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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

A NEW TAX SYSTEM (COMMONWEALTH-STATE FINANCIAL ARRANGEMENTS) AMENDMENT BILL 2003

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer, the Hon Peter Costello, MP)
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Outline


2. The Bill will facilitate the operation of the Act by implementing three measures, which have been agreed to by the States and Territories (the States). These measures relate to:

   - Enabling the Commissioner of Taxation to account for all GST refunds;
   - The timing of final determinations; and
   - Introducing a mechanism for residual Budget Balancing Assistance (BBA) adjustments.

3. The amendments to enable the Commissioner of Taxation to account for all GST refunds when determining the amount of GST revenue collected and to be provided to the States will overcome a technical problem in the current drafting of the Act. Currently, the Act excludes GST refunds under the Tourist Refund Scheme (TRS) and like arrangements from the GST base and results in more GST revenue being provided to the States than is actually collected in net terms.

4. Secondly, the amendments to the timing of final determinations will provide sufficient time for all parties to be able to make their determinations in compliance with the requirements of the Act.

5. Finally, the amendments will introduce a mechanism to allow payments to a State to be adjusted, as that State comes off BBA, to fully account for any overestimate or underestimate of payments in a previous financial year.
Financial Impact Statement

1.6 The amendments will allow the Commissioner of Taxation to account for all GST refunds when making a determination of GST revenue. The existing GST revenue estimates for 2003-04 (and the forward years) are consistent with the Commissioner of Taxation being able to account for all GST refunds as this is how the Act is intended to operate. Therefore, there is no financial impact from these amendments.

1.7 There is no financial impact for the Australian Government from the amendments to the timing of final determinations under the Act.

1.8 The financial impact to the Australian Government of introducing a mechanism for residual adjustments cannot be quantified. The actual size of the Residual Adjustment Amount (RAA) can only be ascertained once final outcomes are known, and a determination of the RAA is made. It is not possible to know the RAAs required in any one year at this time.
Abbreviations

2.1 The following abbreviations are used in this Explanatory Memorandum:

- **BBA**: Budget Balancing Assistance
- **Commissioner**: Commissioner of Taxation
- **GMA**: Guaranteed Minimum Amount
- **GST**: Goods and Services Tax
- **Intergovernmental Agreement**: Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations 1999
- **RAA**: Residual Adjustment Amount
- **States**: States and Territories
- **TRS**: Tourist Refund Scheme
Preliminary Matters

Notes on clauses

Clause 1: Short Title
3.1 Upon enactment, the Bill will be known as the *A New Tax System (Commonwealth-State Financial Arrangements) Amendment Act 2003*.

Clause 2: Commencement
3.2 The Bill will commence on the day it receives the Royal Assent.

Clause 3: Schedule(s)
3.3 The *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* is to be amended as set out in Schedule 1 to the Bill.
4

Taking GST refunds into account in determining GST revenue

4.1 Under the New Tax System there are a number of indirect refund schemes paid to specified entities that are not registered for GST. The main one is the Tourist Refund Scheme (TRS). The TRS allows travellers going overseas to recover the GST or Wine Equalisation Tax paid on eligible goods purchased in Australia and carried in their hand luggage.

4.2 In addition to the TRS, international organisations, diplomatic missions and visiting defence forces can claim refunds of GST, luxury car tax, fuel excise and Wine Equalisation Tax paid on significant purchases in Australia (or be exempted from these taxes on imported goods).

4.3 However, currently subsection 5(4) of the Act only allows the Commissioner of Taxation to make two deductions from GST revenue when determining the amount of GST collected in a year, which is provided to the States. Both relate to refunds of input tax credits paid to registered businesses. The TRS and the other GST refund schemes are excluded.

4.4 As a result, the Commissioner’s GST determination overstates the total GST collected by the amount of the TRS and the other GST refunds. Consequently, the Australian Government is providing the States with more GST revenue than is collected.

4.5 As is clear from the inception of the New Tax System policy, the TRS is intended to be part of the GST base and the exclusion of the TRS is an omission from the Act. 

4.6 In relation to the international refunds, these arrangements were not envisaged as GST refund schemes when the Intergovernmental Agreement was

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1 Tax Reform — not a new tax, a new tax system, August 1998, Chapter 2, pages 91-92.
Taking GST refunds into account in determining GST revenue

negotiated. At that time, it was intended that foreign governments would register for the GST and be entitled to input tax credits and, therefore, would not pay GST on these purchases. These schemes were subsequently set up because some countries did not want to register for GST and claim an input tax credit like regular businesses. They felt this would contravene their right, as specified in international agreements, not to register or pay foreign taxes.

4.7 The proposed amendments to the Act will enable the Commissioner to take account of all GST refunds when determining the amount of GST revenue to be provided to the States. These amendments are discussed in more detail below.

Notes on clauses in Part 1 of Schedule 1

Clause 1: Subsection 5(4)

4.8 This clause replaces the existing subsection 5(4) with a new subsection, which is broad enough to capture those GST refunds that the Commissioner is currently able to deduct from GST revenue under the Act, as well as other GST refunds, such as under the TRS and like arrangements.

4.9 This will ensure that the Commissioner is able to account for all GST refunds when determining GST revenues. This is consistent with the principle that GST revenues equal gross GST collections less all GST refunds.

4.10 The Commissioner is only authorised to account for GST refunds when making the GST determination. The reference to amounts that are attributable to GST is needed because the definition of ‘GST refund provision’ in this Bill will catch refund provisions that apply to GST and that also apply to other kinds of taxes (such as Wine Equalisation Tax or luxury car tax).

Clause 2: Subsection 5(6)

4.11 This clause inserts a definition of ‘GST refund provision’, which is wide enough to apply to all GST refunds, including under the TRS and GST refunds to international organisations, diplomatic missions and visiting defence forces.

4.12 A generic definition of ‘GST refund provision’ is a flexible approach allowing for new GST refund schemes to be introduced in the future without the need to amend the Act.

4.13 Under section 11 of the Act, the GST base cannot be changed without the agreement of all the States. New GST refunds would change the GST base and,
Taking GST refunds into account in determining GST revenue

as a result, could not be introduced, nor deducted by the Commissioner when determining the amount of GST revenue collected, without the agreement of all the States. A note to this effect is included at the end of the definition of ‘GST refund provision’.

Clause 3: Application of Amendments

4.14 Each year in June the Commissioner makes a determination of the amount of GST revenue collected under section 5 of the Act. In this determination the Commissioner adjusts the estimate of GST collected in June in the previous year to reflect the actual GST collected in that month.

4.15 For the financial year in which the Bill commences, the Commissioner will not be able to deduct GST refunds under the TRS and like arrangements from the calculation of actual GST collected in June of the previous financial year. This clause will ensure that the amendments do not apply to GST revenue provided to the States in the financial year prior to the financial year in which the amendments commence. After this year, the Commissioner will be obliged to take account of all GST refunds in making the determination of GST revenues, which will be provided to the States.

4.16 The Bill will commence on the day it receives the Royal Assent. Clause 3 ensures that if Royal Assent has not been received by 1 June in a GST year, the Commissioner will not be obliged to deduct GST refunds under the TRS and like arrangements in relation to that GST year. This is to ensure sufficient time for the Commissioner to be able to deduct these GST refunds in making the determination of GST revenues.
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Timing of determinations

5.1 A number of annual determinations are required under the Act. These relate to GST revenue, the Guaranteed Minimum Amount (GMA) and Budget Balancing Assistance (BBA).

5.2 The Australian Government pays BBA to the States in the transitional period to cover any shortfall of GST revenue compared with each State’s GMA, which is an estimate of the funding each State would have received if tax reform had not been implemented. Each State’s BBA is the difference between the State’s GMA and its share of GST revenue.

5.3 Currently, the determination of each State’s GMA by the Treasurer must be made before 10 June. However, the GMA cannot be determined without the determination of each State’s population by the Australian Statistician, and the determination of hospital grants for each State by the Health Minister. Both of these latter two determinations also have a statutory deadline of 10 June.

5.4 It would not be feasible to satisfy the statutory deadline for the GMA determination if the determinations of population and hospital grants were made on the date required by the Act. To date, the statutory deadline for the GMA determination has been met through informal agreements to bring forward the other determinations. However, there is the potential for slippage if these informal arrangements break down for any reason.

5.5 The Bill will change the dates for making the determinations of GMA, population and hospital grants to ensure sufficient time for all parties to be able to make their determinations in accordance with the requirements of the Act, and to facilitate the consultation process with the States.

5.6 The statutory deadline for the determination of GST revenues will be aligned with the statutory deadline for the GMA determination.
5.7 The Australian Government and the States have agreed that the timing arrangements specified in the Intergovernmental Agreement will be amended to ensure consistency between the Act and the Intergovernmental Agreement. This process will occur outside the amendments to the Act.

**Notes on clauses in Part 2 of Schedule 1**

_Clause 4: GST Determination_

5.8 Clause 4 extends the statutory deadline for the determination of GST revenue by the Commissioner of Taxation under subsection 5(5) of the Act. The Commissioner will be obliged to make this determination before 20 June, instead of the current deadline of 15 June.

_Clauses 5, 6 and 7: Hospital Grants Determination_

5.9 These clauses bring forward the statutory deadlines for the determination of each State’s hospital grants by the Health Minister under subsection 6(1) of the Act. The Health Minister will be obliged to make this determination before 6 June, instead of the current deadline of 10 June.

_Clause 8: Population Determination_

5.10 Clause 8 brings forward the statutory deadline for the determination of each State’s population by the Australian Statistician under subsection 7(1) of the Act. The Australian Statistician will be obliged to make this determination before 6 June, instead of the current deadline of 10 June.

_Clause 9: Guaranteed Minimum Amount Determination_

5.11 This clause extends the statutory deadline for the determination of each State’s GMA by the Treasurer under subclause 2(1) of Schedule 1 of the Act. The Treasurer will be obliged to make this determination before 20 June, instead of the current deadline of 10 June.
Timing of Determinations

Clause 10: Application of Amendments

5.12 The Bill will commence on the day it receives the Royal Assent. Clause 10 ensures that if Royal Assent has not been received by 1 June in a GST year, the changes to the timing of final determinations will not apply until the next financial year. This is to allow sufficient time for the parties to be able to make their determinations in accordance with the new statutory deadlines.
Residual adjustments for GST transitional years

6.1 Both the Treasurer’s determination of GMA, and the Commissioner of Taxation’s determination of GST revenue are made in June each year. The timing of these determinations necessitates the use of estimates when making them (because final outcomes for the year are not known until the following financial year).

6.2 The Intergovernmental Agreement provides for any difference between the estimates used in the Treasurer’s determination of GMA and the final outcomes for that year to be corrected in the following year. This is done through the inclusion of “Adjustments” in the calculation of each State’s GMA in the following year.2

6.3 Similarly, there is provision for the Commissioner’s determination of GST revenue for the year to include the difference between the GST estimate used in the previous year’s determination and the final outcome of GST revenue in the previous year.

6.4 As BBA is the difference between GMA and GST, these ex-post adjustments (to take account of differences between estimated and final outcomes for the year) will give rise to a variation in the amount of BBA that each State is entitled to in the following year.

6.5 That is, if ex-post calculations show that the determinations made in June resulted in an under or overestimate of GST or GMA for the year — this is addressed through an adjustment to the GST or GMA that a State is entitled to in the following year — which affects the State’s BBA entitlement in the following year.

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Residual adjustments for GST transitional years

6.6 The need to amend the Act arises because there is no mechanism to ensure that as a State comes off BBA the required adjustments from the previous year are fully implemented.

6.7 The proposed amendments will introduce a mechanism to address this situation. They will allow payment to a State of an adjustment amount, which would be added to any payment to the State under the Act, or the recovery of an adjustment amount from any payment to the State under the Act. These adjustment amounts will be known as Residual Adjustment Amounts (RAAs). The Bill will provide for the Treasurer to determine the RAA for each State.

Notes on clauses in Part 3 of Schedule 1

Clause 11: Clause 1 of Schedule 1

6.8 Clause 11 makes a minor technical amendment to the overview of Schedule 1 of the Act to reflect the new provision introduced by Clause 12.

Clause 12: Residual Adjustments for GST transitional years

6.9 This clause will enable the Treasurer to determine in a GST year a RAA for each State for a previous GST year. The RAA will reflect the amount by which a State’s payments in a previous GST year were underestimated or overestimated as a result of the estimates used to calculate GST and GMA and which cannot be adjusted through existing mechanisms.

6.10 Consistent with the legislative provision for the determination of the GMA, the detailed method of calculating the RAAs will not be legislated, but rather be settled by agreement between the Australian Government and the States. The amendments provide for the Treasurer to determine RAAs in accordance with an agreed methodology.

6.11 Once determined, the RAA for each State will either be an amount that is recoverable from a State (a negative amount) or an amount that is payable to a State (a positive amount).

- A positive amount will indicate that a State’s payments in a previous GST year were underestimated and the required adjustment cannot be given effect to through existing mechanisms. The amendments will enable the State to be paid a RAA, which would be added to another payment to which a State is entitled under the Act. It is envisaged that the RAA
Residual adjustments for GST transitional years

would normally be added to GST payments to the State. Any additions would be transparently reported.

- A negative amount will indicate that a State’s payments in a previous GST year were overestimated and the required adjustment cannot be given effect to through existing mechanisms. The amendments will enable a RAA to be deducted from another payment to which the State is entitled under the Act. It is envisaged that the RAA would normally be deducted from GST payments to the State. Any deductions would be transparently reported.

6.12 The amendments will ensure that if a RAA has not been given effect to in the GST year in which the RAA is determined, the RAA can be given effect to in the following GST year. This is consistent with the existing section 17 mechanism, which enables payments under the Act to be adjusted in the following GST year. If there was an overpayment or underpayment in the previous GST year, it is expected that RAAs will be given effect to as soon as practicable after the RAAs have been determined.

6.13 The Treasurer will be able to delegate the function of determining RAAs and making the required payment adjustments, which is consistent with the current practice for the determination of other payments under the Act.