PS LA 2013/3 (GA) - Treatment of input tax credits claimed by a recipient of a non taxable supply where the Commissioner has the discretion to give a refund of the overpaid GST to the supplier due to the operation of section 105-65 of Schedule 1 to the Taxation Administration Act 1953.

Australian Government
Australian Taxation Office

Practice Statement Law Administration (General Administration)

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This practice statement is issued under the authority of the Commissioner of Taxation and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by tax officers unless doing so creates unintended consequences or where it is considered incorrect. Where this occurs, tax officers must follow their business line's escalation process.

SUBJECT:	**Treatment of input tax credits claimed by a recipient of a non-taxable supply where the Commissioner has the discretion to give a refund of the overpaid GST to the supplier due to the operation of section 105-65 of Schedule 1 to the *Taxation Administration Act 1953.***
PURPOSE:	**To explain the circumstances in which the Commissioner will use his powers of general administration to allow a recipient to retain an input tax credit that it has claimed where a transaction was incorrectly treated by a supplier as giving rise to a taxable supply.**

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BACKGROUND

1. Section 105-65 of Schedule 1 to the *Taxation Administration Act 1953*[1] applies to an amount that relates to a tax period starting before 31 May 2014. Subsection 105-65(1) provides that the Commissioner need not give a refund, or apply that amount,[2] if an entity overpaid its net amount or an amount of goods and services tax (GST) because:

   (a) a supply was treated as a taxable supply, or an arrangement was treated as giving rise to a taxable supply, to any extent;[3] and

   (b) the supply is not a taxable supply, or the arrangement does not give rise to a taxable supply, to that extent;[4] and

   (c) 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);[5] or
   - the recipient (or in the case of an arrangement treated as giving rise to a taxable supply, the purported recipient)[6] is registered or required to be registered for GST.[7]

2. Where paragraphs 105-65(1)(a) and (b) apply:

   - but neither of the conditions in paragraph 105-65(1)(c) are met – section 105-65 does not apply and the Commissioner must refund the overpaid GST to the supplier;
   - and either or both of the conditions in paragraph 105-65(1)(c) are met – the Commissioner need not refund the overpaid GST to the supplier, but has a discretion to do so.

3. Miscellaneous Taxation Ruling MT 2010/1 outlines the Commissioner's views on section 105-65. In particular, paragraph 128 sets out guiding principles in relation to when the Commissioner may exercise the discretion to give a supplier a refund.

4. This practice statement applies to circumstances where:

   - a supply has incorrectly been treated as taxable to any extent in relation to a tax period starting before 31 May 2014[8]
   - the supplier is registered for GST and has overpaid GST
   - the supplier has issued a tax invoice to the recipient[9]
   - the recipient has over-claimed an input tax credit and would have been entitled to claim that input tax credit if the supply had been a taxable supply

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[1] Unless otherwise stated, all legislative references are to Schedule 1 to the *Taxation Administration Act 1953*.
[2] In accordance with the running balance account rules (see Division 3 and Division 3A of Part IIB).
[3] Paragraph 105-65(1)(a).
[4] Paragraph 105-65(1)(b).
[5] Subparagraph 105-65(1)(c)(i).
[6] In this practice statement, references to 'supply' include an arrangement that was treated as giving rise to a taxable supply, and references to 'recipient' include a purported recipient.
[7] Subparagraph 105-65(1)(c)(ii).
[8] Division 142 of the *A New Tax System (Goods and Services Tax) Act 1999* applies to excess GST in tax periods starting on or after 31 May 2014. This practice statement does not apply to excess GST under Division 142.
[9] Alternatively, the recipient of the supply has issued a recipient created tax invoice.

- the recipient has treated the acquisition as a creditable acquisition when applying other taxation laws such as the income tax law and the fringe benefits tax law
- should the supplier request a refund, section 105-65 would apply such that the Commissioner need not refund the supplier the overpaid GST; and
- the Commissioner has not given a refund of the overpaid GST to the supplier.

STATEMENT

5. This practice statement is concerned with the recipient's ability to retain input tax credits. The ATO view on the circumstances in which it is appropriate to exercise the Commissioner's discretion to refund the overpaid GST to the supplier is set out in MT 2010/1.

6. In the circumstances described in paragraph 4 of this practice statement, the Commissioner generally does not require the recipient to repay the over-claimed input tax credit or pay any general interest charge related to the over-claimed input tax credit.[10] This is referred to as the 'preserving the *status quo*' approach.

7. The factors listed in paragraph 4 are intended to provide a list of preconditions that must be satisfied before adopting an approach that preserves the status quo. However, we acknowledge that there will be other circumstances where it may also be appropriate to adopt such an approach.[11]

8. Preserving the *status quo* will not apply in those limited circumstances where the Commissioner exercises his discretion under section 105-65 to pay a refund of the overpaid GST to the supplier. Subject to an assessment of the facts in such cases, the ATO will seek to recover the over claimed input tax credits from the recipient of the supply. The over claimed input tax credits will be recovered by the ATO where, failure to do so, would produce an outcome inconsistent with the principles upon which the GST system is based.[12]

9. Preserving the *status quo* will also not apply where the supplier reimburses the recipient for the amount of GST incorrectly included in the price of the supply. In such cases, the ATO will generally seek to recover the over claimed input tax credits from the recipient of the supply to obviate a potential windfall gain as the recipient has ultimately not borne the cost of the GST.

10. Preserving the *status quo* is only applicable to historical transactions where the supply has been incorrectly treated as taxable.[13] The ATO expects the incorrect treatment of supplies as taxable to be rectified for future transactions.

11. Where a recipient considers that an acquisition is not a creditable acquisition because they believe the supply is not a taxable supply, the preserving the *status quo* approach is not to be used as a basis for supporting on-going incorrect GST treatment of future transactions. Where uncertainty exists as to the correct GST treatment of the transaction, the ATO will consider, subject to its risk criteria (likelihood and consequence of error), whether it needs to take action to confirm the treatment with both parties.

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[10] In accordance with paragraph 31 of PS LA 1998/1 and paragraph 12 of PS LA 2009/4, recipients can choose whether to adopt this approach or not.
[11] See paragraphs 23 and 24 of this practice statement.
[12] See paragraphs 16 and 17 of this practice statement.
[13] Paragraphs 25 and 26 of this practice statement provide commentary on what is a 'historical transaction'.

12. Preserving the *status quo* relates only to not disturbing the input tax credit claimed by the recipient. It is an administrative approach with the purpose of avoiding unnecessary compliance costs, it does not change the underlying nature of the supply and acquisition or the consequences of these transactions.[14]

13. Where the incorrect treatment of a supply as a taxable supply gives rise to the incorrect treatment of other transactions to which the supplier or recipient is a party, and which may give rise to an unintended benefit, it may not be appropriate to preserve the *status quo*.

14. The recipient's entitlement to an input tax credit can impact upon the application of other taxation laws, such as the income tax law and the fringe benefits tax law. For the preserving the *status quo* approach to apply, the recipient should also have treated the acquisition as a creditable acquisition when working out their obligations or entitlements under these other laws.[15]

15. The approach does not extend to circumstances outside those covered by section 105-65. For example, the approach cannot be applied where a taxable supply has been incorrectly treated as non-taxable. Such errors must be corrected by the supplier and recipient and reported by either activity statement revision or by applying the principles in GSTE 2013/1 *Goods and Services Tax: Correcting GST Errors Determination 2013.*[16]

EXPLANATION

16. The scheme of the GST law 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 a registered recipient being entitled to claim an input tax credit for that taxable supply where it is acquired for a creditable purpose, and
- once GST is embedded in the supply chain, it is the unregistered end consumer that bears the economic burden of the GST.

17. Two important policy considerations behind the operation of section 105-65, based on the principles above, are:

- the economic burden of GST charged on a taxable supply is ordinarily borne by the unregistered end consumer, and
- there should not be a refund of overpaid GST to a supplier where it would result in a windfall gain to the supplier.[17]

[14] See Example 1 of this practice statement for further details on this point.
[15] See paragraphs 41 to 45 of this practice statement for further details.
[16] Further information may also be found in the guide *Correcting GST errors* available on ato.gov.au
[17] See paragraph 37 of MT 2010/1.

18. From the supplier's perspective, subparagraph 105-65(1)(c)(ii) reflects those policy reasons by providing that the Commissioner need not give the supplier a refund of overpaid GST where the recipient is registered for GST. This principle is explained in the Explanatory Memorandum for the Tax Laws Amendment (2008 Measures No. 3) Bill 2008 which states that:

> in the case of business-to-business transactions, the Commissioner is not required to refund overpaid GST because the purchasing business is potentially entitled to input tax credits to offset the GST included in the price of its acquisition.[18]

19. Similarly, from the recipient's perspective, the preserving the *status quo* approach is consistent with the policy reasons behind the operation of section 105-65 by ensuring symmetry between the GST paid and the input tax credit claimed in respect of a business-to-business transaction.

20. Even where there is not complete symmetry between the amount paid as GST by the supplier and the input tax credit claimed by the recipient (for example, where the recipient claims a partial input tax credit), the Commissioner will generally adopt an approach that preserves the *status quo*. In these situations, it is envisaged that the registered recipient of the supply will pass on the cost of the unclaimed GST to their customers as a foreseeable cost of business.[19]

21. MT 2010/1 sets out the factors that the Commissioner will have regard to in exercising the discretion in section 105-65.[20] A number of these principles are also relevant in determining whether it is appropriate to not apply the preserving the *status quo* approach including where:

- it results in a windfall gain to the recipient or disturbs the inherent symmetry in the GST system, or
- it produces an unreasonable outcome, for example an asymmetrical revenue outcome.

22. Applying the Commissioner's powers of general administration, it is appropriate for the Commissioner not to take any compliance action to reverse a transaction in the circumstances outlined in paragraph 4. The approach aims to overcome unnecessary administrative and compliance costs for the parties involved in the transaction that would otherwise arise if reversal of the transaction were to be required.

23. As noted in paragraph 7 of this practice statement, there will be other circumstances in which it will also be appropriate to preserve the *status quo*. Such an approach may be adopted providing it does not produce an outcome that departs from the policy intent underpinning the GST law.

[18] Paragraph 2.3 of the Explanatory Memorandum.
[19] See paragraphs 124 and 128 of MT 2010/1.
[20] See paragraph 128 of MT 2010/1.

24. For example, an Australian based agent of a non-resident recipient may engage an Australian supplier to make supplies to the non-resident recipient. The supplier may incorrectly treat these supplies made to the non-resident recipient as taxable where the supplies are GST-free[21] and the Australian based agent of the non-resident recipient may claim an input tax credit corresponding to the overpaid GST.[22] This may occur where the Australian supplier mistakenly deals with the Australian based agent as if it were the principal rather than an agent of the non-resident recipient. In these circumstances, the recipient (the non-resident) would not have been entitled to a full or partial input tax credit if the supply had been a taxable supply.[23] However, it is a scenario where preserving the *status quo* provides an appropriate outcome.

Transactions to which the preserving the *status quo* approach applies

Historical transactions

25. The approach is only applicable to historical transactions where the GST was overpaid and an input tax credit was over-claimed in an earlier tax period. If a supply is incorrectly treated as taxable in the current tax period, the supplier and recipient should correct the transaction before lodging their activity statements.

26. The ATO expects the incorrect treatment of supplies as taxable to be rectified for future transactions.

Related transactions

27. The approach relates only to not disturbing the input tax credit claimed by the recipient. It does not change the underlying nature of the supply or the consequences of that supply (see Example 1 of this practice statement).

28. Where the incorrect treatment of a supply as taxable has GST implications for other transactions to which the recipient is a party, and the application of the approach gives rise to an unintended benefit, it may be appropriate to reverse the transaction rather than to preserve the *status quo*.

Example 1

29. Entity BB sold an interest in a building project to registered Entity CC. Entity BB treated the sale as a taxable supply and remitted an amount as GST to the ATO and Entity CC claimed a corresponding input tax credit.

30. It was subsequently determined that the disposal of the interest was an input taxed financial supply. The Commissioner may determine that it is appropriate to preserve the *status quo* in relation to this transaction by not requiring the input tax credit wrongly claimed by Entity CC to be returned.

31. However, Entity BB also claimed $5,000 of input tax credits for acquisitions made from Entity DD in relation to the supply it made to Entity CC.

32. Entity BB was not entitled to claim input tax credits for the acquisition from Entity DD. Therefore, the Commissioner would ordinarily recover the input tax credits claimed by Entity BB on the acquisitions from Entity DD.

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[21] Section 38-190 of the *A New Tax System (Goods and Services Tax) Act 1999*.
[22] Division 57 of the *A New Tax System (Goods and Services Tax) Act 1999*.
[23] The non-resident recipient is not registered or required to be registered for GST.

Transactions to which the preserving the *status quo* approach does not apply

The Commissioner exercises his discretion under section 105-65 to pay a refund to the supplier

33. The approach will not apply in circumstances where the supplier seeks a refund of the overpaid GST from the Commissioner, and the Commissioner exercises his discretion under section 105-65 to pay a refund to the supplier.

34. Subject to an assessment of the facts of the case the ATO will seek to recover the over claimed input tax credits from the recipient of the supply. To not recover in such instances would produce an unreasonable result, being one that provides an asymmetrical revenue outcome.

Example 2

35. Supplier (S) treats a supply to registered recipient (R) as GST-free and determines the price of the supply accordingly. Subsequently S is audited by the ATO, which determines that S should have remitted GST on the supply. An assessment is raised and S remits the amount assessed as GST to the ATO and issues a tax invoice to R. R claims a corresponding input tax credit. Contractually S can not seek to recover the GST from R that was not included in the price charged for the supply.

36. Subsequently S objects to the assessment on the basis that the supply was not taxable. The ATO reverses the audit decision and gives a favourable objection decision. S seeks a refund of the overpaid GST from the ATO.

37. In these circumstances, S overpaid the amount as GST because the Commissioner incorrectly treated the supply as taxable therefore it is appropriate to exercise the discretion in section 105-65 to refund the overpaid GST to S.[24]

38. In this situation, it is not appropriate for the Commissioner to allow R to retain the input tax credit. If R was able to retain the input tax credit, R would obtain a windfall gain because GST was not included in the original price paid by R and S bore the cost of the GST assessed by the ATO as it was unable to recover the GST under the contract between S and R.

The supplier reimburses the GST component of the price to the recipient

39. The supplier may reimburse the GST component of the GST inclusive price charged for the supply to the recipient. Examples of where this may occur include:

- where the reimbursement occurs as a pre-condition to the Commissioner exercising the discretion in section 105-65 to refund the overpaid GST to the supplier; and
- where the recipient agrees to reimburse in the course of settling a contractual dispute between the supplier and the recipient relating to the GST inclusive price of the supply.

40. In these cases, the ATO will generally seek to recover the over claimed input tax credits from the recipient of the supply. To preserve the *status quo* in these circumstances would result in the recipient receiving a windfall gain, being the retention of an input tax credit where GST was ultimately not included in the price of the acquisition.

[24] This example is based on Example 15 in Appendix 3 to MT 2010/1.

Other taxation laws

41. The recipient's entitlement to an input tax credit can impact upon the application of other taxation laws, such as the income tax law and the fringe benefits tax law.

42. For example, Division 27 of the *Income Tax Assessment Act 1997* (ITAA 1997) outlines the effect of the GST in determining the amount of a deduction. Provisions such as sections 27-5 (losses or outgoings) and 27-80 of the ITAA 1997 (capital allowances) provide that the quantum of certain income tax deductions will vary depending upon whether the acquirer is entitled to an input tax credit for the acquisition.

43. To ensure appropriate and consistent outcomes, a condition of adopting the preserving the *status quo* approach is that the recipient has treated the acquisition as a creditable acquisition (that is, it has treated the over-claimed input tax credit as if it were an input tax credit to which it is entitled) when working out its obligations and entitlements under the income tax law. The recipient would not request any amendment to the relevant income tax assessment to alter that position, in maintaining the status quo approach.

44. A similar issue arises in applying section 149A of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). A benefit provided in respect of the employment of an employee is a 'GST-creditable benefit' (and is therefore subject to a higher gross-up factor) if the person who provided the benefit[25] is or was entitled to an input tax credit because of the provision of the benefit. Again, a condition of adopting the preserving the *status quo* approach is that the person has treated the over-claimed input tax credit as if it were an input tax credit to which the person is entitled when calculating their fringe benefits tax liability. Again, the person would not request any amendment to the relevant fringe benefits tax assessment to alter that position.

Example 3

45. Brendan makes a GST-free supply to John, but mistakenly believes the supply to be taxable and charges a GST-inclusive price of $550. Brendan pays the GST to the Commissioner and John, who is registered for GST, claims an input tax credit of $50. Brendan later discovers his mistake and advises John. In order to preserve the status quo, John can only claim a tax deduction of $500. He should treat the $50 over-claimed input tax credit as being not tax-deductible. Brendan will only declare $500 as income.

General interest charge

46. Since the preserving the *status quo* approach does not require the recipient to repay the over-claimed input tax credit, it follows that the recipient is not required to pay any general interest charge in respect of the over-claimed input tax credit.

[25] Or a person who is or was a member of the same GST group as the person who provided the benefit.

Amendment History

Date of amendment	Part	Comment
23 June 2016	Paragraph 1	Updated as a result of law change.
	Footnote 8	Footnote inserted as a result of law change.
	References	Updated to add a new legislative reference and contact details.

Subject references	Commissioner's powers of general administration Input tax credits Restriction of refunds Non-taxable supplies
Legislative references	TAA 1953 Part IIB TAA 1953 Part IIB Div 3 TAA 1953 Part IIB Div 3A TAA 1953 section 105-65 of Schedule 1 TAA 1953 subsection 105-65(1) of Schedule 1 TAA 1953 paragraph 105-65(1)(a) of Schedule 1 TAA 1953 paragraph 105-65(1)(b) of Schedule 1 TAA 1953 paragraph 105-65(1)(c) of Schedule 1 TAA 1953 subparagraph 105-65(1)(c)(i) of Schedule 1 TAA 1953 subparagraph 105-65(1)(c)(ii) of Schedule 1 ANTS(GST) 1999 section 38-190 ANTS(GST) 1999 Div 57 ANTS(GST) 1999 Div 142 ITAA 1997 Div 27 ITAA 1997 section 27-5 ITAA 1997 section 27-80 FBTAA section 149A
Related public rulings	MT 2010/1
Related practice statements	PSLA 1998/1, PSLA 2009/4
Case references	
Other references	GSTE 2013/1 Goods and Services Tax: Correcting GST Errors Determination 2013 Explanatory Memorandum for the Tax Laws Amendment (2008 Measures No. 3) Bill 2008
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