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14 September 2012

Dear Sir or Madam

**Submission: Exposure Draft Legislation, Refunding Excess Goods and Services Tax (GST)**

We are writing to your office on behalf of our client, the Australian Capital Territory Land Development Agency (“**LDA**”), to make a submission with respect to the Exposure Draft legislation released on 17 August 2012 that proposes to replace existing section 105-65 in Schedule 1 to the *Taxation Administration Act 1953* (“**the TAA**”) with a new Division 36 in the *A New Tax System (Goods and Services Tax) Act 1999* (“**the GST Act**”). The Exposure Draft legislation is referred to hereinafter as “proposed Division 36”.

The LDA is an ACT Government agency within the Economic Development Directorate. Its core business is developing and selling land on behalf of the ACT Government. The LDA facilitates the development of residential, commercial, industrial and community land.

The LDA acknowledges that Treasury may wish to amend the law dealing with refunds of GST in order to maintain the policy intent that taxpayers should not obtain windfall gains if they have not borne the cost of GST. We agree that there should be no automatic entitlement to a refund of overpaid GST, as this may entitle a supplier to a “windfall gain” in circumstances where the GST has been passed on and has not been borne by the supplier. However, for the reasons set out in this submission, we are of the view that the desired policy outcome of preventing windfall gains is not achieved by precluding GST refunds in all but very limited circumstances.

In a real property context, the impact of proposed Division 36 is particularly harsh given certain presumptions as to when GST is taken to be “passed on”. Specifically, we do not agree with the position taken in Explanatory Memorandum to Exposure Draft legislation for refunding excess GST (“**the EM**”) that GST is “passed on” where there is an agreement in a contract of sale to apply the margin scheme in calculating the GST amount on a supply of real property. We are of the view that proposed Division 36 may cause adverse and unintended outcomes for real property transactions where GST is commonly borne by the supplier.

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### Summary of key submissions

Our key submissions regarding proposed Division 36 are as follows:

1. Use of the margin scheme to calculate GST on supplies of real property does not, of itself, mean that GST has always been “passed on” to the recipient;
2. Proposed Division 36 is inconsistent with the established policy of the Australian Taxation Office (“ATO”) to accept that refunds of GST are payable for miscalculations of GST, including where the GST amount is worked out by applying an incorrect margin scheme valuation (e.g. Item 1 instead of Item 4 of the table in s75-10(3) of the GST Act); and
3. Proposed Division 36 does not give effect to recommendation 45 of the Board of Taxation’s *Review of the Legal Framework for the Administration of the GST*, released on 12 May 2009, that “the law should be amended to clarify that the Commissioner has a discretion to refund the GST where appropriate”.

Our detailed submissions and recommendations are set out in Appendix A.

We thank you for the opportunity to make submissions with respect to the exposure draft legislation and we look forward to working with you to resolve the identified issues.

Please feel free to contact me on (03) 8603 3822 or Sophia Varelas on (03) 8603 3247 if you have any questions.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ross Thorpe', written in a cursive style.

Ross Thorpe



## Appendix A

### 1. “Passing on” in a margin scheme context

In determining whether an entitlement exists to a refund of overpaid GST, proposed Division 36 introduces into the GST Act the concept of whether or not GST has been “passed on” to any other entity. In our view uncertainty and questions of interpretation are likely to arise regarding whether GST has, in fact, been “passed on” as the term “passed on” is not defined in the GST law.

Paragraph 1.50 of the EM comments on whether GST has been “passed on” in a margin scheme context. Specifically, the EM provides that

*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.*

The EM also provides an example in a margin scheme context, example 1.4, which states that:

*a contract of sale that confirms that the margin scheme is to apply to the sale... indicates that some amount of GST is included in the purchase price.*

and

*the contract of sale is sufficient to show that an amount of GST has been passed on.*

The margin scheme only applies in working out the amount of GST on a taxable supply of real property if the supplier and the recipient have agreed in writing that the margin scheme is to apply. Agreeing in writing that the margin scheme is to apply is a legislative requirement as set out in section 75-5 of the GST Act. Such agreement should be viewed in terms of this legislative requirement and not a prima facie indication that the GST has been “passed on”.

Unless the Exposure Draft legislation and/or EM are amended to clarify that the agreement to use the margin scheme in a contract of sale does not, of itself, indicate that GST has been “passed on” by the supplier, refunds of overpaid GST will be precluded in all cases where the margin scheme has been applied. In our view, this is a harsh result.

Where the GST has not been “passed on” by the supplier, a restriction of refunds for overpaid GST results in a loss to the supplier equal to the overpaid GST borne, and a “windfall” gain to the ATO equal to the overpaid GST remitted. This outcome is obviously contrary to the policy intent.

#### *Application of the margin scheme in a residential property context*

For the reasons set out below, it is possible in a residential property context that GST has not been “passed on” to the recipient of a supply even where the contract of sale confirms an agreement for the margin scheme to apply (in accordance with the legislative requirement in section 75-5 of the GST Act):



- the price charged is generally not calculated with any reference to GST and instead is the most favourable price that can be obtained in the market. Accordingly, the supplier commonly “absorbs” the cost of GST on the taxable supply;
- as sales in the residential property market are predominately non-taxable supplies of existing premises, the supplier generally charges a market price without any increase for GST in order to compete in the market;
- many residential property contracts of sale, particularly those where the margin scheme applies, do not separately disclose the GST amount. The contract of sale is generally on a “GST-inclusive” basis rather than a “plus GST” basis; and
- the recipient is generally unaware of the margin and therefore has no knowledge of how much GST applies to the supply, is unable to recover input tax credits and cannot factor in any GST amount to a subsequent supply of the property.

In these circumstances, we consider that GST has not been “passed on” and that the supplier has actually borne the cost of GST. Accordingly, there are many situations in a real property context where a refund entitlement should exist for GST overpaid by the supplier regardless of the fact that the margin scheme has been applied to calculate the GST on the supply. Allowing the supplier to claim a refund of overpaid GST in such circumstances would not result in a windfall gain to the supplier and would actually be consistent with the policy intent of allowing GST refunds for taxpayer’s who have borne the cost of the GST.

### ***Recommendation***

In light of the above, we recommend that the EM be amended to make it clear that not all situations where the margin scheme is applied result in GST having been “passed on” to another party. In our view, there must be a clear acknowledgement from Treasury that the inclusion of a margin scheme clause in the contract of sale is a legislative requirement where the margin scheme is applied and the broader facts and circumstances of the case must be considered in determining whether GST has been “passed on”. Such an acknowledgement would allow taxpayers to effectively self-assess the entitlement to a refund of overpaid GST in a margin scheme context without being automatically precluded from a GST refund due to the presumption that GST has been “passed on”.

In this regard, it would be useful for an additional example to be inserted into the EM that accepts that GST may not have been “passed on” in the case of supplies of residential property and that the price charged to the end purchaser is a market price calculated without reference to the supplier’s GST liability. In such circumstances, a refund entitlement would exist for an overpayment of GST borne by the supplier.

## **2. Proposed Division 36 is inconsistent with the established ATO policy to accept that refunds of GST are payable for miscalculations of GST under the margin scheme**

The EM provides that proposed Division 36 ensures that the restriction on GST refunds applies to overpayments of GST, irrespective of whether the overpayment arises as a result of a mischaracterisation of the supply or miscalculation of the GST payable. In particular, proposed Division 36 and the EM indicate that no refunds of overpaid GST will be allowed where the margin



scheme has been applied to a transaction, and there has been a miscalculation of the GST or mischaracterisation of the supply. We consider that the restriction on refunds in these circumstances is contrary to case law and established ATO policy.

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

The *Sportsbet* case considered, in part, whether the current restriction on GST refunds in section 105-65 of the TAA applied to both miscalculations of GST and mischaracterisations of the supply. Following the *Sportsbet* decision, the Commissioner accepted that the restriction on GST refunds does not apply where the supply is correctly treated but an overpayment arises as a result of a miscalculation of the GST payable. Furthermore, in the Decision Impact Statement for the *Sportsbet* case, the Commissioner specifically accepted the decision in *Sportsbet* to allow refunds of overpaid GST where a taxpayer miscalculates the amount of GST in applying or failing to apply the GST margin scheme.

We acknowledge that this interpretation was based on the wording of section 105-65 of the TAA, and in particular the phrase “a supply was treated as a taxable supply... to any extent”. However, we understand that the policy intent of section 105-65 of the TAA and proposed Division 36 of the GST Act is the same, being the prevention of windfall gains to a supplier who has not borne the GST.

Given that the policy intent of proposed Division 36 appears to be the same as existing section 105-65 of the TAA, there appears to be no valid reason to depart from the Commissioner’s current interpretation of the GST refund provisions with respect to allowing refunds of overpaid GST for miscalculations of GST in a margin scheme context. In our view, it is unreasonable to preclude all refunds of overpaid GST in all cases where the margin scheme has been applied to calculate the GST amount based on a presumption in the EM that GST is “passed on”.

*Commissioner’s Interpretation*

The Commissioner’s interpretation regarding restrictions on GST refunds under the current law in section 105-65 of the TAA is found in Miscellaneous Tax Ruling MT 2010/1 “restrictions on GST refunds under section 105-65 of Schedule 1 to the *Taxation Administration Act 1953*”.

MT 2010/1 was to be amended to reflect the views expressed by the ATO in its decision impact statement regarding *Sportsbet*. We understand that these amendments were to reflect the Commissioner’s view that a refund will exist for overpaid GST resulting from a miscalculation where the supply has been correctly characterised and treated by the supplier. In a margin scheme context, this view would result in refunds of overpaid GST in the following situations:

- supplies are treated as taxable under the margin scheme and there was an error in the calculation of the margin; and
- GST on supplies of real property has been calculated under the ordinary provisions, when in fact the margin scheme applied.

It is expected that any amendments to MT 2010/1, as announced in the decision impact statement for *Sportsbet*, would reflect the Commissioner’s interpretation of section 105-65 of the TAA in allowing refunds of GST in the above noted circumstances. In our view, proposed Division 36 represents a departure from the Commissioner’s interpretation to allow refunds of overpaid GST in these



circumstances. A departure from this view appears to be unreasonable given that proposed Division 36 and section 105-65 of the TAA both aim to achieve the policy that taxpayers should not receive a windfall gain (refer to paragraph 1.22 of the EM).

### ***Recommendation***

We consider that the EM and proposed Division 36 itself should have regard to the established position of the Commissioner to allow refunds of overpaid GST where the GST has been calculated by applying the margin scheme. We suggest that this could be achieved by acknowledging in the EM that situations exist where application of the margin scheme does not necessarily mean that GST has been “passed on” by the supplier.

### **3. Discretion to refund the GST where appropriate**

The Board of Taxation published a *Review of the Legal Framework for the Administration of the GST* in May 2009 (“**the Review**”). The Review included 46 recommendations put forward by The Board of Taxation, most of which were supported by Government. Recommendation number 45 with respect to payment of refunds of overpaid GST stated that:

*The law should be amended to clarify that the Commissioner has a discretion to refund the GST where appropriate.*

The Government supported this recommendation and thereby acknowledged the need for certainty regarding the existence of a discretion to refund overpaid GST in appropriate circumstances.

We acknowledge that this recommendation was made based on the existing law with respect to refunds of overpaid GST, as contained in section 105-65 of the TAA. However, we consider that the recommendation identified the need for certainty regarding refunds of overpaid GST and acknowledged that circumstances will exist in which there is a need for the Commissioner to have an overarching discretion to allow refunds of overpaid GST based on the facts and circumstances of a particular case.

With respect to this recommendation, the public announcement of the Exposure Draft legislation on 17 August 2012 stated that:

*The Assistant Treasurer, the Hon David Bradbury MP, has released draft legislation for public consultation **to implement recommendation 45 of the Board of Taxation’s Review of the Legal Framework for the Administration of the GST**, announced by the Government in the 2009-10 Budget. (our emphasis added).*

Proposed Division 36 removes the Commissioner’s discretion to pay a refund of GST. This is acknowledged in paragraphs 1.2 and 1.14 of the EM.

We acknowledge that the intent of removing the Commissioner’s discretion to pay a refund of GST is to establish specified conditions and allow self-assessment of a refund entitlement (refer to paragraph 1.2 of the EM). However, we consider that the removal of a discretion to allow refunds of overpaid GST in appropriate circumstances is inconsistent with the Review, the public announcement of the Exposure Draft legislation and paragraph 1.14 of the EM.



Over and above this inconsistency, we consider that the removal of a discretion to allow refunds of overpaid GST in appropriate circumstances may lead to situations where the supplier suffers loss in the form of overpaid GST for which no refund is available under the law.

For example, assume that the margin scheme is applied on a supply of land to a GST-registered property developer and that a calculation error gives rise to an overpayment of GST. The price of the supply was worked out without taking into account GST and, by miscalculating the GST liability, the supplier has remitted an excess amount of GST from the sales proceeds. Despite the supplier having borne the GST liability and having suffered loss due to the miscalculation of GST, no entitlement to a refund of the overpaid GST exists under proposed Division 26 in the absence of a provision allowing the Commissioner to exercise a discretion:

- a) no refund is available under proposed section 36-5(2)(a) as GST is taken to be “passed on” to the recipient (based on example 1.4 of the EM with respect to passing on GST where the margin scheme was applied); and
- b) no refund is available under proposed section 36-5(2)(b), regardless of whether or not the supplier reimburses the excess GST amount, as the recipient is registered or required to be registered for GST (even though the recipient is unable to claim input tax credits where the margin scheme was applied).

The removal of a discretion to allow a refund of overpaid GST means that a refund entitlement will never arise in situations such as those set out in the above example and it will not be possible to consider all the facts and circumstances of the case. The removal of a discretion may therefore preclude GST refunds in inappropriate circumstances.

For these reasons, we consider it is important to maintain a discretion to allow refunds of GST in appropriate circumstances. The existence of a discretion would allow for proper consideration of the facts and circumstances of each case.

### ***Recommendation***

In light of the above, we recommend that the Exposure Draft legislation be amended to include a residual discretion to allow refunds of overpaid GST in certain situations. Appropriate principles may be established regarding the circumstances in which the Commissioner may exercise the discretion, similar to principles established for exercising the discretion under section 105-65 of the TAA, as set out in paragraphs 27 to 28 of MT2010/1.