MT 2009/D1 - Miscellaneous tax: restrictions on GST refunds under section 105-65 of Schedule 1 to the Taxation Administration Act 1953

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Draft Miscellaneous Taxation Ruling

Miscellaneous tax: restrictions on GST refunds under section 105-65 of Schedule 1 to the *Taxation Administration Act 1953*

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Preamble

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way the law applies. It is not a public ruling or advice for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953*.

You can rely on this publication to provide you with protection from interest and penalties as follows. If a statement in this publication is later found to be incorrect or misleading and you make a mistake as a result of relying on this publication, you will not have to pay a penalty. In addition, if you have relied on this publication reasonably and in good faith you will not have to pay interest charges. However, you will still have to pay the correct amount of tax, provided the time limits under the law allow it.

What this Ruling is about

1. This draft Ruling sets out the Commissioner's views on section 105-65 of Schedule 1 to the *Taxation Administration Act 1953* (TAA), which provides for a restriction on goods and services tax (GST) refunds.

2. Specifically, this draft Ruling outlines:

- whether section 105-65 of Schedule 1 to the TAA applies to overpayments of luxury car tax (LCT), wine equalisation tax (WET) and taxable importations;
- the meaning of 'overpaid';
- the meaning of 'treated' as a taxable supply;
- the meaning of 'to any extent';
- the operation of section 105-65 where the wrong entity remits the GST;
- the meaning of the Commissioner need not 'give' a 'refund of an amount';
- the circumstances in which the Commissioner may exercise the residual discretion to refund where section 105-65 of Schedule 1 to the TAA applies;
- preserving the status quo;

- the quantum of any refund that is given;
- the operation of section 8AAZN of the TAA to recover amounts refunded without regard to section 105-65 of Schedule 1 to the TAA; and
- whether section 105-65 of Schedule 1 to the TAA is a mere recovery provision or whether its operation must be taken into account in working out an entity's net amount.

3. This draft Ruling also provides examples on how the residual discretion in section 105-65 of Schedule 1 to the TAA may be exercised. In providing these examples, there is no intention to lay down conditions that may restrict the exercise of the Commissioner's residual discretion in any particular case. Nor does this draft Ruling represent a general exercise of the Commissioner's residual discretion. Rather, the examples are provided to assist in determining when the residual discretion may be exercised.

4. This draft Ruling does not consider adjustment events and the operation of Division 19 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).[1]

5. All subsequent legislative references in this draft Ruling are to Schedule 1 to the TAA, except where otherwise indicated.

Date of effect

6. This draft Ruling represents the preliminary, though considered views of the Commissioner.

7. The final Ruling will be a public ruling for the purposes of section 105-60 and may be relied upon, after it is issued, by any entity to which it applies. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and the Commissioner's view of when you can rely on this interpretation of the law in GST public and private rulings.

8. It is proposed that when the final Ruling is issued, it will apply both before and after its date of issue. However, the Ruling will not apply to entities to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

[1] Adjustment events are explained in GSTR 2000/19 Goods and services tax: making adjustments under Division 19 for adjustment events.

Background

Legislative framework

9. A GST refund may arise if an entity (or the Commissioner) revises an activity statement for a tax period and as a result:

- the net amount the entity paid is reduced;
- the entity becomes entitled to a refund under section 35-5 of the GST Act; or
- the amount of the refund under section 35-5 of the GST Act is increased.

10. The refund may arise from:

- the claiming of additional input tax credits;
- a reduction in GST payable; or
- decreasing adjustments.

11. Under the general rules the Commissioner is required to give a refund or apply that amount in accordance with the running balance account (RBA) rules.[2]

12. However where a refund arises from a reduction in the GST payable, subsection 105-65(1) modifies the general rules so that the Commissioner need not give a refund (or apply that amount) if an entity overpaid its net amount or an amount of GST because:

- a supply was treated as a taxable supply, or an arrangement was treated as giving rise to a taxable supply, to any extent; and
- the supply is not a taxable supply, or the arrangement does not give rise to a taxable supply, to that extent; and
- either:
  - the Commissioner is not satisfied that the entity has reimbursed a corresponding amount to the recipient of the supply (or, in the case of an arrangement treated as giving rise to a taxable supply, to the purported recipient); or
  - the recipient of the supply (or, in the case of the arrangement treated as giving rise to a taxable supply, the purported recipient) is registered or required to be registered.

13. Appendix 1 of this draft Ruling provides an illustrative overview of the operation of section 105-65.

[2] See Division 3 and Division 3A of Part IIB of the TAA.

14. There are two important policy reasons behind the operation of section 105-65:

- GST charged on a taxable supply is meant to be borne by the unregistered end consumer,[3] and
- there should not be a refund of overpaid GST to a supplier where it may result in a windfall gain to the supplier.[4]

15. The scheme of the GST Act,[5] on which the section 105-65 policy outlined above is based, is premised on the following principles:

- It is the supplier that determines if the supply it makes is taxable in the first instance. By determining that its supply is a taxable supply, GST is included in the price.
- Double taxation is avoided by the registered recipient being entitled to claim an input tax credit for that taxable supply where it is acquired for a creditable purpose.
- Once GST is embedded in the supply chain, it is the unregistered end consumer that bears the cost of the GST.

16. Prior to 1 July 2008 section 105-65 did not apply to a GST refund where the overpaid GST was for a transaction that did not result in a 'supply' as defined in section 9-10 of the GST Act. This was decided by the Federal Court in *Kap Motors Pty Ltd v. Commissioner of Taxation* [2008] FCA 159; 2008 ATC 20-007; (2008) 68 ATR 927 *(Kap Motors)*.

17. Section 105-65 was amended to cover an overpayment of GST involving an arrangement that was treated as a taxable supply but which does not give rise to a supply.[6] These amendments apply in respect of GST refunds relating to tax periods starting on or after 1 July 2008.

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[3] See Chapter 1 of the Explanatory Memorandum of the A New Tax System (Goods and Services Tax) Bill 1998 – in particular: 'GST is effectively borne by consumers when they acquire anything to consume.' See also Edmonds J in *Federal Commissioner of Taxation v. DB Rreef Funds Management Limited* 2006 ATC 4282 at 4285; (2006) 62 ATR 699 at 702.

[4] See paragraphs 3.40 and 3.41 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax Administration) Bill 1998 and paragraph 2.2 of the Explanatory Memorandum to the Tax Laws Amendment (2008 Measures No. 3) Bill 2008.

[5] See paragraphs 3.15, 3.24 and 5.4 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.

[6] See the *Tax Laws Amendment (2008 Measures No. 3) Act 2008*.

18. Under subsection 105-65(2) the restriction on the Commissioner's requirement to give a GST refund applies to the following amounts:

- so much of any net amount or amount of GST overpaid (or would be if the arrangement were a supply), or
- so much of any net amount payable under section 35-5 of the GST Act that has not been refunded (or would be if the arrangement were a supply).

Legislative context

19. Section 105-65 states:

> (1) The Commissioner need not give you a refund of an amount to which this section applies, or apply (under Division 3 or 3A of Part IIB) an amount to which this section applies, if:
>
> (a) you overpaid the amount, or the amount was not refunded to you, because a *supply was treated as a *taxable supply, or an *arrangement was treated as giving rise to a taxable supply, to any extent; and
>
> (b) the supply is not a taxable supply, or the arrangement does not give rise to a taxable supply, to that extent (for example, because it is *GST-free); and
>
> (c) one of the following applies:
>
> (i) the Commissioner is not satisfied that you have reimbursed a corresponding amount to the recipient of the supply or (in the case of an arrangement treated as giving rise to a taxable supply) to an entity treated as the recipient;
>
> (ii) the recipient of the supply, or (in the case of an arrangement treated as giving rise to a taxable supply) the entity treated as the recipient, is *registered or *required to be registered.
>
> (2) This section applies to the following amounts:
>
> (a) in the case of a *supply:
>
> (i) so much of any *net amount or amount of *GST as you have overpaid (as mentioned in paragraph (1)(a)); or
>
> (ii) so much of any net amount that is payable to you under section 35-5 of the *GST Act as the Commissioner has not refunded to you (as mentioned in paragraph (1)(a)), either by paying it to you or by applying it under Division 3 of Part IIB of this Act;

(b) in the case of an *arrangement:

(i) so much of any net amount or amount of GST to which subparagraph (a)(i) would apply if the arrangement were a supply; or

(ii) so much of any net amount to which subparagraph (a)(ii) would apply if the arrangement were a supply.

Frequently used terms

20. The terms 'supply' or 'taxable supply' also encompass the concepts of an arrangement being treated as giving rise to a supply or a taxable supply (where it is appropriate).

21. The term 'refund' also encompasses applying a refund in accordance with the running balance account rules (where the context so requires).

Ruling

Whether section 105-65 applies to overpayments of LCT and WET and to taxable importations

22. Section 105-65 only applies to overpayments of GST and does not apply where LCT or WET is overpaid or to taxable importations.

Meaning of 'overpaid'

23. In the context of section 105-65, 'overpaid' means the amount that has been remitted must be in excess of what was legally payable on the particular supply in the relevant tax period.

Meaning of 'treated' as a taxable supply

24. Broadly, in the context of section 105-65, a supply would be treated as a taxable supply where the supplier has remitted GST to the Commissioner on that supply or arrangement. In most cases it will be the supplier who treats the supply erroneously as taxable (as the supplier is the entity who has the liability for remitting the GST).[7] However, in some situations it may be the Commissioner (or another party) who treats the supply as taxable. In these circumstances section 105-65 can apply.[8]

[7] There are circumstances, such as with the grouping provisions, where the person who makes the supply is not necessarily the entity who has the liability to remit the GST. For example, see paragraphs 152 to 155 of this draft Ruling. Section 105-65 can still apply in these cases.

[8] In such circumstances it may be appropriate for the Commissioner to exercise his residual discretion to pay the refund. See paragraphs 97 to 107 of this draft Ruling.

25. If the supplier or Commissioner incorrectly treats a supply as taxable but the Commissioner does not exercise the residual discretion to refund the overpaid amount, then the recipient is still entitled to retain the input tax credits which it had claimed for the acquisition of that supply (provided the recipient meets all the conditions for the taxable supply to be treated as a creditable acquisition).

26. However, if a supplier actually reimburses the recipient and the Commissioner decides that it is appropriate in the particular circumstances to exercise his discretion to give a refund, both parties will need to revise their activity statements.[9] The supplier will have to reduce the GST incorrectly paid and the recipient will have to reduce their claim for input tax credits and will have to pay back the input tax credits it previously claimed.

Meaning of 'to any extent'

27. The phrase 'to any extent' are words of wide import.[10] The Commissioner considers that it covers all matters relevant to the GST payable on a taxable supply. This interpretation is consistent with the broad purpose of section 105-65, which is to prevent windfall gains where GST has been incorrectly imposed.

28. This means that section 105-65 will apply to circumstances of a transaction in real property in which the GST liability was calculated using the margin scheme or a mixed supply (that is a supply that is partly taxable and partly input-taxed or GST-free). These matters concern the GST payable on a supply that was treated as a taxable supply to some extent and the 'extent' of that treatment subsequently changes.[11]

Effect where the wrong entity remits the GST

29. Section 105-65 operates to preclude an entity from obtaining a refund of GST that it paid for supplies that are subsequently determined to have been made by another GST registered entity.[12]

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[9] See paragraphs 97 to 107 of this draft Ruling regarding the Commissioner's residual discretion to give a refund.

[10] See *Commissioner of Taxation v. Hornibrook* (2006) 156 FCR 313; 2006 ATC 4761; (2006) 65 ATR 1 where Young J held at paragraph 85 (in ATC 4761) that the words 'to any extent' (as used in the context of subsection 14ZR(2) of the TAA) are 'words of extension'.

[11] See paragraphs 165 to 173 in Appendix 3 of this draft Ruling for an alternative view.

[12] See paragraphs 174 to 185 in Appendix 3 of this draft Ruling for an alternative view.

Meaning of the Commissioner need not 'give' a 'refund of an amount'

30. Section 105-65 is not limited to situations where an actual refund is payable or would be applied to the entity's RBA. The section can also have operative effect in cases where a supplier revises a relevant activity statement and, after netting off underpayments and overpayments, still has a liability to pay a net amount for the particular tax period.[13] Section 105-65 can apply to any component of the revision that represents an overpayment arising from the incorrect treatment of a supply as taxable to any extent.

Circumstances in which the Commissioner may exercise the residual discretion to refund where section 105-65 applies

31. Where the conditions in section 105-65 apply, the Commissioner need not give a refund. However, the Commissioner has a 'residual discretion' to pay a refund in appropriate circumstances.

32. The guiding principles the Commissioner will take into account in exercising the residual discretion are explained at paragraphs 97 to 107 of this draft Ruling.

What is the quantum of any refund given

33. The use of words 'so much of any' indicates that subsection 105-65(1) can apply to an amount that is less than the whole amount that has been overpaid (or not refunded).

34. Accordingly, if a supplier reimburses (in a later tax period) a lesser amount to an entity that is not registered (or required to be registered), then section 105-65 does not apply to that reimbursed amount.[14]

35. However, section 105-65 concentrates on the GST payable on **the** supply and because of this any input tax credits are excluded from the calculation of the quantum of the refund amount.

Recovery of amounts refunded without regard to section 105-65

36. Section 8AAZN of the TAA may be used to recover a refund where the Tax Office's automated system processes that refund without regard to section 105-65. The Commissioner considers that the payment of such a refund constitutes a mistake and therefore an 'administrative overpayment' for purposes of section 8AAZN of the TAA.

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[13] The same outcome applies where the net effect of the transactions is that a refund previously paid under Division 35 of the GST Act is reduced.

[14] See paragraphs 186 to 191 in Appendix 3 of this draft Ruling for an alternative view.

Section 105-65 is more than a mere recovery provision

37. Section 105-65 is a statutory provision that operates at the level of ascertaining the entity's legal obligation to pay its tax liability or its entitlement to a refund and therefore the operative effect of section 105-65 must be taken into consideration in determining an entity's net amount. The provision is not simply a 'recovery' provision.[15]

Explanation

Whether section 105-65 applies to overpayments of LCT and WET and to taxable importations

38. Subsection 105-65(2) refers to 'net amount', which is relevantly defined in section 195-1 of the GST Act.[16] That definition refers to sections 17-5, 126-5 and 162-105 of the GST Act. It is clear that GST is included in the meaning of 'net amount'.

39. It is also clear from the *A New Tax System (Luxury Car Tax) Act 1999* (LCT Act)[17] and the *A New Tax System (Wine Equalisation Tax) Act 1999* (WET Act)[18] that both LCT and WET are included in the net amount.

40. Although both LCT and WET are included in the net amount as used in subsection 105-65(2), this does not necessarily mean that section 105-65 applies to overpayments of LCT or WET.

41. LCT applies to a 'taxable supply of a luxury car' (as defined in section 5-10 of the LCT Act) rather than a 'taxable supply' as relevantly defined[19] in section 195-1 of the GST Act (as having the meaning given by sections 9-5, 78-50, 84-5 and 105-5 of the GST Act). Therefore, an overpayment of LCT does not fit within the wording and operation of section 105-65.[20]

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[15] See paragraphs 192 to 197 in Appendix 3 of this draft Ruling for an alternative view.

[16] Under subsection 3AA(2) of the TAA an expression has the same meaning in Schedule 1 to the TAA as in the *Income Tax Assessment Act 1997* (ITAA 1997). Under subsection 995-1(1) of the ITAA 1997 'net amount' has the same meaning as in section 195-1 of the GST Act.

[17] See subsection 2-10(1), and sections 2-25 and 13-5 of the LCT Act.

[18] See sections 2-20, 2-25, 21-1 and 21-5 of the WET Act.

[19] Under subsection 3AA(2) of the TAA an expression has the same meaning in Schedule 1 to the TAA as in the ITAA 1997. Under subsection 995-1 of the ITAA 1997 'taxable supply' has the same meaning as in section 195-1 of the GST.

[20] Overpayments of LCT are specifically covered by section 17-5 of the LCT Act.

42. WET applies to 'assessable dealings'[21] rather than taxable supplies. Therefore, an overpayment of WET also does not fit within the wording and operation of section 105-65.[22]

43. An importation is not a supply and therefore is not subject to the restrictions of section 105-65.[23]

44. Accordingly, section 105-65 only applies to overpayments of GST and cannot be applied where LCT or WET is overpaid or to taxable importations.

45. The *Tax Laws Amendment (2008 Measures No. 3) Act 2008* amended paragraph 105-65(2)(a) to recognise this by removing a reference to 'an amount of indirect tax' and inserting a reference to 'amount of GST'.

Meaning of 'overpaid'

46. For section 105-65 to apply there has to be an overpayment of GST, that is, the amount of GST remitted for a supply in a relevant tax period must exceed the amount which was required to be remitted on that supply.

47. The word 'overpaid' as used in paragraph 105-65(1)(a) is not a defined term so it takes on its normal meaning. The Macquarie Dictionary[24] relevantly defines 'overpay' as: '1. to pay more than (an amount due).'

48. In *Chippendale Printing Co Pty Ltd v. FC of T & Anor* 96 ATC 4175; (1996) 32 ATR 128 (*Chippendale*), the Full Federal Court made some observations on the meaning of 'overpaid' in the context of the sales tax regime. Lehane J considered that the concept of overpayment includes both a payment exceeding an amount of tax actually due and a payment, as tax, where no amount of tax was actually due.

49. Tamberlin J compared the previous sales tax legislation with the relevant current sales tax legislation. Neither legislation defined the term 'overpaid' but a Schedule to the new legislation referred to 'overpaid' as an amount paid as sales tax that was not legally payable. Tamberlin J thought this expression would also cover the concept of 'overpaid' in the previous legislation and, furthermore, held that this meaning accords with 'the ordinary meaning of the expression which is '…a sum of money paid in excess of what is due'.'[25]

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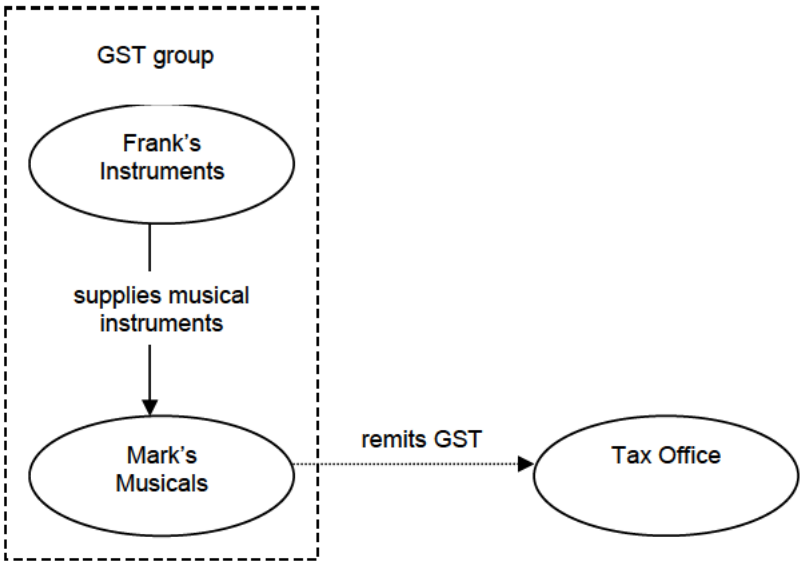
[21] See sections 5-1 and 5-5 of the WET Act.
[22] Overpayments of WET are specifically covered by CR1 in the Wine Credit Table in section 17-5 of the WET Act.
[23] See section 7-1 of the GST Act where it states that GST is payable on 'taxable supplies' and 'taxable importations'. Taxable importations are not supplies and are dealt with under Part 2-3 of the GST Act.
[24] The *Macquarie Dictionary*, 2001, rev. 3rd edn, The Macquarie Library Pty Ltd, NSW.
[25] 96 ATC 4175 at 4179; (1996) 32 ATR 128 at 131.

50. Using the reasoning in *Chippendale* in the context of section 105-65, the amount that has been remitted must be in excess of what was legally payable on the particular supply in the relevant tax period.

Example 1

51. *Frank's Instruments Pty Ltd and Mark's Musicals Pty Ltd are part of the same GST group that sells musical instruments. Frank's Instruments supplies Mark's Musicals with a number of trumpets. Frank's Instruments issues Mark's Musicals with tax invoices however no consideration is provided by Mark's Musicals and no input tax credits are claimed in respect of the supply. Mark's Musicals (the group representative member) lodges the activity statement for the group and mistakenly accounts for the GST on the intra-group supply of the trumpets from Frank's Instruments.*

52. *Some months later Mark's Musicals realises that it has remitted GST on the intra-group supply of trumpets and requests a refund from the Commissioner.*



53. In this example, there has been an overpayment because a payment, as tax, occurred 'where no amount of tax was actually due'. The payment occurred because the supply was initially treated as taxable by Frank's Instruments[26] but subsequently it is ascertained that the supply indeed was not taxable (because it is treated as if it were not a taxable supply under paragraph 48-40(2)(a) of the GST Act). The transaction is covered by section 105-65.[27]

Meaning of 'treated' as a taxable supply

54. For section 105-65 to apply, the relevant supply must be 'treated' as a taxable supply. Broadly, in the context of section 105-65 a supply would be treated as a taxable supply where the supplier has remitted GST to the Commissioner on that supply or arrangement. In most cases it will be the supplier who treats the supply erroneously or incorrectly as taxable (as the supplier is the entity who has the liability for remitting the GST).[28] However, in some situations it may be the Commissioner who treats the supply as taxable. In these circumstances section 105-65 is not precluded from applying.[29]

55. There are no words in section 105-65 which limit its application to circumstances where it was the supplier who treated the supply as taxable. If the legislative intention had been to restrict the provision only to the supplier's misclassification of the supply more restrictive words would have been used, such as 'because **you** treated a supply as a taxable supply'. Furthermore there is nothing in the relevant Explanatory Memoranda or other extrinsic material which would support restricting section 105-65 to situations where the supplier treated the supply as a taxable supply.

Example 2

56. *Rehka treats a particular supply as GST-free. Subsequently she is audited by the Tax Office, which determines that she should have remitted GST on that supply. An assessment is raised and Rehka remits the outstanding GST.*

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[26] See paragraphs 54 and 55 of this draft Ruling – paragraph 105-65(1)(a) does not require that the supply is treated as taxable by a particular entity (in this case it does not matter that the supply was treated as taxable by Frank's Instruments but that, due to the particular grouping provisions, the GST was remitted by Mark's Musicals).

[27] In such circumstances the Commissioner may exercise the residual discretion to pay the refund. See paragraphs 97 to 107 of this draft Ruling.

[28] There are circumstances, such as with the grouping provisions, where the person who makes the supply is not necessarily the entity who has the liability to remit the GST. For example, see paragraphs 152 to 155 of this draft Ruling. Section 105-65 can still apply in these cases.

[29] In such circumstances it may be appropriate for the Commissioner to exercise the residual discretion to pay the refund. See paragraphs 97 to 107 of this draft Ruling.

57. *Rehka subsequently objects to the assessments on the basis that the supply was not taxable. The Commissioner reverses the audit decision and gives a favourable objection decision. Rehka seeks a refund of the overpaid GST.*

58. In this case the operative elements of paragraphs 105-65(1)(a) and 105-65(1)(b) are satisfied, that is, Rehka overpaid GST and a supply was treated as taxable but was subsequently determined not to be taxable. The fact that the Commissioner initially treated the supply as taxable when in fact it was not does not preclude the operation of the section.[30]

Effect of supply being 'treated' as taxable on the registered recipient

59. If the supplier or Commissioner incorrectly treats a supply as taxable but the Commissioner does not exercise the residual discretion to refund the overpaid amount, then the question arises as to whether the recipient is still entitled to retain the input tax credits which it had claimed for the acquisition of that supply.

60. Where the supplier treated the transaction as a taxable supply, then a tax invoice should have issued, which should have shown an amount of GST (or set out that the price was GST inclusive). The recipient should have paid the invoiced amount to the supplier and the supplier should have remitted the GST to the Commissioner.

61. In these circumstances section 105-65 preserves the status quo in that the supply was treated as taxable, the Commissioner retains the remitted GST and, since the Commissioner will not refund the overpaid GST, the supply will also be 'treated' as if it were taxable in the hands of the recipient. Therefore the recipient can retain the input tax credits claimed for the supply (provided the recipient meets all the conditions for the taxable supply to be treated as a creditable acquisition).

62. In other words, the effect of the phrase 'treated as a taxable supply' and subparagraph 105-65(1)(c)(i) is that the tax position will not need to be unravelled unless the supplier reimburses the recipient for the tax sought to be refunded. In the absence of a reimbursement to the recipient the treatment of the transaction as taxable between registered entities is GST-neutral and there would not be any compelling policy reasons to unwind the treatment that was adopted.

[30] In this case it may be appropriate for the Commissioner to exercise the residual discretion to pay the refund. See Example 15 at paragraphs 162 to 164 in Appendix 2 of this draft Ruling.

63. However, where a supplier actually reimburses the recipient and the Commissioner decides that it is appropriate in the particular circumstances to exercise the discretion to give a refund, both parties will need to revise their activity statements.[31] The supplier will have to reduce the GST incorrectly paid and the recipient will have to reduce their claim for input tax credits and will have to pay back the input tax credits it previously claimed.

Meaning of 'to any extent'

64. Paragraph 105-65(1)(a) uses the expression 'a supply was treated as a taxable supply, or an arrangement was treated as giving rise to a taxable supply, **to any extent**' and paragraph 105-65(1)(b) uses the expression 'the supply is not a taxable supply, or the arrangement does not give rise to a taxable supply, '**to that extent**' (emphasis added).

65. Section 105-65 is concerned with supplies that have been treated as taxable supplies (or arrangements giving rise to taxable supplies). Therefore, the section is not concerned with input tax credits or tax on importations. Nor is the section concerned with a GST-free supply that was incorrectly treated as input taxed. None of these matters concerns the GST payable on a taxable supply.

66. However, the phrase 'to any extent' are words of wide import[32] and the Commissioner considers that it covers all matters relevant to the GST payable on a taxable supply. This interpretation is consistent with the broad purpose of the provision to prevent windfall gains where GST has been incorrectly imposed, as indicated in the Explanatory Memorandum accompanying the introduction of the original provisions.[33]

67. It is also consistent with the Explanatory Memorandum to the Tax Laws Amendment (2008 Measures No. 3) Bill 2008 (which introduced the current version of section 105-65) at paragraph 2.8 where it is stated that '[t]hese amendments ensure that the restriction on providing refunds of GST applies to situations in which transactions have been treated incorrectly as taxable supplies to any extent.'

[31] See paragraphs 97 to 107 of this draft Ruling regarding the Commissioner's residual discretion to give a refund.
[32] See *Commissioner of Taxation v. Hornibrook* (2006) 156 FCR 313; 2006 ATC 4761; (2006) 65 ATR 1 where Young J held at paragraph 85 that the words 'to any extent' (as used in the context of subsection 14ZR(2) of the TAA) are 'words of extension'.
[33] See paragraphs 3.40 and 3.41 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax Administration) Bill 1998.

68. Further, in the comparison table after paragraph 2.10 it is stated that the new section 105-65 applies where:

- 'input taxed or GST-free supplies are incorrectly treated as taxable supplies and GST has been remitted', or
- 'an amount of GST on a taxable supply has been remitted that exceeds the amount of GST correctly payable on that taxable supply'.

69. Accordingly, paragraph 105-65(1)(a) is not only predicated on the idea that there is a supply that is **incorrectly** treated as having the status of a taxable supply, but by extension through the use of the phrase 'to any extent' that there is a supply that is treated as taxable to **an extent**. Paragraph 105-65(1)(b), similarly, is activated if the extent of the taxable treatment subsequently alters, for example because the GST payable has altered.

70. As the phrase 'to any extent' has a broad meaning, section 105-65 would cover the circumstance of a transaction in real property in which the GST liability was calculated using the margin scheme and a supply that was determined to be a mixed supply. These matters concern the GST payable on a supply that was treated as a taxable supply to some extent and the 'extent' of that treatment subsequently changes.

Margin scheme cases

71. Under Division 75 of the GST Act the amount of GST payable on taxable supplies of real property may be calculated (using the margin scheme) on the margin for the supply. There may be circumstances where the margin for a supply decreases after the lodgment of the activity statement. For example, there may be a valid adoption of another method (for example, valuations method) after the activity statement has been lodged.

72. Where the margin for a supply of real property decreases, it follows that the GST payable on the taxable supply decreases. In these circumstances, as an amount of GST payable on the taxable supply has been remitted that exceeds the amount of GST correctly payable on that taxable supply, section 105-65 applies.

Mixed supply cases

73. A mixed supply is a supply that is partly taxable and partly GST-free or input taxed.[34] In situations where the supplier incorrectly apportions a higher component of the supply to the part that is subject to GST, the supplier overpays its GST liability (that is the supplier pays more at this point than was legally due on the supply).

74. In these circumstances the extent to which a supply is treated as taxable has changed because the supplier initially, and incorrectly, treated the taxable component of the supply as higher than it was. When it is subsequently determined that the taxable component of the supplier was actually less, there has been an overpayment to which section 105-65 applies.

Example 3

75. *Amie supplies grocery items to end consumers. As part of a promotional activity, Amie packaged some GST-free food items with taxable items (such as promotional calculators and watches) and sold them as a single package (that is, the promotional items could only be acquired in packages with the food products).*

76. *Amie initially calculated the taxable component as forming 70% of the value of the supply. However, after an internal review by the company accountant, it was determined that the taxable component of the supply was only 50% of the total value.*

77. In this case there has been an overpayment of GST because the supply was treated as a taxable supply to the extent of 70% but was only taxable to the extent of 50%. Accordingly section 105-65 will apply to these circumstances.[35]

Effect where the wrong entity remits the GST

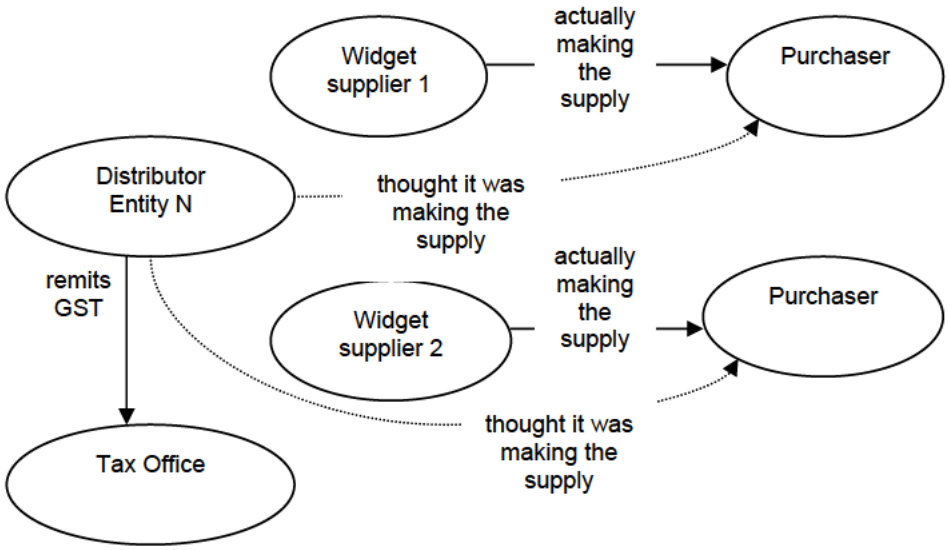
78. In some instances an entity may in error remit GST on a supply that was not made by that entity.

[34] The Explanatory Memorandum to the Tax Laws Amendment (2008 Measures No. 3) Bill 2008 expressly considers that these types of situations would be covered by section 105-65. For example, paragraph 2.14 states that an 'overpayment of GST may occur, for example, if a transaction is treated as a taxable supply when it is a mixed supply that is partly a taxable supply and partly a GST-free supply'. Furthermore, example 2.2 expressly covers a mixed supply scenario.

[35] See paragraphs 97 to 107 of this draft Ruling regarding the Commissioner's residual discretion to give a refund where a corresponding amount has not been reimbursed to the recipient and the recipient is not registered nor required to be registered.

Example 4

79. *Entity N is acting as a distributor for a collective of individual registered entities that make and supply widgets. The individual widget suppliers are making the supplies but Entity N thought it was the supplier and hence remitted the GST on its own behalf (rather than as agent for the widget makers). Entity N subsequently ascertains that it was not the correct supplier and seeks a refund.*



80. A question arises as to whether section 105-65 operates to preclude an entity from obtaining a refund of GST paid by that entity for supplies that are subsequently determined to have been made by another registered entity. The Commissioner considers that section 105-65 applies in these circumstances.

81. In Example 4 at paragraph 79 of this draft Ruling Entity N has 'overpaid' GST because, as it was not the supplier, it had no legal obligation to remit GST. Furthermore, Entity N would have made the overpayment because it erroneously treated the supply by the widget makers as its taxable supply to the extent of 100%.[36] In this sense paragraph 105-65(1)(a) is satisfied.

82. Paragraph 105-65(1)(b), however, must also be satisfied in order for the restriction on refunds to apply to this type of situation. It is the Commissioner's view that paragraph 105-65(1)(b) is made out since the extent of the purported supply by Entity N has altered. The supply was treated as a taxable supply to the extent of 100% but is in effect taxable to the extent of 0%.

[36] See paragraphs 54 to 55 of this draft Ruling in which the view is taken that it need not be the supplier who 'treats' a supply as taxable.

Meaning of the Commissioner need not 'give' a 'refund of an amount'

83. It is possible for a supplier to have understated or overstated their net amount for a prior tax period while also incorrectly treating some non-taxable supplies as taxable. In such cases a supplier may revise the relevant activity statement to account for these errors.

84. When the supplier revises the relevant activity statement for a tax period, they will net off their underpayments and overpayments to determine a new net amount for that period. After such a revision the supplier may still have to pay a net amount for the particular tax period, that is, the revision creates a liability and not a refund. In this situation the liability contains within it a component that represents an overpayment arising from the incorrect treatment of a supply as taxable.

85. For the reasons set out below, the Commissioner considers that section 105-65 operates to the amount of the overpayment in these circumstances.[37]

86. Subsection 105-65(1) provides that the Commissioner need not 'give' a 'refund of an amount' to which the section relates. The word 'give', in the context in which it is used here, does not mean that an actual refund in respect of the overpaid amount need arise. The concept of 'give' a refund can also cover situations where the supplier obtains a positive economic benefit in respect of the overpaid amount by being able to use it in determining a lesser net amount.

87. In *KAP Motors* it was held at paragraph 28, in the context of section 105-65, that where a literal construction of a statutory provision has an inconvenient or improbable result, it may be legitimate to prefer a construction that is reasonably open and more closely conforms to the legislative intent. If a literal interpretation of 'give' a refund was accepted then the policy purpose (to ensure suppliers do not get a windfall gain) would not be achieved in cases where the supplier obtains the benefit of the overpaid amount without reimbursing the recipient.

88. Accordingly the Commissioner is of the view that section 105-65 is not limited to situations where an actual refund is payable or would be applied to the entity's RBA.

89. Furthermore, the word 'amount' indicates that individual transactions are contemplated by the section and that it can operate at an individual GST level. It is also implicit in the language of section 105-65, by the use of the phrase 'a supply was treated as a taxable supply' that the section is intended to apply at the level of each individual supply rather than only at the total revised net amount.

[37] The same outcome applies where the net effect of the transactions is that a refund previously paid under Division 35 of the GST Act is reduced.

90. Additionally, in subsection 105-65(2) there is a reference to 'so much of any net amount', which indicates that the Commissioner can look at each individual supply to determine if it is an amount to which section 105-65 should apply. These factors indicate that section 105-65 is predicated on an examination of individual transactions rather than on overall net amounts for a particular period.

91. The relevant Explanatory Memorandum[38] also supports the view that the section applies to individual components of GST that may make up the net amount. For example, paragraph 2.2 states that 'if a business overpays GST **on a sale** to customer then **the GST** may be refunded to the business only if the business has first refunded **the** overpaid amount' (emphasis added). Paragraph 2.8 reiterates that the restriction on providing refunds 'applies to situations in which *transactions* have been treated incorrectly as taxable supplies' (emphasis added).

92. Accordingly the Commissioner is not prevented from examining each individual supply or transaction that has occurred to determine if it could give rise to a refund to the supplier.

Example 5

93. *Andrew Enterprises is registered for GST and makes supplies only to unregistered end consumers. For Quarter 1 it had a GST liability of $2,400. In Quarter 4 it realises that it has incorrectly charged GST of $400 on a supply that should have been GST-free. Andrew Enterprises has not reimbursed its unregistered end consumers.*

94. Section 105-65 applies to the overpayment of $400. Therefore Commissioner is not required to give a refund of the $400 to Andrew Enterprises.

Example 6

95. *Assuming the same facts in Example 5 but in addition Andrew Enterprises also discovers in Quarter 4 that it made a mistake in the calculation of its net amount for Quarter 1. The mistake results in an increase in GST payable of $500. The net result of these adjustments is an increased liability of $100 for Quarter 1 ($500 of GST less $400 of overpaid GST).*

96. Section 105-65 still applies to the overpayment of $400. As the Commissioner is not required to give a refund of the $400, Andrew Enterprises is liable to pay GST of $500.

[38] Explanatory Memorandum to the Tax Laws Amendment (2008 Measures No. 3) Bill 2008.

Circumstances in which the Commissioner may exercise the residual discretion to refund where section 105-65 applies

97. Under the general rules, which include section 35-5 of the GST Act and Divisions 3 and 3A of Part IIB of the TAA, the Commissioner must, where the relevant conditions are present, pay a refund of the net amount.

98. Section 105-65 places a restriction on the payment of a refund of overpaid GST. If the supplier satisfies the Commissioner that it has reimbursed the recipient of the supply and the recipient of the supply is not registered nor required to be registered the Commissioner must refund the overpaid GST. In all other cases section 105-65 provides that the Commissioner 'need not' give a refund.

99. Whilst not free from doubt, the Commissioner considers that the words 'need not', in the context of section 105-65, do not prohibit the giving of a refund and accordingly the Commissioner has a 'residual discretion' to pay a refund in appropriate circumstances.

100. Given the scheme of the GST Act,[39] the payment of a refund when an entity has not complied with the specific requirements of section 105-65 will be the exception rather than the norm. Therefore, the onus is on the supplier to demonstrate that their circumstances make it appropriate for the Commissioner to give a refund despite the fact that the Commissioner need not do so.

101. The relevant principles for making administrative decisions were set out by Mason J in *Minister for Aboriginal Affairs v. Peko-Wallsend Ltd & Ors* (1986) 162 CLR 24, where his Honour said at 39-40:

> What factors a decision-maker is bound to consider in making the decision is determined by construction of the statute conferring the discretion… **where a statute confers a discretion which in its terms is unconfined, the factors that may be taken into account in the exercise of the discretion are similarly unconfined, except in so far as there may be found in the subject matter, scope and purpose of the statute some implied limitation on the factors to which the decision-maker may legitimately have regard** …By analogy, where the ground of review is that a relevant consideration has not been taken into account and the discretion is unconfined by the terms of the statute, the court will not find that the decision-maker is bound to take a particular matter into account unless an implication that he is bound to do so is to be found in the subject matter, scope and purpose of the Act. [Emphasis added.]

102. It is therefore important to consider the subject matter, scope and purpose of section 105-65.

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[39] Where a supplier treats a supply as taxable, the price of that supply includes GST. See for example paragraph 3.15 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998, which states that 'The price paid for a taxable supply always includes the GST.'

103. The Explanatory Memorandum to the A New Tax System (Goods and Services Tax Administration) Bill 1998 (which introduced section 39 of the TAA, the predecessor to section 105-65) states:

> 3.40 However, if GST is overpaid in a situation where supplies were incorrectly treated as taxable supplies in a GST return or assessment, a refund will have to be paid only if the Commissioner is satisfied that the recipients of the supplies on which the GST was overpaid have been reimbursed. The recipients of the supplies must not be registered or required to be registered for GST purposes. [New subsection 39(3)]
>
> 3.41 Because GST is payable by suppliers but is ultimately borne by the consumers of goods and services, a refund of overpaid GST would ordinarily result in a windfall gain to the supplier. A supplier will need to satisfy the Commissioner that an amount corresponding to the refund will be passed on to the persons who ultimately bore the cost of the overpaid GST.

104. The Explanatory Memorandum to the Tax Laws Amendment (2008 Measures No. 3) Bill 2008 (which introduced the current version of section 105-65) at paragraph 2.2 states:

> 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.

105. It is clear that the scope and purpose of section 105-65 is designed to prevent windfall gains to suppliers. The potential or otherwise for a windfall gain in relation to a refund of overpaid GST is therefore something that must be taken into account in relation to the exercise of the residual discretion.

Guiding principles to consider in exercising the residual discretion

106. Section 105-65 does not specify what factors are relevant to the exercise of this residual discretion. In exercising the residual discretion, the Commissioner will have regard to the following guiding principles:

(a) The Commissioner must consider each case based on all the relevant facts and circumstances.

(b) The Commissioner needs to follow administrative law principles such as not fettering the discretion or taking into account irrelevant considerations.

(c) The Commissioner must have regard to the subject matter, scope and purpose of section 105-65. As explained in paragraph 105 of this draft Ruling, the scope and purpose of section 105-65 is designed to prevent windfall gains to suppliers.

(d) The residual discretion should be exercised where it is fair and reasonable to do so and must not be exercised arbitrarily. The circumstances in which the Commissioner considers it may be fair and reasonable to exercise the residual discretion include, but are not limited to, the following:

(i) The overpayment of GST occurs as a result of an arithmetic error made by the supplier.

For instance, an entity had treated its supply as GST-free when making the supply to the customer but when filling out its activity statement the entity incorrectly includes the supply as a taxable supply in the calculation of the net amount returned on the activity statement.

(ii) The overpayment of GST arises as a direct result of the actions of the Commissioner.

For instance, an entity had treated its supply as GST-free and the Commissioner subsequently treats that supply as taxable but later reverses that decision.

(iii) Where a registered recipient has not yet on-supplied the thing to its customers.

Where a registered recipient has not yet on-supplied the thing to its customers, the revised GST treatment may be able to be taken into account in making the supply. Accordingly, if the supplier reimburses the registered recipient, the registered recipient can effectively reduce the GST charged to its customers. This might be the case where a supply incorrectly treated as taxable is of a significant identifiable asset, such as real property. It is unlikely to be the case where the supplies are of financial services.

(iv) Where a registered recipient acquired the supply for a private purpose.

If a registered recipient acquired the supply for a private purpose then they should be treated like an end-consumer because they would not be in a position to pass on the GST to their customers.

107. Appendix 2 of this draft Ruling provides examples of circumstances illustrating the exercise of the Commissioner's residual discretion.

'Preserving the status quo'

108. Notwithstanding the primary stated policy of preventing windfall gains, the drafting of subparagraph 105-65(1)(c)(ii) also appears to reflect a 'preserving the status quo' policy. In other words, there is nothing to be gained from reversing transactions where the supplier and recipient are both registered for GST.

109. When the supplier has decided to treat a supply as taxable it includes GST in the price it charges to the recipient. Where the acquisition of that supply is used by the registered recipient in its enterprise, it has been entitled to input tax credits in relation to that acquisition. In such cases there would not usually be any compelling reasons to justify paying a refund. Since the treatment of the supply as taxable was GST neutral, then notwithstanding the fact that both the supplier and the recipient have separate and distinct responsibilities under the law, there would not usually be any policy reasons to unwind the treatment that was adopted. Such unwinding may give rise to administrative and compliance costs, as well as a risk to the revenue if there is any doubt about the Commissioner's ability to recover input tax credits.

110. In the circumstances where the 'preserving the status quo' policy is appropriate, the Commissioner will not require suppliers and recipients to revise their activity statements to unwind the relevant transactions.

111. The 'preserving the status quo' policy cannot be extended to any circumstances outside of those covered by section 105-65. For example, the policy cannot be applied to the reverse situation of the incorrect treatment of a taxable supply as non-taxable. Such errors are usually corrected by activity statement revisions.

What is the quantum of any refund given

112. A refund given by the Commissioner is usually equivalent to the amount of GST that has been overpaid (or not refunded). Subsection 105-65(1) provides that the Commissioner need not refund an amount to which the section applies if an entity overpaid the amount (or the amount was not refunded to the entity).

113. However, subsection 105-65(2) provides that the section applies to 'so much of any net amount or amount of GST' as the entity has overpaid (or 'so much of any net amount' that has not been refunded to the entity). The Commissioner considers that the use of words 'so much of any' indicates that subsection 105-65(1) can apply to an amount that is less than the whole amount that has been overpaid (or not refunded).

114. Accordingly, if a supplier reimburses (in a later tax period) a lesser amount to an entity that is not registered (or required to be registered), then section 105-65 does not apply to that reimbursed amount because neither of the conditions in paragraph 105-65(1)(c) are satisfied.[40]

115. The lesser amount will be refunded under the general rules and the restriction on refund provision will not apply to this amount. However, the restriction on refund provision will still apply to the amount not reimbursed.

Example 7

116. *Laurren treats a supply made to Hoa (who is not registered or required to be registered) as a taxable supply for $1,100. After Laurren lodges her activity statement, she realises that the supply should have been GST-free. Laurren and Hoa agree that only $70 of the total $100 overpaid GST should be reimbursed. Laurren reimburses $70 to Hoa.*

117. Section 105-65 does not apply to the $70 that can be refunded to Laurren. However, section 105-65 does apply to restrict the refund of the remaining $30.

No adjustment for other transactions

118. The use of the words 'so much of any' in subsection 105-65(2) does not allow the amount refunded to be adjusted to reflect the effect of some other transaction, such as the offsetting of input tax credits claimed by the supplier.

119. The Commissioner considers that the restriction on refund provision in section 105-65 is transaction based and operates at a transaction level, not at a higher global level. The transaction or transactions related to the claiming of input tax credits are unrelated to the transaction which is the focus of section 105-65.[41] In other words, section 105-65 concentrates on the GST payable on the supply and because of this any input tax credits are excluded from the calculation of the quantum.

[40] Subparagraph 105-65(1)(c)(i) does not apply to the amount reimbursed because the Commissioner is satisfied that a reimbursement of that amount has occurred and subparagraph 105-65(1)(c)(ii) does not apply because the entity is not registered.

[41] Also input tax credits are allowed where, among other things, an entity acquires a thing in carrying on the entity's enterprise – see sections 11-5 and 11-15 of the GST Act. Therefore, the claiming of input tax credits is not necessarily linked to the making of a particular supply.

Example 8

120. *Entity FS provides services to Belinda (who is not registered or required to be registered for GST) for $5,500. Entity FS believes the supply of services to be taxable and accordingly remits GST of $500 to the Tax Office. Entity FS also claims $150 worth of input tax credits on acquisitions it used to make the supply to Belinda. It is later ascertained the supply of services to Belinda was in fact an input taxed supply. Entity FS reimburses $500 to Belinda and seeks a refund of the overpaid GST.*

121. The Commissioner must refund the entire $500 to Entity FS (that is, the refunded amount under section 105-65 cannot be reduced by the $150 input tax credit that was claimed in respect of the supply). However, the Commissioner would disallow the input tax credit claim of $150 if he was within the time permitted by section 105-50. The input tax credit no longer relates to a taxable supply.

Recovery of amounts refunded without regard to section 105-65

122. There are cases where the Commissioner may inadvertently refund amounts without regard to the operation of section 105-65. For example, an entity revises an earlier activity statement that results in a refund of overpaid GST. The refund is processed and paid automatically by Tax Office systems without regard being had to section 105-65. Later the Commissioner discovers that the refund of GST was one to which section 105-65 applied.

123. In this situation section 8AAZN of the TAA may be used to recover a refund that was paid without regard to section 105-65.

124. Section 8AAZN of the TAA relevantly states:

> **8AAZN(1) [Overpayments are court recoverable as debts due]**
>
> An administrative overpayment (the overpaid amount):
>
> (a) is a debt due to the Commonwealth by the person to whom the overpayment was made (the recipient); and
>
> (b) is payable to the Commissioner; and
>
> (c) may be recovered in a court of competent jurisdiction by the Commissioner, or by a Deputy Commissioner, suing in his or her official name.
>
> …
>
> **8AAZN(3) [Administrative overpayment]**
>
> In this section:
>
> *administrative overpayment* means an amount that the Commissioner has paid to a person by mistake, being an amount to which the person is not entitled.

125. If section 105-65 applies so that the Commissioner need not pay a refund, and the Tax Office processes a refund without regard to that section, the Commissioner considers that the payment of that refund constitutes a mistake and therefore an 'administrative overpayment' for purposes of section 8AAZN of the TAA.

126. The word 'mistake' in the context of section 8AAZN of the TAA is not a defined term and takes its meaning from the common law. The concept of mistake under the common law (as determined in the unjust enrichment context) encompasses:

- mistakes of fact and law (see *David Securities Pty Ltd v. Commonwealth Bank of Australia* (1992) 175 CLR 353 (*David Securities*);
- a positive but mistaken belief in an existing matter and also ignorance of an existing matter (see *Hookway v. Racing Victoria Ltd* (2005) 13 VR 444 (*Hookway*) and *David Securities*); and
- circumstances where a party was forgetful or negligent in making the payment (see *Commercial Bank of Australia Ltd v. Younis* [1979] 1 NSWLR 444 and *Tutt v. Doyle* (1997) 42 NSWLR 10).

127. In *David Securities* the High Court said that a payment was a voluntary payment rather than a mistake if the payer:

- chooses to make the payment even though the payer believes a particular law or contractual provision requiring the payment is, or may be, invalid;
- is not concerned to query whether payment is legally required, that is, the payer is prepared to assume the validity of the obligation to make the payment; or
- is prepared to make the payment irrespective of the validity or invalidity of the obligation to make the payment, rather than contest the claim for payment.

128. It may be argued that a payment in disregard of section 105-65 falls within the second category of voluntary payments above. However, the Commissioner considers that an absence of regard for section 105-65, in the context of an automated refund system, is not an assumption that the payment is legally required to be made.

129. GST is a self actuating system and, due to the sheer volume of activity statements that are required to be processed, relies necessarily on a degree of automation in the processing of these activity statements.

130. Section 8AAZN must be read in the context of such a system, and therefore a refund that is effected without any consideration of the facts and without knowledge that the recipient of the supply has been reimbursed (or that the recipient was registered) cannot be said to be made voluntarily.

131. The High Court in *David Securities* also referred (at paragraph 40) to the fact that money paid under a mistake of law could refer to 'circumstances where the plaintiff pays moneys to a recipient who is not legally entitled to receive them'.

132. The decision of the Victorian Court of Appeal in *Hookway* also supports the above views regarding 'voluntariness'. The court considered that a payment in disregard of whether there was a legal obligation to make the payment was only 'voluntary' if there was a conscious decision to disregard that obligation. The Commissioner considers that a payment, which would otherwise be restricted under section 105-65 but is made in disregard of the section, is simply an error that has not been subject to conscious consideration and therefore should not be regarded as a 'voluntary payment'.

Section 105-65 is more than a mere recovery provision

133. Paragraph 105-65(2)(a) provides that that the section applies to so much of any 'net amount' as has been overpaid. The net amount is intended to reflect the amount that an entity is legally obligated to pay or the amount that is legally refundable. The assessment of the net amount should be made taking into consideration all relevant legislation, including the TAA provisions which may impinge upon the amount the taxpayer is legally obligated to pay or entitled to be paid in the form of a refund.

134. Section 105-65 restricts the entity's right to a refund in the sense that when section 105-65 applies the entity is, to that extent, not legally entitled to a refund of the GST it was not legally required to pay. The net amount assessed accordingly should reflect that the taxpayer is not legally entitled to the refund. In other words, section 105-65 can be seen as a statutory provision that operates at the level of ascertaining the entity's legal obligation to pay its tax liability or its entitlement to a refund and is not simply a 'recovery' provision.

135. In this regard sections 105-50, 105-55, 105-60 and 105-65 should be read together with the GST Act as part of a legislative scheme concerned with determining an entity's legal obligation to pay GST or its entitlement to be paid a refund as reflected in the net amount.

136. These provisions clearly affect an entity's entitlement to a refund or their liability to pay tax and as such the provisions are more than mere recovery provisions and must be taken into account in determining the net amount.

Example 9

137. *Sheree remits GST of $2,000 in Quarter 1. Sheree has not claimed input tax credits and her net amount is $2,000. In Quarter 3 Sheree realises that some of the transactions in Quarter 1 were actually GST-free and that consequently the correct amount of GST payable was $1,700. Sheree does not refund any amounts to her end consumers. She requests the Commissioner to make an assessment of her net amount for Quarter 1.*

138. In this situation, the Commissioner will make an assessment of Sheree's net amount for $2,000 as this reflects the proper amount due and payable after the operative effect of section 105-65 is taken into account. This is because Sheree has not reimbursed a corresponding amount to the recipients of the supplies and as such is not entitled to a refund of the overpaid GST. However, Sheree has legal rights to challenge the assessment under Part IVC of the TAA. If Sheree was entitled to a refund of the overpaid GST, the Commissioner would reflect this by making assessment of her net amount for $1,700.

Appendix 1 – Overview of the GST refund rules

This Appendix sets out an illustrative diagram. It does not form part of the proposed binding public ruling.

139. The following diagram provides a simplified illustration of the GST refund rules in the context of section 105-65.

The general rule…	***However…***	***Unless…***
The Commissioner must refund (or apply an amount) in accordance with the running balance account rules (Division 3A of Part II of the TAA).	The Commissioner need not give a refund (or apply that amount) if the conditions in section 105-65 apply.	The Commissioner exercises the residual discretion under section 105-65 to give the refund (or apply that amount).

Appendix 2 – Examples: exercise of the residual discretion

This Appendix sets out examples. It does not form part of the proposed binding public ruling.

140. The operation of the residual discretion in section 105-65 depends on the facts and circumstances of each case. The following examples are not intended to fetter the exercise of the Commissioner's residual discretion, but are for illustrative purposes only.

Example 10

141. *Kasey carries on an enterprise and she made a series of supplies to Anita between July 2000 and July 2002. Anita was registered for GST. Kasey charged GST on the supplies and Anita claimed input tax credits. But it is subsequently established that the supplies should have been treated as GST-free under section 13 of the A New Tax System (Goods and Services Tax Transition) Act 1999* (*Transition Act). The contractual terms contained in Kasey's contract have the practical effect that the price cannot be increased for the first six months.*

142. *The evidence in relation to 2001 and 2002 is ambiguous. However Kasey is now not restricted by her contract from increasing her price and has increased her price which includes the GST on the supplies she has treated as taxable supplies. Kasey contends that she sought informal advice from the Tax Office in August 2000 and was told that her supplies would not be GST-free under section 13 of the Transition Act.*

143. *Following the decision in Federal Commissioner of Taxation v. DB Rreef Funds Management Limited Ltd* 2006 ATC 4282; (2006) 62 ATR 699 *(DB Rreef) it was apparent that the supplies Kasey made should have been treated as GST-free.*

144. *However, Kasey is a sole trader who prepared her own activity statement and does not keep up to date on tax developments. She did not become aware of the DB Rreef case until hearing about discussion of refund opportunities in relation to section 13 of the Transition Act in June 2008. She put in a section 105-55 notification for a refund at that time.*

145. This may be an appropriate case for the exercise of the Commissioner's residual discretion in relation to the first six month period when Kasey can establish that she could not and did not increase her prices. This takes into account the Tax Office's informal advice that encouraged Kasey to charge the GST and there is a reasonable explanation for the lengthy delay in claiming the refund.

146. A factor weighing against the exercise of the residual discretion is that there is a loss to the revenue in respect of a transaction that is intended by the GST system to be revenue neutral. Nevertheless, on balance this may be an appropriate case to exercise the Commissioner's residual discretion.

147. The following example illustrates another situation where the Commissioner is unlikely to exercise the residual discretion.

Example 11

148. *A management company (MC) supplies consulting services to a financial supply provider (FS). Both parties are registered for GST. The supplies were treated as taxable and MC remitted GST equivalent to the full amount charged whilst FS claimed a reduced input tax credit of 75% of the GST included in the price.*

149. *It is subsequently ascertained that the supply of services should have been GST-free (under the transitional rules). MC requests a refund of 25% of the overpaid GST on the basis that it will refund this amount to FS since FS was not able to obtain an input tax credit in respect of this component.*

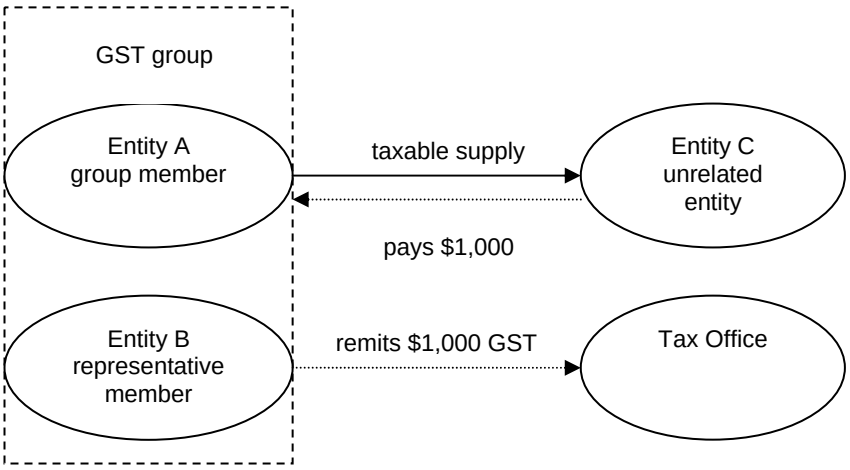
150. On balance, the Commissioner is unlikely to exercise the residual discretion to refund an amount equivalent to the 25% unclaimed input tax credit amount. The transaction occurred between registered entities and in these cases the policy is to 'preserve the status quo'. There do not appear to be exceptional circumstances in this particular case. The fact that FS only claimed a reduced input tax credit is not exceptional, particularly since many entities in this position will pass on the unclaimed cost of GST to their customers.[42]

151. Furthermore section 105-65 is concerned with supplies that have been treated as taxable by suppliers and is not concerned with input tax credit claims of recipients.

Example 12

152. *Entity A is a member of a GST group and the representative member is Entity B. Entity A makes a supply to an unrelated party, Entity C, who is not registered for GST. GST of $1,000 is charged on the supply. Entity B, as the representative member, remits the $1,000 of GST to the Tax Office.*

[42] GST is effectively borne by consumers when they acquire anything to consume (see paragraph 15 and footnote 5 referred to in that paragraph of this draft Ruling). See also paragraph 5.4 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.



153. *It is subsequently determined that the supply by Entity A to C was in fact GST-free. Section 105-65 applies to the overpaid GST of $1,000 because Entity B overpaid the amount on a supply that was treated as taxable (by Entity A) but was not in fact taxable. Entity B, as the representative member who remitted the GST, seeks a refund from the Commissioner of the overpaid amount.*

154. *Paragraph 105-65(1)(c) requires that Entity B provide a reimbursement to Entity C before a refund can be given. However, since in this case Entity A had the contract with Entity C, Entity A is the entity that makes the reimbursement to Entity C.*

155. This may be an appropriate case for the exercise of the Commissioner's residual discretion in relation to the overpayment of $1,000. Although Entity B did not make the reimbursement, a reimbursement was in fact made and for this reason no windfall gain occurs to either Entity A or B. The recipient of the supply, who bore the cost of GST on a supply that was not subject to GST, has been effectively compensated. In this type of case it may be fair and reasonable for the Commissioner to exercise his residual discretion to refund the amount.

Example 13

156. *At 1 July 2000 Heavy Industries Ltd is considering whether certain goods are taxable or GST-free. It decides that its supplies are all taxable. After taking all factors into consideration Heavy Industries Ltd decides that a uniform 7% increase in prices is sufficient to cover the cost of implementing the new GST.*

157. *In June 2007 Heavy Industries Ltd's accountants advise that they believe that certain supplies made by the company should be treated as GST-free. Heavy Industries Ltd lodges a section 105-55 notice seeking to notify the Commissioner of their entitlement to a refund in relation the relevant GST-free supplies incorrectly treated as taxable supplies. All of Heavy Industries Ltd customers are registered taxpayers. Heavy Industries Ltd seeks to argue that they bore the economic cost of the GST.*

158. In this case the factors weighing against the refund are that Heavy Industries Ltd has taken the GST into account in determining the price that it considered necessary to cover the cost of the GST under the new regime. This cost has been embedded in the price and ultimately borne by the unregistered end consumer.

159. On balance this is a case where it is not appropriate to refund the overpaid GST.

Example 14

160. *Tom inadvertently remits GST of $2,000 on a particular supply when the correct GST amount should have been $200. Tom has charged Charles, a non-registered recipient, the correct amount of GST of $200. Tom realises his mistake in the next tax period and seeks a refund of $1,800, which is the overpaid GST amount.*

161. The incorrect payment satisfies paragraphs 105-65(1)(a) and 105-65(1)(b) because the supply was treated as taxable to higher extent than it actually was. However, since Charles has been charged the correct amount of GST, Tom is not required to make reimbursement to Charles. Further Tom will not obtain a windfall gain by being refunded the overpaid GST. In this case, it is fair and reasonable for the Commissioner to exercise the residual discretion to refund the overpaid GST.

Example 15

162. *Rehka treats a particular supply as GST-free. Subsequently she is audited by the Tax Office, which determines that she should have remitted GST on that supply. An assessment is raised and Rehka remits the outstanding GST.*

163. *Rehka subsequently objects to the assessments on the basis that the supply was not taxable. The Commissioner reverses the audit decision and gives a favourable objection decision. Rehka seeks a refund of the overpaid GST.*

164. In this case, Rehka overpaid the GST because the Commissioner incorrectly treated the supply as taxable. It is fair and reasonable for the Commissioner to exercise the residual discretion to refund the overpaid GST.

Appendix 3 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.

Meaning of 'to any extent'

165. This draft Ruling takes a broad interpretation of section 105-65 as applying to many circumstances where there has been a reduction in the GST amount occurring post-supply. However, the alternative view is that section 105-65 is limited to those types of overpayments that result from the character of supply altering.

166. Under this alternative view, for section 105-65 to apply:

- the amount of GST remitted for a supply in a relevant tax period must exceed the amount which was required to be remitted on that supply, and
- the overpaid amount must arise due to a mischaracterisation in the nature of the supply.

167. The word 'overpaid' is not a defined term so it takes on its normal meaning. The *Macquarie Dictionary*[43] relevantly defines 'overpay' as: '1. to pay more than (an amount due).'

168. Using the reasoning in *Chippendale* in the context of section 105-65, the amount that has been remitted must be in excess of what was legally payable on the particular supply. However, under the alternative view, the overpayment must also arise **because** of a misclassification in respect of the supply.

169. The sequential logic of paragraphs 105-65(1)(a) and 105-65(1)(b) would appear to be that the entity seeking the refund must have overpaid an amount **because** a supply was treated as a taxable supply but the supply was not actually taxable, but rather has some other GST treatment (for example, it is GST-free).

170. Section 105-65 appears to link the concept of 'overpayment' with the treatment of the supply and accordingly not every eventuality of an excess payment of GST would appear to be covered by section 105-65.

171. The requirement for a nexus between the overpayment and treatment of the supply under the alternative view means that mere clerical errors or mathematical mistakes would not, on their own, activate section 105-65. Similarly section 105-65 would not necessarily apply where the amount of GST payable for a taxable supply is subsequently altered after the supply has occurred (such as in margin scheme cases).

[43] The *Macquarie Dictionary*, 2001, rev. 3rd edn, The Macquarie Library Pty Ltd, NSW.

172. However the alternative view is arguably not supported by the language of the provision. If Parliament had intended the section to apply only when the refund arose from a change from status of the supply from taxable to GST-free or input taxed it could have used the language ' if and only if', rather than words which are actually enacted which are ' For example because it is GST-free'. 'For example' suggests that it is not an exhaustive list of the type of cases that may lead to an entity incorrectly charging GST.

173. On balance the Commissioner is of the opinion that the view expressed in the draft ruling (at paragraphs 27 to 28 represents the better interpretation of the provision. The view in this draft Ruling accords with the policy and purpose of section 105-65 to ensure that registered suppliers in a supply chain do not obtain a windfall gain by claiming refunds of overpaid GST where that GST has been borne directly or indirectly by recipients of the supply.

Effect where the wrong entity remits the GST

174. This draft Ruling position is that section 105-65 applies where a registered entity incorrectly remits the GST on a supply that has in fact been made by another registered entity.

175. Example 4 at paragraph 79 of this draft Ruling states:

> *Entity N is acting as a distributor for a collective of individual registered entities that make and supply widgets. The individual widget suppliers are making the supplies but Entity N thought it was the supplier and hence remitted the GST on its own behalf (rather than as agent for the widget makers). Entity N subsequently ascertains that it was not the correct supplier and seeks a refund.*

176. Under the alternative view, section 105-65 does not apply to these types of situations.

177. Paragraphs 105-65(1)(a) and 105-65(1)(b) relevantly provide that the Commissioner need not give 'you' a refund if:

(a) you overpaid the amount…because a supply was treated as a taxable supply to any extent; and

(b) the supply is not a taxable supply to that extent (for example, because it is GST-free).

178. The sequential logic of the paragraphs 105-65(1)(a) and 105-65(1)(b) is that the entity seeking the refund (in this case Entity N) must have overpaid an amount because a supply was treated as taxable but the supply is not actually taxable, but rather has some other GST treatment (for example it is GST-free).

179. On the facts of Example 4 in paragraph 79 of this draft Ruling, Entity N has made overpayments of GST. The reason it made these overpayments was because it thought it was the supplier and hence believed it was making taxable supplies. There is no doubt that a supply was made – 'supply' is defined as any supply whatsoever and

would encompass the supply of widgets.[44] Accordingly paragraph 105-65(1)(a) is satisfied.

180. However, as section 105-65 is a cumulative provision, paragraph 105-65(1)(b) must also be satisfied.

181. Paragraph 105-65(1)(b) requires that the supply that was purportedly made in paragraph 105-65(1)(a) no longer be a taxable supply.

182. Whether paragraph 105-65(1)(b) is satisfied depends upon whether the supplies that were made by the 'real' suppliers were indeed taxable supplies or not. On the facts of Example 4 in paragraph 79 of this draft Ruling, since the widget makers were registered for GST when the supplies were made then the supplies made by them would have been taxable. In these cases, as the supplies themselves have not changed status and were always taxable (despite being accounted for by the wrong entity) paragraph 105-65(1)(b) is not satisfied. That is, the supplies of widgets were taxable and remained taxable for the entire period in which they were made. Hence paragraph 105-65(1)(b) does not apply.

183. The relevant Explanatory Memorandum[45] states that the restriction on refunds applies where 'an amount of GST on a taxable supply has been remitted that exceeds the amount of GST correctly payable on that taxable supply'. Based on this reasoning, where GST is correctly collected from end users by a registered entity on a taxable supply, that GST amount does not exceed the amount of GST correctly payable on the supply, despite the fact that that it has been collected by the wrong entity.

184. However, under the alternative view, where a supply is subsequently determined to be made by another entity that was **not** registered, nor required to be registered for GST, the supply, whilst initially treated as taxable, is in fact not taxable **at all**. In other words, paragraph 105-65(1)(b) is made out because the status of the actual supply is not taxable. In this case the Commissioner considers that section 105-65 does apply because an amount of GST has been remitted that exceeds the amount that was correctly payable on the supply.

185. On balance the Commissioner is of the opinion that the view expressed in the draft Ruling (at paragraph 29) represents the better interpretation of the issue. The view in this draft Ruling accords with the policy and purpose of section 105-65 to ensure that that registered suppliers in a supply chain do not obtain a windfall gain by claiming refunds of overpaid GST where that GST has been borne directly or indirectly by recipients of the supply. The Commissioner also has a residual discretion to provide a refund in appropriate cases.

[44] See subsection 9-10(1) of the GST Act.
[45] See the table after paragraph 2.10 in the Explanatory Memorandum to Tax Laws Amendment (2008 Measures No. 3) Bill 2008.

What is the quantum of any refund given

186. This draft Ruling position is that section 105-65 allows the Commissioner to make a partial refund in appropriate circumstances – for example where a lesser amount is reimbursed by the supplier to an unregistered recipient. However, there is an alternative view that section 105-65 applies in an 'all or nothing' manner as far as the quantum of the refund is concerned.

187. Subsection 105-65(1) provides that the Commissioner need not refund **an** amount to which the section applies if you overpaid **the** amount. Subsection 105-65(2) further provides that the section applies to 'so much of **any** net amount or amount of GST as you overpaid'. The use of words such as 'the amount', 'an amount' and so much of 'any' amount overpaid appear to indicate that the quantum referred to throughout the provision is intended to be the same amount.

188. The relevant Explanatory Memorandum[46] also draws a parallel between the requirement for the amount reimbursed to a recipient to correlate with the refunded amount:

> A supplier will need to satisfy the Commissioner that **an amount corresponding to the refund** will be passed onto to the persons who ultimately bore the cost of the overpaid GST. (Emphasis added.)

189. The above points indicate an intention that the amount refunded must be equivalent to the amount that was overpaid (and that if reimbursement occurs to a recipient it must also equate to the overpaid amount).

190. Under the alternative view, if a supplier partially reimburses a recipient, the Commissioner cannot give a refund of that lesser amount to the supplier.

191. On balance the Commissioner is of the opinion that the view expressed in this draft Ruling (at paragraphs 33 to 35) represents the better interpretation of the issue. The view in the draft Ruling accords with the overall policy of ensuring that entities do not get a windfall gain because the amount of the refund correlates to the amount of the reimbursement. The view in this draft Ruling also ensures that refunds can be provided in situations where a supplier may only be able to reimburse a portion of the overpaid amount to the recipient.

[46] Paragraph 3.41 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax Administration) Bill 1998.

Section 105-65 is a mere recovery provision

192. The view taken in this draft Ruling is that section 105-65 is more than a mere recovery provision and provisions of it nature must be taken into account in working out the net amount which in turn reflects the taxpayer's legal obligation to pay GST or their entitlement to a refund.

193. The alternative view is that the process of determining the net amount is complete when the Commissioner has determined the net amount in accordance with section 17-5 of the GST Act as modified by those provisions referred to in section 17-99 of the GST Act and therefore precludes sections 105-50, 105-55, 105-60 or 105-65 of the TAA from having any effect on the taxpayer's liability to tax or in the calculation of their entitlement to a refund. This would be the taxpayer's one true net amount and is determined either by lodgment of the activity statement or by the Commissioner issuing an assessment. Division 33 or 35 of the GST Act then makes that amount due and payable or refundable and sections 105-50, 105-55, 105-60 and 105-65 may only operate to determine whether the Commissioner is entitled to recover that liability or is required to refund the net amount already determined.

194. Under the alternative view the net amount advised to the taxpayer would not necessarily be the same as the final amount collected or refunded from the taxpayer.

195. For instance, in Example 9 at paragraph 9 of this draft Ruling, Sheree's assessed net amount would be $1,700 but the Commissioner could restrict payments of the refund of $300 because section 105-65 applies to that amount. Sheree would not have any objection rights under Part IVC of the TAA.

196. On balance the Commissioner is of the opinion that the view expressed in this draft Ruling (at paragraph 37) represents the better interpretation of the issue. The view in this draft Ruling reflects the fact that the ascertainment of an entity's true net amount (for example for the purposes of an assessment) requires taking into consideration all of the provisions that impinge upon the calculation of the relevant liability or entitlement.

197. The GST Act should be given a sensible interpretation, which achieves its purpose and facilitates its administration. It should therefore be read as taking account of all statutory provisions which affect the net amount payable or recoverable.

Your comments

198. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

199. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**12 February 2010**
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Detailed contents list

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Subject references:

- GST payments
- GST refunds
- GST returns
- GST returns, payments & refunds
- GST tax periods

Legislative references:

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