CTA Conference
20 - 21 October 2014

Division 142 and refunds of overpaid GST

"Things are not always what they seem; the first appearance deceives many; the intelligence of a few perceives what has been carefully hidden." - Phaedrus

Introduction

Effective from 30 May 2014, the refund provisions in section 105-65 of Schedule 1 to the *Taxation Administration Act 1953* ("TAA") were repealed and replaced with Division 142 of the *A New Tax System (Goods and Services Tax) Act 1999* ("GST Act")[1].

The new refund regime aims to remedy perceived shortcomings of the previous regime through the use of "deeming" provisions whereby overpaid or "excess GST" is taken to have always been payable and always on a taxable supply unless the recipient is reimbursed for the GST passed on.

This paper considers the application of Division 142, in particular the extent of its reach relative to the old refund regime and how this impacts taxpayers who were previously potentially unaffected by restrictions to refunds. In this context, questions of whether the GST has been "passed on" and "reimbursed" are also discussed as is the Commissioner's discretion to pay a refund which, although retained in the new regime, is expected to have a more limited operation.

The premise behind the provisions

Section 142-1 sets out the underlying rationale behind Division 142, that is:

> *"Excess GST is not to be refunded if this would give an entity a windfall gain."*

This is consistent with the legislative intent of Division 142 as set out in the Explanatory Memorandum ("EM") to the Bill introducing the new provisions[2], which states at paragraph 2.7:

> *"The GST Act envisages that the supplier 'passes-on' the GST to the recipient of the supply. If GST is passed on but there is a refund of the GST to the supplier, the supplier will have a windfall gain unless it reimburses the recipient of the supply. Accordingly, a provision to restrict refunds of excess GST is appropriate to prevent windfall gains and provide an incentive for the supplier to reimburse their customer."*

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[1] Refer to the *Tax Laws Amendment (2014 Measures No.1) Act 2014*

[2] *Tax Laws Amendment (2014 Measures No.1) Bill 2014* "(TLAB 2014")

A similar sentiment was expressed in the EM to the *Tax Laws Amendment (2008 Measures No 3) Bill 2008* ("TLAB 2008") which introduced section 105-65 of Schedule 1 to the TAA. The EM relevantly states at paragraph 2.2:

> *"Under section 105-65 of Schedule 1 to the TAA 1953 (restriction on refund provisions), if a business overpays GST on a sale to a customer then the GST may be refunded to the business only if the business has first refunded the overpaid amount to the affected customer. This is because it is the customer who is intended to bear the cost of the GST. Without the restriction on refund requirement, there is a potential for a windfall gain to arise to businesses that receive the refund of GST but have not borne the incidence of the tax."*

The handful of cases that have dealt with the refund provisions under the old regime, which gave the Commissioner a residual discretion to pay a refund, also recognise the importance of preventing windfall gains.

The first of these cases was *KAP Motors Pty Ltd* v *Commissioner of Taxation* [2008] FCA 159 (*"KAP Motors*"). In this case the Federal Court considered the application of section 105-65 in the context of agreed facts which included that the taxpayer had overpaid GST under the mistaken belief it had made taxable supplies. The taxpayer neither agreed nor undertook to reimburse its customers. The Commissioner contended that a refund of overpaid GST would ordinarily result in a windfall gain to the supplier. In response to that proposition, Emmett J stated at [33]:

> *"Section 105-65 should not be given an expansive construction. While its object may be commendable, in seeking to avoid windfall gains for taxpayers, it is, in a sense, a paternalistic interference with the rights of taxpayers. It proceeds on the basis that GST that should not have been paid has been paid by a taxpayer. Its operation is to ensure that the Commissioner receives a windfall rather than a taxpayer."*

As subsequent refund cases highlighted weaknesses in the ability of section 105-65 to restrict refunds in certain circumstances (discussed below), it seems that a further paternalistic interference was seen as necessary with the introduction of Division 142. The new provisions clearly aim to tighten the restrictions on refunds of overpaid GST.

The legislation

The provisions of Division 142 are as follows:

> **Subdivision 142-A—Excess GST unrelated to adjustments**
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> **142-5 When this Subdivision applies**
>
> (1) This Subdivision applies if, after disregarding any amounts covered by subsection (2), your assessed net amount for a tax period takes into account an amount of GST exceeding that which is payable.

(2) Disregard the following amounts:

(a) an amount of GST that was correctly payable and attributable to the tax period, but which later becomes the subject of a decreasing adjustment;

(b) an amount of GST that is payable, but is correctly attributable to a different tax period.

142-10 Refunding the excess GST

For the purposes of each taxation law, so much of the excess from subsection 142-5(1) (the ***excess GST***) as you have passed on to another entity is taken to have always been:

(a) payable; and

(b) on a taxable supply;

until you reimburse the other entity for the passed-on GST.

142-15 When section 142-10 does not apply

Commissioner satisfied it is inappropriate for that section to apply

(1) Treat section 142-10 as never having applied to the extent that the Commissioner is satisfied that:

(a) applying that section would be inconsistent with the principle that excess GST is not to be refunded if this would give an entity a windfall gain; and

(b) you have requested a decision under this subsection in the approved form.

(2) The Commissioner must notify you in writing of any decision relating to you made under subsection (1).

If there never was a supply

(3) Treat section 142-10 as never having applied to the extent that:

(a) you treated the excess GST as payable on a supply, but in fact there never was a supply; and

(b) you reimburse the other entity for the passed-on GST.

So far as it relates to your creditable acquisitions

(4) Section 142-10 does not apply for the purposes of applying subsection 11-15(2) (about creditable purpose) to you.

If the recipient knows you have not paid the excess GST

(5) Section 142-10 does not apply for the purposes of applying a taxation law to the other entity if, and while, that other entity knows, or could reasonably be expected to have known, that you have not paid the excess GST to the Commissioner.

Subdivision 142-B—GST related to cancelled supplies

142-20 Refunding GST relating to cancelled supplies

(1) This section applies if:
- (a) your assessed net amount for a tax period takes into account an amount of GST on a supply; and
- (b) you have a decreasing adjustment attributable to a later tax period as a result of the cancellation of the supply.

(2) Reduce:
- (a) your decreasing adjustment; and
- (b) if the recipient of the supply has a corresponding increasing adjustment—the recipient's increasing adjustment;

to the extent that you have passed on that GST to the recipient, but not reimbursed the recipient for the passed-on GST.

(3) This section has effect despite sections 19-55 (about decreasing adjustments for supplies) and 19-80 (about increasing adjustments for acquisitions).

Subdivision 142-C—Passed-on GST

142-25 Working out if GST has been passed on

(1) Some or all of an amount of GST may have been ***passed on*** to another entity even if:
- (a) a tax invoice is not issued to or by that other entity; or
- (b) a tax invoice issued to or by that other entity relates to that GST, but does not contain enough information to enable that GST to be clearly ascertained.

(2) If:
- (a) you issue a tax invoice to another entity, or another entity issues a recipient created tax invoice to you; and
- (b) the invoice contains enough information to enable some or all of an amount of GST to be clearly ascertained; and
- (c) in a case where you must pay the assessed net amount for a tax period to which the invoice relates—you have paid that assessed net amount to the Commissioner;

the invoice is prima facie evidence of that part of that GST having passed on to that other entity.

When a restriction to refunds applies

Division 142 applies to tax periods starting on or after the day of Royal Assent, that is, 30 May 2014. Section 105-65 continues to apply to tax periods starting on or prior to 30 May 2014.

Under Division 142 taxpayers can self-assess their entitlement to a refund although the Commissioner retains a limited discretion to pay a refund if this would not give rise to a windfall gain. This is in contrast to the previous regime where the Commissioner had a residual discretion to refund an amount and taxpayers had no entitlement to self-assess.[3]

Excess GST

From section 142-5 above, it is clear that Division 142 applies only in respect of "excess GST". That is, where a taxpayer's "assessed net amount for a tax period takes into account an amount of GST exceeding that which is payable."

Net amount

A taxpayer's "assessed net amount" is the net amount (defined broadly in section 17-5 of the GST Act as GST liability on taxable supplies less input tax credit entitlements, increased or decreased by any adjustments) assessed for a tax period. Interestingly, the GST on taxable importations is not included in the net amount while input tax credits for creditable importations are, causing an artificial reduction in the net amount.

In *Naidoo* v *Commissioner of Taxation* [2013] AATA 443 ("*Naidoo*"), the Administrative Appeals Tribunal ("Tribunal"), noted that section 17-5 "*provides for the working out of the net amount, a defined term, in a precise manner using clear and unambiguous language*"[4]. Section 33-15 of the GST Act deals separately with payments of "assessed GST on taxable importations" while section 155-20 of Schedule 1 to the TAA sets out when the Commissioner is treated as having made an assessment of the GST payable on a taxable importation. In the light of the Tribunal's comments in Naidoo, it is worth questioning whether these provisions are adequate to draw the GST payable on taxable importations into the definition of "assessed net amount" or whether GST overpaid on taxable importations are outside the scope of Division 142.[5]

Under section 17-20 of the GST Act, the Commissioner may make a determination relating to how a net amount for a tax period is to be worked out to take account of the correction of GST errors. Pursuant to this section, the Commissioner issued GSTE 2013/1: *Correcting GST Errors Determination 2013*.

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[3] See footnote 48 in Miscellaneous Tax Ruling MT 2010/1: restrictions on GST refunds under section 105-65 of Schedule 1 to the *Taxation Administration Act 1953.*

[4] At [91]

[5] Ultimately, this may not be a significant issue given that a taxpayer who makes a taxable importation will also make a creditable importation in respect of the same transaction. Therefore, if GST has been incorrectly overpaid it is likely that a corresponding amount will have been overclaimed as an input tax credit.

GSTE 2013/1 sets out the circumstances where taxpayers can correct an error in a later GST return where the error is made in working out the net amount for an earlier tax period and is not otherwise outside the period of review. GSTE 2013/1 applies for tax periods that start after 1 July 2012 and notes that an "*error is a mistake you made in working out your net amount for a tax period that would…have resulted in your net amount or assessed net amount being overstated or understated. An error does not include an amount that the Commissioner need not refund to you under section 105-65 in Schedule 1 to the Taxation Administration Act 1953, unless the Commissioner exercises the discretion to give you a refund*."

GSTE 2013/1 has not yet been updated in the light of Division 142. However, the Commissioner has issued guidelines which state that a "restricted refund" is not a GST error.[6] The guidelines, however, still appear to be made in the light of the old refund regime.

Given that "credit errors" (that is, errors which would have resulted in a net amount or assessed net amount for an earlier tax period being overstated) are not subject to value limits or time limits pursuant to GSTE 2013/1, unless the Determination is made subject to Division 142, any errors resulting in an overpayment of GST could be rectified in a later GST return, regardless of quantum and only subject to the time limits imposed under section 105-55 in Schedule 1 of the TAA.

Assessed net amount

Under the self-assessment regime, the taxpayer's lodgment of its Business Activity Statement ("BAS") creates an assessment[7]. An amended assessment may also be made by the Commissioner, whether or not at the request of the taxpayer[8]. An amended assessment effectively results in a new assessed net amount for the taxpayer for the relevant tax period[9].

Therefore, as Division 142 is tied to an assessed net amount, if a taxpayer successfully objects against the Commissioner's assessment or amended assessment pursuant to Part IVC of the TAA, a Court or Tribunal will have jurisdiction to consider the application of Division 142 in the same proceedings.[10]

What is "excess GST"?

Unlike section 105-65 which applied only where an overpayment of GST arose as a result of a taxpayer incorrectly treating a supply or arrangement as taxable to any extent, Division 142 potentially applies in any circumstance where an amount of GST exceeds that which is payable. In this regard, Division 142 has a much broader reach than did section 105-65.

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[6] https://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/In-detail/Instructions-and-guides/Correcting-GST-errors/?page=8

[7] Refer to subsection 155-15(1) of Schedule 1 to the TAA

[8] Refer to subdivision 155-B of Schedule 1 to the TAA

[9] Refer to section 155-80 of Schedule 1 to the TAA

[10] Amendments were made to the TAA to give taxpayers the ability to seek merits review of section 105-65 decisions. This arose following Naidoo where the Tribunal found it did not have jurisdiction to review the Commissioner's decision made under section 105-65 as it was not part of the assessment process.

It does not matter how the excess arose. At paragraph 2.34, the EM states:

> *"In practice, excess GST can arise in 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 a transaction or arrangement which is not a supply as a taxable supply;*
> - *miscalculating a GST liability under the GST law, for example under the margin scheme or gambling supplies; or*
> - *incorrectly reporting an amount of GST on a GST return."*

Consequently, taxpayers that may not have been restricted in claiming a refund of overpaid GST under the previous regime may now be precluded from obtaining a refund of excess GST.

Perhaps most notably, the miscalculation of a GST liability which gives rise to excess GST may be the subject of a restriction in refunds. This was not the case under the previous refund provisions.

In *International All Sports*,[11] GST was overpaid because the taxpayer took the view that it was only prizes paid to gamblers whose wagers had been by way of gambling supplies that were to be subtracted as "total monetary prizes" in the formula set out in section 126-10(1) of the GST Act. It was common ground that those supplies were neither taxable nor ever treated as taxable (being supplied to non-residents and treated as GST-free).[12] Jessup J stated:

> "*Despite the persistent endeavours of counsel for the Commissioner, I confess to a complete inability to appreciate how it might be said, on the assumed facts of the present case, that the overpayments made by the applicants arose because supplies were treated as taxable supplies, or arrangements were treated as giving rise to taxable supplies, to any extent. . . .In my view . . . s 105-65(1)(a) is quite irrelevant to the circumstances of the present case.*[13]

Jessup J further observed:

> *"First, the reading of s 105-65(1)(a) which I prefer is not "too literal a reading" – it is the only reading which the words of the paragraph sensibly convey. Secondly, the subsection is not "concerned simply with an overpayment", but with an overpayment of a particular kind, made in the circumstances referred to. Thirdly, the words "to any extent" at the end of the paragraph, and the corresponding words "to that extent" in para (b), address the situation in which a particular supply might have been treated as a taxable one to some extent only. It is not concerned to expand beyond its sensible meaning the wording of the main operative part of the paragraph. And fourthly, the "evident purpose of the section", in my view, is to deal with the situation in which the recipient of a particular supply has been charged an amount from which one eleventh was included in the calculation of the supplying entity's "net amount", but has not been reimbursed a*

[11] *International All Sports v Commissioner of Taxation* [2011] FCA 824
[12] *Ibid* at [55]
[13] *Ibid* at [55]

> *corresponding sum in anticipation of a refund being received from the Commissioner. That purpose, and the circumstances which are before the court in the present case, pass each other like ships in the night."*[14]

Following, *International All Sports*, the Commissioner took the view that section 105-65 did not apply in cases where a taxpayer always correctly characterised a supply but a miscalculation resulted in an overpayment of GST. On this basis, the Commissioner considered that section 105-65 did not apply to circumstances where:

- a supplier correctly characterised a supply as taxable but merely miscalculated the GST for that supply in the calculation of their net amount;
- supplies were treated as taxable under the margin scheme where there was an error in the calculation of the margin;
- GST on supplies of real property had been calculated under the ordinary provisions, when in fact the margin scheme applied;
- Division 72 of the GST Act (the Associate provisions) applied but an overpayment of GST arose from an error in the calculation of the market value;
- a supplier chose to apply Division 87 of the GST Act to a supply of long term accommodation in commercial residential premises, but the supplier then failed to apply the concessional rate when calculating the value of the supply;
- GST on a taxable supply of a fringe benefit was overpaid as a result of an error in working out the price under subsection 9-75(3) of the GST Act;
- GST was overpaid due to a miscalculation of GST which arose when a taxpayer failed to pay LCT on a luxury car; or
- GST on a taxable supply of an insurance policy was overpaid as a result of an error when working out the value of the taxable supply pursuant to section 78-5 of the GST Act.[15]

Given that Division 142 is concerned with an amount of GST which exceeds that which is payable, and is not limited to circumstances where a supply or arrangement is incorrectly treated as taxable to any extent, the above scenarios are within the scope of the new provisions.

Thus, it is important for taxpayers to ensure, more so now than previously, that they have robust systems and processes in place to ensure that GST is correctly calculated on supplies and that the net amount reported in their BAS is correct as once the excess GST is paid to the Commissioner the chances of a refund are slim to none where that GST has been passed on and not reimbursed.

What is not "excess GST"?

Subsection 142-5(2) provides that certain amounts are to be disregarded when determining a taxpayer's excess GST. These are:

[14] *Ibid* at [56]

[15] Refer to MT 2010/1 at paragraph 25B.

- an amount of GST that was correctly payable and attributable to the tax period but later becomes the subject of a decreasing adjustment; and
- an amount of GST that is payable but is correctly attributable to a different tax period.

Therefore, where the GST is correctly payable but an adjustment event arises in a later tax period or there is an attribution error, the amounts are not taken into account when calculating any excess GST and Division 142 has no application. Circumstances that fall outside of Division 142 include decreasing adjustments (which reduce the net amount) caused by any event which has the effect of:

- cancelling a supply or acquisition (subject to section 142-20, discussed below);
- changing the consideration for a supply or acquisition; or
- causing a supply or acquisition to become, or stop being, a taxable supply or creditable acquisition.[16]

Such scenarios would have similarly been outside the scope of section 105-65.

Refunding excess GST

Section 142-10 deems excess GST that a taxpayer has passed on to another entity to have always been payable and on a taxable supply, until the taxpayer reimburses the other entity for the passed on GST.

Therefore, where excess GST has been passed on to another entity, and not been reimbursed, there is no entitlement to a refund as the GST is deemed to have been correctly payable.

When is GST passed-on?

Whether or not GST has been passed on is crucial to the application of Division 142. If GST has not been passed on then Division 142 has no work to do and the taxpayer is entitled to a refund of overpaid GST as a matter of right.[17]

Whether or not GST has been passed on is a question of fact and will depend upon the circumstances of each case. The burden of proving that the GST has not been passed on falls to the taxpayer.

Subsection 142-25(1) provides that even if a tax invoice has not been issued, or it has been issued but does not contain enough information to enable the GST to be clearly ascertained, some or all of the GST may have been passed on. Therefore, there may nevertheless be passing on even with a lack of a tax invoice or valid tax invoice.

However, the existence of a tax invoice is *prima facie* evidence of passing on as suppliers with a GST liability would, in most cases, be expected to pass the cost of GST on to their customers[18]. Specifically,

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[16] Subsection 19-10(1) of the GST Act

[17] Note 2 to section 142-10 states that any excess GST a taxpayer has not passed on will be refunded as described in section 155-75 of Schedule 1 to the TAA (in broad terms, applied to the taxpayer's running balance account).

[18] Refer to the EM to TLAB 2014 at paragraph 2.68

subsection 142-5(2) provides that if you do issue a tax invoice then that tax invoice is *prima facie* evidence of the GST having been passed on where:

- the invoice contains enough information to enable some or all of an amount of GST to be clearly ascertained; and
- the invoice relates to an assessed net amount that is payable and you have paid that assessed net amount to the Commissioner.

It is interesting to note that section 142-5 refers to a "tax invoice" rather than an invoice. For attribution purposes, a taxpayer accounting on a non-cash basis will have a GST liability for a taxable supply in the tax period that an invoice is issued or any payment is received, whichever occurs first.[19] Therefore, a situation may arise where excess GST has been attributed to a tax period on the basis of an invoice and that invoice is not *prima facie* evidence of the GST having been passed on.

The presumption that the GST has been passed on may be rebutted in a number of ways. For example, even though a tax invoice may have been issued the supplier may be able to show that the recipient has not yet paid the invoice amount. The EM to TLAB 2014 provides examples of when excess GST is <u>not</u> passed on:

- Example 2.1 – a transcription error resulting in an additional amount of GST being incorrectly included in the assessed net amount for a tax period.

- Example 2.2 – an incorrect amount of GST being included in the assessed net amount for a tax period due to double counting a particular taxable supply. The excess amount has not been passed on because only one amount of GST was passed on for the particular taxable supply, not two.

- Example 2.5 – an accounting error incorrectly stating the value of a transaction and the GST payable where the recipient has paid the correct amount to the supplier.

- Example 2.6 – a systems error resulting in the incorrect coding of a GST-free product as taxable (resulting in tax invoices being issued to customers showing the product as taxable and GST being remitted in GST returns). Where the GST was not factored into the price of the product, the supplier effectively bears the cost of the excess GST and the excess GST has not been passed on.

- Example 2.11 – a supply is treated as GST-free and this is reflected in the price charged to customers. If the supplier can demonstrate that the price charged does not include GST the Commissioner accepts that the GST has not been passed on.

[19] Subsection 29-5(1) of the GST Act

- Example 2.17 – a property development company develops and markets 10 residential apartments at a price of $500,000 on the understanding the purchaser agrees in writing to the vendor's use of the margin scheme. In working out its pricing structure, a GST component of $11,000 was calculated for each apartment. The company has difficulty selling the last apartment and therefore drops the price to $450,000 but incorrectly includes $11,000 GST in its BAS. The company's approach to pricing, the reduction in the purchase price and the application of the margin scheme indicate that an amount of less than $11,000 in GST was passed on in respect of the sale of the last apartment and the excess GST has not been passed on.

Importantly, in examples 2.6, 2.11 and 2.17, the taxpayer would need to demonstrate that GST was not included in the price of the supply and hence not passed on.

The EM to TLAB 2014 recognises at paragraph 2.75 that the question of whether an indirect tax has been passed on is a relatively complex inquiry because prices may be set with reference to a wide range of factors. Accordingly, the seller's pricing policy and practice are where the inquiry should begin.

The High Court case, *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 ("*Avon*") provides guidance on passing on. This case considered provisions in the sales tax legislation which limited an entitlement to a refund of sales tax to the extent that the tax had not been passed on. At [9] of the judgment, the High Court stated:

> *"That sales tax is expected to be passed on depends upon the circumstances that sales of goods occur within an economy geared to make a profit. It is the profit-making motive of business which, in the nature of things, generally results in sales tax being passed on. This is because, leaving aside rare cases where sales tax is separately identified and superadded to the invoice price after sale, sales tax can only be passed on indirectly through the price mechanism. In a profit making structure, businesses will set prices so as to ensure at least that all foreseeable costs are recovered, anything above this being conceptualized as a margin of profit. Because sales tax is levied upon the vendor prior to the ultimate sale by retail…it forms part of the cost structure of doing business. There is nothing extraordinary in the proposition that in the usual course of things sales tax will be passed on."*

Given the High Court's comments above, taxpayers will undoubtedly face a very difficult task of rebutting the presumption that GST has been passed on.

The way in which the Commissioner is likely to approach the question of passing on is evident through a number of examples in the EM to TLAB 2014 where GST was regarded to have been passed on. These examples include:

- Example 2.15 – A property development company makes a taxable supply of real property to another property developer. The parties agree in writing on a GST-exclusive price and that the margin scheme is to apply to the sale. This indicates that an amount of GST is included in the total purchase price. Notwithstanding that no tax invoice is issued, the contract of sale is sufficient to show that an amount of GST has been passed on.

- Example 2.16 – A state government entity supplies both commercial and new residential premises. It conducts a detailed feasibility study on a new development project and includes estimates of its GST liability as part of its overall cost recovery and pricing structure. It later discovers that it used an incorrect valuation day and overpaid GST under the margin scheme. The fact that its GST liability was taken into account in determining its cost recovery and pricing structure through a detailed feasibility study, and the GST component was paid by its customers, tends to indicate it has passed on the excess GST. (This example is discussed further below in the context of the Commissioner's discretion)

The EM does note at paragraph 2.78 that margin scheme cases need to be considered in the same way as other cases where GST is overcharged. The EM notes that whether the GST is calculated under the general rules or under the margin scheme, it is a foreseeable cost that would generally be taken into account in a business' pricing and costing structure.

On this basis, if there is a contract for sale and the purchase price is stated to be GST-inclusive with no other terms and conditions specifying the amount of GST payable (or how the GST is to be calculated), it seems likely that the presumption that the GST is part of the foreseeable costs of business and would ordinarily be passed on will still stand, absent any evidence to the contrary.

When is the passed on GST reimbursed?

Once the excess GST is reimbursed, section 142-10 is taken to no longer apply and there is an adjustment event[20]. Accordingly, the taxpayer has a decreasing adjustment which is attributable to the tax period in which the taxpayer becomes aware of the adjustment, that is, when the excess GST is reimbursed.[21] Until such time, the excess GST is deemed to be payable.

This allows for transactions where GST has been incorrectly paid to be unwound (for both parties in a business to business context and for the supplier in a business to consumer context) through the use of adjustments to the net amount. This adjustment is made in the tax period that the excess GST is reimbursed. Therefore, there is no need to go back and amend the BAS for the tax period in which the GST and input tax credits were originally attributed. On this basis, the reimbursement does not result in an amended assessment for any party.

It is likely to be rare in a business to business context that the parties would seek to unwind a transaction where GST was overpaid by the supplier but a corresponding amount was overclaimed as an input tax credit by the recipient. However, there may be commercial reasons for unwinding transactions where, for example, the GST-inclusive price of a supply impacts the amount of other taxes

[20] See Note 1 to section 142-10 of the GST Act.
[21] Section 29-20 of the GST Act sets out the attribution rules for adjustments.

payable such as stamp duty. The ability to do this is administratively easier under Division 142 than under the previous regime.

In the previous regime, the unwinding of business to business transactions was generally not warranted as the Commissioner did not ordinarily exercise his discretion to pay a refund where the recipient of a supply incorrectly treated as taxable to any extent was registered or required to be registered for GST. This is on the basis that, as stated by the EM to TLAB 2008:

> *"…in the case of business to business transactions, the Commissioner is not required to refund overpaid GST because the purchasing business is potentially entitled to input tax credits to offset the GST included in the price of its acquisition."*[22]

In the limited circumstances where the Commissioner did exercise his discretion to pay a refund, or the supplier reimbursed the recipient for the GST incorrectly paid, the Commissioner generally sought to recover the overclaimed input tax credits from the recipient to prevent any windfall gain to the recipient.[23]

The term "reimburse" is not a defined term in the GST Act, and therefore takes its ordinary meaning. The Macquarie Dictionary defines the word "reimburse" to mean *"to make repayment for expense or loss incurred…to pay back; refund; repay."*

In *MTAA Superannuation Fund (RG Casey Building) Property Pty Ltd* v *Commissioner of Taxation* [2011] AATA ('*MTAA'),* the Tribunal stated at [60] that "reimbursement requires payment not an agreement to pay." Therefore, it found that an undertaking by the supplier to make a payment to the recipient did not constitute reimbursement.

The examples in the EM to TLAB 2014 also indicate that actual repayment of an amount corresponding to all or part of the excess GST is required.[24]

In an ATO Interpretative Decision ATO 2013/56 concerning the previous refund regime, the Commissioner considered that an amount of overpaid GST had not been reimbursed when a supplier merely made a journal entry in its accounts, unless the journal entry offset a pre-existing liability owed by the recipient to the supplier. The Commissioner stated that a journal entry in the supplier's accounts acknowledging a debt owed to the recipient is at best a promise to pay – it does not mean that the supplier has actually repaid the overpaid GST.

Can reimbursement of overpaid GST be made by means other than through the payment of money? For example, would a payment in-kind be sufficient? Consider a situation where a retailer issues a face value voucher to customers who have overpaid GST on a product. Here the customers receive a right to

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[22] Paragraph 2.3 of the EM.

[23] See Practice Statement Law Administration (General Administration) PS LA 2013/3 (GA): Treatment of input tax credits claimed by a recipient of a non taxable supply where the Commissioner has the discretion to give a refund of the overpaid GST to the supplier due to the operation of section 105-65 of Schedule 1 to the *Taxation Administration Act 1953*, at paragraphs 8 to 9

[24] See examples 2.7, 2.8 and 2.9

goods or services equal to the value of the GST overpaid, which on a spectrum is more than (in the words of the Tribunal in *MTAA)* an "agreement to pay" but perhaps falls short of actual payment.

In this regard, and on the basis that payment in-kind is acceptable, it would seem that it is not until the voucher is physically redeemed for goods or services by the customer that the excess GST will be taken to have been reimbursed.[25]

Example 2.9 in the EM to TLAB 2014 suggests that where excess GST has only been partially reimbursed, the Commissioner will treat section 142-10 as continuing to deem the difference between the excess GST and what has been reimbursed as having always been payable and on a taxable supply. (This practical approach appears to be read into the law as it is not evident on the face of the provision)

Thus, continuing with the example discussed above, if a taxpayer issues a face value voucher equal to the excess GST and this is only partially redeemed by a customer, section 142-10 would likely apply to the difference between the excess GST and the amount that has actually been redeemed or reimbursed.

When section 142-10 does not apply

Claiming input tax credits

The deeming provision in section 142-10 has the effect that where the excess GST has been passed on to another entity that is registered or required to be registered for GST, the other entity's entitlement to input tax credits is not affected. This is on the basis that the excess GST is deemed to have been correctly payable on a taxable supply.

Although section 142-10 deems the excess GST to have always been payable and on a taxable supply, it does not deem a transaction to be a taxable supply for the purposes of determining whether the taxpayer has made an acquisition for a creditable purpose under subsection 11-15(2) of the GST Act. Therefore, where a supplier has incorrectly treated an input taxed supply as taxable and passed on the excess GST, the deeming provisions in section 142-10 do not extend to allow a supplier to treat its supply as taxable and claim input tax credits for related business inputs.[26]

Further, subsection 142-15(5) ensures that the deeming provisions do not apply for the purposes of applying a taxation law to the recipient where the recipient knows, or could reasonably be expected to have known, that the taxpayer has not paid the excess GST to the Commissioner. This is effectively an anti-avoidance provision. As the EM to TLAB 2014 states at paragraph 2.65, these provisions:

> *"…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. For instance, where the corresponding GST is not paid to the Commissioner. This is achieved as the provisions do*

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[25] If a face value voucher is supplied for no consideration (e.g. a give-away), there should be no GST payable on redemption of the voucher. Refer to GST Ruling GSTR 2003/5 *Goods and Services Tax: Vouchers* at paragraph 58.
[26] Refer to subsection 142-15(4)

> *not apply where the other entity knows or could reasonably be expected to have known that the supplier has not paid the excess GST to the Commissioner."*

If there never was a supply

Pursuant to subsection 142-15(3), section 142-10 is treated as never having applied to the extent that a taxpayer treated the excess GST as payable on a supply where there was in fact no supply and the other entity is reimbursed for the passed on GST.

The note to subsection 142-15(3) states that if a taxpayer reimburses the passed on GST, an equivalent amount will be refunded as described in section 155-75 in Schedule 1 to the TAA, that is, applied to the taxpayer's running balance account.

Therefore, unlike reimbursements that fall within section 142-10, an adjustment event does not arise. This is due to the fact that an adjustment event attaches to a supply or acquisition and as there can be no supplies or acquisitions when subsection 142-15(3) applies, there is no adjustment event. While not dealt with in the legislation, presumably in these circumstances if a recipient is reimbursed by the taxpayer but has claimed input tax credits equal to the amount reimbursed, the Commissioner may amend the recipient's assessment for the affected tax period(s).

Commissioner's discretion and windfall gain

Subsection 142-15(1) gives the Commissioner a discretion to treat section 142-10 as never having applied and thus to refund excess GST even if the GST has been passed on and has not been reimbursed to the other entity. The discretion arises to the extent the Commissioner is satisfied that applying section 142-10 would be inconsistent with the principle that "excess GST is not to be refunded if this would give an entity a windfall gain"[27]. The discretion can only be exercised upon the request of the taxpayer in the approved form.[28]

The EM to TLAB 2014 explains at paragraph 2.55:

> *"The discretion should only be exercised where the Commissioner is satisfied that a refund of the excess GST would not provide an entity with a windfall gain."*

The provisions speak of a windfall gain to "an entity" and not just the supplier. Accordingly, in considering whether or not to exercise his discretion to refund excess GST, the Commissioner will have regard to whether the recipient of the supply stands to make a windfall gain. As noted by the EM to TLAB 2014 at paragraph 2.56:

> *"Ordinarily, where GST has been passed on by a supplier to a recipient, a refund to the supplier would result in the supplier having a windfall gain. Although less common, there could also be cases where a refund could lead to a windfall gain for another entity — for example, a recipient*

[27] Paragraph 142-15(1)(a) of the GST Act
[28] Paragraph 142-15(1)(b) of the GST Act

that has claimed input tax credits is effectively compensated for the GST they overpaid, and for whatever reason is able to retain the input tax credits they claimed."

The prospect of a windfall gain to the recipient was considered by the Tribunal in *Luxottica Retail Australia Pty Limited v Commissioner of Taxation* [2010] AATA 22 ("*Luxottica")*). In Luxottica the parties agreed a contract price for a supply but the GST had been mistakenly overcharged. The circumstances are such that Division 142 would apply. The question that arises, however, is whether in these circumstances the Commissioner's limited discretion under Division 142 would operate in the same way as the Commissioner's residual discretion under section 105-65.

In *Luxottica*, the Tribunal considered it appropriate to exercise the residual discretion to pay a refund to the supplier even though unregistered customers had not been reimbursed. The case concerned the application of promotional discounts to the sale of spectacles where the lenses were GST-free and the frames were taxable. In deciding to exercise the residual discretion, the Tribunal stated at [58] and [60]:

"The reason for this is quite straightforward. A reimbursement to the customer would, of course, have the effect of reducing the selling price…The customer would walk away from the transaction having paid, in net terms, less than he or she contracted with the Applicant to pay…

…

On the Commissioner's approach in this case, the windfall gain would flow to the undeserving customer. That is not the right outcome."

The Tribunal did not directly address whether the supplier would receive a windfall gain if the Commissioner's residual discretion were exercised. It may well be that under Division 142 the fact that "an entity" (that is, the customer) stands to receive a windfall gain would be sufficient for the Commissioner to deny a refund.

Regardless of what the outcome may be under Division 142, it is clear that the question of whether there has been a windfall gain remains key to the exercise of the Commissioner's discretion.

As noted above, the concept of "windfall gain" has been discussed in various cases dealing with section 105-65, including *MTAA*. In MTAA, the taxpayer contended that GST was overpaid on rental charges because it was paid in respect of an agreement that was GST-free under the GST transitional rules. The recipient of the taxpayer's supply was registered for GST and the Tribunal accepted that the recipient can be expected to have enjoyed the benefits of input tax credits. In considering the Commissioner's discretion, the Tribunal stated at [65]:

"…A practical business approach to administration of the GST laws is not consistent with allowing windfall gains. And to the extent that community standards and expectations have a role to play, those standards and expectations would require denial of windfall gains for two large organisations that do not bear the cost of the overpaid amount."

It is likely that, similar to the previous refund regime, in a business to business context, the Commissioner will not exercise his discretion to pay a refund under Division 142 unless denying the refund would result in "unintended consequences"[29].

Exercising the discretion – examples in the EM

The EM to TLAB 2014 provides examples of more unusual cases where the Commissioner is likely to exercise his discretion to pay a refund.

Example 2.12 – wrong entity

Example 2.12 involves two registered entities, Lintoned and Benwell, which sell their respective 50 per cent interest in a commercial property as tenants in common, for $50,000 plus $5,000 GST each, to Neville Co, a registered purchaser. Neville Co claims a total of $10,000 input tax credits in relation to the transactions. The Commissioner subsequently determines that Lintoned and Benwell are operating as a tax law partnership, which is a separate entity for GST purposes. The partnership is assessed for, and pays, $10,000 GST. As stated in the EM:

> *"Entities Lintoned and Benwell have each overpaid GST of $5,000 and they have each passed on that excess GST to Neville Co. However, in effect, Lintoned and Benwell have remitted the passed-on GST twice, once through remitting the GST in their own names, and once through remitting it in the name of the tax law partnership.*
>
> *In these circumstances it is appropriate for the Commissioner to exercise the discretion where the Commissioner is satisfied that the refund of excess GST to Lintoned and Benwell will not result in a windfall gain for either entity."*

Assume in this example that the tax law partnership was later found to have overpaid GST in respect of the transaction. Division 142 would presumably apply as the excess GST had not been passed on by the tax law partnership. Rather, it was the GST charged by Lintoned and Benwell that had been passed on and paid by Neville Co.

Examples 2.18 and 2.16 – margin scheme

Example 2.18 in the EM to TLAB 2014 provides another scenario where the Commissioner considers it would be inappropriate to prevent refunds. Specifically:

> *"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.*

[29] See the EM to TLAB 2014 at paragraph 2.58

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 audit by the Commissioner, 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 (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.

…The total amount of GST payable on the whole development has not changed — it is 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.

…

Having regard to the facts and circumstances of Developer AB's situation, and given that there are corresponding overpayments and underpayments arising from the change to the margin scheme cost base, the Commissioner considers that it would be inappropriate to prevent refunds of GST in those tax periods where the GST liability was overpaid because such refunds would not result in a windfall gain to any entity. AB needs to remit the additional GST liability in tax periods where more GST was payable."

Therefore, considering the sales in totality (rather than on a transaction by transaction basis), there is no windfall gain to AB as the overall GST payable has not changed. Certainly, it would seem inequitable for the Commissioner to require payment of any underpaid GST but not allow a refund of the overpaid GST.

It is interesting to contrast this example with another margin scheme example provided in the EM to TLAB 2014. Example 2.16 mentioned above was provided to demonstrate how the GST may have been passed on where the estimated liability is factored into a detailed feasibility study. In this example, State Co owned the land before 1 July 2000 and, in calculating its likely GST liability under the margin scheme, used a valuation day of 1 July 2000. State Co later discovers that it was entitled to make a valuation as at the day of the taxable supply (a higher valuation figure). Therefore, State Co's margin on each sale is lower and it has overpaid GST. In this example, State Co was regarded as having passed on the GST but there was no discussion as to whether or not the Commissioner would exercise his discretion.

Unlike example 2.18, looking at the totality of the transactions, State Co has overpaid GST on all sales. There are no offsetting underpayments. State Co would obtain a windfall gain as the GST has been passed on in the price of its supplies and the recipients have not been reimbursed.

Are there, however, any "unintended consequences" that would arise if the Commissioner did not exercise his discretion to pay a refund? In this regard, it is worth remembering that although the GST has been passed on, a recipient is not entitled to an input tax credit for any GST paid under the margin scheme. The recipient agrees to pay the price specified in the contract for sale and is not concerned with how GST under the margin scheme may be calculated, nor indeed with any errors in the calculation. Therefore, it would be the underserving recipient that would receive a windfall if it were reimbursed for the excess GST. This point has echoes of *Luxottica*, which as discussed above. A further point to note is that the GST Act specifically allows State Co to use a later, higher valuation and to therefore reduce its GST liability. However, given that miscalculations are now clearly intended to be covered by Division 142, this of itself is unlikely to be seen as an "unintended consequence".

Example 2.13 – retail sales

Example 2.13 involves Supermarket A which introduces a new product which it incorrectly treats as taxable. GST is included in the price from the outset. The product is marketed by other supermarkets that correctly classify the product as GST-free and charge a lower price. When Supermarket A discovers its error, it stops including GST in the price and lowers its price to match other supermarkets. Supermarket A does not consider it to be cost-effective to locate and reimburse affected customers for the overcharged GST. Supermarket A requests the Commissioner to exercise his discretion on the grounds that it was disadvantaged in the market place by an error, resulting in lost sales and profitability. The Commissioner decides not to exercise his discretion as a windfall gain would result if Supermarket A were paid a refund.

Assume Supermarket A agreed to discount the price of the product for a certain period of time so that customers at large (including those that were overcharged previously) "saved" an amount equal to the GST that had been overcharged on the product. Alternatively, Supermarket A may give away re-useable shopping bags to customers equal to the value of the GST overcharged. Could this be one of the more unusual cases warranting the exercise of the Commissioner's discretion given that from a monetary perspective, Supermarket A would not have a windfall gain and affected customers are indirectly "reimbursed" for the GST overcharged?

Cancelled supplies

Section 142-25, or the "*Qantas* amendment"[30], ensures that where there is an adjustment event as a result of a supply being cancelled, any decreasing adjustment the supplier has (and any corresponding increasing adjustment the recipient may have) is reduced to the extent that GST has been passed on to the recipient but has not been reimbursed.

This provision is directed at ensuring suppliers do not receive a windfall gain. As noted at paragraph 2.62 of the EM to TLAB 2014:

> *"Having regard to the decision in Qantas, in many cases there is still 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. If this is the case, there could be a decreasing adjustment even if there is no reimbursement of the*

[30] This refers to the High Court case, *Commissioner of Taxation* v *Qantas Airways Ltd* [2012] HCA 41, where the majority found that GST is payable by Qantas when a customer books and pays for domestic air travel but does not turn up for the flight and forfeits the fare.

consideration paid for the supply that was cancelled. If the intending supplier has passed on GST to its customer and not reimbursed the customer, such a decreasing adjustment would provide it with a windfall gain. This provision prevents such an outcome by reducing the decreasing adjustment of the supplier to the extent the GST has been passed on and not reimbursed. The provision also limits increasing adjustments for registered recipients."

Review Rights

As excess GST is included in a taxpayer's assessed net amount (being deemed to have always been payable and on a taxable supply), taxpayers may object against their assessment under Part IVC of the TAA should the Commissioner refuse to exercise his discretion to pay a refund.

In addition, subsection 110-50(2) of Schedule 1 to the TAA was amended to treat a refusal by the Commissioner to make the requested decision under subsection 142-15(1) (that is, to exercise his discretion), as a reviewable decision. This gives taxpayers a separate right of review under Part IVC of the TAA.

Conclusion

Division 142 seeks to overcome perceived weaknesses in section 105-65. It does so through the use of deeming provisions which extend the range for the restriction of refunds. But things are not always what they seem and time may yet uncover weaknesses in what Division 142 has sought to remedy.