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13 September 2012

Dear Michael

Submission: Draft Legislation on Refunding Excess GST

Thank you for the opportunity to talk with you and comment on the draft legislation *Refunding Excess GST* **(draft rules).** As you are aware, we also spoke to the ATO and the Assistant Treasurer's office on the draft rules.

The Property Council is the peak body representing the interests of owners and investors in Australia's $670 billion property investment sector. The Property Council serves the interests of companies across all four quadrants of property investment, debt, equity, public and private.

The Property Council supports Government's drive to clean up the GST regime but draft rules on refunding excess GST creates unintended and unfair impacts that conflict with current ATO practise.

The Key Issues

Unless taxpayers fall within very narrow and uncommercial exceptions, the draft rules deem that:

1) all inadvertent GST errors are correct and payable by a taxpayer; and

2) GST on margin scheme transactions is always passed on and not refundable.

The industry is deeply concerned that the draft rules are unfair because they will effectively stop the ATO refunding legitimate claims for overpaid GST that are not "windfall gains" including:

1) transactions where GST is not passed on to the taxpayer; and

2) inadvertent errors in transactions that can be unwound to ensure no "windfall gain" occurs.

In many cases, the ATO will collect more than 10% GST even where there would be no windfall gain if the refund is allowed.

These problems are also made worse given that the Commissioner will still collect GST underpayments on any similar transactions.

The draft rules contradict the current law and practice of paying refunds for margin scheme property transactions as resolved between the Government and industry in late 2011.

The Impacts

The draft rules effectively punish developers, landlords and property vendors operating in good faith.

For instance, if a developer is involved in a multi-staged residential development but underpays GST in the first stage of development and then overpays GST in the final stage of development, the ATO will collect additional tax to make up the underpayment and will not refund any GST overpayment.

The draft rules will not even allow for an offset of the underpayments & overpayments. Consequently the ATO will collect more than 10% GST on the transaction. In this situation, the developer will bear the additional cost burden because it has GST-inclusive fixed price contracts and the extra GST cost cannot be passed on to the purchaser.

The net GST paid overall is the correct amount with no windfall gains to the developer. However, where the ATO pursues the underpayments and refuses refunds for overpayments, a windfall gain is artificially created in favour of the Government.

The logical and consistent approach would be to allow the refund and assess the underpayment – but if Government policy is not to allow refunds we expect it also not to assess underpayments. Is this Government policy?

A second illustration of the problems raised by the draft rules relates to errors that can be "unwound".

For example, if a retirement village operator is mistakenly charged GST on supplies, the supplier will not get a refund and the operator cannot gets its money back. If the refund were provided, the error would be unwound and no windfall gain would result.

Another example is a Landlord that inadvertently invoices a tenant $1,000,000 + GST instead of $100,000 + GST – it will no longer get a refund for the overpaid GST and ends up paying 90% GST. If the refund were provided, the error would be unwound and no windfall gain would result.

Taxpayers who diligently pay their tax, risk overpayment and will be punished for trying to do the right thing. This will ultimately end up in additional disputes with the ATO.

Further detailed examples are attached in **Appendix A.**

The draft refund rules are in conflict with good Government and fair tax policy:

- ☒ The draft rules undermine ATO practise resolved with Government to refund GST on margin scheme sales;
- ☒ The draft rules contradict Court decisions that overpaid GST must be refunded to taxpayers;
- ☒ The ATO collects windfall amounts that it is not entitled to keep; and
- ☒ The draft rules punish taxpayers who use conservative tax practises and encourages taxpayers to underpay their tax.

Other problems

The draft rules also give rise to other uncertainties and/or complexities as:

- ☒ they assume, but do not expressly provide, that the underlying supply or arrangement when excess GST is not refunded will be a taxable supply. It is important that this be expressly stated to ensure the GST Act, other tax acts and standard commercial contracts operate properly;

☒ the draft rules appear to cover 'decreasing adjustment' based on an example in the EM, but this should not be the case; and

☒ there should still be the opportunity for the Commissioner to refund overpaid GST in appropriate circumstances.

The Solutions

We are aware that the problems highlighted above and in our Appendix A are inadvertent. There are simple solutions that can be easily implemented:

☑ Amend the EM example 1.4 to reflect current ATO payment of margin scheme refunds and provide further examples that will more clearly illustrate the operation of the rules – refer Appendix B;

☑ Remove proposed section 36-5(2)(b)(ii) so that taxpayers can 'unwind' transactions to reimburse non-creditable recipients – refer Appendix C.

☑ Expressly provide that the retained GST is for a "taxable supply" – refer Appendix D.

☑ Confirm that adjustment events are not covered by the section – refer Appendix E.

☑ Maintain a residual discretion for the Commissioner to refund GST where appropriate – refer Appendix F.

We look forward to further discussions with you to address these issues.

Please do not hesitate to contact me on 0406 45 45 49 if you have any queries or to set up a time to meet.

Yours sincerely

Andrew Mihno

Executive Director International & Capital Markets

Property Council of Australia

0406 45 45 49

Submission Appendix

Property Council of Australia
September, 2012

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Appendix A

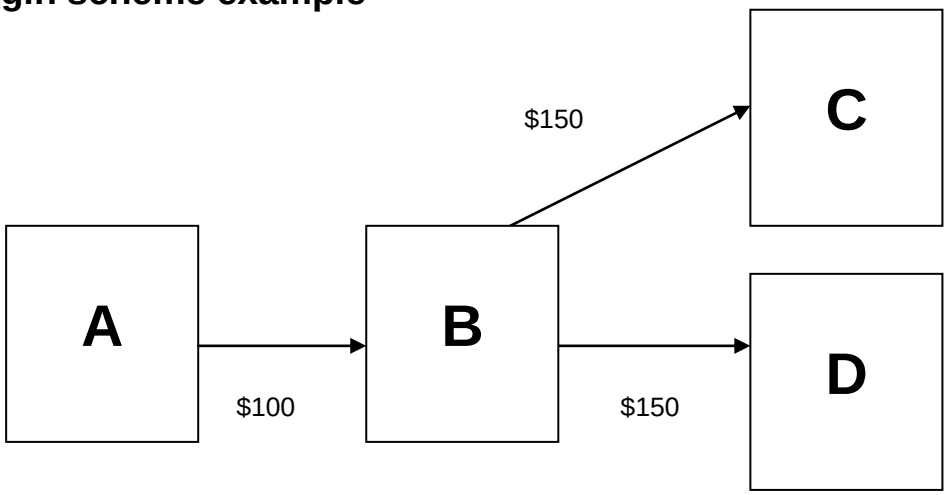
Examples: Unfair and impractical outcomes

We attach to this submission **seven examples of unfair and impractical outcomes** that will result if this draft legislation is not amended. Those examples are, in summary:

Example	Description	Effective GST rate	Loss to	Windfall to
1	Margin scheme apportionment	11%	Developer	ATO – asymmetrical correction to cost base allocation The developer can't pass on the GST but cannot get a refund either.
2	GST registered margin scheme purchaser	15%	Developer	ATO - no correction of calculation error, even though no ITC claimed Developer has overpaid in error and can't get a refund from the ATO.
3	Retirement village operator mistakenly charged	12.5%	RV operator	ATO – no capacity to reverse classification error even though no ITC claimed Builder has overpaid in error and can't get a refund from the ATO.
4	Landlord double invoicing	20%	Landlord	ATO – no capacity to reverse clerical/systems error even though no ITC claimed Landlord has overpaid in error and can't get a refund from the ATO.
5	Landlord error on invoice	90%	Landlord	ATO – no capacity to reverse typographical error even though no ITC claimed Landlord has overpaid in error and can't get a refund from the ATO.
6	Residential property vendor	10% on residential premises	Vendor	ATO - no capacity to reverse classification error, even though GST is reimbursed to purchaser Vendor has overpaid in error and can't get a refund from the ATO.
7	Co-owned property vendors	20%	Vendors	ATO – double payment of GST due to inability to reverse payments by wrong entity Vendors have overpaid in error and can't get a refund from the ATO.

Not refunding excess GST - Perverse outcomes 1

Margin scheme example



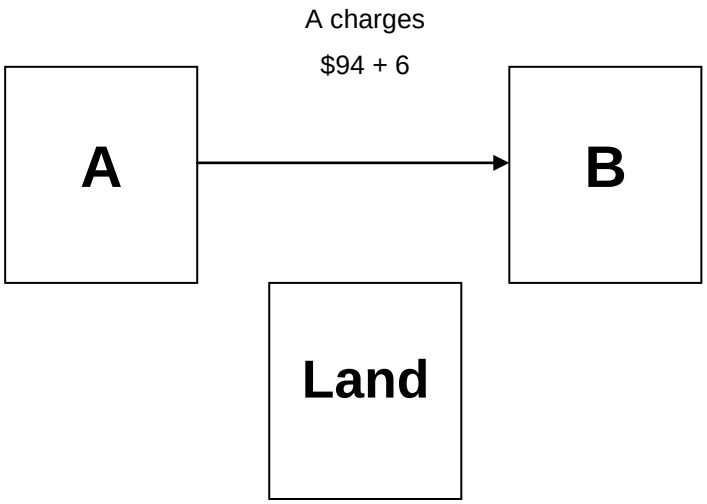
- B buys block of land from A for $100 under margin scheme
- B builds 2 townhouses, subdivides and sells a new lot to each of C and D for $150 (again, under the margin scheme & GST-inclusive as to end purchasers).
- B apportions the 'margin scheme cost base' of $100 on a 50:50 basis as each lot is the same price.
- ATO reviews B and decides apportionment should be 70:30 as Lot C has a better aspect (although each townhouse is sold for $150 as the building on Lot D has a better fit out)
- The Developer has, on the ATO's view, overpaid GST on lot D and underpaid on lot C
- The ATO collects the underpaid GST but will not refund overpaid GST – the Developer cannot pass on the extra GST and must bear the burden.

	B's GST on Sales		**ATO's view on apportionment**	**Proposed Div 36 outcome (unless eg 1.4 changed)**
Sales to C	Price Cost base Margin ÷11 =	150 50 100 9	150 70 80 7	2 overpayment not refunded
Sale to D	Price Cost base Margin ÷11 =	150 50 100 9	150 30 120 11	2 shortfall assessed by ATO
Net GST		**18**	**18**	**20**

[Result: GST is 11% of margin]

Not refunding excess GST - Perverse outcomes 2

Margin Scheme registered recipient example

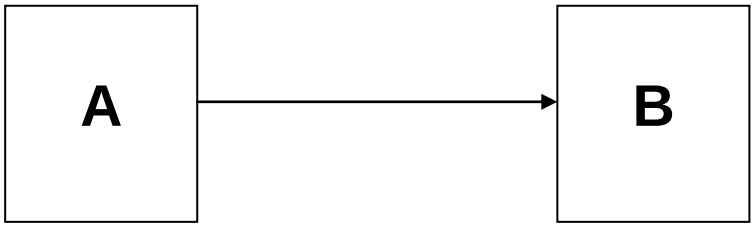


- A sells land to Developer B for a price of $94+ GST under the margin scheme.
- A mistakenly believes the 'margin scheme cost base' is $34, so charges GST of $6 (ie. 94- 34 = 60 x 10% = 6).
- Developer B is registered for GST but can claim no input tax credit for the $6 per section 75-20.
- A later realises the 'cost base' is $54, so the GST should have been $4.
- Due to proposed 36-5(2)(b)(ii) A cannot get a refund of the $2 overpaid GST.
- After considerable legal costs incurred over whether A is required to contractually refund B it is determined no contractual refund is required so B is $2 worse off.

[Result: GST is 15% of margin]

Not refunding excess GST: Perverse outcomes 3

Supplier to non-creditable recipient



Charges

Construction:	120
Interest:	30
GST:	15

Should have charged:

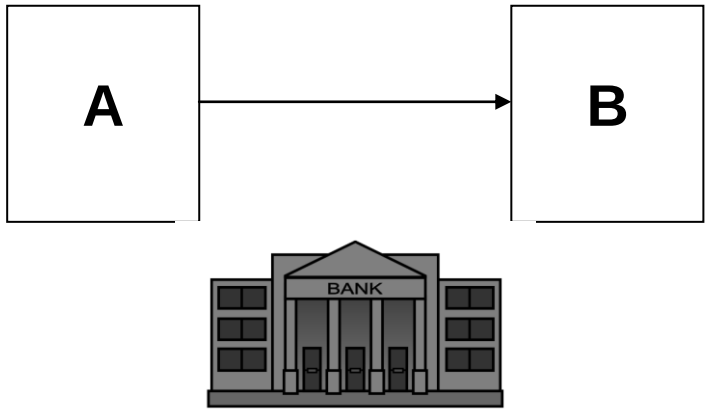
Construction:	120
GST:	12
Interest:	30

- Builder A constructs apartments for retirement village operator B
- The contract requires building construction to be paid on progress claims, interest on late payments and GST.
- A incorrectly invoices B for GST on the $120 construction and the $30 interest (ie. GST of $15).
- B, a retirement village operator, claims no credit.
- B identifies the mistake and insists on a refund of the $3 overcharge for GST.
- However, A is unable to obtain a refund from the ATO (due to proposed 36-5(2)(b)(ii)).
- After incurring considerable legal costs as to whether the incorrectly charged GST needs to be refunded, B does not get a refund and bears the incorrect $3

[Result: GST is 12.5% on construction]

Not refunding excess GST: Perverse outcomes 4

Supplier double invoices



Charges

Rent:	120
GST:	12

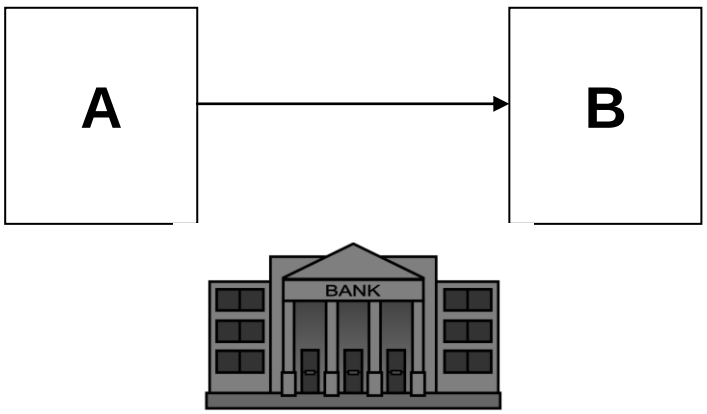
But mistakenly issues and processes two invoices for the month of October instead of one

- Landlord A leases an office tower to Bank B
- The lease requires $120 rent plus GST to be paid monthly.
- A incorrectly invoices B for $120 rent and $12 GST twice for the month of October and B pays both invoices.
- B, a bank, claims no credits.
- In December B identifies the mistake and insists on a refund of the $132 second payment.
- A refunds the $120 but disputes refunding the $12 GST.
- After incurring considerable legal costs as to whether incorrectly charged GST needs to be refunded, A refunds B the $12 charged for GST.
- However, A is unable to obtain a refund from the ATO (due to proposed 36-5(2)(b)(ii) and example 1.7) so the $12 is a net cost to A.

[Result: GST is 20% of rent]

Not refunding excess GST: Perverse outcomes 5

Supplier error on invoice



Charges

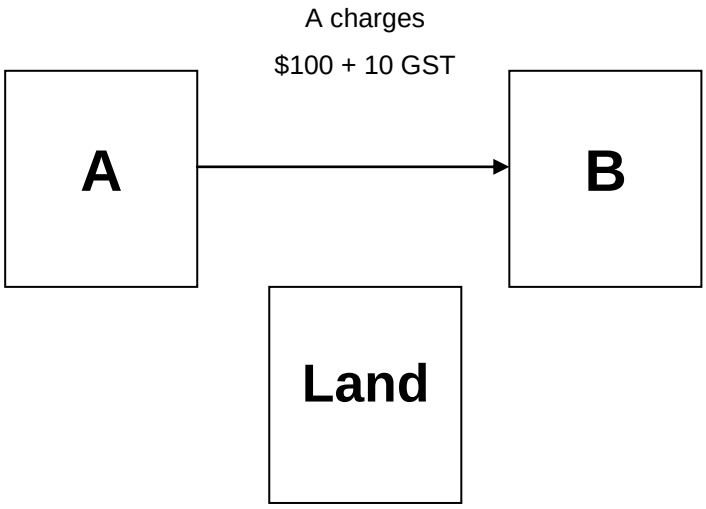
Rent:	1,000,000
GST:	100,000
Instead of the agreed	
Rent:	100,000
GST:	10,000

- Landlord A leases an office tower to Bank B
- The lease requires $100,000 rent plus GST to be paid monthly.
- A systems error of the property manager means the manager incorrectly invoices B for $1,000,000 rent and $100,000 GST for the month of October and B pays.
- B, a bank, claims no credits.
- In December B identifies the mistake and insists on a refund of the $990,000 overpayment.
- A refunds the $990,000 to B and seeks to get the $90,000 mistakenly overpaid GST back from the ATO.
- However, A is unable to obtain a refund from the ATO (due to proposed 36-5(2)(b)(ii) and example 1.7) so it has paid $100,000 of GST on $110,000 of rent.

[Result: GST is 91% of rent]

Not refunding excess GST - Perverse outcomes 6

Sale of residential property incorrectly treated as commercial property example



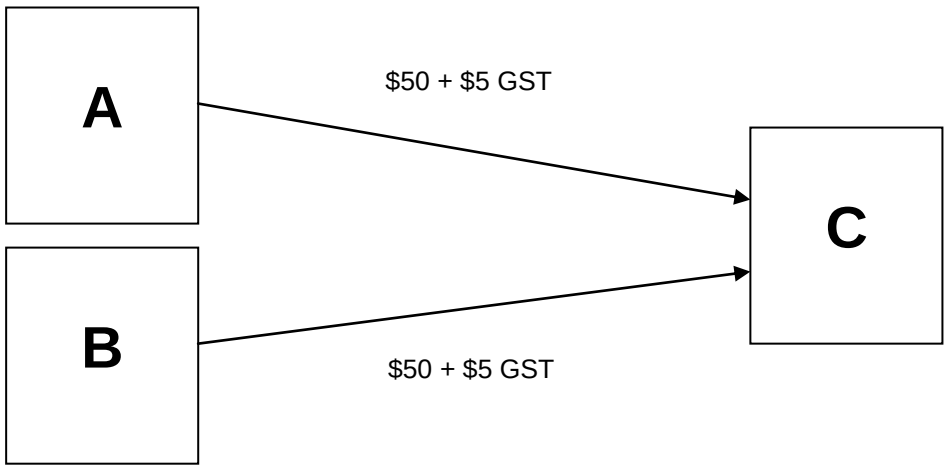
- A sells a property to B for a price of $100 + GST.
- Both parties believe the property is commercial residential property (with vacant possession). A recovers $10 GST on the sale. B expects that it is entitled to a GST credit on the property.
- B lodges its GST return to claim the $10 GST credit. ATO denies the GST credit on the basis that the property is residential property and should not have been subject to GST and further that B will make input taxed supplies of the property involving residential rent.
- Sale of property should have been input taxed residential property and not subject to GST.
- B requests repayment of the $10 overcharged for GST from A.
- After incurring considerable legal costs as to whether the incorrectly charged amount for GST needs to be repaid, A reimburses B the $10.
- However, A is unable to obtain a refund from the ATO (due to proposed 36-5(2)(b)(ii)) so the $10 is a net cost to A.

[Result: 10% GST on residential housing]

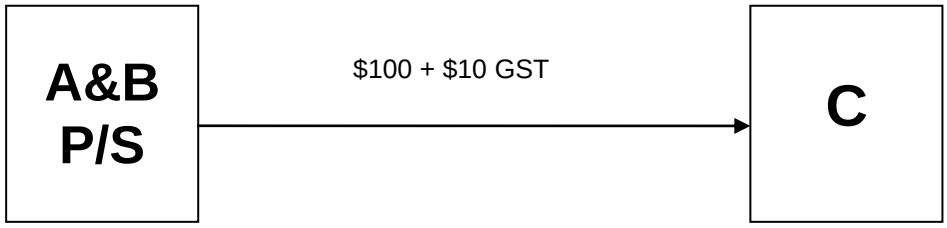
Not refunding excess GST - Perverse outcomes 7

Wrong entity pays GST example

Treatment by parties:



ATO view:



- A & B own a commercial property as tenants in common. Each is registered for GST.
- A & B each sell their 50% interest in the property (with vacant possession) to C for a price of $50 + $5 GST each. A & B remit GST of $5 each.
- C is registered for GST and claims two input tax credits of $5.
- ATO reviews the transaction and decides that A & B are operating as an enterprise tax law partnership. It therefore assesses the partnership for underpaid GST of $10.
- Due to proposed 36-5(2)(b)(ii), A & B cannot get a refund of the $5 each overpaid GST.
- A & B (as partners) seek recovery of the additional GST from C under the contract. After considerable legal costs are incurred, a court holds that C has already paid GST under the contract and the GST clause does not allow recovery of GST a second time.
- A & B have borne GST twice, but only recovered GST once from C.

[Result: A & B pay a 20% GST rate]

Appendix B

Amendments to the EM regarding further margin scheme examples

1 Amendments to EM

The EM should be amended to remove confusion regarding the operation of refunds and the margin scheme. This will avoid the 'absurd outcome' in Example 1 of Appendix A, as the overpayment would be refunded (as well as the shortfall being assessed and paid).

Below is a potential amendment to the draft EM that will provide additional and amended examples regarding margin scheme (shown in mark-up to the existing paragraph 150):

1.50 Further, a tax invoice may not be issued in respect of some types of taxable supplies, for example, when using the margin scheme. Where an overpayment has occurred as a result of a miscalculation under the margin scheme, a contract of sale or other relevant document may demonstrate that an amount of GST has been passed on.~~, even though the precise amount of GST may not have been separately identified in the documents for commercial reasons.~~ ***[Schedule X, item 42, subparagraph 36-5(30)(a)(i)]***

Example 1.4: Passing on in margin scheme context

Leslie's Developments Pty Ltd (**LD**) is a property development company and is registered for GST. LD makes a taxable supply of real property to Phe Pty Ltd (**Phe**), another developer.

LD and Phe agree in writing on a GST-exclusive price and that an amount for GST can be charged using~~to use~~ the margin scheme in calculating the GST liability on the supply.

LD provides Phe with a contract of sale that confirms ~~that~~ the GST-exclusive price and that the margin scheme is to apply to the sale. This indicates that some amount of GST is included in the total purchase price. Notwithstanding that no tax invoice is issued in respect of the supply, the contract of sale is sufficient to show that an amount of GST has been passed on to Phe.

Example 1.5: No passing on in margin scheme context

Leslie's Developments Pty Ltd (**LD**) is a property development company and is registered for GST. LD makes a taxable supply of new residential premises to Mr & Mrs Amarco.

LD sells its new residential premises at the best price it can get in the market, but as the residential property market is predominantly non-taxable sales of existing property it uses the margin scheme to reduce the amount of GST it would otherwise bear. LD's price cannot be increased to cover its GST liability. Its sales contract with the Amarcos is for a GST-inclusive price and has a standard margin scheme agreement clause which is legislatively required in order that LD is able to apply the margin scheme.. No tax invoice is supplied to the Amarcos and they have no knowledge of how much the GST liability of LD is.

Even though the existence of the margin scheme clause in the contract indicates that LD will have a GST liability on the sale, as LD is selling to an end consumer in the residential property market for a GST-inclusive price it has borne the amount of its GST liability and not passed it on.

If LD were to overpay GST as a result of a miscalculation under the margin scheme on the sale to the Amarcos, it would not be prevented from getting a refund of the overpayment.

2 Rationale for these EM Amendments

As we discussed, the rationale for the above changes to the EM are to avoid absurd outcomes where GST is not refunded on GST-inclusive margin scheme transactions. The refunding of such amounts was the norm from the introduction of GST in 2000 until a change in ATO view in 2009 for two years. That ATO view was overturned in 2011 after substantial lobbying and submissions and the ATO reverted to the norm of refunding GST on margin scheme sales.

The rationale for this practice is based on:

- the unique circumstances of margin scheme sales;
- the alignment with Commissioner's practice; and
- judicial precedent.

2.1 Unique circumstances of margin scheme sales

In the case of property developers supplying new residential premises under the margin scheme to end users, it is fair and reasonable for the developer to obtain a refund of any overpaid GST on the basis that **there is no windfall gain to Developers.** GST is not a factor in setting prices for sales of residential premises – they are set by a market dominated by non taxable sales.

In this regard, we note that your submission of 8 October 2008 to the Senate Standing Committee on Economics regarding TLAB (2008 Measures No. 5) expressly noted that new residential property represented only 12% of the total value of the market and that developers do not determine the market price.

To set out the relevant circumstances in more detail:

- Prices in the residential property market are set without regard to GST (if any). That is, sales of new houses or apartments in the residential property market are determined by the market regardless of GST (if any) to be payable by the vendor (as Treasury noted in the abovementioned submission).
- Further, purchasers in this residential property market are generally not registered for GST and in any case are unable to claim an input tax credit for any GST so the price they are willing to pay for residential premises is a total GST-inclusive (if any) price.
- As a result of the above, contracts for the sale of new residential premises to end purchasers are made on a GST inclusive basis rather than a "plus GST" basis. This can be contrasted with commercial property or commercial residential premises, where sales are generally subject to GST and purchasers are generally registered for GST and entitled to input tax credits. In these markets, prices are often determined on a "plus GST" basis, unlike the residential property market.
- It is widely acknowledged that Developers bear the GST on sales. As discussed above, because the purchase price is determined by the market, any GST applicable to the sale is borne by the Developer, not the purchaser. To illustrate this point by way of example, if there was an increase in the GST payable in relation to a Developer's supply of the apartment, the Developer would not be able to seek an additional amount from the purchaser.
- Where the margin scheme is applied, purchasers are unaware of the GST amount paid by a Developer. This can clearly be distinguished from other taxable supplies in the GST system on the basis that:

a) GST is less than 1/11th of the price;

b) The amount of GST does not need to be disclosed to recipients (i.e. no tax invoice is required); and

c) No input tax credit arises in any circumstances.

All of these factors support the view that the Developer absorbs the cost of any GST payable on its sale of new residential premises to end purchasers, so there is no windfall gain and the developer should be allowed a refund of any GST overpaid.

2.2 Alignment with Commissioner's views

The exercise of the discretion to allow refunds in margin scheme sales to end users would also align to the Commissioner's previous views on application of the margin scheme.

To illustrate this: it is common for most developers to subdivide or strata title a single title and apply the margin scheme when selling the individual lots. This requires the developer to apportion the margin scheme "cost base" (the consideration or a valuation, as applicable) across the individual lots, and the types of methods that may be used to do so are set out in various rulings of the Commissioner – refer GSTR 2006/7 at paragraphs 68 – 69 and GSTR 2006/8 at paragraphs 58 – 68.

The Commissioner may query an apportionment methodology during an audit or review and also accepts that the taxpayer may change an apportionment methodology if its is not appropriate. However, an apportionment method can only be changed if "the changed method is applied to calculate the margin for all the sales" (GSTR 2006/8, paragraph 58). The total amount of GST payable on the whole development does not change – as it will be the total sales prices less the total margin scheme cost base – but the timing of when the GST is payable may change – more in one period less in another.

If, however, in changing apportionment methodologies (either self assessed or after an audit), the Commissioner was to refuse to pay refunds of GST in months where the GST liability was reduced but still impose the GST liability in months where more GST was payable, then the Commissioner would collect more GST than is payable under the margin scheme.

This is not only contrary to the whole purpose behind the margin scheme provisions (refer Explanatory Memorandum to the GST Act at paragraphs 6.98 and 6.100), it is also a clear windfall gain to the Commissioner at the expense of the taxpayer.

In order to align the Commissioner's published views on the margin scheme and the express purpose of the margin scheme provisions with the proposed section 36, we submit that sales under the margin scheme to end users be used as an example of circumstances where the GST is not passed on.

2.3 Judicial precedent

We note that there is judicial authority to support the exercise of the Commissioner's discretion in relation to circumstances which would cover margin scheme recalculation cases.

In *Luxottica Retail Australia Pty Ltd v Commissioner of Taxation [2010] AATA 22* (**Luxottica**), the Administrative Appeals Tribunal decided that based on the circumstances of that case, the residual discretion in section 105-65 should have been exercised.

In *Luxottica*, the taxpayer offered a promotion whereby spectacle frames (taxable) were offered at a discount to their normal selling price on the condition that customers also acquired lenses for those frames (GST-free). The main issue in the case was how GST should be calculated where a discount is agreed to be applied solely to the taxable component. The Tribunal found the reasoning for the exercise of the discretion in section 105-65 to pay the refund in that case was "straightforward" on the basis that:

- reimbursing the customer would have reduced the agreed selling price of the spectacles (i.e. the customer would walk away having paid less than what they had originally contracted to pay despite the supply still being taxable). As such, the windfall would flow to "the undeserving customer" which was "not the right outcome"[1]; and
- the act of reimbursement would necessarily cause an adjustment to the price with a consequent adjustment to the GST amount payable on the transaction requiring a further reimbursement, requiring further adjustment, and so on…In the words of the Tribunal, "such a process of reiterating prices, values and GST payable has no place in a taxpayer's compliance with GST as a 'practical business tax'[2]".

In our view, those principles can be applied equally to any overpayment of GST by developers as a result of incorrectly calculating the GST payable under the margin scheme. That is, a Developer's reimbursement to purchasers of new apartments would result in a windfall gain to those purchasers relative to the market price they agreed to pay and would not be the right outcome given such purchasers had originally contracted to pay an inclusive price and were not aware of how much GST was paid by the Developer.

Further, as the supply remains a taxable supply, the "reiterating prices/recalculating GST" problem would also apply in relation to sales under the margin scheme meaning that in margin scheme cases, refunds should be paid without any requirement to reimburse purchasers.

3 Conclusion

This change to the EM is critical to the proper operation of Division 36. If the legislation allows the Commissioner to collect underpayments but not refund overpayments for the margin scheme transactions then it will be a fundamental shift in the GST regime that will have far reaching unintended consequences.

If this change to the EM is not made, the PCA cannot support the proposed draft rules.

[1] Refer paragraphs 58 and 60 of *Luxottica* decision

[2] Refer paragraph 58 of *Luxottica* decision

Appendix C

Remove s.36-5(2)(b)(ii)

We submit that proposed section 36-5(2)(b)(ii) be deleted.

If the supplier is prepared to (or contractually required to) and does reimburse the recipient of the supply for mistakenly changed GST, then the supplier should get a refund regardless of whether that recipient is registered or not.

This change resolves the ‘absurd outcomes’ in examples 2-6 of Appendix A, where the recipient of the supply was registered but not entitled to a full input tax credit on their acquisition.

If the parties decide to ‘unwind’ the transaction such that any mistakenly charged GST is reimbursed, then the status of the recipient should have no bearing on whether a refund is claimable.

Appendix D

Expressly provide for “taxable supply”

The draft rules imply, but do not expressly state, that any excess GST that is not refunded but “taken to have been always payable” is for taxable supply. Apart from the obvious example of the recipient keeping its input tax credit, there are at least six other circumstances in which it is critical that the supply or arrangement that gave rise to the excess GST being remitted needs to be a “taxable supply” as defined for GST.

Recipients input tax credit entitlement

For example, Note 2 at the end of proposed section 36-5(2) provides that:

> *“If the excess GST has been passed on to a registered entity … that entity can treat the excess GST as being payable for working out the amount of its input tax credits under section 11-25.”*

Refer also to paragraphs 1.36-1.38 of the EM.

This implies that the recipient can treat the supply (or deemed supply) as a taxable supply – but section 11.5(b) expressly requires the relevant acquisition to be of a “taxable supply” (as defined) in order for the recipient to claim (or keep) a credit.

We therefore submit Division 36 must have a section that confirms that the supply or arrangement for which the “excess GST is taken to have been always payable” is a “taxable supply”.

The definition of “taxable supply” in section 195-1 should also cross-reference this new provision.

Other provisions and implications

The need to have an express provision ensuring the relevant supply or arrangement is a “taxable supply” is also necessary for the proper operation of other GST and non-GST provisions, including:

a) tax invoices being valid
Tax invoices must state “the extent to which each supply to which the documents relates is a “taxable supply” (section 29-70(1)(c)((iv)). In order for the recipient to hold a valid tax invoice for the GST taken to have been payable due to section 36, the section needs to ensure the relevant underlying supply of arrangement treated as a taxable supply is a “taxable supply”;

b) recipient created tax invoices
RCTI’s only apply for “taxable supplies” (section 29-70(3)), so could only ever be valid for section 36 GST if the section has an express provision that the relevant supply or arrangement is a “taxable supply”;

c) credits on related acquisitions
Where a supplier mistakenly treats a supply as taxable and charges GST, it would have, in the normal course, have claimed input tax credits on acquisitions related to the supply. If the excess GST is not refunded and treated as payable, then the relevant credits of the supplier should also be treated as claimable (or else the supplier could suffer denied credits on inputs to a supply on which GST is payable). This requires the relevant supply or arrangement on which excess GST is not refunded to be expressly defined to be a taxable supply;

d) GST clauses in contracts
Most standard GST clauses in contracts that allow a pass-on of GST are drafted to allow the supplier to charge an additional amount if its supply is a “taxable supply”. In order for these clauses to be effective where the mistakenly paid GST is not refunded, the relevant supply must be defined to be a taxable supply. If not, the supplier may be in a position that it must contractually refund a recipient who has

claimed (and is entitled to keep – see Note 2 above) a credit even though the supplier does not get a refund from the ATO. That is, the recipient gets a credit *and* its amount paid for GST back – a clear windfall to the recipient;

e) income tax provisions relating to GST:
Under section 17-5 of the ITAA 1997, an amount is not assessable income to the extent that it relates to GST payable on a taxable supply. If excess GST will be treated as always being payable under proposed section 36, unless this is expressly stated to be for a taxable supply, the supplier will also be liable for GST and will also be assessed to income tax on the excess GST (double tax); and

f) FBT provisions:
Similar problems arise with the FBT provisions where they interact with GST provisions to determine FBT liabilities.

Appendix E

Adjustment events excluded

The EM should have an express statement that “adjustment events” covered in Division 19 of the GST Act (such as a change to the consideration for a supply) are not caught by proposed Division 36.

In this regard, Example 1.7 in the EM, which is similar to our ‘absurd outcomes’ 4 and 5 in Appendix A, is likely to be an “adjustment event” rather than a refund situation. We suggest it is used as an example of where an adjustment is triggered, requiring adjustment notes and giving rise to increasing and decreasing adjustment liabilities/entitlements, which is not covered by the proposed Division 36.

Appendix F

Maintaining a Residual Discretion

In our view, there is a rationale for maintaining a Commissioner's discretion that will allow refunds in appropriate circumstances. The discretion should be similar to the discretion in 105-65 except that, as recommended in the Board of Taxation report, clarified to ensure it is a discretion of the Commissioner to refund where the provisions of proposed Division 36 would not otherwise allow a refund.

In line with previous ATO practises, the Commissioner could exercise the residual discretion under the draft rules using the following principles:

- the Commissioner must consider all relevant facts and circumstances (not fettering the discretion or taking into account irrelevant considerations);
- the Commissioner must have regard to the subject matter, scope and purpose of section 36 and, in particular, the purpose of preventing "windfall gains" for suppliers; and
- the discretion should be exercised where it is fair and reasonable to do so.