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Refunding Excess GST – Exposure Draft Legislation

The Corporate Tax Association (CTA) welcomes this opportunity to comment on the Exposure Draft legislation on refunding excess GST (ED). Released for consultation on 17 August 2012, the ED proposes to remove the Commissioner's discretion to refund an overpaid amount of GST and instead, allow taxpayers to "self-assess" their entitlement to a refund, primarily by reference to the concept of "passing on". As stated in the accompanying Press Release, the ED implements recommendation 45 of the Board of Taxation's Review of the Legal Framework for the Administration of the GST (Board of Taxation's GST review).

Before commenting on the proposed Division 36, there are a number of observations we would make in respect of the ED and the accompanying Press Release:

- The ED does not by any stretch of the imagination implement recommendation 45 of the Board of Taxation's GST Review. Recommendation 45 reads as follows:

  > "The GST law should be amended to clarify that the Commissioner **has a discretion** to refund the GST where appropriate." (emphasis added)

  This recommendation was aimed at addressing uncertainty around the meaning of the words "need not" in sec 105-65, in particular whether those words mean that the discretion is a discretion to refund, or a discretion not to refund. This issue and the Board of Taxation's consequential recommendation cannot in any way be regarded as supporting the complete removal of the Commissioner's discretion.

  Recommendation 44 of the Board of Taxation's GST review was also related to sec 105-65, but was aimed specifically at addressing concerns around the Commissioner's ability to recover overpaid refunds. The recommendation states that:

  > "The law should be amended to allow over claimed refunds to be treated as an amount of tax which becomes payable when either refunded to the taxpayer or applied against a tax debt."

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The ED does not implement this recommendation either, as the proposed Division 36 denies refunds at the outset rather than deeming the amount to be payable once refunded to the taxpayer or applied against a tax debt.

To suggest that the ED implements either of these recommendations is, in our view, a misrepresentation of the Board of Taxation's intentions when making these recommendations.

- Although the outcome of the Federal Court decision in *International All Sports v Commissioner of Taxation* [2011] FCA 824 arguably gives rise to a need to amend sec 105-65 to deal with miscalculations, it certainly does not warrant the removal of the provision altogether, as is suggested in the Explanatory Memorandum (EM). To this end, we note that the decision in *International All Sports* recognises and supports the operation of sec 105-65 to deny refunds in circumstances where it would result in a windfall gain.

- The proposed amendments, if enacted, will be retrospective in their application from 17 August 2012. We understand that this can sometimes be necessary, for example where the proposed measures are aimed at protecting the integrity of the tax system. We do not accept that the proposed Division 36 fits within this category. On this point, we note that the Press Release sends mixed messages regarding the purpose of the proposed amendments - is it to implement recommendation 45 of the Board of Taxation's GST review, to protect the integrity of the tax system or to align with the recently introduced self-assessment system for indirect taxes? Without a clearer understanding of the impetus behind these proposed changes, the proposed Division 36 looks like an overreaction to a few identified problems with sec 105-65 which could easily be overcome with a few minor amendments. We note that this confusion seems to be reflected in the approach to the Board of Taxation recommendation and the interpretation of the *International All Sports* case as outlined above.

The CTA does not support the proposed changes as outlined in the ED for a number of reasons. Most of these are related to the fact that the ED gives rise to outcomes which are in direct conflict with the broad policy intent of the proposed Division 36 (and indeed sec 105-65), in particular:

- the need for neither the supplier or recipient to bear the cost of the excess GST, and
- for transactions to be GST neutral.

GST registered recipients who cannot claim full Input Tax Credits (ITCs)

The assumption that the operation of the proposed Division 36 will result in a revenue neutral outcome where the supplier and recipient are registered overlooks the circumstance where the recipient is not able to claim full ITCs. A common example is where the recipient incurs excess GST on an acquisition used to make input taxed supplies. In this situation, the recipient will have borne the cost of the excess GST, thereby resulting in an outcome that is not revenue neutral.

To this end, we note para 1.36 of the EM, which states:

> "A recipient who is registered, or required to be registered, would ordinarily have claimed input tax credits on the acquisition of the thing supplied (subject to the normal GST rules). This means that the passed-on amount has been recovered by the recipient and neither the supplier nor the recipient has borne the cost of the excess GST. Overall, there is a revenue neutral outcome of the transaction."

The concept of revenue neutrality is integral to the application of the GST law to transactions between registered recipients. The proposed Division 36 does not achieve this outcome in this circumstance.

GST registered suppliers bearing the cost of excess GST where the cost is not 'passed on'

Also falling foul of the proposed Division 36 are registered suppliers who have overpaid an amount of GST and have not 'passed on' that amount on to the recipient. In this circumstance, unless the supplier can recover the overpaid GST, the supplier will bear the cost of the excess GST. This will occur where, for example, a contract between a supplier and a recipient allows for a specified amount to be paid, irrespective of the GST payable.

An example of this is in the real property and margin scheme context where the price of the land sold does not change depending on what the vendor's GST liability is (i.e. the purchaser simply pays a price for the land) and the purchaser does not know (or care) how much GST the vendor is paying under the margin scheme. Other examples include where a taxpayer has failed to apply correctly or at all GST concessional provisions, the wrong entity has accounted for GST, a taxable supply is treated as having been made when it fact it hasn't and where a GST registered customer compels a supplier under contract law to reimburse it for excess GST passed on to it.

In these circumstances, where the supplier incorrectly overpays GST on the supply, the proposed Division 36 will prevent that supplier from recovering that overpaid amount. This outcome is in direct conflict with the stated policy objective for transactions to be revenue neutral.

Offsetting of underpayments and overpayments

The draft rules do not allow for overpayments of GST on certain supplies to be offset against underpayments of GST on other supplies. This outcome is also inequitable and results in a windfall gain to the ATO at the expense of taxpayers particularly where a revenue neutral outcome would have resulted if no overpayments or underpayments had occurred.

The equitable outcome in these circumstances would be for the overpayment to be processed as a refund and for the underpayment to be subject to the normal rules of assessment, objection and appeal rights.

Reliance on tax invoices

Although not defined, the EM places significant reliance on the concept of 'passing on' and looks to the issuing of a tax invoice as evidence that the GST has been passed on to the recipient:

> "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 issuing of a tax invoice (or a recipient created tax invoice) will be strong evidence that GST has been passed on."[1]

This assumption does not take into account common scenarios that typically lead to an overstatement of GST. For example:

- Incorrect GST coding being applied internally but the price to the end consumer does not change.
- Transposition errors and other errors related to BAS preparation that lead to higher amounts of GST being reported on the BAS than was priced to the customer.
- Miscalculations of the GST mix of a mixed supply scenario where the end price to the consumer does not change.

In these circumstances, even though an invoice is issued, the GST would not be 'passed on'. Denying a refund in these circumstances would result in an outcome which is, once again, in direct conflict with the policy intent behind the proposed Division 36.

Further, the concept of 'passing on' as set out in the EM completely disregards the commercial reality of transactions where the purchaser would have paid the same amount for the supply regardless of the amount stated on the tax invoice or other document.

Removal of the ability of taxpayers to object to assessments

As recognised in the EM at para 1.35, the deeming of any excess GST to have always been payable will, in most instances, result in taxpayers having no basis on which to amend the

[1] Paragraph 1.46 Explanatory Memorandum

GST return relating to the amount, request the Commissioner to amend the assessment or object to the assessment in respect of the excess amount, as there is no change to the underlying net amount.

Adopting this approach will encourage taxpayers to treat supplies as non-taxable where they are uncertain of their tax position, so as to preserve their appeal rights. We note that under the current regime, taxpayers are more likely to adopt a conservative position and treat the supply as taxable, and seek a refund if they are successful in challenging the ATO. Clealry the latter is preferable to the former, for both taxpayers and the ATO.

Impact of Division 36 on other parts of the GST Act

It is unclear how the proposed Division 36 will interact with other parts of the GST Act, including (but certainly not limited to):

- Division 11 (Creditable acquisitions)
- Division 19 (adjustment events);
- Divisions 83 and 84 (reverse charge provisions); and
- Subdivision 153-B (agency agreements).

In summary, the issues canvassed above demonstrate that the proposed Division 36 not only fails to implement the Board of Taxation's recommendations, results in an unjust enrichment to the ATO where refunds are properly payable and is unable to cater for the myriad of situations where refunds should be provided in order to achieve revenue neutrality.

Given this, we suggest that serious consideration be given to retaining and amending the current sec 105-65 as required. Alternatively, the proposed law should be amended to allow refunds where it is fair and equitable to do so and no unjust enrichment occurs. The CTA would be happy to assist in this process if required.

Please do not hesitate to contact me should you wish to discus any aspect of this submission further.

Yours sincerely,

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