An evaluation of the new GST refunds regime

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The new GST refunds regime in Div 142 of the A New Tax System (Goods and Services Tax) Act 1999 operates so as to restrict suppliers from recovering overpaid or over reported GST in circumstances where the burden of the excess amount has been "passed on" to recipients of supplies. The reforms followed years of uncertainty for the Commissioner and taxpayers in applying the previous restriction on GST refunds provision set out in s 105-65 of Sch 1 to the Taxation Administration Act 1953. The new regime includes a number of improvements, including a (qualified) input tax credit entitlement for recipients where the supplier has overcharged GST and is denied a refund under Div 142. Ongoing uncertainties include interpreting the meaning of "passed on" and the extent to which the High Court sales tax decision of Avon Products Pty Ltd v Commissioner of Taxation (2006) 230 CLR 356; [2006] HCA 29 will be applied in the GST context.

INTRODUCTION

Division 142 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) is the new regime dealing with refunds of "overpaid" GST. Broadly, Div 142 applies to restrict the refund of an amount of GST mistakenly included in a taxpayer's assessed net amount in certain circumstances. Specifically, the amount will not be refunded by the Commissioner of Taxation to the taxpayer if the burden of the GST has been "passed on" by the taxpayer to the recipient of the supply.

Between August 2012 and June 2013, several iterations of Div 142 (initially, proposed Div 36 of the GST Act) were canvassed, culminating in the *Tax Laws Amendment (2013 Measures No 4) Bill 2013* which lapsed when Parliament was prorogued on 5 August 2013 for the federal election. Public submissions reflect concern that the provisions would have been excessively restrictive, arbitrary, unfair and likely to give rise to an array of unintended outcomes.[1] There were also concerns about the retrospective effect of the Division, which was to apply to tax periods commencing after 17 August 2012.[2]

The new government published a revised exposure draft of proposed Div 142 of the GST Act in February 2014 and, on 27 March 2014 the *Tax Laws Amendment (2014 Measures No 1) Bill 2014* (the Bill) was introduced into the House of Representatives, accompanied by a revised explanatory memorandum (the EM). The Bill was widely seen as an improvement on earlier drafts, particularly as it removed the application date of 17 August 2012 and contemplated that Div 142 would apply prospectively from the date of Royal Assent.

On 30 May 2014, the *Tax Laws Amendment (2014 Measures No 1) Act 2014* (the Act) received Royal Assent and Div 142 of the GST Act came into effect. The Division applies to tax periods commencing on or after 31 May 2014 (the day following Royal Assent). The previous GST refunds

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[1] The public submissions can be found at http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Refunding-excess-GST/Submissions.

[2] The former proposed provisions relating to proposed Div 36 and, subsequently, proposed Div 142 are not discussed in detail in this article. Those provisions and explanatory memoranda are available on the Treasury website: http://www.treasury.gov.au.

regime found in s 105-65 of Sch 1 to the *Taxation Administration Act 1953* (TAA) continues to apply in relation to net amounts for tax periods commencing on or prior to 30 May 2014, and will be repealed on 1 July 2018.[3]

In order to understand Div 142, it is necessary to appreciate the history of the restriction on refund provisions in the GST law, which will continue to apply throughout a lengthy transitional period. Some of the challenges faced by the Commissioner and taxpayers in applying s 105-65, which ultimately culminated into a need for comprehensive reform, are discussed below.

PROBLEMS WITH S 105-65

As noted above, the old GST refund provisions are set out in s 105-65 of Sch 1 to the TAA. That section continues to apply to tax periods commencing on or before 30 May 2014. As described below, the drafting of the section has created difficulties for both taxpayers and the Commissioner and has been the subject of several amendments in recent years. The section will continue to apply to tax periods commencing on or before 30 May 2014 and an understanding of how the section operates is important for taxpayers seeking refunds of GST in respect of those periods.

> In the absence of s 105-65, a taxpayer that identified an overpayment of GST and consequently amended a Business Activity Statement (BAS) to take account of the error and reduce the amount of GST payable would be entitled to a refund of the GST under s 8AAZLF of the TAA and s 35-5(1) of the GST Act. This default position of entitlement to a refund of overpaid GST was modified by s 105-65, which states that the Commissioner "need not" refund the overpaid amount in circumstances where a transaction or supply was incorrectly treated as taxable to any extent and, either the amount of overpaid GST had not been reimbursed to the recipient of the supply or the recipient of the supply was registered or required to be registered. The words "need not" indicate that the Commissioner had a residual discretion to pay the refund in appropriate circumstances.

The policy reason for a provision that restricts GST refunds is that when the GST regime operates as intended, it imposes a tax on final consumers, not businesses. Consequently, in theory at least, consumers bear the burden of the GST, not the businesses that are liable to remit the tax. It follows that if the supplier has charged an amount of GST to a customer only to discover that no GST was payable in the circumstances, the "better" approach is often for the supplier to be denied a refund by the Commissioner. Otherwise, the undeserving supplier would receive a windfall gain. The supplier should only receive a refund if it has reimbursed the customer for the GST or if it can be demonstrated that the supplier has not "passed on" the GST to the customer. The concept of "passing on" is discussed in more detail below.

Problems for the Commissioner

Section 105-65 has proven to be a problematic provision for the Commissioner, as evidenced by a number of adverse outcomes in cases heard by the Administrative Appeals Tribunal and Federal Court. A number of these outcomes have been addressed by way of amendments to s 105-65.[4] Some of the unresolved issues with s 105-65, from the Commissioner's perspective, include the following:

- The restriction only applies where the overpayment is a result of the taxpayer incorrectly treating a supply or arrangement as taxable to any extent. It does not apply to miscalculations in circumstances where, for example, a supply was always treated as fully taxable. This is apparent on the face of the drafting of the section, but was also confirmed in *International All Sports v*

[3] The old provisions will continue to apply after the date of repeal to tax periods commencing on or prior to 30 May 2014; eg where the taxpayer has lodged a valid notice under s 105-55 of Sch 1 to the *Taxation Administration Act 1953* keeping the period open beyond the default statutory time limits; see para 2.99 of the Explanatory Memorandum.

[4] See, in particular, amendments under the *Tax Laws Amendment (2008 Measures No 3) Act 2008* with effect from 1 July 2008 to address the decision in *KAP Motors Pty Ltd v Commissioner of Taxation* [2008] FCA 159 that s 105-65 did not apply where an "arrangement" was treated as a taxable supply but there was no supply at all.

Commissioner of Taxation [2011] FCA 824 (the *Sportsbet* case).[5] Prior to the decision in the *Sportsbet* case, the Commissioner took the view that s 105-65 applied to miscalculations as well as mischaracterisations.[6]

- Section 105-65 only applies where there has been an overpayment of GST or where an amount has not been refunded due to the incorrect treatment of a supply as a taxable supply (s 105-65(1)(a)). Historically, there have been doubts as to whether there has been an overpayment in circumstances where the incorrect "GST" has been offset by input tax credits that were incorrectly claimed, resulting in an understated net amount; ie in circumstances where the taxpayer has not paid more than it was required to pay and has not received a refund that was less than it was entitled to receive.[7] This situation was canvassed in *Re Naidoo and Commissioner of Taxation* [2013] AATA 443 (the *Naidoo* case) and the tribunal found that in those circumstances there is no overpayment of GST for the purposes of s 105-65 and the section does not apply.

Problems for taxpayers and related amendments

Two recent cases in the tribunal have also had significant repercussions for taxpayers in respect of the tribunal's jurisdiction to review decisions made by the Commissioner pursuant to s 105-65. In *Re The Private Tutor and Commissioner of Taxation* [2013] AATA 136 (the *Private Tutor* case), the tribunal made some comments about s 105-65 that, while not strictly relevant to the outcome of that matter, nonetheless conveyed the view of Deputy President Frost that refunds denied by the Commissioner under s 105-65 do not form part of that taxpayer's "net amount" for the relevant tax period. It followed that a decision made under s 105-65 was not an objection decision for the purposes of s 14ZZ of the TAA and did not fall within the jurisdiction of the tribunal's review.[8] This was reiterated shortly after in the *Naidoo* case, where the issue squarely arose, confirming that taxpayers had no Pt IVC review rights in respect of a s 105-65 decision.[9]

This created significant issues for taxpayers who were dissatisfied with a decision made by the Commissioner. While a taxpayer could commence judicial review proceedings in the Federal Court under the *Judiciary Act 1903* and the *Administrative Decisions (Judicial Review) Act 1977*, those proceedings were likely to be more costly, the threshold to be met by taxpayers seeking to have a decision overturned would be higher and the approach would be unchartered territory for taxpayers as all s 105-65 cases had proceeded under Pt IVC of the TAA, (as do most tax disputes).

Consequently, the Act introduced amendments that had the effect of making decisions made under s 105-65 reviewable in the manner set out in Pt IVC of the TAA (s 105-65(4) of Sch 1 to the TAA).

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[5] Much is made in the Explanatory Memorandum of the consequences of the *Sportsbet* case including, for example, paras 2.17-2.19.

> 3.15 Prior to the Federal Court of Australia's decision in *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.
>
> 3.16 The effect of the *Sportsbet* decision is that the restriction in section 105-65 does not apply where the supply is always correctly characterized and treated by the supplier, but an overpayment of GST arises from a miscalculation of the GST payable.

Certainly, this outcome is confirmed by the *Sportsbet* case, but arguably it is not "the effect" of the *Sportsbet* case. It is clear that, on a plain English reading of s 105-65, it does not apply to supplies or arrangements that were always characterised correctly by a taxpayer.

[6] See Explanatory Memorandum at para 2.17. See also MT 2010/ 1, paras 23-25D, for the situations where the Commissioner considered s 105-65 of Sch 1 to the *Taxation Administration Act 1953* applied and did not apply and, in particular, his change in view in relation to the situation where the supply was always correctly characterised as a taxable supply, but an overpayment of GST arose from a miscalculation. The Commissioner refers to the decision in the *Sportsbet* case as supporting his change in view so that s 105-65 did not apply to mere miscalculations, however, it is questionable whether that case supports that proposition and therefore, the Commissioner's change in view. Similarly, Treasury's reference to the *Sportsbet* case as having resulted in miscalculations not being covered by s 105-65 of Sch 1 to the *Taxation Administration Act 1953* appears to be misplaced.

[7] See Explanatory Memorandum at para 2.21.

[8] *Re The Private Tutor and Commissioner of Taxation* [2013] AATA 136 at [20].

[9] See discussion in Lazanas G and Thomas R, "The Private Tutor and Naidoo – Two Tribunal Cases on s 105-65, Net Amount, Overpayment and Jurisdiction" (2013) 13 AGSTJ 84.

This will assist taxpayers seeking review of decisions on restrictions of GST refunds made in respect of tax periods commencing on or before 30 May 2014.

DETAILED ANALYSIS OF THE NEW DIV 142

Division 142 has been inserted into the GST Act rather than the TAA. Division 142 forms part of "the special rules" in Pt 4-4 of Ch 4 of the GST Act which are described in the heading as "mainly about net amounts and adjustments". According to s 45-1 of the GST Act, which introduces the special rules, they "apply only in particular circumstances, and are generally quite limited in their scope". They also "modify the application of the basic rules for the GST in Chapter 2".[10] The shift from the TAA (where the old s 105-65 resided) to the GST Act reflects a change in approach in the treatment of overpaid or over-reported GST from an amount that, though strictly not "GST", the Commissioner is nonetheless able to retain under the administrative provisions, to an amount that is transformed into "GST payable" under the provisions of the GST Act.

The provisions are set out in three subdivisions. Subdivision 142-A relates to "Excess GST unrelated to adjustments", Subdiv 142-B relates to "GST related to cancelled supplies" and Subdiv 142-C relates to "Passed-on GST". Each of these subdivisions will be discussed in turn.

Subdivision 142-A – Excess GST unrelated to adjustments

Application of the subdivision

Subsection 142-5(1) deals with the application of the subdivision and states the following:

> **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.
>
> Note: This Subdivision applies whether or not you have paid, or been refunded, the assessed net amount.
>
> Example: Sunny Co mistakenly reports a negative net amount of $4,000 made up of GST of $10,000 less input tax credits of $14,000. In fact, Sunny Co's GST should have been $8,000 making its negative net amount $6,000. Sunny Co has excess GST of $2,000.

The application of s 142-5(1) will be significantly wider than the application of the old s 105-65 of Sch 1 to the TAA. The new provision has relieved the Commissioner of the burden of establishing whether there was a miscalculation or a mischaracterisation or whether there was an amount that was always treated as taxable or always treated as GST-free to some extent or to the same extent. Subdiv 142-A will apply in circumstances where the "assessed net amount for a tax period takes into account an amount of GST exceeding that which is payable". Section 195-1 of the GST Act states that the "*assessed net amount* for a *tax period, means the *net amount *assessed for the tax period".[11] In other words, Div 142 will be relevant in all circumstances where the taxpayer overstated the GST component of the "GST – Input tax credits" calculation of the net amount for a tax period (subject to amounts covered by subsection (2), discussed below).[12]

Importantly, unlike the old s 105-65 of Sch 1 to the TAA, the new provisions extend much further than denying refunds on overpayments. They apply when the *assessed net amount* (ie the net amount assessed for a tax period) includes more GST than that which is payable, whether that amount has actually been overpaid or not. If the taxpayer mistakenly reports the amount and is accordingly

[10] The decision to change the proposed division from Div 36 to Div 142 effectively moved the provisions from "The Basic Rules" (Ch 2) to "The Special Rules" (Ch 4) of the *A New Tax System (Goods and Services Tax) Act 1999*.

[11] Section 17-5 of the *A New Tax System (Goods and Services Tax) Act 1999* sets out the net amount formula.

[12] It is noted for completeness that Div 142 applies to excess GST, not understated input tax credits, and Div 142 will not apply to prevent a taxpayer from receiving a refund of input tax credits or a reduction in the taxpayer's net amount on the basis that it understated its input tax credit entitlement.

assessed on it pursuant to the self-assessment regime for indirect taxes, but has not paid the amount, the Commissioner can require the amount to be paid.[13]

As the taxpayer is not the only party that can assess the taxpayer's net amount for a period, they are not the only party whose mistake can trigger the application of Subdiv 142-A. The Commissioner can also make a mistake in assessing the taxpayer and cause an amount of excess GST to be included in the taxpayer's assessed net amount under Div 142. Even if the Commissioner's view that the GST was payable is set aside on objection, or is overturned by the tribunal or courts on review or appeal; Div 142 may still apply so as to make the taxpayer liable to pay any excess GST incorrectly assessed by the Commissioner. This is confirmed (though somewhat indirectly) by Example 2.11 in the EM:

> **Example 2.11: 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 (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 Commissioner 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 these amendments.
>
> The amendments apply as Jenny's assessed net amount for the tax period (the first amended assessment) takes into account an amount of GST exceeding that which is payable. In applying the amendments, 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 the amendments do not apply. Accordingly the Commissioner further amends Jenny's assessed net amount (second amended assessment) to reflect the favourable objection decision.

Conveniently for Jenny in the above example, as no GST was passed on to the recipient of the supply, Subdiv 142-A does not apply so as to require Jenny to pay the amount that was incorrectly assessed by the Commissioner. By implication, however, had the Commissioner been satisfied that the amount had been passed on by Jenny to her customers, the Commissioner's error would have resulted in Jenny incurring a GST liability that she would not have otherwise incurred. This leads to an outcome where the Commissioner can incorrectly assess a taxpayer for an amount of GST and, in doing so, that amount is transformed into GST payable under Div 142, regardless of what the tribunal or the courts have to say about the correctness of the Commissioner's assessment.

The government has previously been alert to this issue, and in a consultation paper titled "Implementation of the Recommendations of the Board of Taxation's Review of the Legal Framework for the Administration of the GST" dated September 2009, the Treasury stated that in the context of s 105-65, it would be appropriate for the Commissioner to exercise his discretion to pay a refund where:

> the overpayment of GST has directly resulted from actions of the Commissioner. In particular, where the supply was originally treated as non-taxable, the Commissioner has assessed the supplier on the basis that it is taxable, but the assessment is overturned on objection or appeal.[14]

Contrary to this statement, under Div 142, the Commissioner will have no discretion to refund the GST to the taxpayer if the taxpayer is taken to have "passed on" the GST and, in the Commissioner's

[13] The words "refund" and "overpayment" are used throughout this article for convenience. However, it is noted that references to the taxpayer "overpaying GST" are to the taxpayer overstating the GST in its net amount calculation and references to the taxpayer obtaining a "refund" are references to the taxpayer reducing the GST that has formed part of its net amount calculation.

[14] The Treasury, Commonwealth of Australia, "Implementation of the Recommendations of the Board of Taxation's Review of the Legal Framework for the Administration of the GST" (September 2009) para 2.8.9.

view, the taxpayer would receive a "windfall gain". It is unclear why Treasury's views on how such a scenario should be dealt with have changed. Arguably, it would be a harsh and arbitrary outcome for taxpayers who took the correct view of the law in reporting their GST to be required to pay more GST because of an error on the part of the Commissioner.

Similarly, there will be no relief for taxpayers who overpay amounts of GST in reliance on the Commissioner's mistaken views, for example, based on incorrect views stated in public rulings that are later revised or overturned. It follows that Div 142 may, in some circumstances, present a disincentive for taxpayers to comply with the Commissioner's published views on contentious issues, as there will be no relief in the event that the Commissioner is proven to be incorrect.

As a consequence of the new changes, the point in time at which Subdiv 142-A will become relevant will be at an earlier stage than under s 105-65 of Sch 1 to the TAA. In the context of disputes with the Commissioner, s 105-65 was often only a concern once the taxpayer was at risk of "overpaying" an amount. For example, the application of s 105-65 could create problems for a taxpayer that paid an amount of disputed GST so as to prevent the Commissioner from commencing debt recovery proceedings or as part of a "50/50 arrangement" to minimise a taxpayer's potential interest liabilities. In contrast, the point in time at which Subdiv 142-A will become relevant is as soon as the disputed GST is assessed, which generally will be on the lodgement of GST returns (ie Business Activity Statements) or where the Commissioner issues or amends an assessment. It follows that the Commissioner will be able to require payment or commence recovery proceedings to recover disputed GST that is incorrectly assessed and is not required (or may not be empowered) to refund that GST if the assessment is set aside or overturned.

Subsection 142-5(2) describes the amounts that are disregarded for the purposes of Subdiv 142-A as follows:

> (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.

The effect of s 142-5(2)(a) is to quarantine amounts included in the "assessed net amount for a tax period" that were correctly payable and attributable to that tax period, but that are the subject of decreasing adjustments, presumably on the basis that these amounts may otherwise fall within the ambit of both Divs 19 and 142. Confusingly, it is difficult to see how such an amount could fall within the ambit of s 142-5(1) in any event, as a later decreasing adjustment would be attributable to the later tax period in which the adjustment event occurs and the assessed net amount for the earlier tax period (the tax period referred to in s 142-5(1)) would be unaffected. Nonetheless, the purpose of the carve-out is apparently to give primacy to the adjustment provisions in Div 19 of the GST Act in circumstances where the provisions overlap[15] (though it is noted that Subdiv 142-B does impact some decreasing and increasing adjustments).

The exclusion of amounts that have been assessed in the wrong period is an obvious one, as in most cases (subject to time limits on recovery etc), even if the taxpayer has passed on the GST, the taxpayer will remain liable to report and pay the GST in the correct period. The effect of s 142-5(2)(b) is simply to avoid requiring taxpayers to remit the GST in two different tax periods.

(Not) refunding excess GST

The most important provision in Subdiv 142-A is s 142-10, which treats an amount of excess GST as identified in s 142-5 (the *excess GST*) as an amount of GST that has always been payable on a taxable supply. Section 142-10 states:

> **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

[15] See Explanatory Memorandum at paras 2.42 to 2.44.

(b) on a *taxable supply;

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

Note 1: If you reimburse the passed-on GST so that this section ceases to apply there will be an adjustment event under paragraph 19-10(1)(b) or (c). You will have a decreasing adjustment (see section 19-55) and the other entity may have an increasing adjustment (see section 19-80).

Note 2: Any excess GST you have not passed on will be refunded as described in section 155-75 in Schedule 1 to the *Taxation Administration Act 1953*.

Note 3: While this section applies, paragraph 11-5(b) (about taxable supplies) is satisfied for the corresponding acquisition by the other entity.

The term *taxation law* is defined in s 995-1 of the *Income Tax Assessment Act 1997* as follows:

"taxation law" means:

(a) an Act of which the Commissioner has the general administration (including a part of an Act to the extent to which the Commissioner has the general administration of the Act); or
(b) legislative instruments made under such an Act (including such a part of an Act); or
(c) the *Tax Agent Services Act 2009* or regulations made under that Act.

Consequently, when an amount is deemed by s 142-5 to be GST that is payable, it is treated as GST for the purposes of all the taxation laws administered by the Commissioner including, relevantly, the TAA, which deals with the collection and recovery of GST.

Importantly, the provision only applies where, first, an amount of excess GST has been "passed on" to another entity and, secondly, the amount has not been reimbursed to the other entity.

Reimbursement by the supplier

When the excess GST is reimbursed by the supplier, Subdiv 142-A will not apply so as to deny the taxpayer a refund. It is a matter for the reimbursed entity to ensure that it accounts for any increasing adjustment that arises once it has received a reimbursement of the GST from the supplier. "Note 1" to s 142-10 states that if the supplier reimburses the passed-on GST, the supplier will have a decreasing adjustment and the recipient may have an increasing adjustment.

It is noted that no increasing adjustment would have previously arisen for the recipient, and no decreasing adjustment would have previously arisen for the supplier, in circumstances where there was no actual change in the amount of GST payable on the supply for the purposes of calculating the adjustment amount under ss 19-50 and 19-55 of the GST Act. That is, if a supply was incorrectly treated as taxable where it was in fact GST-free, no GST was ever payable on the supply and therefore there was no change in the GST amount for the purposes of calculating an increasing or decreasing adjustment. However, as s 142-10 has the effect of treating the excess GST as GST that was always payable on a taxable supply "until you reimburse the other entity", even where a supply was never taxable under the basic rules, there *will* be a change in the amount of GST payable on the supply once the GST is reimbursed for the purposes of calculating adjustments.

The words, "until you reimburse the other entity" are also significant as they indicate that a taxpayer cannot amend an earlier BAS and claim interest on an overpayment of GST in relation to the period leading up to the reimbursement. That is, the GST was always payable until the reimbursement took place.

"Taken to have always been payable" – inclusion in the assessed net amount and review rights

Section 142-10 provides that so much GST that has been passed on to another entity is taken to have *always been payable* until the other entity is reimbursed. Consequently, as with any amount of GST payable, the amount will be included in the entity's net amount calculation. As the excess GST forms part of the net amount calculation, the taxpayer's rights of review and appeal under Pt IVC of the TAA will be triggered.

"On a taxable supply"

Under Div 142, recipients of supplies that give rise to excess GST taken to have "always been payable" will be entitled to claim corresponding input tax credits in respect of that GST.[16] Realistically, it is likely that in many cases where the supplier has treated the supply as taxable and issued a tax invoice, the recipient will have already claimed the input tax credits, even if there was no strict entitlement to do so under the GST Act (eg because the supply to the recipient was not taxable or not taxable to the extent demonstrated by the tax invoice). The Commissioner has historically had an administrative policy of not always reversing the GST treatment of transactions where the recipient has over claimed input tax credits equivalent to overpaid GST where the overpaid GST is not refunded.[17] This practice statement which is not legally binding on the Commissioner and which was withdrawn with effect from 15 September 2008 (though somehow continues to apply to a limited extent) provides limited comfort for recipients as to their entitlements to input tax credits.

Section 142-10 will create an input tax credit entitlement for eligible recipients under the GST Act in the same way that it creates a legal liability for the supplier to remit the GST, namely, by treating the excess GST as always having been payable on a *taxable supply*. It is stated in the EM:

> Such a recipient can continue to treat the excess 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 excess GST as having always been payable and always on a taxable supply. This is designed to preserve the GST outcomes of the original treatment, despite including excess GST and to clarify that the recipient can claim an input tax credit in relation to the acquisition. However, the recipient may have an increasing adjustment where the excess GST is reimbursed to it.[18]

Note 3 has also been inserted into s 142-10, which states that, "[w]hile this section applies, paragraph 11-5(b) (about taxable supplies) is satisfied for the corresponding acquisition by the other entity". Consequently, the provisions will give rise to a substantive input tax credit entitlement for the recipient.

However, this position in relation to the recipient's entitlement to claim input tax credits is modified by s 142-15(5), which states:

> *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.
>
> Note: Section 142-10 still applies for the purposes of applying taxation laws to you.

Curiously, the provision addresses "you" being the supplier, whereas it is in fact a subsection that deals with the entitlements of the recipient. Moreover, it is interesting that a provision that deals with input tax credit entitlements is tucked away in Div 142 of the GST Act that deals with "Refunding excess GST" and no reference to this subsection is made in Div 11 of the GST Act, which deals with the input tax credit entitlements of the recipient.

The purpose of this provision is the prevention of contrived arrangements which give rise to exposure to the revenue. Such an arrangement may exist where a supplier purports to make taxable supplies but does not do so (eg because it is not carrying on an enterprise) but, nonetheless, the effect of s 142-10 is to treat the excess GST as payable, and to give rise to an input tax credit for the

[16] Explanatory Memorandum at paras 2.63-2.65.

[17] This is set out in PS LA 2002/12 *Refunds of GST Incorrectly Included in the Price of Non-taxable Supplies*. While the practice statement was withdrawn with effect on 15 September 2008, it contains a statement that notwithstanding the withdrawal, "the Commissioner will continue to abide by the approach described in PSLA 2012/2, that is not to require reversal of transactions where a supply or arrangement that occurs solely between registered entities has been incorrectly treated as a taxable supply, provided certain conditions are met."

[18] Explanatory Memorandum at para 2.64.

recipient, even if the GST is never paid by the supplier to the Commissioner. However, the provision itself does not clearly express this intention and, curiously, the EM provides no examples of how this provision might work in practice.[19]

Arguably, the drafting of this provision is broad and incomprehensively vague. While it may be targeted towards contrived arrangements, it may apply in a much wider range of scenarios. For example, a recipient may make an acquisition from a supplier at arm's length and, upon receipt of a tax invoice, claim its input tax credits. The recipient may come to "know" that the supplier has not remitted the GST for any number of reasons. It may become aware of proceedings between the supplier and the Commissioner in the courts or it may be notified that the supplier has gone into liquidation. It is unclear why, in respect of an arm's length transaction, this should disentitle the recipient to its input tax credits. This is an arbitrary outcome, where the recipient has not been involved in any contrivance or collusion with the supplier.

The effect of the word "while" is also unclear. Does this mean that if a recipient does not know that the supplier has not remitted the GST it may claim its input tax credits, but if the recipient becomes aware that the GST has not been remitted, is it required to pay the input tax credits back to the Commissioner? Does it also mean that if a recipient knows the GST hasn't been remitted, but makes no further enquiries for a period of time, it may cease to know, and the input tax credits can be claimed? And, in what circumstances will a recipient be "reasonably expected to have known" whether the supplier has remitted the GST or not? These questions are not answered by the provision or the EM, making the subsection very difficult to apply in practice.

Section 142-15 generally deals with circumstances where s 142-10 does not apply. The other subsections in s 142-15 are discussed below.

Circumstances when s 142-10 does not apply: Section 142-15

The approach of treating amounts that were not payable under the substantive provisions of the GST Act as though they were always payable has a ripple effect that impacts the supplier, the recipient and other entities in the supply chain. The subsections in s 142-15 attempt to deal with this ripple effect to an extent.

Subsections 142-15(1) and 142-15(2) – The Commissioner's Discretion

Div 142 confines the Commissioner's discretion to pay a refund to very specific circumstances. The discretion is contained in s 142-15(1) and s 142-15(2), which state:

> *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.
>
> Note: Refusing to make the requested decision is a reviewable GST decision (see Subdivision 110-F in Schedule 1 to the *Taxation Administration Act 1953*).

The language used in this provision is unusual. The section instructs the taxpayer to "*treat*" s 142-10 as never having applied in certain circumstances (which is, in itself, a strange alternative to simply stating that the section does not, in fact, apply in those circumstances), but then qualifies this instruction by requiring the taxpayer to obtain the consent of the Commissioner in order to do so. It uses the language of "self-assessment" in circumstances where a taxpayer must effectively request that the Commissioner expressly grant the refund.

The language is also curious in that the section states that s 142-10 should not apply where the denial of a refund of the excess GST to the supplier would be "inconsistent with the principle that excess GST is not to be refunded if this would give an entity a windfall gain". Arguably, denying a refund to a taxpayer who would not receive a windfall gain would not be "inconsistent with the principle that excess GST is not to be refunded if this would give an entity a windfall gain". It simply

[19] See brief discussion in Explanatory Memorandum at para 2.65.

would *not give effect* to that principle. The section might have been more clearly and accurately expressed if it had adopted the language used at para 2.55 of the EM: "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 term "windfall gain" is unique to Div 142 and is undefined. It is a phrase that must, therefore, be interpreted with reference to its ordinary meaning and will likely lend itself to differing interpretations as between taxpayers and the Commissioner. For example, it is not clear whether the "windfall gain" is to be gauged by reference to an individual transaction or by analysing the broader implications for a supplier. It is possible that the mistaken "passing on" of GST on a non-taxable supply might actually lead to a supplier losing business, preventing any windfall gain in overall terms.

The EM further complicates matters by suggesting that the windfall gain may arise for a party other than the supplier requesting the refund, such as the recipient of the supply. In this respect, the EM states at para 2.56:

> Although less common, there could also be cases where a refund could lead to a windfall gain for another entity – for example, a recipient 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.

This is a somewhat strange observation, as it presupposes that the supplier is going to reimburse the recipient for the excess GST, which would mean that s 142-10 ceases to apply and the discretion in s 142-15, including the question as to whether there is a windfall gain for any party, would be irrelevant. The suggestion here is perhaps that an exercise of the discretion may be sought where the supplier has *not* reimbursed the recipient for cash flow reasons but it has undertaken that it *will* do so once it has the benefit of the refund and such an undertaking would be sufficient to satisfy the Commissioner that the supplier will not receive a windfall gain.[20] However, the supplier would be required to satisfy the Commissioner that the recipient in that scenario, or whatever party in the supply chain ultimately has the benefit of the refund, would not receive a windfall gain either. Apart from the reference to "another entity" in the paragraph cited above, no example is provided as to how another party's windfall would be relevant to the exercise of the discretion in practice.

Notably, the discretion in s 142-15(1) operates so as to treat s 142-10 as "never having applied", meaning that in order to exercise the discretion, the original assessed net amount must be amended in order to give effect to the decision, rather than attributing a decreasing adjustment to a later period. It follows that the timing of the application of s 142-15(1) will be limited by the "period of review" that is set out in the amendment provisions at s 155-35 of Sch 1 to the TAA. Once that period of review expires, s 142-10 will continue to apply so as to treat amounts as having "always been payable", but the Commissioner's discretion will no longer be available, as there will be no power to amend the relevant assessment.[21]

Paragraph (a) of s 142-15(1) states that the Commissioner must be satisfied of the relevant matters and para (b) of s 142-15(1) in turn provides that a request for the Commissioner to exercise the discretion must be made in the approved form. It is unclear why the requirement for the Commissioner to be satisfied has been included in s 142-15(1) rather than allowing the taxpayer to self-assess in circumstances where the requirements are satisfied, just as the taxpayer would self-assess if it took the view that the GST was not passed on or that it had reimbursed the recipient. Requiring the Commissioner to "be satisfied" in those circumstances, but not in respect of s 142-15, is a

[20] This intention was expressed more clearly (though still somewhat vaguely) in the exposure draft of Div 142. There, the discretion was described in s 142-10(3) as applying where the Commissioner is satisfied that a 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".

[21] The timing provisions apply similarly in respect of s 142-15(3).

contradictory approach that appears to serve very little purpose, particularly having regard to changes brought about by the self-assessment provisions for indirect taxes which started on 1 July 2012.[22]

Some guidance has been provided in the EM as to how the provision will apply in practice. The following is one of three examples that are provided as to how the discretion might be exercised and one of two examples of where the discretion would be exercised:

> **Example 2.12 Commissioner's discretion and wrong entity**
>
> Entities Lintoned and Benwell own a commercial property as tenants in common. Each carries on a separate enterprise and is registered for GST.
>
> Entities Lintoned and Benwell each sell their 50 per cent interest in the property (with vacant possession) to Neville Co for a price of $50,000 plus $5,000 GST each. Entities Lintoned and Benwell each remit GST of $5,000.
>
> Neville Co is registered for GST and claims two input tax credits of $5,000 each.
>
> The Commissioner reviews the transaction and decides that Entities Lintoned and Benwell are operating an enterprise as a tax law partnership. The tax law partnership is a separate entity for GST purposes. The Commissioner therefore assesses the partnership for underpaid GST of $10,000. The partnership duly pays the $10,000.
>
> 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.

This is a straightforward and non-controversial example of where a supplier should be entitled to a refund and the situation would not be suitably addressed by the other provisions in the Division.

The second example demonstrates the very limited circumstances in which the Commissioner will exercise the discretion, by suggesting that his approach will not take into account commercial considerations, such as where a taxpayer is required to lower its prices in order to compete with other suppliers in the market and, therefore, arguably, bears the burden of the GST:

> **Example 2.13 Commissioner's discretion**
>
> Supermarket A introduces a new product which it classifies as subject to GST, but which is correctly GST-free. It includes GST from the outset in the price of the product, which it sells to a large number of customers. The product is also marketed by other supermarkets who are correctly classifying the product as GST-free, so, after a few months, Supermarket A finds that it needs to reduce the price it charges for the product compared to its competitors.
>
> Shortly afterwards, Supermarket A is advised that the product is GST-free, but it is not cost-effective to try to locate customers to provide a reimbursement of the overcharged GST.
>
> Supermarket A considers that it has passed on the excess GST. It makes a request in the approved form for the Commissioner to exercise the discretion under the amendments to pay a refund of the excess GST, on the grounds that it was disadvantaged in the market place by its mistake, and has lost sales and profitability as a result.
>
> In order to exercise the discretion, the Commissioner needs to be satisfied that applying the amendments would be inconsistent with the principle that a refund of excess GST should not give an entity a windfall gain.
>
> The Commissioner forms the view that as the GST has been passed on, a windfall gain has arisen to Supermarket A. Accordingly, the Commissioner decides not to exercise the discretion under the amendments. If Supermarket A is in doubt whether it has passed on the excess GST, it could ask the Commissioner for a private ruling about the matter.

[22] See also Treasury, *Review on Aspects of Income Tax Self Assessment Discussion Paper* (March 2004) Recommendation No 6.3, in the context of a review of the self-assessment of income tax, where it is stated "Treasury should conduct a detailed review of discretions that go to the determination of a taxpayer's liability and, wherever practical, recommend replacement tests that a taxpayer can apply at the time of lodgement".

The preliminary question that is glossed over in this example is whether Supermarket A has in fact passed on the GST to its customers. Putting that issue to one side, the example seems to indicate that an assessment of whether there has been a "windfall gain" will not take into account broader economic considerations.

It is noted in this regard that the Board of Taxation in its report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs titled, *Review of the Legal Framework for the Administration of the Goods and Services Tax* dated December 2008 recommended that "[t]he law should be amended to clarify that the Commissioner has a discretion to refund the GST where appropriate".[23] This was a recommendation with which the government agreed.[24] Arguably, there remains a necessity for the Commissioner to retain his discretion in other circumstances that are not covered by s 142-15(1). An example of where the Commissioner's discretion to pay the refund should be exercised is where the "excess GST" has only arisen as a consequence of an error as to the application of the law on the part of the Commissioner (as agreed by Treasury in its Second Consultation Paper, referred to above).

Section 142-15(3) – no supply

There is a carve-out in s 142-15(3) for excess GST that was treated as payable on a supply where there was no supply at all and passed on to the recipient, but it only applies in circumstances where the excess GST has been reimbursed. If the GST has not been reimbursed, s 142-10 applies so that the GST is taken to have always been payable. If the GST is reimbursed, s 142-10 is treated as never having applied. The section states:

> *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.
>
> Note: If you reimburse the passed-on GST, you will be refunded an equivalent amount as described in section 155-75 in Schedule 1 to the *Taxation Administration Act 1953*.

Essentially, the effect of this provision is that there will be no adjustment event in relation to the reimbursement of the GST, as rather than s 142-10 applying "until the recipient is reimbursed", which is the language of s 142-10, the provision will not apply at all. The correct approach to obtaining the refund will be for the supplier to amend the Business Activity Statement which included the amount in the assessed net amount (rather than taking up a decreasing adjustment in the later tax period) and the recipient must amend its assessed net amount to reflect that it had no entitlement to the corresponding input tax credits.

The requirement to amend the "original" assessed net amount, rather than applying a decreasing adjustment in a later tax period, will mean that the supplier will have a reduced period of time in which to obtain a refund. This is because s 155-35(2) of Sch 1 to the TAA generally imposes a four-year period of review from the day on which the Commissioner gave notice of the assessment. That time limit does not apply in relation to decreasing adjustments, as an adjustment event can occur in any subsequent period.[25]

Section 142-15(4) – no input tax credit entitlement for the supplier

The supplier will not have the benefit of being able to treat its supply to the recipient as taxable for the purposes of determining whether it has a creditable purpose in relation to its acquisitions. In this regard, s 142-15(4) states:

[23] Board of Taxation, Australian Government, *Review of the Legal Framework for the Administration of the Goods and Services Tax*, A Report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs (December 2008) Recommendation No 45.

[24] Bowen MP, the Hon Chris, Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, "Government Response to Board of Taxation Review of GST Administration", Media Release No 42 (12 May 2009).

[25] The statutory time limits apply to the adjustment commencing from the period to which the adjustment is attributable; ie the time limit is usually four years from the day the Commissioner gives notice of the assessment relating to the tax period in which the adjustment event occurs.

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.

This means that even if Div 142 applies so as to treat an amount of GST as payable on a taxable supply, if the supply isn't otherwise taxable under the substantive provisions of the GST Act, acquisitions made by the supplier in relation to that supply will not be acquired for a "creditable purpose" for the purposes of s 11-15 of the GST Act and the supplier will not be entitled to claim input tax credits in respect of those acquisitions.

This has the potential to seriously disadvantage some taxpayers. For example, a taxpayer may take the view that it is making taxable supplies of new residential premises. In circumstances where the Commissioner disagrees, the Commissioner can apply Div 142 so as to keep the GST on the taxpayer's supplies of the residential premises (which were not taxable) whilst denying the taxpayer any input tax credits in relation to the acquisitions relating to the supplies. This oppressive outcome demonstrates the dangers of disturbing the equilibrium between the treatment of supplies and acquisitions that is inherent in the substantive provisions of the GST Act.

Section 142-15(5) – if the recipient knows you haven't paid the excess GST

This provision has been dealt with above.

Subdivision 142-B – GST relating to cancelled supplies

The following section operates to prevent suppliers from making a decreasing adjustment in respect of cancelled supplies where GST passed on to the recipient of the supply has not been refunded:

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;

(c) 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).

The EM provided the following explanation (notes omitted):

2.61 Where there is an adjustment event as a result of a 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.

2.62 Having regard to the decision in *Qantas*,[26] 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 consideration paid for the supply that was cancelled. If the intending supplier had 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 amendments also limit increasing adjustments for registered recipients.

Interestingly, the decision in *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA 41 (the *Qantas* case)[27] is invoked to explain why this provision is necessary, notwithstanding that in the *Qantas* case the provision would not apply as the supply for which the consideration was paid was not

[26] *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA 41.

[27] *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA 41.

cancelled and there was no decreasing adjustment. In fact, the *Qantas* case demonstrates that it will only be a rare case, if it is ever the case that an amount of consideration is paid by a recipient and retained by a supplier in circumstances where no supply whatsoever has been made in connection with that consideration. In most cases there will, at least, be a supply of rights under an executory contract.

Quite unhelpfully, rather than illuminating the circumstances in which the section would apply, the guidance in the EM is limited to a scenario where the provision would *not* apply:

> **Example 2.14: Decreasing adjustment, cancelled supply**
>
> In September 2014 Bams Co makes a taxable supply of goods to FT Co for $55,000 and issues a tax invoice, which includes GST of $5,000.
>
> On 21 October 2014, Bams Co lodges its monthly GST return for the September 2014 tax period. Its assessed net amount takes into account the GST payable of $5,000 for the supply made to FT Co.
>
> In November 2014, FT Co returns all of the goods because they are defective and seeks a refund. Bams Co refunds $55,000. The return of goods and associated refund cancels the supply. This is an adjustment event. Bams Co has a decreasing adjustment of $5,000 attributable to the November 2014 tax period as a result of cancelling the supply, while FT Co has an increasing adjustment of $5,000.
>
> Since Bams Co has reimbursed all of the passed-on GST of $5,000 its decreasing adjustment is not reduced to any extent. Similarly, FT Co's increasing adjustment is not reduced by any extent.

By analogy, the section would apply to deny Bams Co a decreasing adjustment in circumstances where all the goods were returned because they were defective but Bams Co did not refund the recipient. In reality, this is a very unlikely scenario, which tends to confirm initial impressions that the section will likely be of very limited application.

Subdivision 142-C – passed-on GST

The meaning of "passing on"

While the Commissioner considered that the question of whether the GST was passed on to a recipient was relevant to the exercise of his discretion in s 105-65, the words were not used in that provision and were not specifically referred to in the cases that dealt with s 105-65. Arguably, however, the analysis as to when GST has been passed on in the context of Div 142 is fundamentally the same as the analysis that has been undertaken in respect of s 105-65. This is because, in both cases, the critical issue is whether the burden of the GST has passed from the supplier to the recipient of the supply. The EM states that this is "a question of fact and must be determined on a case by case basis taking into account the particular circumstances of each case".[28]

Division 142 allows a taxpayer (supplier) to self-assess a "refund" of excess GST where the GST was not passed on by the taxpayer to the recipient, as s 142-10 does not apply in those circumstances. The term "passed on" is not explicitly defined, but a definition has been inserted into the dictionary at s 195-1 of the GST Act which states that "passed on" has a meaning affected by s 142-25. The heading of s 142-25 seems to suggest that it will guide taxpayers in "working out" if the excess GST has been passed on, but it does not attempt to do so. It simply provides the following guidelines:

> **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.

[28] See Explanatory Memorandum at para 2.67.

Essentially, the purport of the provision is that the GST *may* have been passed on if no tax invoice is issued. That is, it is not necessary to expressly communicate to a recipient that the price of the supply has been embedded with GST, or the amount of that GST, in order for the GST to have been "passed on". This particularly affects supplies where the recipient does not request a tax invoice as it is not eligible to claim input tax credits; eg supplies made under the margin scheme and gambling supplies, as well as in the retail industry where tax invoices are increasingly not produced by retailers for low value purchases unless specifically requested.

On the other hand, if a tax invoice has been issued that allows the excess GST to be clearly ascertained, it *will* be prima facie evidence that the GST has been passed on.

Passing on in the sales tax context

The phrase "passing on" was previously used in the Australian sales tax legislation in a similar provision that restricted refunds of sales tax, and has been considered by the courts in that context, as well as in relation to other fees and taxes.[29] The leading authority is *Avon Products Pty Ltd v Commissioner of Taxation* (2006) 230 CLR 356; [2006] HCA 29 (the *Avon Products* case), a decision of the High Court. At the relevant time, the *Sales Tax Assessment Act 1992* provided that a taxpayer would be entitled to a credit where the taxpayer "has paid an amount as tax that was not legally payable".[30] The amount of the credit was "[t]he amount overpaid to the extent that the claimant has not passed it on". The EM refers at length to the *Avon Products* case and leverages off the outcomes of that case in describing how the phrase "passing on" should be interpreted for the purposes of GST.

In the *Avon Products* case, the High Court stated that, as there was no definition of "passed on" in the Act, it was necessary to apply the ordinary meaning of the term. This, the court said, needed to be done with references to the particular circumstances of a case. The court stated:

> That question ought not to be approached in an abstract way divorced from the circumstances of a particular case. *To speak of a test is to invite error by superimposing upon the words of the statute some alternative formulation which obscures rather than reveals the nature of the inquiry that must be undertaken in order to determine whether a taxpayer has established an entitlement to a credit*.[31] (emphasis added)

The High Court stated that the onus of proving that the amount was not passed on rested with the taxpayer. This, the court said, was due in part to the wording of the provision, to the process for claiming a credit which required the taxpayer to make an application to the Commissioner and to the fact that in any subsequent Pt IVC appeal, the taxpayer would have the burden of proving that the decision made by the Commissioner should have been made differently (under the terms of s 14ZZO(b) of the TAA). The same reasoning may apply in respect of Div 142, at least in so far as a taxpayer would bear the onus of proof in Pt IVC proceedings.

The High Court made the following comments as to the nature of the enquiry to be undertaken:

> As has been explained, it is for the taxpayer to establish a circumstance out of the ordinary, namely that the amount of the overpayment of sales tax has not been passed on. Where the whole or part of the economic burden of sales tax may have been passed on indirectly through prices, the inquiry in this regard is likely to be complex. The complexity arises 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 starting point must be the seller's pricing policy and practice*.
>
> In this way, the question is to be approached with reference to the actual conduct of the seller in setting prices based upon its actual knowledge at the relevant time. That knowledge includes the belief that the component of sales tax which later proves to have been an overpayment is a real cost of doing business.

[29] See, eg, in the sales tax context, *Amway of Australia Pty Ltd v Commonwealth of Australia* [1999] FCA 283, *Otto Australia Pty Ltd v Federal Commissioner of Taxation* 90 ATC 4604 and 91 ATC 4305; *Case 45/95*, 95 ATC 395 and *Case VT96/160*, 97 ATC 274.

[30] *Sales Tax Assessment Act 1992* (Cth), Sch 1, Table 3, CR1.

[31] *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 at [6].

> Accordingly, it is unsurprising that a seller's intention, whether subjective or objectively ascertained, will generally be to pass the burden of the impost on to the purchaser.[32] (emphasis added)

Importantly, the High Court found that in the ordinary course, the sales tax would be passed on, and it was incumbent on the taxpayer to prove otherwise:

> Additionally, once it is appreciated that it is in the nature of sales tax to be passed on, there is nothing remarkable in the consequence that proof to the contrary will occur comparatively seldom.[33]

Avon sold products via a network of sales representatives acting as its agent in door-to-door sales. Prior to introducing a product, Avon's finance team would undertake a detailed cost analysis setting out cost estimates, including sales tax. Avon gave evidence that its prices were "benchmarked wherever possible against prices charged by its competitors for comparable products, or at a price which the market would bear". The prices did not change in response to reductions in taxable values for its goods. Further, "Avon would consider introducing a product only if the regular price exceeded the maximum estimated cost by an acceptable profit margin" and similarly, while it frequently discounted its products, it did so only where Avon would continue to meet its gross profit margin.[34] The main thrust of Avon's argument was that it did not increase its prices on account of the tax, and its customers did not pay more than they otherwise would have because of the tax. Consequently, the tax could not be said to have been passed on.[35]

The High Court rejected Avon's argument that the tax is only passed on if the price of the goods is increased by the amount of the tax, and also rejected the "test" put forward by Avon, that if the buyer was no worse off than they otherwise would have been if the sales tax was not imposed, the tax was not passed on. The High Court stated:

> Avon's approach suffers from the fallacy that it converts the question posed by the words of credit ground CR1 in Table 3 of Sched 1 to the Act into a hypothetical question, expressed in the nature of a "test". Avon submitted that this test is necessary in order to inform the factual inquiry required to answer the question as to whether sales tax was passed on. This should not be accepted; the "tests" merely restate the question using words different from the statutory language, and thus distract attention from the real task of the court.[36]

The High Court endorsed the findings of the Full Federal Court to the effect that:

> where the facts disclose that the taxpayer has set prices at a level to ensure that they exceed cost (including sales tax) it will be difficult for the taxpayer to satisfy the onus … to show that it has borne the tax burden itself.[37]

This is a very difficult outcome for taxpayers, and not simply because of the high, almost insurmountable evidentiary burden. Many suppliers argue, particularly in the context of retail supplies or the residential property market, they have no choice but to price to the market, regardless of the GST treatment of the supply. A supplier that makes supplies to recipients who are unable to claim input tax credits, for example, may not be in a position to "price up" on account of GST if, in the market in which the supplier operates, the change in price would lead to an unfeasible decline in the demand for the supply. This is particularly the case in circumstances where Div 142 applies, as a supplier who *incorrectly* treats a supply as taxable is likely to be operating in a market where other suppliers are not overpaying GST. For obvious commercial reasons, the supplier will not usually be in a position to charge 10% more than other suppliers for the same supply (as was the case in Example 2.13 of the EM, discussed above). That supplier may well argue that the outcome in the *Avon Products* case does not reflect the commercial reality of whether or not suppliers are able to shift the burden of the GST.

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[32] *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 at [10]-[11].

[33] *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 at [12].

[34] *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 at [14].

[35] *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 at [24].

[36] *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 at [25].

[37] *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 at [21].

Similarly, if a supplier has identified that unregistered consumers are willing to pay a certain price for a particular supply, there is no obvious reason to assume that the supplier would charge any less for the supply on the basis that less GST was payable, or that the consumer would be unwilling to pay the same price if the supply was not taxable. One of the most common arguments made by suppliers in the residential property market is that unregistered consumers pay what they are willing to pay and suppliers are effectively "price takers" who must set their prices accordingly. For this reason unregistered customers often don't request tax invoices and do not enquire as to the GST treatment of the supplies that are made to them.

Division 142 will no doubt bring the *Avon Products* judgment to the forefront of the debate on "passing on". The connection that the Commissioner had previously drawn between the exercise of his discretion in s 105-65 and the High Court decision was a more tenuous one, as s 105-65 did not specifically refer to "passing on" of the GST. That is not the case with the provisions in Div 142. Will the tribunal and the courts consider themselves bound by the sales tax jurisprudence, or will they approach "passing on" differently in the GST context? This remains to be seen. Certainly the High Court in the *Avon Products* case did not lend much credence to authorities that dealt with different statutory regimes, even where they directly applied the doctrine of "passing on".[38]

UNINTENDED CONSEQUENCES?

One of the consequences of the application of Div 142 is that GST may be payable on something other than a taxable supply. Further it could be payable at a rate of more than 10%. These are fundamental tenets of the GST regime that will be affected by the operation of the provision.

The consequence that GST will be payable on something other than a taxable supply may have constitutional implications. Section 55 of the *Commonwealth of Australia Constitution Act* states that "[l]aws imposing taxation, except laws imposing duties of customs or of excise, shall deal with one subject of taxation only". The operation of this section in the context of the GST Act was considered in *O'Meara v Federal Commissioner of Taxation* (2003) ATC 4406. In that case, Hely J made the following finding:

> In the present case, Parliament has according to "common understanding and general conceptions" imposed a tax on a single subject of taxation, namely on private consumption in Australia. That is one subject of taxation for the purposes of s 55 of the *Constitution*.

Arguably an amount of GST that is payable because a supplier made an error in calculating its net amount is not a tax on private consumption in Australia.[39] However, the description of the GST as a tax on private consumption should be considered in the light of the later High Court decision of *Commissioner of Taxation v Reliance Carpet Co Pty Ltd* [2008] HCA 22, which described the subject matter of the tax as "taxable supplies". In this respect, their Honours stated at [3]-[5]:

> The GST
>
> 3. Provision respecting the assessment and payment of the GST is made by the statute styled *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (the Act). An important point respecting the nature of the GST was made as follows by the Full Court of the Federal Court in *Sterling Guardian Pty Ltd v Commissioner of Taxation*:
>
> > In economic terms it may be correct to call the GST a consumption tax, because the effective burden falls on the ultimate consumer. But as a matter of legal analysis what is taxed, that is to say what generates the tax liability (and the obligations of recording and reporting), is not consumption but a particular form of transaction, namely supply …

[38] See *Avon Products Pty Ltd v Commissioner of Taxation* [2006] HCA 29 at [27]-[28] and, in particular, the High Court's approach in distinguishing the decision of Mason CJ in *Commissioner of State Revenue (Vict) v Royal Insurance Australia* [1994] HCA 61.

[39] Submissions on the constitutional issue were put to Treasury in consultation, including in the submission made by the *Tax Institute of Australia* on 19 September 2012 in relation to the Exposure Draft on Refunding Excess GST (Div 36) available at http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/2012/Refunding%20excess%20GST/Submissions/PDF/The_Tax_Institute.ashx.

By way of contrast to the Australian system, counsel for the Commissioner referred to Art 2(1) of the first Council directive http://www.austlii.edu.au/au/cases/cth/HCA/2008/22.html - fn3 on the harmonisation of legislation of member states of the European Community concerning turnover taxes; this indicates that VAT is a general tax on the consumption of goods and services.

4. Section 7-1 of the Act relevantly states that GST is payable on "*taxable supplies" http://www.austlii.edu.au/au/cases/cth/HCA/2008/22.html - fn4. Section 9-5 answers a question "what are taxable supplies?", posed by a hypothetical taxpayer, by stating that "you make a ***taxable supply***" if, among other criteria not presently relevant, "you make the supply for *consideration".
5. The composite expression "a taxable supply" is of critical importance for the creation of liability to GST.

Section 142-10 treats excess GST that has been passed on to another entity as payable on a taxable supply for certain purposes (subject to the exclusions in s 142-15), but the operation of s 142-10 is predicated on the fact that the excess GST is not, in fact, GST that is payable on a taxable supply (as that term is defined in s 9-5 of the GST Act). If the amount was payable on a taxable supply, it would not be "excess GST" for the purposes of s 142-5. None of the requirements for a taxable supply under s 9-5 are required to be met in order for GST to be payable under Div 142,[40] other than that the supplier be registered for GST; ie in order for there to be an assessed net amount and therefore an amount of excess GST for the purposes of s 142-5. There is no requirement that the supply be made in the course or furtherance of an enterprise or that the supply be connected with Australia. In fact, no supply is required to be made at all. Arguably, when GST is payable in circumstances where there is no taxable supply, or no supply at all, it is arguable that an additional subject matter of taxation has been introduced. Whether any taxpayer will have the appetite to contest the provisions on this constitutional basis is another matter.

Constitutional issues aside, this "deeming" of GST payable is likely to have many cascading consequences, some of which may not be intended by Treasury. In this regard it is not dissimilar from the application of s 105-65, which was described by Emmett J in *KAP Motors Pty Ltd v Commissioner of Taxation* [2008] FCA 159 at [33] as a "paternalistic interference with the rights of taxpayers".

Of particular concern is the very real risk that the provisions will disadvantage conservative taxpayers who, when in doubt, "report the GST" while contentious matters are resolved. The taxpayer response to the decision of Emmett J in *Gloxinia Investments Ltd as Trustee for Gloxinia Unit Trust v Commissioner of Taxation* [2009] FCA 641 is an apt example of this. Without delving too deeply into the details of that case, it suffices to say that certain supplies of residential premises that had been treated by many suppliers as taxable supplies of new residential premises were found by Emmett J to be input taxed supplies of second-hand residential premises. Following the decision, the Commissioner appealed to the Full Federal Court and subsequently, after losing that appeal, the Commissioner also applied for special leave to appeal to the High Court but was refused.[41]

Some taxpayers took a "conservative" approach and continued to report the GST on their supplies while the matter continued to make its way through the courts. Others chose to hold on to the GST pending the outcome, which was that the supplies were input taxed. In those circumstances, the application of Div 142 would prejudice only "conservative" taxpayers who reported the GST and would be denied a "refund" of that GST in circumstances where the GST was "passed on" – and given the Commissioner's expansive view of that term, this almost certainly will have been the case where the taxpayer believed the supply was taxable when it was made. Taxpayers who did not report the

[40] There is an argument that a supplier must be *eligible* to be registered for GST (which is a requirement for a taxable supply under s 9-5(d)) in order for there to be an "assessed net amount" for a tax period and therefore an amount of excess GST for the purposes of s 142-5. If a taxpayer is not eligible to be registered, for example, because it is not carrying on an enterprise, s 25-55 of the *A New Tax System (Goods and Services Tax) Act 1999* states that the Commissioner must cancel the GST registration of the taxpayer. There can be no assessed net amount for a tax period in which the taxpayer is not registered for GST.

[41] *Commissioner of Taxation v Gloxinia Investments (Trustee)* [2010] FCAFC 46; *Commissioner of Taxation of the Commonwealth of Australia v Gloxinia Investments Limited as Trustee for Gloxinia Unit Trust* [2010] HCATrans 255 (1 October 2010).

GST (and who were not assessed by the Commissioner on the GST) would need not concern themselves with the application of Div 142, and could hold on to the GST, whether it was "passed on" or not.

A provision that disadvantages taxpayers who err on the side of reporting GST is likely to discourage such behaviour. Even taxpayers who are eager to be compliant cannot be expected to report GST in circumstances where the act of doing so can transform the very nature of the amount from "GST that is not payable" to "GST that was always payable". It will be a strange and arbitrary outcome for cautious taxpayers to feel compelled to deal with contentious questions of whether GST is payable by withholding the amounts rather than remitting them, yet in the circumstances this would probably be a fair and reasonable way for those taxpayers to manage their risk of exposure.