
Chapter 1

Refunding excess GST

Outline of chapter

1.1 Schedule # to this Bill amends the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), the *Income Tax Assessment Act 1936* (ITAA 1936) and the *Taxation Administration Act 1953* (TAA 1953) to ensure that overpaid goods and services tax (GST) is only refundable in certain circumstances. The provisions apply to overpayments of GST, irrespective of whether the overpayment arises as a result of a mischaracterisation or miscalculation of the GST payable.

1.2 The amendments allow taxpayers to self-assess their entitlement to a refund of amounts of excess GST by reference to the specified conditions. The Commissioner will have a discretion to refund the excess GST in exceptional circumstances where it would be appropriate, but the provisions would not otherwise allow a refund.

1.3 All references to section 105-65 are to that section in Schedule 1 to the TAA 1953. All other legislative references are to the GST Act unless otherwise specified.

Context of amendments

Scheme of the GST Act

1.4 The scheme of the GST Act is premised on the following principles (see Chapter 1 of the Executive Summary in the Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998*):

- 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;
- GST is effectively borne by private consumers when they acquire anything to consume; and
- To ensure that GST is effectively borne by consumers, anyone who is registered is generally entitled to an input tax

credit for the GST on what they acquire or import for the purpose of their enterprise.

1.5 Accordingly, the scheme of the GST Act envisages that the supplier 'passes on' the GST to the recipient of the supply and there should not be a refund where it may result in a windfall gain. Symmetry is also maintained between the GST payable and the corresponding input tax credit which may be claimed by a GST registered recipient.

Restriction on refunds under section 105-65

1.6 Section 105-65 operates to ensure that taxpayers do not obtain a windfall gain by restricting the circumstances in which the Commissioner may be required to refund an overpaid amount of GST.

1.7 The provision applies to amounts of GST that have been overpaid by a taxpayer in certain circumstances, either as a result of the taxpayer remitting more than he or she is legally required to pay under section 33-3 or 33-5, or because an amount under section 35-5 has not been refunded or applied under Division 3 of Part IIB of the TAA 1953 (subsection 105-65(2)).

Commissioner's discretion to refund

1.8 Section 105-65 provides that the Commissioner is not required to refund an overpayment that would otherwise be refundable if either:

- the taxpayer does not reimburse a corresponding amount to the recipient of the supply (subparagraph 105-65(1)(c)(i)); or
- the recipient of the supply is registered or required to be registered for GST (subparagraph 105-65(1)(c)(ii)).

1.9 The provision confers on the Commissioner a residual discretion to refund an overpayment of GST even if either of the above criteria is satisfied.

1.10 The provision states that the Commissioner 'need not' pay a refund in particular circumstances. This language has caused some uncertainty and conjecture about whether the discretion is a discretion to refund, or a discretion not to refund. The Commissioner has maintained the view that the provision provides a discretion to refund.

1.11 The uncertainty surrounding the nature of the provision was identified by the Board of Taxation in its *Review of the Legal Framework for the Administration of the Goods and Services Tax*. Accordingly,

recommendation 45 of the Board's report stated that the law should be amended to clarify that the Commissioner has a discretion to refund the GST where appropriate.

Overpayments of GST under section 105-65

1.12 A taxpayer may overpay an amount of GST by incorrectly treating a supply (or arrangement) it makes as a taxable supply and the supply (or arrangement) is actually not a taxable supply to any extent. This includes incorrectly apportioning the taxable and non-taxable components of a mixed supply.

1.13 The taxpayer typically will have included an amount of GST in the price of the supply, included the amount of GST on a tax invoice issued to the recipient of the supply and remitted that amount of GST to the Commissioner. This may, however, depend on the specific facts and circumstances of each case.

1.14 A taxpayer may also overpay an amount of GST as a result of a miscalculation, for example, errors made:

- in calculating the GST amount under the margin scheme, under Division 75; or
- in calculating the 'global GST amounts' under Division 126.

1.15 Prior to the Federal Court of Australia's decision in *International All Sports v Commissioner of Taxation* [2011] FCA 824 (*Sportsbet*) handed down on 26 July 2011, the Commissioner considered that section 105-65 applied to miscalculations (as well as mischaracterisations) of the GST payable.

1.16 The effect of the *Sportsbet* decision is that the restriction in section 105-65 does not apply where the supply is correctly treated but an overpayment arises as a result of a miscalculation of the GST payable. Following the *Sportsbet* decision, the Commissioner has also accepted that a taxpayer miscalculates the amount of GST in applying the GST margin scheme.

1.17 The decision in *Sportsbet* gives rise to the potential for 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.

Summary of new law

1.18 Schedule # amends the GST law to allow taxpayers to self-assess their entitlement to a refund by reference to a set of objective criteria, rather than having to rely on the Commissioner to exercise the discretion to refund an overpaid amount of GST. However, 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.

1.19 This Schedule also ensures that the policy of denying windfall gains to taxpayers is achieved, irrespective of how the overpayment arises. In doing so, the amendments address the impacts of the Federal Court's decision in *Sportsbet* by amending the law to ensure that overpayments of GST resulting from a miscalculation of the GST payable are not excluded from the provisions.

1.20 Division 142 is inserted into the GST Act to provide that, subject to certain exceptions, where an assessed net amount takes into account an amount of GST that exceeds what is actually payable, then so much of that excess after adjustments and corrections ('extra GST') that has been passed-on to another entity is taken to have always been payable and always been on a taxable supply until the taxpayer reimburses the 'other entity' for the passed-on GST. The recipient generally will be taken always to have been able to claim the amount of the input tax credit corresponding to the amount of extra GST.

1.21 Division 142 also applies to excess GST relating to cancelled supplies. In such circumstances, any decreasing adjustment is reduced to the extent that any passed-on GST is not reimbursed to the recipient of the supply.

1.22 Division 142 only applies where an assessed net amount includes excess GST. Net amounts are defined as GST – Input tax credits. Where a refund or credit arises as a result of the Commissioner amending an assessed net amount to include additional input tax credits, Division 142 has no application.

1.23 Because Division 142 impacts on the assessed net amount, taxpayers will be able to challenge their assessment under Part IVC of the TAA 1953.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>An amount of extra GST is taken to have always been payable except where the taxpayer has not passed on that amount to a recipient, or if the amount of extra GST has been passed on, the recipient of the supply has been reimbursed.</p> <p>Extra GST does not include an amount that is covered by a decreasing adjustment attributable to a later tax period, or is correctly attributable to a different tax period.</p>	<p>A taxpayer is not entitled to a refund of an overpaid amount of GST if the taxpayer has not reimbursed the recipient of the supply, or if the recipient is registered, or required to be registered, for GST.</p>
<p>The restriction applies to all overpayments of GST, including as a result of incorrectly treating a supply or arrangement as fully or partly taxable, or incorrectly calculating the amount of GST payable on a supply. However, the restriction on refunds will not apply unless the extra GST is also passed on to another entity.</p>	<p>The restriction only applies where the overpayment arises as a result of the taxpayer incorrectly treating a supply or arrangement as taxable to any extent.</p>
<p>Instead of a taxpayer having to rely on the Commissioner's discretion to refund the extra GST, that taxpayer is able to self - assess their entitlement against specified criteria. If one of the criteria is not satisfied, the taxpayer is not entitled to a refund of the extra GST.</p> <p>However, the Commissioner retains a discretion to refund an amount in exceptional circumstances only.</p>	<p>The Commissioner may exercise a discretion to refund an amount, even if the conditions to restrict a refund in section 105-65 are met.</p>
<p>The restriction on refunds provision establishes that the adjustment provisions in Division 19 will apply without restriction, although where the adjustment event effectively cancels a supply, the supplier will only be entitled to a decreasing adjustment to the extent that they have reimbursed the extra GST to the recipient.</p>	<p>Section 105-65 does not refer to 'adjustment events' covered in Division 19.</p>

Detailed explanation of new law

1.24 Schedule # replaces existing section 105-65 with new Division 142 of the GST Act to ensure that where the taxpayer's assessed net amount for a tax period takes into account an amount of GST exceeding that which is payable the excess GST is only refundable in certain circumstances.

Excess GST unrelated to adjustments

1.25 Excess GST is an amount of GST that has been taken into account in an assessed net amount, but is subsequently found not to be payable. *[Schedule #, item 7, section 142-5]*

1.26 It does not matter how the excess arose - whether by a mischaracterisation of a transaction as a taxable supply, a miscalculation of the amount of GST payable or an accounting or reporting error.

1.27 In practice, this can arise as a result of a range of circumstances including:

- incorrectly treating a GST-free or input taxed supply as a taxable supply (including incorrectly apportioning the taxable and non-taxable components of a mixed supply);
- incorrectly treating something which is not a supply as a taxable supply;
- miscalculating a GST liability under the GST law, for example, under Division 75 or 126; or
- incorrectly reporting an amount of GST on a GST return.

1.28 However, overpayments of GST do not attract Division 142 unless the extra GST is also passed on to another entity. If, for example, the overpayment simply occurs as a result of an error in preparation of the GST return, it will be clear that there has not been passing on of the extra GST.

Example 1.1: Amount paid under Division 33

James is registered for GST. On 28 April 2013, James lodged his quarterly GST return for the tax period ending 31 March 2013. His assessed net amount for that tax period is \$3,500. James pays this amount to the Commissioner under section 33-3.

On 16 September 2013, James realises that he incorrectly included an additional amount of GST of \$100 in his net amount for the tax period ending 31 March 2013. As his assessed net amount for that tax period has taken into account the \$100, the additional GST of \$100 exceeds what is payable. Therefore, the \$100 is an amount of excess GST to which section 142-5 applies.

Example 1.2: Amount applied under Division 3 of Part IIB

Retro Robynne is registered for GST. On 21 October 2012, Retro Robynne lodges its monthly GST return for the tax period ending 30 September 2012. Retro Robynne's assessed net amount for that tax period is a refund of \$400. The Commissioner applies this amount against an outstanding tax debt of \$150 on Retro Robynne's running balance account and refunds the balance of \$250 to Retro Robynne.

On 2 May 2013, Retro Robynne realises that it incorrectly included an amount of \$200 as GST payable on its GST return. Had it correctly reported the GST payable on its return, its assessed net amount would have been a refund of \$600. As Retro Robynne's assessed net amount for that tax period takes into account the \$200, the additional GST of \$200 exceeds what is payable. The \$200 is an amount of excess GST to which section 142-5 applies.

1.29 Section 142-5 also applies if excess GST is included in an amendment to an assessed net amount. This is because section 155-80 provides that an amended assessment of a net amount is an assessment.

1.30 It does not matter whether a taxpayer has actually paid (pursuant to Division 33), or been refunded (pursuant to Division 35), the assessed net amount. Where the assessed net amount takes into account an amount of excess GST, the provision applies.

Extra GST

1.31 Subdivision 142-A applies to an amount of 'extra GST' rather than 'excess GST'. Extra GST is the excess GST *less* any part of that excess GST that is either:

- covered by a decreasing adjustment attributable to a later tax period; or
- otherwise correctly attributable to a different tax period.

[Schedule #, item 7, subsection 142-5(2)]

Excess GST related to decreasing adjustments

1.32 Adjustments can arise because of adjustment events such as cancelling a supply, changing the consideration for a supply or causing a supply to stop being a taxable supply.

1.33 An adjustment that arises from a change in consideration would not ordinarily give rise to a windfall gain since the change in GST payable would be proportionate to the change in consideration. Note that Subdivision 142-B provides special rules for cancelled supplies (see paragraph 1.36).

1.34 Where an adjustment event in a later tax period results in a decreasing adjustment for the supplier that is attributable to that later tax period, the excess GST is reduced by the amount of the decreasing adjustment. Thus the decreasing adjustment is taken into account under the adjustment provisions and not as extra GST under Subdivision 142-A. *[Schedule #, item 7, paragraph 142-5(2)(a)]*

Example 1.3: Decreasing adjustment, no refund payable

In June 2015, GCorp pays \$330,000 to JCorp for services provided in that quarter.

On 28 July 2015, JCorp lodges its quarterly GST return for the tax period ending 30 June 2015. JCorp's assessed net amount for that tax period takes into account the \$30,000 GST payable on the services supplied to GCorp.

In August 2015, GCorp complains to JCorp about the cost of the services and gets a refund of \$44,000 from JCorp. The change in consideration for the supply is an adjustment event. JCorp has a decreasing adjustment of \$4,000 (ie 1/11th of \$44,000). JCorp issues an adjustment note to reflect the change to the supply.

The extra GST is zero (ie the excess GST of \$4,000 less the amount of the decreasing adjustment of \$4,000). JCorp instead attributes the decreasing adjustment of \$4,000 to its September 2015 quarterly tax period.

Excess GST attributable to another tax period

1.35 Where the GST has been attributed to an incorrect tax period the excess GST that arises in that incorrect tax period does not form part of the extra GST. This will usually occur in an audit situation where the taxpayer has attributed an amount in a particular tax period but the Commissioner assesses the amount as being correctly attributable to a different tax period. *[Schedule #, item 7, paragraph 142-5(2)(b)]*

Example 1.4: Amount attributable to another tax period

Pete's Biz is registered for GST. On 1 April 2015, Pete's Biz makes a taxable supply to Alan for \$6,600 and issues him with a tax invoice that includes an amount of GST of \$600.

On 21 April 2015 Pete's Biz lodges its monthly GST return for the tax period ending 31 March 2015, which includes the GST of \$600 relating to the taxable supply made to Alan.

On 3 September 2015 the Commissioner conducts an audit and determines that Pete's Biz has incorrectly attributed the GST of \$600 to the March tax period instead of the April tax period. The Commissioner amends the assessments for the monthly tax periods ending March 2015 and April 2015. The excess GST in the March tax period does not form part of the extra GST under paragraph 142 5(2)(b) as it is correctly attributable to a different tax period (ie April).

Excess GST relating to cancelled supplies

1.36 Where the adjustment event is as a result of the supply being cancelled and this results in a decreasing adjustment for the supplier, the adjustment is reduced to the extent that GST has been passed-on to the recipient of the supply but not reimbursed. [*Schedule #, item 7, section 142-20*]

1.37 Having regard to the decision in *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA 41, in many cases there will still be a supply where money is paid for goods and services that are ultimately not provided. However, there might be cases where money is paid with a mere expectation of a future supply, which does not eventuate.

Example 1.5: Decreasing adjustment, cancelled supply

In September 2012 B Pty Ltd makes a taxable supply of goods to R Pty Ltd for \$55,000 and issues a tax invoice, which includes GST of \$5,000.

On 21 October 2012, B Pty Ltd lodges its monthly GST return for the September 2012 tax period. Its assessed net amount takes into account the GST payable of \$5,000 for the supply made to R Pty Ltd.

In November 2012, R Pty Ltd returns all of the goods because they are defective and seeks a refund. B Pty Ltd refunds \$55,000. The return of goods and associated refund cancels the supply. This is an adjustment event. B Pty Ltd has a decreasing adjustment of \$5,000 attributable to the November 2012 tax period as a result of cancelling the supply.

Since B Pty Ltd has reimbursed all of the passed-on GST of \$5,000 its decreasing adjustment is not reduced to any extent.

Refunding extra GST

1.38 Section 142-10 provides that, subject to certain exceptions, so much of the 'extra GST' which has been passed-on to another entity is taken to have always been payable and always on a taxable supply, until the taxpayer reimburses the 'other entity' for the passed-on GST.

1.39 Under section 142-10, generally taxpayers would no longer need to ask the Commissioner to exercise the discretion to refund an amount that has been overpaid. Instead, taxpayers would self-assess their entitlement to a refund of extra GST against the following criteria:

- where the extra GST has not been passed on, the taxpayer would be entitled to a refund of the extra GST;
- where the extra GST has been passed on by the taxpayer, the taxpayer would be entitled to a refund to the extent that they have reimbursed the other entity with the amount of the extra GST.

1.40 If the taxpayer can establish that either of the above conditions are satisfied, the taxpayer is entitled to a refund of the extra GST and 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). Alternatively, reimbursing the passed-on GST means that the taxpayer may have a decreasing adjustment (see section 19-55) and the other entity may have an increasing adjustment (see section 19-80).

Example 1.6: Extra GST not passed on

Melissa leases an office tower to Bank Ezy. The lease requires \$120,000 rent including GST to be paid monthly. Bank Ezy pays the correct amount but Melissa incorrectly records the transaction as \$220,000 in her records and pays GST on \$220,000.

Six months later Melissa realises her accounting error. As the extra GST (on the additional \$100,000) has not been passed on Melissa can apply to the Commissioner to amend her assessment for the period in which she paid the extra GST.

Example 1.7: Extra GST reimbursed

John buys a set of spectacles from Joe's Optics and pays GST on the total price of the spectacles. Joe's Optics had passed on the GST to John. The proprietor of Joe's Optics is advised by the Commissioner following an audit that the lenses are GST-free and that Joe's Optics had overpaid GST.

The extra GST is taken to have always been payable under subsection 142-10(1) until Joe's Optics reimburses John for the passed-on GST.

When John returned for his annual sight check-up he was advised of the error and was reimbursed for the extra GST. As John has been reimbursed for the passed-on GST, subsection 142-10(1) ceases to apply and the extra GST is no longer taken to be payable.

Joe's Optics would account for the reimbursement to John as a decreasing adjustment, attributable to the tax period in which the reimbursement was made.

Example 1.8: Extra GST reimbursed – business to business transaction

In the quarter ended 30 September 2015, E Pty Ltd provides debt collection services to F Pty Ltd at a GST-inclusive price of \$22,000. F Pty Ltd uses those services in its business of making financial supplies, and is entitled to claim a reduced input tax credit of 75% in relation to those acquisitions.

Due to a systems error, E Pty Ltd inadvertently charges \$3,000 GST when it invoices F Pty Ltd for the supply. F Pty Ltd pays a total of \$23,000 to E Pty Ltd and calculates its entitlement to an input tax credit as 75% of \$3,000. E Pty Ltd's assessed net amount for the tax period takes into account the \$3,000 GST paid to it by F Pty Ltd.

E Pty Ltd later discovers the error and advises F Pty Ltd. F Pty Ltd wishes to obtain a refund of the overpaid amount and E Pty Ltd duly reimburses the sum of \$1,000 to F Pty Ltd. Accordingly, subsection 142-10(1) ceases to apply and the extra GST is no longer taken to be payable.

E Pty Ltd would account for the reimbursement to F Pty Ltd as a decreasing adjustment, and F Pty Ltd would account for its receipt of the reimbursed amount as an increasing adjustment.

Example 1.9: Extra GST partially reimbursed

Croft Enterprises is registered for GST. On 25 May 2013, Croft Enterprises makes a supply to Christine for \$220, including GST of \$20. Christine is neither registered nor required to be registered.

In its quarterly GST return lodged 28 July 2013, Croft Enterprises includes GST payable of \$20 for the supply to Christine. The \$20 is taken into account in Croft Enterprises' net amount for the tax period ending 30 June 2013.

On 20 September 2013, Croft Enterprises realises that the supply was not a taxable supply and therefore the \$20 is extra GST. The \$20 is

taken to have always been payable until Croft Enterprises reimburses Christine. However, Croft Enterprises only reimburses \$15 of the GST paid to Christine. Therefore, the remaining \$5 (being the difference between the extra GST and what has been reimbursed) is taken to have been always payable under section 142-10. Croft Enterprises is entitled to a refund of extra GST of \$15.

Example 1.10: Treating extra GST as GST payable

Shawn is registered for GST and has monthly tax periods. During the tax period ending 31 July 2013, Shawn makes a number of supplies. She treats these as taxable supplies and includes GST on these supplies in her GST return lodged on 21 August 2013. Her assessed net amount is \$4,000.

On 9 December 2013, Shawn discovers that some of the supplies she treated as being taxable supplies are in fact not taxable supplies, and as a result, she has overpaid \$1,000 of GST to the Commissioner. The \$1,000 is excess GST.

If Shawn has passed on the extra GST and not reimbursed the recipient/s, the extra GST is taken to have always been payable and no refund entitlement arises.

Amended assessments

1.41 Where the assessed net amount has been amended but the taxpayer has not passed on the extra GST, then section 142-10 does not apply. This means that if it is later determined that GST was not in fact payable on that supply, the taxpayer's assessed net amount could be further amended to reflect this favourable outcome.

Example 1.11: Amended assessment and GST not passed on

Jenny treats a particular supply as GST-free and this is reflected in the price she charges customers. Her assessed net amount for the tax period reflects the GST-free treatment of that supply (ie she does not report any GST for that supply).

Later, she is audited by the Commissioner, who determines that the supply she treated as GST-free was a taxable supply. The Commissioner amends her assessment for that tax period (first amended assessment).

Jenny objects to the amended assessment on the basis that she considers that the supply is not taxable and enters into an arrangement with the ATO to pay half of the assessed net amount in dispute.

Subsequently, the Commissioner allows her objection in full. However, in giving effect to the favourable decision, the Commissioner must consider the application of Subdivision 142-A.

Section 142-5 applies as Jenny's assessed net amount for the tax period (ie the first amended assessment) takes into account an amount of GST exceeding that which is payable. In applying section 142-5, it does not matter how much, if any, of the assessed net amount Jenny has actually paid.

As Jenny is able to demonstrate that the price she charged does not include GST, the Commissioner accepts that she has not passed on the GST and that subsection 142-10(1) does not apply. Accordingly the Commissioner further amends Jenny's assessed net amount (second amended assessment) to reflect the favourable objection decision.

1.42 If an amendment of the assessment results in the taxpayer's liability being reduced, the amount by which the liability is reduced is treated as though it was never payable and the Commissioner must apply that amount in accordance with the running balance account rules under Divisions 3 and 3A of Part IIB of the TAA 1953 (section 155-75 in Schedule 1 to the TAA 1953).

Commissioner's discretion

1.43 In exceptional circumstances, affected taxpayers may still be able to receive a refund of extra GST if the Commissioner is satisfied that the refund of the extra GST would flow to the entity that has effectively borne the cost of the extra GST and would not give an entity a windfall gain.[*Schedule #, item 7, subsection 142-10(3)*]

Example 1.12: Commissioner's discretion and wrong entity

Entities A and B are related entities and are not grouped for GST. Both entities own several commercial properties that are leased. Entities A and B are registered for GST and report quarterly. Entity B sells one of the commercial properties from its portfolio to Eric Pty Ltd for \$770,000 in the quarter ending 31 March 2015. However, the sale of the commercial property is reported in Entity's A quarterly GST return on 28 April 2015. The return includes the GST payable of \$70,000 which is remitted to the ATO by Entity A.

Entities A and B subsequently discover the error in November 2017. Entity B applies for an amendment to include the GST of \$70,000 in its quarterly tax period ending 31 March 2015 and remits the GST payable. Entity A applies for a refund of the extra GST in its assessment for the tax period ending 31 March 2015 by applying in writing for an amendment to that assessment.

Entity A has excess GST of \$70,000. Since the GST is passed on to Eric Pty Ltd and not reimbursed to it, the extra GST is taken to have always been payable under subsection 142-10(1) by Entity A.

In these circumstances it is appropriate for the Commissioner to exercise the discretion under subsection 142-10(3) where the Commissioner is satisfied that the refund of extra GST will flow to Entity A, who has effectively borne the cost of the extra GST and Entity A, B or any other entity will not receive a windfall gain.

Input tax credits

1.44 A recipient who is registered for GST would ordinarily have claimed input tax credits on the acquisition of the thing supplied (subject to the normal GST rules).

1.45 Such a recipient can continue to treat the extra GST in the same way that they treat the GST payable on the transaction for the purpose of working out the amount of its input tax credits under Division 11. This is achieved by treating the extra GST as having always been payable and always on a taxable supply. This should not result in any change to the recipient's input tax credits but is designed to preserve the GST outcomes of the original treatment despite including extra GST. However, the recipient may have an increasing adjustment where the extra GST is reimbursed to it.*[Schedule #, item 7, paragraph 142-10(1)(b)]*

1.46 Subsection 142-10(4) has been added to guard against the potential for parties to contrive arrangements that may enable additional input tax credits to be claimed where there would otherwise be no entitlement, where the corresponding GST is not paid to the Commissioner. This is achieved by stating that subsection (1) does not apply where the other entity knows or could reasonably be expected to have known that the supplier has not paid the extra GST to the Commissioner. Without such an amendment an opportunity may arise due to the approach taken in Division 142 which provides extra GST as having been always payable and always been on a taxable supply.*[Schedule #, item 7, subsection 142-10(4)]*

1.47 A supplier who is required to treat its supplies as input taxed cannot treat those supplies as taxable supplies in order to claim input tax credits on their business inputs. Subsection 142-10(2) makes it clear that while subsection 142-10(1) treats extra GST that has been passed on as GST payable and on a taxable supply, it does not affect the supplier's creditable purpose. Subsection 142-10(2) does not change the fact that acquisitions by a supplier making input taxed supplies are not acquisitions made for a creditable purpose under subsection 11-15(2).*[Schedule #, item 7, subsection 142-10(2)]*

Working out whether extra GST has been passed on

1.48 The phrase ‘passed on’ is not defined in the GST legislation. Whether GST has been passed on is a question of fact and must be determined on a case by case basis taking into account the particular circumstances of each case.

1.49 A tax invoice issued to an entity, that contains enough information to allow the amount of GST payable in relation to the supply to be clearly ascertained, will be prima facie evidence of that part of the extra GST having been passed on. [Schedule #, item 7, section 142-15]

1.50 The onus is on the taxpayer to demonstrate that the extra GST has not been passed on. This may be achieved by showing the pricing policies of the entity at that time in respect of that transaction or that type of transaction. This aspect is discussed in greater detail below.

1.51 GST may have been passed on even though a tax invoice has not been issued, or does not specifically or separately identify the GST component or is not a valid tax invoice for the purposes of the GST Act. [Schedule #, item 7, paragraph 142-15(a)]

1.52 For example, information contained in a document purporting to be a tax invoice, but that does not satisfy the requirements under subsection 29-70(1), or that does not result in the Commissioner treating the document as a tax invoice under subsection 29-70(1B), may be sufficient to indicate that the extra GST has been included in the price of a supply and therefore passed on.

1.53 Some guidance on the question of ‘passing on’ can be obtained from the decision of the High Court in *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 (Avon), which concerned the former sales tax regime. In Avon, the High Court noted that a central feature of the sales tax regime was that ‘the economic burden of the impost is generally not intended to be borne by the person liable to remit it; it is passed on’.

1.54 The GST regime is similar to the former sales tax regime in that the entity liable to remit the tax is not intended to be the entity that actually bears the cost of the tax. As such, a number of judicial observations can be readily adapted to a GST context:

- in an economy geared to making a profit, GST is expected to be passed on;
- businesses set prices to cover foreseeable costs;

- GST will be passed on in the usual course of doing business;
- it is inherent in an indirect system that GST will be passed on; and
- it is for the taxpayer to establish a circumstance out of the ordinary, namely that the amount of the overpayment has not been passed on.

1.55 Whether an indirect tax has been passed on through the pricing process can be a relatively complex inquiry. This is 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). However, the seller's pricing policy and practice will be the starting point of that inquiry.

1.56 The seller's pricing policy and practice is based upon its actual knowledge at the relevant time. That knowledge includes the belief that the component of tax which later proves to have been an overpayment is a real cost of doing business.

Margin scheme

1.57 The margin scheme represents another method by which GST can be calculated for certain supplies of real property. The GST, as calculated either under the general rules or under the margin scheme, is a foreseeable cost that would normally be taken into consideration in the costing and pricing structures of a business. In this regard margin scheme cases need to be considered in the same way as other situations of 'overpayment'. Each case must be considered on its own facts and the question asked, 'has the extra GST been passed on?'

1.58 A mere assertion that GST was not a factor in setting the price is not, of itself, sufficient to establish that the extra GST has not been passed on. Instead, a wide range of factors may be relevant to the question of 'passing on' in any particular case. In the case of taxable sales of real property, some of those factors may include the market in which the taxpayer operates and the contracts under which sales are made.

1.59 However, it is also necessary to consider the seller's pricing policy and practice, with reference to the actual conduct of the seller in setting prices based upon its actual knowledge at the relevant time. As such, that knowledge includes the belief that the component of tax which later proves to have been an overpayment is a real cost of doing business.

Example 1.13: Where GST has been passed on

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 the margin scheme in calculating the GST liability on the supply.

LD provides Phe with a contract of sale that confirms 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, which is subsequently paid by Phe to LD. 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 1.14: Where GST may have been passed on

State Co is a State Government entity which supplies both commercial and new residential premises. It conducts a detailed feasibility study on a new development project, and this includes estimates of its GST liability as part of its overall cost recovery and pricing structure. State Co owned the land before 1 July 2000 and, in calculating its likely GST liability under the margin scheme, uses a valuation day of 1 July 2000. State Co proceeds with the development of the project in 2014 and pays GST under the margin scheme.

Two years later, State Co discovers that it was entitled to use Item 4 in the table in subsection 75-10(3) of the GST Act, that is, it was entitled to make a valuation as at the day the taxable supply took place (a higher figure than the valuation as at 1 July 2000). State Co's margin on each sale is therefore lower and, as a result, it has overpaid GST.

In considering whether State Co is entitled to a refund, it is necessary to consider whether State Co had passed on the extra GST. Under its detailed feasibility study, State Co had estimated its GST liability before the sales using the lower valuation (and thus higher GST) which it took into account in determining its cost recovery and pricing structure. The GST component was eventually paid by its customers. These circumstances tend to indicate that State Co has passed on the extra GST.

Example 1.15: Where GST may not have been passed on

Toni's Development Pty Ltd (TD) is a property development company and is registered for GST. TD undertook a development of 10 residential apartments.

Each apartment is marketed at a price of \$500,000 inclusive of GST. In working out its pricing structure, TD calculated a GST component of \$11,000 on each apartment.

Within 3 months of the completion of the development, TD sold 9 of the apartments at the marketed price. In the ensuing months, TD had difficulty selling the last apartment. In order to effect a sale and move on to another development, TD dropped the price of the last apartment to \$450,000 and sold it at that price.

In completing its GST return for the tax period in which the sale was made, TD included in its net amount \$11,000 of GST in relation to the last apartment. TD has overpaid GST. A range of factors including TD's approach to pricing, the reduction in price and the application of the margin scheme indicate that TD has passed on an amount of GST less than \$11,000 on the sale of the last apartment.

Example 1.16: Seeking the Commissioner's discretion

Developer AB carries out multi-staged residential developments supplying new residential housing in sub-divisions. It acquires land from another entity under the margin scheme, and, as part of its detailed budget for a new project, considers the pricing structure for the supply of new houses on that land. AB estimates that the GST component under the margin scheme would be \$11,000 on each of the residences.

AB builds and sells the residences to unregistered individuals who acquire the property solely for private purposes. AB then remits GST calculated under the margin scheme.

Due to an ATO audit, AB is required to change the basis on which the costs of its original purchase of the land are allocated between sales of completed sub-divisions (ie the margin scheme cost base is changed). This has the effect that AB has underpaid its GST liability on the sale of some residences and overpaid GST on other sales.

In this case, Developer AB had factored approximately \$11,000 GST into its cost recovery and pricing structure for each residence. The total amount of GST payable on the whole development has not changed – it will be the total sales prices less the total margin scheme cost base – but the amount of GST payable on individual sales and, in turn, the timing of when the GST is payable may change – more GST may be payable in one tax period and less in another.

Developer AB considers that Division 142 applies to restrict the refund of the extra GST and that its circumstances warrant seeking the Commissioner's discretion under subsection 142-10(3) to refund the extra GST.

Developer AB will be given a refund of the extra GST by satisfying the Commissioner that the refund of extra GST would flow to the entity that has effectively borne the cost of the extra GST and would not result in a windfall gain.

Review rights

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.

Application and transitional provisions

1.61 The amendments in Schedule # apply in relation to working out your assessed net amount for a tax period starting on or after 17 August 2012. *Schedule #, item 14]*

1.62 Draft legislation clarifying the circumstances in which the restriction on GST refunds applies was initially released on 17 August 2012 for public consultation. It was desirable that the uncertainty associated with the scope and operation of the current law, as well as the uncertainty about when the Commissioner will exercise the discretion be addressed from the date of announcement.

1.63 Current section 105-65 continues to apply in relation to net amounts for tax periods commencing prior to 17 August 2012.

Example 1.17: Tax period commencing before 17 August 2012

Harry's Biz is registered for GST. On 15 April 2012, Harry's Biz makes a supply to Christopher for \$5,500 and issues him with a tax invoice that includes an amount of GST of \$500. Christopher is not registered for GST.

On 21 May 2012, Harry's Biz treats the supply as a taxable supply in its GST return for the tax period ending 30 April 2012. On 2 February 2013, Harry's Biz discovers that the supply is actually a GST-free supply, and as a result, it has incorrectly included GST of \$500 in his net amount for the tax period ending 30 April 2012. In determining whether Harry's Biz is entitled to a refund of the overpaid amount, existing section 105-65 applies.

Example 1.18: Tax period commencing after 16 August 2012

Stark Enterprises is registered for GST. On 21 October 2012, Stark Enterprises lodges its monthly GST return for the tax period ending 30 September 2012. Its assessed net amount for that tax period includes GST payable of \$1,000 for supplies Stark Enterprises treated as being taxable supplies.

On 1 March 2014, Stark Enterprises realises that those supplies are not taxable and it has overpaid \$1,000. The \$1,000 is extra GST to which section 142-5 applies.

Consequential amendments

1.64 The remaining provisions in this Schedule are consequential amendments that result from the repeal of section 105-65. *[Schedule #, item 13]*

1.65 A number of other notes in the GST Act and ITAA 1936 are amended to remove references to section 105-65. *[Schedule #, item 3, note 1 to subsection 35-5(1); item 5, note to section 35-99; items 8-10, note 1 in section 51-60, note 1 in section 54-65, and note at the end of the definition of 'taxable supply' in section 195-1; items 11 and 12, note in subsection 98A(2) and note in subsection 98B(4) of the ITAA 1936]*

1.66 Various other consequential amendments, including those in the *Income Tax Assessment Act 1997*, have been addressed by subsection 142-10(1), specifically by referring to the extra GST as always been payable and on a taxable supply, for the purposes of each taxation law. *[Schedule #, item 7, subsection 142-10(1)]*

1.67 A number of other amendments have been made to provide appropriate references to these provisions. *[Schedule #, item 1, note 2 to subsection 17-5(1); item 2, after table item 1AA in section 19-99; item 4 after table item 1 in section 35-99; item 6, after table item 10A in section 37-1]*

