
Refunding Excess GST – Exposure Draft Legislation

Indirect Philanthropy and Resource Tax Division

The Treasury

20 September 2012

The Taxation Committee of the Business Law Section of the Law Council of Australia welcomes the opportunity to make a submission in relation to the Exposure Draft (the ED) of amendments to be made to *A New Tax System (Goods and Services Tax) Act 1999* and the *Taxation Administration Act 1953* changing the ability of taxpayers to obtain a refund of overpaid GST.

Concerns

It is acknowledged that there have been significant difficulties with the operation of section 105-65 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) and that some changes are required in order to promote certainty.

However, it is submitted that the reforms proposed by the ED will not achieve the objective of certainty and will instead reward those taking aggressive tax positions at the expense of those seeking to meet their obligations.

The changes introduced in proposed Division 36 will deprive taxpayers of rights of review, giving rise to concerns as to whether or not there is an incontestable tax arising from the amendments.

Finally, the terms of the proposed Division 36 contains a number of practical flaws, including:

- a failure to provide certainty in the process by which a taxpayer can agree to reimburse its customer (or customers) pending clarification of the entitlement to a refund;
- a process for the reimbursement of a "class" of recipients, rather than one by one refunds;
- a proper mechanism for mirroring GST payable because of Division 36 and an entitlement to input tax credits for those amounts under the general provisions of the GST law.

Each of these are discussed in more detail below.

Rewarding the underpayment of tax

Part of the difficulty that has arisen in the context of refunds of overpaid GST has stemmed from the implementation of GST as a transactional tax. Taxpayers need to apply the GST in a real time environment. This often means that assumptions are made about the operation of the tax system that are not correct. It also means that it is a mistake to assume that GST is simply "passed on" to the recipient of the supply in every case.

The operation of such a tax system requires the ability to correct errors. If a taxpayer has overpaid tax through a misstatement, miscalculation or a mischaracterisation of a supply, that needs to be able to be corrected.

The operation of proposed Division 36 would be such that a taxpayer would be encouraged to resolve any ambiguity in relation to the appropriate amount of tax payable

on a transaction in favour of paying the least amount of tax. It would always be possible for such a taxpayer to review the position and pay an additional amount of tax at a later point. However, if the taxpayer adopts a more conservative position, resolving ambiguity in favour of paying the higher amount of tax, Division 36 makes it very difficult for such a taxpayer to recover a refund if tax was in fact overpaid.

As a matter of tax policy, this is unsatisfactory.

Absence of satisfactory review rights

Incontestability

The stated purpose of the proposed amendments is to remove the Commissioner's discretion regarding the refunding of GST under section 105-65 of the TAA. However, the consequence of declaring that overpaid tax that has been "passed on" to another entity was always payable is potentially an "incontestable tax" and may well be an invalid use of Commonwealth legislative powers.

As described by Kitto J in *Giris Pty Ltd v Federal Commissioner of Taxation* (1969) 119 CLR 365, an "incontestable tax" "refers to a tax provided for by a law which while making the taxpayer's liability depend upon specified criteria, purports to deny him all rights to resist an assessment by proving in the courts that the criteria of liability were not satisfied in his case" (at 378-9).

The proposed operation of Division 36 in the manner described in the draft Explanatory Memorandum would effectively render a taxpayer unable to challenge the "overpayment" of the tax wherever the taxpayer remains profitable notwithstanding the miscalculation of the tax. The mere building of the cost of GST into the overall pricing of activities does not mean that the tax has been "passed on" in any particular circumstance. However, the approach suggested in the draft Explanatory Memorandum would deny a taxpayer the ability to contest that GST was not "passed on" in a particular circumstance.

Need for residual discretion

The nature of GST and the wide variety of circumstances in which it arises makes it desirable for the Commissioner to retain a residual discretion to refund overpaid GST in circumstances in which it is fair and reasonable to do so. Such a discretion would operate outside the normal self-assessed refund entitlement processes and would operate when there are practical difficulties in demonstrating the extent to which the overpaid GST has been passed on (such as regulated price environments or markets of great price sensitivity) or difficulties in transaction by transaction reimbursement of overpaid tax. The availability of the discretionary relief may be structured to achieve a measure of flexibility whilst still meeting the stated goal of avoiding "windfalls" from refunding overpaid GST.

The proposed amendments should provide the Commissioner with such a residual discretion.

Process of reimbursement

Agreements to reimburse

The amendments provided by the ED fail to specify the circumstances in which a taxpayer can arrange for the reimbursement of the overpaid tax, pending receipt of a refund from the Commissioner.

Proposed section 36-5(2) provides an exception to the operation of section 36-5(1) only where the overpaid tax:

- has not been passed on; or
- has been passed on but has been reimbursed.

The exclusion to the operation of section 36-5(1) should be extended to circumstances in which the taxpayer has agreed to reimburse the entity that has borne the burden of the tax upon receipt of a refund from the Commissioner.

A taxpayer should not be placed in a position in which they are required to bear:

- the cashflow detriment of the reimbursement pending resolution of a claim for a refund; and
- the risk of being unable to recover the overpaid tax,

in order to trigger an ability to seek a refund of the overpaid tax.

Class based reimbursement

The amendments provided by the ED also fail to provide for the ability of a taxpayer with a diverse range of customers to provide a "class based" reimbursement.

Many taxpayers are unable to identify the amount of tax passed on to specific individual customers. This may be in the retail context where transactions are conducted in cash or in other contexts where the volume of transactions makes it impossible to determine tax borne by individual customers.

The consequence of the drafting of the ED, confirmed by para 1.55 of the proposed Explanatory Memorandum, is that such taxpayers will never be able to claim refunds of overpaid GST.

Again, this is an unsatisfactory approach for the legislature to adopt. The mistaken overpayment of GST in this context should not result in a permanent windfall of revenue. Rather, there should be a process by which a taxpayer who is unable to trace the overpaid tax borne by individual customers, should be able to reimburse its future customers – for example through the provision of a temporary reduction in prices – so as to pass back the benefit of the overpaid tax to the taxpayer's regular customers.

Any proposed regime of the kind contained in the ED should address these practical issues. We submit that the mechanism provided by section 22 of the *Taxation Administration Act 1997* (Vic) and similar provisions applying in other jurisdictions provides a better balance between the need for certainty of revenue and the rights of individual taxpayers

Mirroring with Division 11

If the overpaid tax is to be treated as always payable to the extent that it is passed on, it is essential that the amendments provide a clear mechanism for the availability of an input tax credit for that overpaid tax. The current mechanism provided by the ED is inadequate for this purpose. The current reference in Note 2 to proposed section 36-5(2) does not adequately deal with situations in which the preliminary requirements of section 11-5 are not met because:

- the overpaid tax arose in relation to a transaction that was not in fact a supply; or

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- the supply acquired by the entity to whom the overpaid tax was passed on was not a taxable supply.

Additional drafting should be included in any amendment to ensure that input tax credits are properly available to the entity to whom the tax has been passed on in all circumstances.

The Committee submits that the proposed amendments need to be substantially reconsidered and supplemented with additional measures to address the foregoing observations. The Committee would appreciate the opportunity to consult in more detail regarding these proposed amendments.

Generally

Should you wish to discuss any aspect of this matter please contact the Committee Chair, Teresa Dyson on (07) 3259 7000.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its constituent bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Large Law Firm Group, which are known collectively as the Council's constituent bodies. The Law Council's constituent bodies are:

- Australian Capital Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Independent Bar
- The Large Law Firm Group (LLFG)
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of approximately 56,000 lawyers across Australia.

The Law Council is governed by a board of 17 Directors – one from each of the constituent bodies and six elected Executives. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive, led by the President who serves a 12 month term. The Council's six Executive are nominated and elected by the board of Directors. Members of the 2012 Executive are:

- Ms Catherine Gale, President
- Mr Joe Catanzariti, President-Elect
- Mr Michael Colbran QC, Treasurer
- Mr Duncan McConnel, Executive Member
- Ms Leanne Topfer, Executive Member
- Mr Stuart Westgarth, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.