Institute of Chartered Accountants Australia

14 September 2012

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**Dear Brenda**

**Exposure Draft – Refunding excess GST**

The Institute of Chartered Accountants in Australia (the Institute) welcomes the opportunity to make a submission in relation to the 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 17 August 2012 and seeks to implement Recommendation 44 of the Board of Taxation's review of the legal framework for the administration of the GST. This recommendation was accepted by the government in its 2009-2010 Budget announcement.

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 Institute does not support the proposed change to the GST law to convert the discretion contained in *section 105-65* of *Schedule 1of* the *Taxation Administration Act 1953* (TAA 1953) to the statutory requirement of 'passing on' in the ED.

The Institute is very much opposed to the proposed amendment, in its current form, that:

- The proposal, if enacted will be retrospective in its application from 17 August 2012. It was also announced without consultation. This is not in any way an exception to the government's position that retrospective application of amendments can be tolerated if they are of an anti-avoidance nature or integrity measure. Any suggestion that the proposals are directed at unjustified refunds is, in our view, based on a misinterpretation or misrepresentation of the decision in *International All Sports v Commissioner of Taxation* [2011] FCA 824 (Sportsbet):

- Sportsbet was not concerned – as is asserted by the Explanatory Memorandum (**the EM**) - with situations where an overpayment arose as a result of a miscalculation of the GST payable. The decision quite clearly finds that:

  'the "evident purpose of the section" [s.105-65] ... is to deal with the situation in which the recipient of a particular supply has been charged an amount from which one eleventh was included in the calculation of the "net amount", but has not been reimbursed a corresponding sum in anticipation of a refund being received from the Commissioner.'

  The Sportsbet decision found, in that case, that this was not the position – but not on the basis that Sportsbet had made a miscalculation. There simply was no amount that could be shown to have been included in the price of the supply of gambling services.

- That if s 105-65 did not apply it could lead 'to opportunities for taxpayers to obtain windfall gains if an overpayment arises as a result of a miscalculation, which is inconsistent with the policy intent that taxpayers should not obtain a windfall gain irrespective of how the overpayment arose.'

  The decision in Sportsbet recognised and supported the position that a refund should not be made if it would result in a windfall. This is because it had been 'borne' by the recipient of a supply. The interpretation adopted in the EM seems to be based on a misunderstanding of the purpose and operation of Div 126 of the GST Act. More specifically, the misunderstanding is in relation to the calculation of GST on the value of the intermediation service in gambling activities (being based on 'the margin or spread' arising from gambling activities from all participants over time) rather than the broader 'principle' that it was a miscalculation. The proper role and interpretation of Div 126 – as found by Jessup J - is no more than an acceptance and affirmation of the position that the input/output method of calculating GST on financial intermediation is not possible[1]. Furthermore, contrary to the Commissioner's assertion in Sportsbet, it was not the proper construction of the section.

  In doing so, His Honour confirmed, rather than rejected the principle of 'passing on' and 'windfall gains' as alluded to in the EM. It ought also to be noted that in *Luxottica Retail Australia Pty Ltd v Commissioner of Taxation* [2010] AATA 22, the decision did no more than apply the 'anti-windfall' principle asserted by the EM. It was not – as is suggested in the decision impact statement to that decision 'as a result of making an arithmetic or recording error.'

Essentially, the distinction between 'miscalculation' and 'anti-windfall' that the ED seeks to establish as a reason for retrospectivity is misplaced. In the cases referred to above, the existing s 105-65 operates to deny windfall gains in the spirit of the 'unjust enrichment' principle which the ED seeks to establish.

There is no justification for retrospectivity!

- The adoption of 'passing on' as explained in the EM is not an accurate terminology to describe the circumstances where the GST has been 'borne' by the customer and, hence, where a refund to the supplier may give rise to an unjust enrichment. The EM, in this respect misrepresents or misinterprets the

[1] See His Honour's reference to *HJ Glawe Spiel- und Unterhaltungsgeräte ufstellungsgesellschaft mbH & Co KG v Finanzamt Hamburg-Barmbek-Uhlenhorst* [1995] 1 CMLR 70 and Hill J's comments on financial intermediation in *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126 at paragraph 16.

concept of 'unjust enrichment' for windfall gains in its description of how 'passing on' occurs.

The term 'passing on' is not defined in the ED but indicates that it is presumed to mean that GST is included in the price. The EM states that 'an amount of GST is generally taken to have been passed on if it has been included in the price of a supply, even if that amount is not separately identified and disclosed.'

The EM refers to the following statement in the Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998*:

> GST is effectively borne by consumers when they acquire anything to consume … 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.

*The* Institute notes that this broad concept is universally accepted as not being an accurate statement of the incidence of a GST. By way of illustration, in The Modern VAT, the authors state:

> Contrary to the view often held by policy makers, the real burden of the tax is not necessarily borne only by consumers. The real loss of income that is the counterpart to ... the revenue raised by government, may also be felt by the owners, employees and/or financiers of the firms whose output is being taxed. The effective incidence of a VAT ... is determined not by the formal nature of the tax but by market circumstances, including the elasticity of demand for consumption and the nature of competition between suppliers.[2]

In particular, where financial intermediation is concerned, it is more likely that the burden of a GST is suffered by the supplier.[3] Recent cases and commentary in the EU show that the assessment of 'passing on' in a value-added tax contradict and reject the approach suggested in the EM.[4]

The High Court in *Avon Products Pty Limited v Commissioner of Taxation* [2006] HCA 29[5] found that:

> it is for the taxpayer to establish a circumstance out of the ordinary, namely that the amount of the overpayment of sales tax has not been passed on. Where the whole or part of the economic burden of sales tax may have been passed on indirectly through prices, the inquiry in this regard is likely to be complex. The complexity arises because prices may be set with reference to a wide range of factors (including considerations of cost of production, competitive advantage, operational cash flow and customer goodwill).

Essentially, contrary to the statements in the EM, there is no authority that the term 'passing on' has the meaning ascribed to it in the EM. If anything, for supplies of financial or risk intermediation, the authorities point the other way – that is, the incidence of GST is borne by the supplier.

The Institute opposes the statutory test of 'passing on' on the basis that its use as proposed is misinformed and contrary to value-added tax authority. It is at best, a rough and inaccurate

[2] Ebrill, L et al, *The Modern VAT* , Washington, IMF, 2001
[3] Edgar, T., ed, *The Search for Alternatives to Exempt Treatment,* GST in Retrospect and Prospect, 2007 page 136-141
[4] Capriles, T., *Shortcomings of the EU passing on defence*, (2012) 1(1) World Journal of VAT/GST Law
[5] As far as the case can be relevant, since it expressly dealt with a different tax system and commenced with the prima facie assumption of incidence which is rejected in the EU and other VAT authorities.

proxy for the determination of 'windfall gains' and 'unjust enrichment' which are expressed to be the real targets of the existing section and of the proposed amendment.

In view of the fundamental flaws, uncertainty and risk inherent in the ED, the Institute prefers a statutory test that provides for a Commissioner's discretion (**subject to merits based review**) to withhold a refund. To do otherwise would result in unjust enrichment without the customer being reimbursed. In the Institute's view, such a discretion is necessary and appropriate because:

- It can accommodate those situations (such as the charities that overpaid GST on entry tickets to museums etc) where the community generally can benefit from the overpayment; and
- Cases where it is reasonable to refund – such is seen to be the case in both Sportsbet and Luxottica without or in advance of reimbursement; and
- A range of circumstances of overpayment of GST where it would be reasonable to refund the amount over paid – such as those dealt with in MT 2010/1.

Further, a discretion suits the new self assessment regime because any refund for tax periods after 1 July 2012 must arise by the Commissioner 'making and amendment.'

The Institute has a number of specific comments and observations in relation to the ED.

## Specific comments

### Refunds arising from overpaid GST

In the Institute's view, it seems clear enough that the proposed Div 36 relates to refunds arising from overpaid GST, and not from unclaimed or under-claimed input tax credits. However, it would be useful to also make it explicit. In that respect, the reference to input tax credit in paragraph 1.7 of the EM is ambiguous.

In this regard, we do not consider it appropriate to deal with these shortcomings in the EM. The Institute notes the comment of Emmett J in *KAP Motors Pty Ltd v Commissioner of Taxation* (2008) 168 FCR 319 at [33]:

> Section 105-65 should not be given an expansive construction. While its object may be commendable, in seeking to avoid windfall gains for taxpayers, it is, in a sense, a paternalistic interference with the rights of taxpayers.

As such, the statutory provision should be clear and complete and its operation reviewable on its merits.

### Application of Div 36

The proposed Div 36 is silent on how it applies to the following:

- Decreasing adjustments
- An off the invoice discount in the same period as you invoice the supply
- Mixed supplies
- Accounting for supplies in the wrong tax period
- Accounting for GST under protest
- Reverse charge
- Same GST group
- Wrong taxpayer paying the GST
- Incorrect ruling from the Commissioner
- Third party consideration

The Institute strongly asserts that a refund should be available in these cases but the ED does not express them as exceptions – unless it can be dealt with by 'passing on.' In many cases this will not be the situation.

Again, the variation of circumstances makes a Commissioner's (reviewable) discretion an appropriate legislative mechanism to address the mischief.

**Expressions of 'passed on' and 'reimbursed'**

Section 105-65 of the TAA 1953 refers to 'reimbursed'. The proposed Div 36 uses both expressions of 'passed on' and 'reimbursed.'

As indicated above, the Institute considers that the use of the term 'passed on' is uncertain and problematic as an objective test.

Reimbursement is, of itself, dependent upon the notion of the GST having been 'passed on' both from a economic and quantitative perspective.

***i. Reimbursed***

The expression 'reimbursed' has been the subject of a debate at a recent National Tax Liaison Group GST Sub-committee meeting. Matters discussed included:

- the situation where a customer is sent a cheque and it is returned, or if an amount is credited to the customer for the customer to claim; and
- difficulties in identifying and contacting the customer?

Is there a role for the 'unclaimed monies' provisions to operate?

It is also worth noting that the reimbursement has to take place before the amendment can be sought. The reason for this is that the refund is only available for so much of that passed-on amount for which the entity has been reimbursed. However, what happens if you do not know which recipients are registered?

Again, the variety of circumstances makes a Commissioner's (reviewable) discretion an appropriate legislative mechanism to address the mischief.

***ii.Passed on***

In our general comments, the Institute questioned whether the expression 'passed on' is appropriate and a suitable proxy for what seems to be a policy of preventing unjust enrichment?

The Institute is not accepting the term 'passed on' is a desirable or appropriate statutory test. However, if it were to be used, then the ED should clearly allow taxpayers to demonstrate on the balance of probability that they have not passed on some or the entire GST burden in the price.

***iii. Rebuttable presumption***

The proposed s 35-5(3)(b) of the ED involves a rebuttable presumption of passing on. In the Institute's view, the rebuttable nature of the presumption of passing on should be more explicit.

**Assessed net amount or overpayment of GST**

The examples in the proposed s 36-5 suggest that it is an overpayment of GST that cannot be corrected in a BAS – not an overstatement of an 'assessed net amount.' The section states

'…your *assessed net amount for a tax period takes into account an amount of GST that exceeds what is payable.'

GST is defined as a tax that is imposed. The issue of whether GST was payable or whether only assessed net amounts were payable needs to be addressed.

The Institute has questioned the structure of the self assessment amendments in that there are a number of provisions dealing with what is 'payable' – i.e. GST imposed, GST payable, assessed net amounts payable.

**Recipients who cannot claim full input tax credits**

Under the ED, registered recipients who have been overcharged GST and who are not entitled to claim full input tax credits will be denied restitution. The proposed Div 36 will deem the overpaid GST to always have been payable, and will allow input tax credits to the recipient (see proposed s 36-5(2) and Note 2 in particular). But that will not assist those who cannot claim full input tax credits. There needs to be a mechanism to unwind the transaction in these circumstances.

**Commissioner's discretion to refund**

Paragraph 1.2 of the EM states that the amendments also remove the Commissioner's discretion to pay a refund and instead allow taxpayers to self assess their entitlement to a refund of amounts of excess GST by reference to the specified conditions.

As indicated above, there will always be circumstances for which a residual discretion may alleviate unintended consequences, or otherwise provide for a just result. An example may be when the recipient is registered and a member of the same economic group (though not GST group) is the supplier. Another example would be when the overpayment resulted from clear ATO error (compare, for example, MT 2010/1, paragraph 128). It is not clear why refunds should be denied in such circumstances.

In the Institute's view, there should be a Commissioner's discretion to refund in certain circumstances. The Commissioner's discretion should be subject to a merits based review.

**Jurisdictional issues**

There has been a jurisdictional issue with s 105-65 of TAA 1953 and uncertainty about whether the Administrative Appeals Tribunal (**Tribunal**) has jurisdiction to hear appeals relating to that provision. It would be timely to expressly provide that disputes over the proposed Div 36 attract the jurisdiction of the Tribunal in Part IVC proceedings

**Passing on in gambling context**

As indicated above, the comments about gambling in Example 1.5 are misplaced. Div 126 of the GST Act will make 1/11th of the excess of the 'global GST amount' the 'amount of GST that exceeds what is payable.' What is required to avoid the proposed s 36-5 is that the excess of 1/11th of the global GST amount has 'not been passed on to any other person.'

But any particular event is a sharing of risk between persons in different states of risk. If we are looking for the burden of the tax paid on the margin (if any), GST is a charge against the profit over a period from a number of different persons for whom the gambling provider is an intermediary. The profit is determined by the skill of the provider in pricing risk. In character, the tax is a direct tax on profit and not an indirect tax that is passed on.

It cannot be said that the burden of GST is borne by any of the punters. Particularly not on the one who collects. If he has paid a price, it is in the margin that has been earned over time by the provider. It is impossible to reimburse it because it is impossible to value.

At the time of the amendment that gave rise to the Sportsbet litigation, the Institute submitted that the wording of Div 126 should be amended to reflect its purpose and object. The Federal Court noted the deficiency in the legislation and its variance with the purpose as set out in the EM.

There are many academic works dealing with the taxation of gambling – all of which contradict the example and theme of the EM. The Institute submits that a court will not apply the proposed statutory scheme to gambling supplies in the way suggested in the EM. The Institute submits that:

- Div 126 should be amended to reflect the proper tax base, being the 'amount the gambling operator keeps for himself.' Events can be GST-free, but not any particular bet.
- The discretion to refund overpayments be able to take into account whether a refund is appropriate in any particular circumstance.

**Exclusions**

Real property margin scheme should be excluded from the operation of the proposed Div 36. This can be done by acknowledging that margin scheme will be deemed to have been paid out of the vendor's margin.

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

Yours sincerely

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