refunds arising from errors (such as classification errors) would rarely, if ever, give rise to an adjustment under Division 19. This is confirmed in paragraphs 70 and 71 of GST ruling GSTR 2000/19, *Goods and services tax: making adjustments under Division 19 for adjustment events*. For example, Example 1.7 in the EM would not, absent proposed Division 142, give rise to a decreasing adjustment for Joe's Optics. Rather, Joe's Optics would need to seek an amended assessment for the tax period in which it attributed the GST payable on the spectacles. The EM appears to assume that an adjustment event arises for Joe's Optics under section 19-10(1)(c) on the basis that proposed section 142-10(1) deems the supply of the spectacles to have always been taxable until the GST is reimbursed to John, at which point the supply is no longer deemed to be taxable and is instead treated as GST-free. Similar issues arise in respect of Examples 1.8 and 1.9. Further, even if the views expressed in the EM are correct, in some circumstances, reimbursed GST will still require an amended assessment for an earlier tax period, for example, where a transaction is treated as a taxable supply, but is later found not to involve a supply (such as was the agreed position between the parties in *KAP Motors Pty Ltd v Commissioner of Taxation* (2008) 168 FCR 319).

The Institute believes there is significant doubt that proposed section 142-10(1) operates in the manner suggested by the EM in respect of taxpayers claiming GST refunds and hence the position is unclear. The Institutes further believes that a specific decreasing and increasing adjustment should be included in proposed Division 142 in respect of reimbursed GST.

Including a specific adjustment provision in proposed section 142-10(1) is administratively simple and avoids the need for the parties to determine if a particular GST refund gives rise to a retrospective amended assessment or an adjustment (or both). It provides certainty for taxpayers as to how GST refunds should be claimed. Further, it aligns the interests of suppliers and recipients. Where a supplier reimburses passed on GST to a recipient and must claim the refund via a retrospective amendment, registered business recipients would generally have previously claimed an input tax credit on the transaction. In these circumstances, the recipient would be required to reverse its previously claimed input tax credits via an amended assessment and hence would have a shortfall amount, which potentially gives rise to penalties and interest for the recipient. Given the supplier makes the decision whether to reimburse the recipient (subject to any contractual agreement between the parties), the recipient may be put into a position where it is subject to penalties and interest on a shortfall amount with no control over the refund process. This is likely to lead to complex negotiations over GST clauses and disputes between parties. An adjustment mechanism avoids such disputes and is fair and equitable to recipients.

Objection and appeal rights

The EM describes a taxpayer's review rights in respect of proposed Division 142 (paragraph 1.60):

> Division 142 impacts on the assessed net amount and therefore the assessment of that net amount. Accordingly taxpayers may challenge that assessment, including the Commissioner's decision not to exercise the discretion to pay the refund, under Part IVC of the TAA 1953.

The Institute is concerned that this position may not be correct and that specific review rights should be included in the ED.

Proposed Division 142 operates in the context of the self-assessment system. It is likely that a taxpayer would be entitled to seek review under Part IVC of the TAA in respect of a dispute with the Commissioner under proposed section 142-10(1), that is, a dispute concerning whether a taxpayer has passed on GST to another entity or reimbursed passed on GST to that entity.

The position in respect of a decision of the Commissioner not to pay a GST refund under proposed section 142-10(3) is less clear and there is a significant risk that the Commissioner's decision under this proposed section would not be reviewable under Part IVC. Treasury is aware of the jurisdictional issue that currently arises under section 105-65 of Schedule 1 to the TAA, namely, whether the Administrative Appeals Tribunal (the **Tribunal**) has the jurisdiction to review a decision of the Commissioner not to refund GST under that section. The same issue will almost certainly arise under proposed section 142-10(3).

Accordingly, the Institute recommends that the Commissioner's decision not to pay a GST refund under proposed section 142-10(3) should be included as a *reviewable GST decision* under section 110-50(2) of Schedule 1 to the TAA.

The concept of GST in proposed section 142-5(1)

Proposed section 142-5(1) refers to 'an amount of **GST** exceeding that which is payable' (emphasis added). However, proposed Division 142 does not contain a specific definition of GST and therefore the definition of GST in section 195-1 applies, namely, 'tax that is payable under the *GST law and imposed as goods and services tax by' the various GST imposition Acts. GST is also defined in section 17-5(1) as 'the sum of all of the GST for which you are liable on the *taxable supplies that are attributable to the tax period' for the purpose of the *net amount* formula in that section. The Institute believes that the concept of GST in proposed section 142-5(1) is intended to encompass GST remitted by a taxpayer in respect of a taxable supply and hence should be aligned with the definition in section 17-5, rather than section 195-1. Accordingly, the Institute recommends an appropriate definition of GST is included in the ED that aligns with the definition of GST in section 17-5.

Excess GST is not defined and is ambiguous

Proposed section 142-5(2) uses the concept of 'excess GST', but does not define it. The EM describes 'excess GST' as 'an amount of GST that has been taken into account in an assessed net amount, but is subsequently found not to be payable' (paragraph 1.25). The meaning of excess GST needs to be inferred from the words in proposed section 142-5(1). This leads to uncertainty as to the scope of the concept. In particular:

- Is there 'excess GST' where, in a particular tax period, a taxpayer overpays GST on some transactions and underpays on others? This appears to depend on whether the 'amount of GST' in proposed section 142-5(1) is considered on a transaction basis or in aggregate, which is unclear.

- The EM makes it clear that proposed Division 142 should apply to mischaracterisations, miscalculations and accounting or reporting errors in respect of supplies (paragraph 1.26 and 1.27), but that it should not include adjustments or input tax credits. These inclusions and exclusions are primarily achieved through the inclusion of the term 'GST'. As discussed above, the Institute believes that GST is used here in a similar sense used in section 17-5(1), namely, 'the GST for which you are liable on the *taxable supplies that are attributable to the tax period'. The Institute further believes that using 'GST' in proposed section 142-5(1) to identify the scope of the proposed Division creates uncertainty. On a narrow reading of proposed section 142-5(1), excess GST only applies to taxable supplies and this limits the scope of the proposed section. In particular, it is arguable that proposed section 142-5(1) does not cover the situation where a taxpayer incorrectly treats something which is not a supply as a taxable supply (such as was the agreed position between the parties in the *KAP Motors* case), since the transaction does not involve a taxable supply. For similar reasons, the proposed section may not apply to misclassified supplies, although this is less clear.

- Whether excess GST is limited to amounts in a single tax period or can include amounts that are payable in a different tax period, for example, adjustment events which arise in later tax periods. The absence of a definition of GST in proposed section 142-5(1) is discussed above and is one reason for the uncertainty. A further concern is the use of the phrase 'takes into account' in proposed section 142-5(1), the scope of which is also uncertain. The ED and the EM are both inconsistent in this respect. The EM suggests that the excess GST is intended to encompass GST remitted by a taxpayer in respect of a taxable supply and not, for example, increasing adjustments and overclaimed input tax credits (refer paragraphs 1.26 and 1.27 and the final item in the *Comparison of key features of new law and current law*). This is also confirmed by the reference to 'taxable supply' in proposed section 142-10(1)(b). However, the reference to decreasing adjustments in proposed section 142-5(2)(a) and the inclusion of Example 1.3 in the EM suggest that excess GST can include adjustments and that it has a broad meaning.

These problems appear to flow from the fact that GST is defined in the context of the net amount formula in section 17-5 (as discussed above), but that there is no similar concept or definition in respect of a taxpayer's *assessed net amount*. Hence, the concept of excess GST in proposed section 142-5(1) uses an uncertain expression to refer to what is a relatively simple concept, namely, the amount included as GST in a taxpayer's assessed net amount.

The Institute recommends that proposed section 142-5 be reworded to include a definition of 'excess GST' and also to clarify the concept to resolve the uncertainties highlighted above.

Refunding excess GST relating to cancelled supplies

Proposed section 142-20 provides that, where a supplier has a decreasing adjustment as a result of a cancelled supply, the adjustment is reduced to the extent that GST has been passed-on to the recipient of the supply but not reimbursed.

The Institute questions whether the proposed section is necessary following the decision in *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA 41. The EM simply indicates that there might be cases where money is paid with a mere expectation of a future supply, which does not eventuate, without identifying any such cases. If it is the case that the proposed section is included in the ED to deal with a theoretical possibility, rather than situations that are of real concern, the Institute believes it should be removed from the ED.

Further, the proposed section may adversely impact on ordinary commercial arrangements. For example, wholesalers of goods commonly pay volume and other rebates to retailers. These types of rebates constitute adjustment events for both parties and are not controversial. Such rebates are generally taken to include a GST component. However, proposed section 142-20 would potentially require wholesalers to prove that GST is included in their rebates as a reimbursement and may result in wholesalers being denied decreasing adjustments where they are unable to positively demonstrate that GST is included in their rebates.

In the event the proposed section remains, the Institute believes there should be a corresponding provision that reduces the (registered) recipient's increasing adjustment. The recipient will be out of pocket where it has an increasing adjustment, but is not reimbursed for the GST. Further, the ATO will obtain a windfall in these circumstances.

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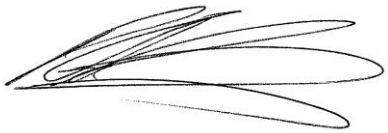
If you have any questions regarding the contents of this submission, please do not hesitate to contact either me on (02) 9290 5609 or Donna Bagnall on (02) 9290 5761.

Yours sincerely



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