PS LA 2002/12 (Withdrawn) - Refunds of GST incorrectly included in the price of non-taxable supplies

This cover sheet is provided for information only. It does not form part of *PS LA 2002/12 (Withdrawn) - Refunds of GST incorrectly included in the price of non-taxable supplies*

It is withdrawn with effect from 15 September 2008. A public ruling covering a number of interpretative issues relating to the application of section 105-65 of Schedule 1 to the *Taxation Administration Act 1953* has now been issued (MT 2010/1). The Commissioner is currently considering whether to issue a separate Practice Statement (GA) to address the GST implications of transactions between registered entities. In the interim the Commissioner will continue to abide by the approach described in PS LA 2002/12, 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.
Law Administration Practice Statement PS LA 2013/3 GA was published on 1 August 2013. This practice statement sets out the Commissioners view in relation to the reversal of transactions where a supply or arrangement that occurs solely between registered entities has been incorrectly treated as a taxable supply.

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Practice Statement Law Administration

PS LA 2002/12

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This law administration practice statement is issued under the authority of the Commissioner and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. ATO personnel, including non ongoing staff and relevant contractors, must comply with this law administration practice statement, unless doing so creates unintended consequences or is considered incorrect. Where this occurs, ATO personnel must follow their business line's escalation process.

SUBJECT:	**Refunds of GST incorrectly included in the price of non-taxable supplies**
PURPOSE:	**To explain, in practical terms, ATO policy in regard to the exercise of the discretion in subsection 105-65(1) of Schedule 1 to the *Taxation Administration Act 1953*. Particular reference is made to situations where GST is incorrectly included in the price of non-taxable supplies made to registered recipients who subsequently claim input tax credits.**

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STATEMENT

How does section 105-65 of Schedule 1 to the *Taxation Administration Act 1953* apply?

1. Subsection 105-65(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA) provides that where goods and services tax (GST) is incorrectly included in the price of a non-taxable supply, the ATO is not obliged to refund or credit the overpaid amount to the supplier when both of the following conditions are met:

   - the ATO is not satisfied that the supplier has reimbursed the GST incorrectly included in the price to the recipient (subparagraph 105-65(1)(c)(i) of Schedule 1 to the TAA); and
   - the recipient is registered or required to be registered for GST purposes (subparagraph 105-65(1)(c)(ii) of the TAA).

2. However, where either or both of the above conditions are met, section 105-65 of Schedule 1 to the TAA provides that the ATO is not under an obligation to refund, but has a discretion to do so.

3. The flowchart at Appendix 1 illustrates how the ATO will exercise the discretion in subsection 105-65(1) of Schedule 1 to the TAA.

When will the ATO exercise the discretion in subsection 105-65(1) in Schedule 1 to the TAA?

4. The ATO will exercise the discretion when the scenarios indicated in the Table at Appendix 2 apply. This table covers the four possible combinations in relation to the paragraphs in subsection 105-65(1) of Schedule 1 to the TAA. The combinations are as follows:

   - paragraphs 105-65(1)(a),(b) and subparagraph 105-65(1)(c)(i) apply;
   - paragraphs 105-65(1)(a), (b) and subparagraph 105-65(1)(c)(ii) apply; or
   - paragraphs 105-65(a), (b) and subparagraphs 105-65(1)(c)(i) and (ii) apply.

5. As a general rule, the ATO will not exercise the discretion to allow a refund or credit in accordance with subsection 105-65(1) of Schedule 1 to the TAA if the supplier has not first reimbursed the recipient. However, there are some limited exceptions to this rule and these are explained in Appendix 2.

What if the error occurred in the current tax period?

6. The ATO will only exercise the discretion in relation to historical transactions, that is, where the GST incorrectly included in the price was attributed to tax periods earlier than the current one. If an error occurs in the current tax period and is discovered before the activity statement for the tax period is due, it should be corrected immediately. For example, activity statements lodged by the supplier and the recipient should be prepared on the basis of correct source documents where practicable.

7. There may be situations where a supply has been incorrectly treated as taxable in an earlier tax period and the recipient has not yet claimed an input tax credit. This could occur if the supply had been made in the previous tax period, the recipient accounted on a cash basis and did not pay for the acquisition until the current tax period. In any situation where the input tax credit has not yet been claimed, the recipient should not claim it if it knows that the supply is not a taxable supply, as the acquisition is not a creditable acquisition. The registered recipient does not have a legal entitlement to an input tax credit and should seek direct reimbursement of the amount of GST incorrectly included in the price from the supplier.

How is a refund of the overpaid amount obtained?

8. A supplier may obtain a refund of an overpaid amount by revising each activity statement for every tax period in which the error occurred. The revisions will (all things being equal) result in a Running Balance Account (RBA) surplus which will be paid as a refund provided that there are no other taxation liabilities against which it will be off-set.

9. Where the circumstances of the supplier fall within the Correcting GST Mistakes guide (NAT 4700); the supplier may use the guide to correct mistakes. Generally, this entails off-setting the mistake as a credit in a later activity statement.

What if the registered recipient claimed an input tax credit before discovery of the error?

10. If the registered recipient claims an input tax credit before becoming aware that the relevant supply is not a taxable supply, the recipient may seek a reimbursement of the GST amount included in the price from the supplier. The supplier will then be able to seek a corresponding refund from the ATO. However, the registered recipient must repay the input tax credit it incorrectly claimed by revising its activity statements for each tax period in which the errors occurred. It may also use the small error correction procedures in Fact Sheet NAT 4700 (Correcting GST Mistakes) if the requirements in the fact sheet are met.

When a non-taxable supply is incorrectly treated as taxable why can't it be treated as an adjustment in the next Business Activity Statement?

11. An adjustment can only arise if the conditions of Subdivision 19-B of the GST Act[1] (supplies) or Subdivision 19-C of the GST Act (acquisitions) are met.

12. The effect of a reimbursement is to change the consideration for a supply or acquisition. While this gives rise to an adjustment event, it does not give rise to an adjustment. This is because there is no change to the GST or input tax credit that is correctly attributable to the tax period, that is, both are correctly nil and have always been nil. It follows that there is no adjustment under Division 19 for either the supplier or registered recipient.

What if a supplier neither reimbursed its recipients nor cancelled tax invoices, but obtained a refund of overpaid GST under self-assessment?

13. Any refund paid by the ATO pursuant to a self revision by a supplier in subsection 105-65(1) of Schedule 1 to the TAA circumstances will be made on the assumption of correct self-assessment. To do otherwise and attempt to check all revisions pre-issue would be counter productive and inconsistent with both the spirit and letter of self–assessment and the Taxpayers' Charter. It would lead to unnecessary delays in the processing of the majority of claims that are valid.

14. Essentially, the ATO will consider that a refund or credit would have been validly received or applied only in circumstances where we are satisfied that the supplier has not received a windfall gain as a result of the error.

15. If it is later found that, had the ATO been aware of the facts before the refund issued, it would not have allowed the refund because the supplier had made no attempt to reimburse its recipients or cancel tax invoices, the ATO must seriously consider initiating prosecution action for the making of a false or misleading statement under Subdivision 2B of Part III of the TAA, and the Criminal Code, depending on the facts leading up to the false statement. Accordingly, the matter will be referred to the ATO Fraud Investigations section.

16. In addition to the prosecution action, the ATO may also seek from the Court a reparation order under section 21B of the *Crimes Act 1914* for an amount equal to the amount refunded.

[1] *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

Will the ATO enforce the reversal of transactions that occur solely between registered entities?

17. The ATO recognises that reversing transactions and revising every activity statement to correct errors of this particular type amounts to a paper 'round robin' among the registered recipient, the supplier, and the ATO. Significant compliance costs can be incurred with no change to the financial result. Figure 1 below illustrates the effect. Accordingly, the ATO has accepted an alternative solution that results in no detriment to GST revenue.

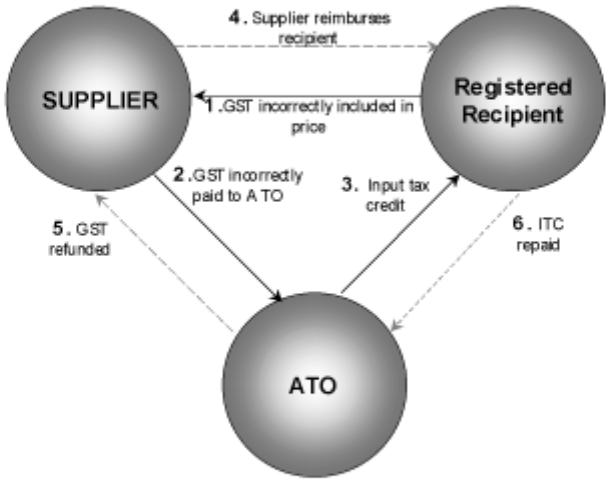


Figure 1 The round–robin effect of reversing transactions between registered entities (refer paragraph 17)

An alternative approach to past transactions between registered entities

18. When input tax credits are claimed in good faith before it is discovered that non–taxable supplies were treated as taxable, the ATO will adopt the policy in paragraph 24 below. This policy is an alternative to requiring the reversal of all transactions and the revision of activity statements by registered entities. However, the policy will only apply where both the supplier and the recipient meet the conditions below.

19. Neither party is obliged to adopt the policy, even if they both meet the criteria. The choice is theirs. If the incorrectly taxed supply is a one–off mistake, either or both of the parties may find it more convenient to simply reverse the transaction and revise activity statements. On the other hand, a supplier may have hundreds of registered recipients, with wide geographic dispersion. Reversal and revision may be a very costly exercise with no gain to either the revenue or the parties to the transaction. In the latter case, provided that both supplier and recipients meet the pre–conditions, the policy may be adopted in respect of those supplies where this occurs.

20. The thrust of the policy is that if both of the registered parties meet the criteria and do nothing to disturb the situation, then neither will the ATO if there is no compromise to revenue or the integrity of the tax system by doing so. The General Interest Charge (GIC) that would otherwise be payable by the recipient is effectively waived under this strategy (see also Principle 1 in paragraph 25 below).

21. The principles in the policy cannot be extended to any circumstances outside of those covered by section 105–65 of Schedule 1 to the TAA. For example, the policy cannot be applied to the reverse scenario of the incorrect treatment of a taxable supply as non–taxable. Such errors must be corrected either by activity statement revision or using Fact Sheet NAT 4700 (Correcting GST Mistakes).

Conditions for a Registered Supplier

22. The conditions for a registered supplier are:

- A non–taxable supply has been treated as a taxable supply;
- The supplier issued to the recipient an invoice that would be a valid tax invoice if the supply had been a taxable supply;
- The supply did not occur in the current tax period. The amount incorrectly included as GST in the price has been included in the supplier's activity statement for a previous tax period and the amount remitted to the ATO;
- The supplier has not reimbursed the registered recipient for the amount incorrectly included as GST in the price;
- The supplier has not cancelled the tax invoice by issuing any later document that indicates the correct non–taxable status of the supply; and
- The supplier began to treat current and future supplies of the same type as non–taxable as soon as it became aware of the error.

Conditions for a Registered Recipient

23. The conditions for a registered recipient are:

- The recipient is in possession of a document that would be a valid tax invoice if the supply had been a taxable supply;
- The invoice indicates that a supply is a taxable supply and includes an amount represented as GST in the price;
- The supply is non–taxable;
- The recipient relied on the tax invoice to claim the input tax credit;
- If the supply had been a taxable supply the recipient would have been entitled to claim full or partial input tax credits;
- The ATO has already refunded or credited the amount included as GST in the price to the recipient;
- The recipient has not been reimbursed by the supplier;
- The tax invoice has not been cancelled by the supplier and superseded by a later document that indicates the true status of the supply as non–taxable; and
- The registered recipient ceased to claim input tax credits for current and future acquisitions of the same type as soon as it became aware of the error.

The Policy

24. The following policy will apply to an entity only if the conditions in paragraphs 22 and 23 are met. The conditions are self–regulating, and if one of the entities to a supply fails to meet all of its conditions, the other party would also fail to meet its conditions.

- The ATO will not require the supplier to retrospectively amend its activity statements in relation to non–taxable supplies that have been incorrectly treated as taxable;
- The ATO will not credit or refund to a supplier the amount of GST incorrectly included in the price;
- If the supplies were non–taxable because they were input–taxed, and the supplier has claimed input tax credits on acquisitions in relation to those supplies because it incorrectly treated those input–taxed supplies as taxable, the supplier must repay those input tax credits. If the supplier had treated the supplies as taxable supplies in reliance on an earlier ruling issued to it by the ATO, it may ask the Commissioner to decide whether subsection 105–60(2) of Schedule 1 to the TAA requires the credits to be repaid;
- The ATO will not require the registered recipient to retrospectively revise its activity statements and repay the input tax credits it claimed in reliance on incorrect tax invoices; and
- Cases where the supplies were non–taxable for a reason other than that they were GST–free or input taxed need to be considered on their individual merits. An example would be a supply made by a person who is not registered or required to be registered for GST, and on which GST has been incorrectly included in the price and remitted. These types of cases should be decided only after consultation with the Interpretation and Field Practices Management section.

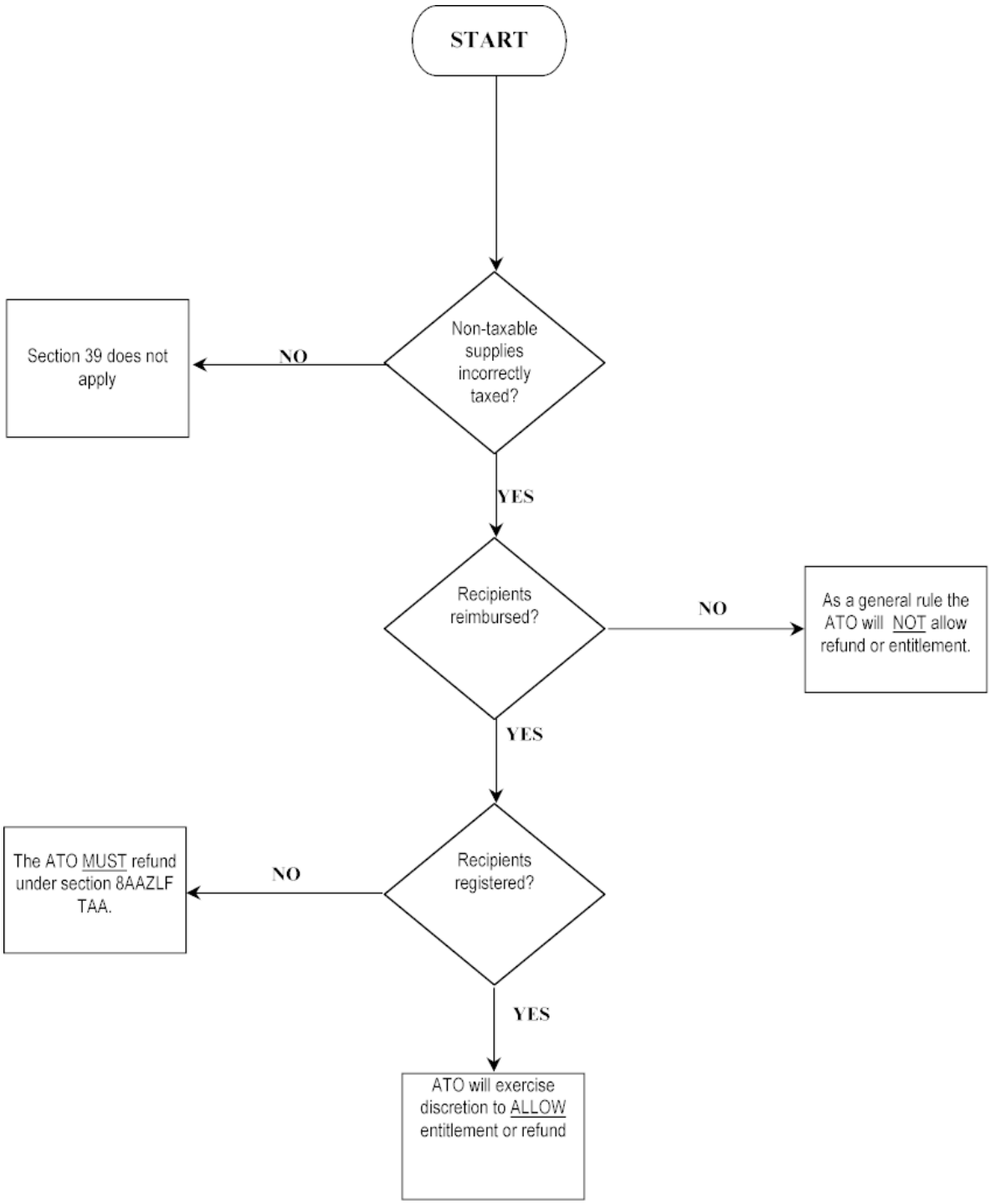
25. By way of summary, there are two important principles to keep in mind. These are:

<u>Principle 1:</u> The policy will not apply if the supplier has reimbursed the recipient. Both parties will need to revise their activity statements and the recipient will have to pay back the input tax credit it claimed. The ATO will give favourable consideration to any requests by the registered recipients for remission of the GIC that would automatically accrue when the input tax credit is repaid in these circumstances.

<u>Principle 2:</u> The net financial result of applying the policy must be neutral to GST revenue. However, if a registered recipient has claimed only a partial input tax credit on the basis of GST being incorrectly included in the price of a non–taxable supply, its financial interests may be better served if it does not rely on the above policy, but repays the partial input tax credit that it claimed, and seeks a refund of the full amount incorrectly included as GST in the price from the supplier. If it relies on the policy, it will be foregoing the amount of credit that it did not claim, and it has no basis to claim it subsequently. However, if a recipient in this position decides that it is not cost effective to revise activity statements and pursue a full refund from the supplier, the ATO will not require it to do so.

Appendix 1

How the ATO will exercise the discretion in subsection 105–65(1) of Schedule 1 to the *Taxation Administration Act 1953*



Appendix 2

Subsection 105–65(1) of Schedule 1 to the *Taxation Administration Act 1953*

How the ATO will exercise the discretion

NOTE: This decision matrix assumes a situation where paragraphs (a) and (b) of subsection 105–65 (1) apply, i.e., a non–taxable supply has been treated as taxable. It also assumes that the supply occurred in a tax period earlier than the current one.

	Subparagraph (c)(ii) applies (ie, *Unregistered recipient*)	**Subparagraph (c)(ii) does not apply (ie, *Recipient is registered*)**
Subparagraph (c)(i) applies **(i.e., *the supplier has reimbursed the recipient*)**	The ATO must refund the amount pursuant to section 8AAZLF of the *Taxation Administration Act 1953*.	The ATO will exercise the section 105–65 discretion to **ALLOW** the entitlement or refund.
Subparagraph (c)(i) does not apply **(i.e., *the supplier has not reimbursed the recipient*)**	**General Rule** The ATO will not refund or credit the overcharged amount. **Exceptions to the Rule** The ATO will exercise the discretion to allow a refund when: (a) The supplier can demonstrate that it has absorbed the cost of the amount incorrectly included as GST in the price and did not pass it on to the consumer. Before allowing such a refund or credit, the ATO will require from the supplier conclusive and tangible proof of its claims. There is also an expectation that such instances would be limited to supplies that were made very soon after the GST was implemented on 1 July 2000. (b) The supplier has complied with a written directive from the Australian Competition and Consumer Commission [ACCC] in relation to supplies that occur prior to 30 June 2002. A likely scenario giving rise to this situation is where the recipients cannot be readily traced, such as for numerous supplies made to cash customers in the public at large.	**General Rule** The ATO will not refund or credit the overcharged amount. **Exceptions to the Rule** The ATO will exercise the discretion to allow a refund when: (a) The supplier can demonstrate that it has absorbed the cost of the amount incorrectly included as GST in the price, did not pass it on, and it has cancelled earlier tax invoices sent to the registered recipients. The ATO will require tangible proof of such claims. (b) Cases where genuine financial hardship may result from any refusal to refund the amount incorrectly included as GST in the price. An example would be where the supplier has not received payment from the recipient. However, before making any refund to the supplier, the ATO will require that earlier tax invoices have been cancelled.

Amendment history

Date of amendment	Part	Comment
11 December 2013	Note	Included reference to publication of PS LA 2013/3 (GA)
13 February 2008	Contact details	Updated.
1 July 2006	Thoughout	References to subsection 39(3) of the TAA updated to subsection 105–65(1) of Schedule 1 to the TAA. References to subsection 37(2) of the TAA updated to subsection 105–60(2) of Schedule 1 to the TAA.
16 February 2007	Paragraph 9	Wording updated in order to clarify meaning.

Subject references	adjustment events business activity statements GST GST input tax credits and creditable acquisitions GST invoices GST returns, payments and refunds GST refunds, taxable supply
Legislative references	TAA 1953 8AAZLF TAA 1953 Pt III Subdiv 2B TAA 1953 Sch 1 105–60(2) TAA 1953 Sch 1 105–65(1) ANTS(GST)A 99 Subdiv 19–B ANTS(GST)A 99 Subdiv 19–C ANTS(GST)A 99 35–5 Crimes Act 1914 21B Criminal Code
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