

22 September 2009

The Board of Taxation  
C/- The Treasury  
Langton Crescent  
CANBERRA ACT 2600  
By email: [taxboard@treasury.gov.au](mailto:taxboard@treasury.gov.au)

Dear Sir/Madam

### **Review of the Application of GST to Cross-Border Transactions**

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make this submission in response to the Board's Discussion Paper on the application of GST to cross-border transactions. AFMA represents industry participants in the wholesale banking and financial markets, including Australian and foreign banks, securities companies, fund managers, traders and industry service providers.

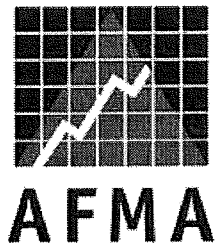
In the ordinary course of business, AFMA's members both provide and receive large cross-border supplies relating to financial services (for example, custodial services, trade execution, clearing and investment management). Members encounter significant difficulty in applying the current GST rules to cross-border transactions. To a significant degree this results from the peculiarities of the Australian GST rules. Hence, we believe the problems identified in the Discussion Paper are significant and greater efficiency is needed in collecting GST on cross-border transactions. The Review can play an important role by promoting changes that better align our GST system with international practices, whilst improving the GST rules for business.

AFMA has taken a close interest in the development of government policy on the GST from the outset of its development. In the attached paper we make recommendations that would improve the operation of the cross-border rules for services and reduce the regulatory burden for business without compromising the tax revenue base. We would be happy to discuss these matters further during the course of the Board's consultation process.

Yours sincerely

**David Lynch**  
**Head of Policy & Markets**





**Submission to the Board of Taxation**  
**Review of the Application of GST to**  
**Cross-Border Transactions**

**September 2009**

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## **1. Summary of AFMA's Recommendations**

### **1.1 Registration of non-resident entities**

The Australian GST legislation has one of the most inclusive definitions of supplies that are potentially taxable in the world.

This results from an expansive definition of 'enterprises carried on in Australia' in subsection 9-25(6)(b), which feeds into the definition of 'supplies connected with Australia' for the purpose of the Act. This overly inclusive definition, when combined with Australia's narrow definition of financial supplies, significantly increases the risk that non-residents supplying financial services to Australian business will be drawn into the Australian GST net. Thus, they would be required to pay GST on supplies that generally are not taxed in other countries, even though these non-residents have no business presence in Australia (ie no permanent establishment) for income tax purposes.

Consistent with the objective of minimising the number of non-resident entities required to register for GST in Australia, AFMA believes the concept of carrying on an enterprise in Australia for GST purposes should be aligned with the income tax definition of what constitutes a permanent establishment.

#### ***Recommendation 1***

Delete Subsection 9-25(6)(b):

Thus, subsection 9-25(6) would read "An enterprise is carried on in Australia if the enterprise is carried on through a permanent establishment (as defined in subsection 6(1) of the *Income Tax Assessment Act 1936*)".

#### *Outcomes*

- Fewer non-residents would be required to register for GST in Australia.
- Australian business making input taxed supplies would be required to reverse charge more supplies under Division 84.
- GST on services to private consumers can be protected using Division 57, or Option 2.4 if the non-resident prefers a representative to administer their compliance obligations. Division 85 can be modified to administer e-commerce and telecommunications.
- Easier Australian Taxation Office (ATO) enforcement as the GST liability is placed on an Australian entity.
- Non-resident enterprises could still register voluntarily under Subsection 23-10, if they so desired.

## 1.2 Cross-border supplies provided to an entity in Australia

Subsection 38-190(3) currently requires GST to be paid on supplies made to non-residents where the service is provided to another entity in Australia. This is an unclear provision and it is difficult for business entities to take account of this risk in every cross-border transaction. Indeed, standard global contracts that are commonly used by corporations around the world to access global financial markets often encounter GST complexity and high administration costs. Further, if the non-resident service provider is not registered for GST in Australia, this can lead to double taxation or tax cascading when these standard agreements are entered into with Australian corporations.

As Australian corporations raise more capital overseas and superannuation funds increasingly invest outside Australia, the inefficiency to market access caused by Subsection 38-190(3) will become an even more significant problem.

### **Recommendation 2**

i) Amend Section 38-190(3)(b) to read:

“the supply is provided, or the agreement requires it to be provided, to another entity in Australia who is not registered for GST”.

ii) Provide tax administrative guidance that:

Evidence of GST registration is satisfied by obtaining the Australian recipient’s ABN, or other evidence that they are carrying on an enterprise.

### *Outcomes*

- In essence, this would give effect to Option 1 of the Discussion Paper.
- An obligation to charge GST will remain if the ultimate consumer is not registered for GST in Australia.
- Because any recipient in Australia registered for GST would reverse charge the supply from the offshore entity where it relates to the provision of an input taxed supply, there would be no revenue loss to Australia.
- Recommendation 2 will be of limited benefit if Option 1 is not adopted, as a substantial body of supplies would remain connected with Australia through the overly inclusive definition of an ‘enterprise carried on in Australia’.

### **1.3 Division 83 reverse charge becomes redundant**

Division 83 is rarely used in practice, particularly by the financial services industry, because the majority of situations to which it would have usefully been applied are excluded by Subsection 83-5(1)(b).

If Recommendations 1 and 2 above are implemented and Australia adopts specific place of consumption proxies for business to business (B2B) transactions (see section 2 below), then Division 83 will be effectively redundant. This is because the division only applies to B2B transactions where the supplier does not have a permanent establishment in Australia but the supply is still "done" in Australia. If recommendations 1 and 2 are accepted and Australia adopts specific B2B proxies for place of consumption consistent with those being developed in the OECD, then if the non-resident's service is not connected with Australia through a permanent establishment, the reverse charge rules (Division 84) would apply to the service only if the acquisition is not fully creditable. There is no need for Division 83 if the services done in Australia are provided to a registered recipient and are fully creditable.

#### ***Recommendation 3***

Repeal Division 83 if Recommendations 1 and 2 above are accepted and OECD proxies for B2B services are adopted. B2B transactions that are not fully creditable would be subject to the ordinary reverse charge rules under Division 84.

## **2. Getting the GST Policy Framework Right – Transaction Certainty, Neutrality and Business Efficiency**

AFMA members agree with the general thrust of the Board's Discussion Paper on the application of GST to cross-border transactions. In particular, we agree that the approach taken by Australia should be consistent with the general principles outlined by the OECD on this subject and that the regime should not unnecessarily draw non-residents into the GST system.<sup>1</sup>

The OECD's work is building on principles agreed by the Committee on Fiscal Affairs in 2006 to the effect that:

- Internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption; and
- The burden of value added taxes (VAT) themselves should not lie on taxable businesses except where explicitly provided for in legislation.

AFMA members note that the OECD also advocates that the sourcing of goods and services domestically should not provide an advantage, or a disadvantage, over buying the same products sourced from another jurisdiction. Hence there is a need for simplicity of administration including certainty around which particular taxing rules apply and ensuring transaction neutrality (that is, the GST on, say, acquiring a service from abroad should be no more and no less than if that service were provided in Australia through an enterprise in Australia). The overriding principle should be that the rules should be aimed at minimising GST cascading in B2B transactions in order to enhance Australia's international competitiveness.

AFMA's members are mainly concerned with taxation of financial services and the extent to which the cross-border GST rules affect global financial services in Australia. Australia is considered to have a narrow definition of exempt financial supplies compared with most OECD countries (including Canada and New Zealand) and, as a result, proportionately more of the Australian finance industry's intermediary/arranger services are subject to GST than in other OECD countries. It follows that any cross-border supplies of these intermediary/arranger services are more likely to be brought into the Australian GST net under any cross-border rules than would be the case in other OECD countries.

This is an important point for the Board to note because the OECD countries that are currently developing guidelines for cross-border transactions do not face the various issues that Australia does in the financial services space. That is, the OECD countries (that have comparable sophisticated debt/equity markets to Australia) exempt "arranger services". Accordingly, the OECD Technical Advisory Group Working Party 9 may not specifically consider cross-

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<sup>1</sup> The OECD has established a Technical Advisory Group to assist the OECD Committee of Fiscal Affairs's Working Group 9 in forming guidelines on how best to apply the above principles to the importation of services and intangibles.



border taxation treatment as they relate to financial supplies and it will be largely up to Australia to ensure business efficiency in this sector.

The current Australian legislation relies on an iterative approach adopted from the New Zealand regime as to whether a transaction is subject to GST. This approach is not efficient for global businesses as the application of the current rules are not readily able to be interpreted without the assistance of a technical tax expert. A "best in class" GST regime for cross-border transactions should have clear, practical rules that can be applied in a relatively straight forward manner by a lay person.

Accordingly, AFMA contends that it is essential that any revision of the cross-border rules should be mindful of global financial services in Australia and take into account their nature when designing the rules. AFMA recommends the following principles:

- Clear rules on place of supply should be adopted that are easy to follow and in line with general OECD guidelines;
- Neutrality must be maintained between resident and non-resident businesses providing or receiving financial services;
- Compliance with the rules for non-resident and resident businesses should be relatively straight forward and efficient;
- Administering the rules (including revenue protection) by the ATO should be made as simple as possible, and
- The rules should have an overriding principle seeking to minimise GST cascading in B2B transactions.

AFMA fully supports the Board's proposition that, to enable business efficiency and minimise GST cascading throughout the supply chain, the cross-border rules should be changed for B2B transactions in order to minimise the need for non-resident entities to register for GST and where possible the reverse charge mechanism should be used to shift the collection of GST on imported services to Australian registered businesses.

Furthermore, AFMA considers that business to consumer transactions (B2C) should be differentiated from B2B transactions with B2C services taxed appropriately using Australian resident agents/proxies for the non-resident makers of the supply.

AFMA suggests that a specific set of place of supply rules that determine the place of taxation (and method of taxation) should be introduced. The rules should clearly set out what proxies to use and recognise practical proxies for B2B transactions. These business proxies should reflect that businesses generally acquire services whether domestically or from abroad for a commercial purpose and as a general rule the recipient's location is a reasonable proxy for consumption for business purposes.

AFMA's experience is that the identity of the recipient of the supply is generally evidenced by a contract in most business dealings. Therefore, except where the contract requires a non-resident entity to provide services to an unregistered party in Australia, the recipient should be treated for GST purposes as the contractual party with whom the supplier of the services has an agreement. The importation of services for commercial purposes should be taxed in a practical and efficient manner using the reverse charge rules for B2B transactions providing the beneficiary of the service is a registered entity, or using the agency rules where the beneficiary of the service is not registered for GST.

Finally, the complexity and volume of business supplies particularly in the financial services sector should be recognised. Attempts to fragment single supplies into separate supplies some of which are "connected with Australia" and others "not connected with Australia" are commercially unworkable and should be resisted as much as possible. AFMA strongly suggests that Division 96 of the *A New Tax System (Goods and Service Tax) Act, 1999* (cth) should be amended to ensure that Australia does not artificially fragment "single supplies" which have a single commercial purpose.

### **3. Issues Raised by Australia's Approach to Cross-Border Transactions – Financial Services**

Developed financial markets are highly integrated across international borders and should be viewed as global in nature. Users (of which the largest operate in multiple jurisdictions) can choose to purchase financial services from a number of competing jurisdictions, while providers have a wide range of locations from which they can conduct their financial services business under similar regulatory regimes but different economic and taxation conditions.

As discussed in Section 2, Australia is one of the few developed countries that taxes intermediary/arranger services. This feature of the Australian GST regime, when combined with Australia's current overly inclusive cross-border rules, impedes the provision of many global financial services from Australian businesses or to Australian customers. This inefficiency means that Australia's financial markets are perceived as being less competitive than other regional markets.

The following practical examples supplement the issues raised in Chapter 4 of the Discussion paper and illustrate the nature of the GST problems faced by the financial services industry in Australia in relation to a number of common global transactions. It is because of these types of transactions that AFMA endorses practical business proxies in line with those being developed by the OECD makes our recommendations above.

#### **3.1 International payment systems**

A person in Australia may seek to engage a local Australian bank to pay a person in Brazil an amount of money to acquire some goods. The local bank discusses the issue with a multinational bank that, inter alia, has branches in both Australia and Brazil. Eventually the local bank enters into an arrangement with the Australian branch of the multinational bank to organise its Irish affiliate to provide a payment system platform to the local bank to enable the local bank to make international payments to its customer's counterparty in Brazil. The local bank receives the money from its customer (who has agreed that the counterparty in Brazil will pay for the financial service) and then forwards the funds to the local branch of the multinational bank. The transaction is executed via the platform provided by the multinational's Irish subsidiary and the funds (less a payment fee) are paid from the Brazilian branch of the multinational bank to the counterparty in Brazil. The Irish entity then shares some of the fee with the Australian local bank and some of the fee with the local branch of the multinational bank.

The current cross-border transaction rules make the drafting of agreements for such arrangements complex and expensive. There is uncertainty around whether the Irish entity makes a taxable transaction of a payment system through an enterprise in Australia (because it was introduced to the local bank by a person in Australia) or whether the service is really "done" from outside

Australia. There are issues as to whether the supply is partly connected with Australia and somehow needs to be fragmented for the purposes of Division 96. The local bank does not pay for the service but rather is remunerated by the service provider. Should the local bank reverse charge some or all of the service or is the acquisition fully creditable?

Practically, the Irish affiliate has these types of agreements with customers all over the world. It is not going to register for GST in Australia and from a systems perspective it is virtually impossible to get the Australian branch of the multinational bank to identify and pay the GST on that part of the supply that is connected with Australia. Arguably if any GST were payable by the Irish service provider, it would be fully creditable to the local bank – however, the answer is not clear. Implementing the Recommendations in Section 1 would assist in clarifying the treatment of these types of transactions.

### **3.2 Cross-border underwriting**

The provision of underwriting services is an example of a commonly used international financial service that is adversely impacted by the current law. For instance, an Australian company that observes an opportunity to raise low cost funds from Japanese investors and decides to raise debt finance by issuing securities in Japan may look to have its offering underwritten on a best endeavours basis by a Japanese securities company. It would not be unusual for the Australian company in this situation to have been introduced to the Japanese securities company by relationship bankers located in Australia.

Since the Australian company was introduced to the Japanese securities company by a representative in Australia, a strict reading of s.9-25(6)(b) would mean the Japanese entity could potentially be required to register for GST assuming it meets the GST registration turnover threshold and the service is not considered to be in relation to rights used or enjoyed outside Australia. This would be the case even though the actual (underwriting) service is provided in Japan. This outcome does not seem right, given that the service provided is fully creditable because it relates, in its entirety, to a GST-free supply (of debt securities in Japan) being made by the Australian company. Nevertheless, it is not clear whether the Japanese bank's services relate to rights used or enjoyed outside Australia.

### **3.3 Global banking services provided to an Australian multinational**

The underwriting example can be expanded upon to most global banking services. That is, major global companies, like for example BHP Billiton (BHP), typically engage the services of multinational banks in many parts of the world to provide specific services, such as corporate advice on potential targets, underwriting services relating to debt or equity raisings, global trade finance services etc. Thus, a multinational bank with a branch in Australia will have, over time, many and varied associated non-resident entities potentially

providing various different services from anywhere in the world to BHP. Under the current rules, the multinational bank could be required to register all the various non-resident entities for GST where the value of services exceed the registration threshold in Australia because the services supplied are arguably taxable if BHP was introduced to the non-resident entities by, say, a relationship manager in Australia.

If one considers all the Australian customers seeking access to global markets and needing the assistance of a multinational bank, the current cross-border rules would probably require a multinational bank to register all its non-resident entities for GST in Australia. Division 83 is useless in this situation and grouping does not help matters. Indeed, if all the non-resident entities were grouped for GST purposes, there would be services between entities that would be excluded because of grouping while others would have to be reverse charged under Division 84 to the extent they relate to input taxed supplies made by the non-resident entities, while other services would be partly connected with Australia under Division 96 and still others completely outside the scope of the Australian GST regime. Administering a group where all entities in the world are registered for Australian GST is clearly impractical. The risks are virtually impossible to control without enormous amounts of resources dedicated to tracking all deals done throughout the world. In the case where the multinational bank's customer is a corporate like BHP then the irony is that any GST that is charged to BHP is likely to be fully recoverable. It is for this reason that AFMA members recommend specific proxies for B2B transactions.

### **3.4 Global broking and custody**

Custodial services include securities settlement, safekeeping, income and dividend identification and collection, processing corporate actions, proxy voting, cash management and reporting. Often, multinational companies provide these services to customers throughout the world from regional hubs. For instance, in Europe the hub may be in the UK, in Asia it may be Singapore. Corporate customers from any country in the world that wish to trade international shares will sign a global broking and custody agreement with multinational service providers located in one of the regional hubs. These regional hubs have agreements with affiliates in all countries where the shares are traded, whereby the affiliates provide sub-broking/custodial services to the respective regional hubs.

Therefore, if a corporation located in, say, Europe wants to trade Australian shares then it will contract with the global broker/custodian in the nearest regional hub being the UK. The global broker/custodian will have an agreement with an Australian-based broker/custodian to execute its services in Australia. The vast bulk of the services performed by the Australian-based sub-custodian for the global custodian is for the benefit of non-residents and is a GST-free supply. In general, the regional brokers/custodians do not want to register for GST in Australia because of the administration involved.

If an Australian entity, such as a superannuation fund, decides to trade international shares it may enter into a global broker/custodian agreement with a global broker/custodian located in, say, Singapore. As with all the regional hubs the Singapore broker/custodian has agreements throughout the world with its affiliates to provide broker/custodian services to it in relation to the various stock exchanges (including Australia). An Australian superannuation fund trading predominantly international shares may occasionally trade an Australian share under the global agreement (eg rather than trade BHP on the London stock exchange it may execute the trade on the Australian stock exchange). Currently, the ATO suggests the law requires the Australian sub-custodian to charge the Singapore custodian GST where the ultimate beneficial owner of the shares is located in Australia.

Complications arise because the Singapore broker/custodian not being registered for GST in Australia will on charge the unrecovered GST back to the Australian superannuation fund, which in turn may or may not self assess GST under Division 84. The Australian superfund can argue that it is not required to reverse charge the service from Singapore because the Singapore broker and custodial service is "partly connected" with Australia to the extent the service relates to Australian shares. They will argue this where part of the service is provided "through an enterprise that the supplier carries on in Australia" by virtue of S.9-25(5). The outcome is a very complex tax situation which may result in double taxation.

Problems of this nature disadvantage Australia's financial services industry when compared to other countries in the Asia Pacific and is one of the impediments to Australia being a regional financial hub. This is another example of a situation where a more efficient tax outcome would be achieved by relying on the reverse charge mechanism, as it is the Australian superfund that is best placed to work out the extent to which the regional service relates to an input taxed supply made by it.

## **4. Business and Broader Policy Context for the Review**

The broad policy context within which the review of cross-border transactions sits provides the framework through which the relevance and benefits of various options to improve the GST regime should be assessed. The approach adopted by the Review should be aligned with the policy direction taken by the Government in other areas and promote outcomes that are consistent with it.

AFMA's focus is on the cross-border provision of financial services, which is a significant and especially global part of our economy. There are a number of government policies in this area which are relevant to the Review.

### **4.1 Macroeconomic policy**

To maintain macroeconomic balance, Australia must raise significant amounts of capital overseas to finance the balance of payments. A smooth interaction between the domestic and foreign capital markets is necessary to ensure that Australian borrowers have the most cost effective access to foreign markets. Global financial institutions play an important role in financing the deficit by arranging and underwriting the issuance of securities by Australian companies in overseas markets. Reform of the GST cross-border rules could strengthen the link to overseas markets in a modest but worthwhile manner.

### **4.2 International capital flows**

The Australian economy is more international with cross-border investment flows growing strongly over the last decade.<sup>2</sup> ASIC has observed that significant economic benefits may arise from improving access between Australian markets and foreign markets and participants on those markets.<sup>3</sup> Open and efficient markets allow businesses to access capital as cheaply as possible and allocate it to businesses in the most efficient ways. This includes more choice for investors and businesses and more competition, leading to a drive for further efficiencies.

The expansion in capital flows has been accompanied by growth in financial services transactions to assist portfolio investment in debt, equities and financial derivatives. This growth has been accommodated within the existing GST regime but, nonetheless, members believe that enhancements to the GST rules on cross-border financial services transactions are necessary and desirable. Amongst other things, this would complement policies that ASIC is

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<sup>2</sup> Australian investment abroad was \$1,011 billion at the end of 2008, of which portfolio investment accounted for 37% and financial derivatives 11%. At December 2008, foreign investment in Australia was \$1,724 billion, of which portfolio investment was 53% and financial derivatives 6%. Of the portfolio investment liabilities, debt securities accounted for 40% and equity securities for 13%. Australian Bureau of Statistics - 5352.0 - International Investment Position, Australia.

<sup>3</sup> ASIC Report 134: Enhancing capital flows into and out of Australia, July 2008.

implementing to facilitate and promote cross-border trade and investment in financial services.

#### **4.3 Cost effective finance for business**

Australian business needs access to a full range of cost effective financial services. Competitive tension in financial markets supports innovation and the provision of services on an efficient basis. This is manifest in the range, quality and cost effectiveness of the products available in the market, all of which are pertinent to the overall performance of the economy. Australia's financial markets benefit from the combination of strong domestic institutions and a broad representation of foreign-owned financial providers, who help to provide depth to the markets through liquidity and scale, as well as competition.

Market access is an important dimension of competition, as potential overseas providers may not enter a market (especially a small market in global terms), or do so on limited terms, if the associated regulatory and tax compliance costs are too high. Alternatively, higher costs of entry may be passed on to Australian borrowers and investors. Reform of the GST cross-border rules could improve aspects of the access to Australia's financial markets.

#### **4.4 International financial hub**

Developed financial markets are highly integrated across international borders and should be viewed as global in nature. The largest market users operate in multiple jurisdictions and can choose to purchase financial services from a number of competing jurisdictions, while providers have a wide range of locations from which they can conduct their financial services business under similar regulatory regimes but different economic and taxation conditions.

Reform of the cross-border rules would make Australia a more attractive place for global financial services firms to do business. This is consistent with the Government's objective to promote Australia as a global and regional financial centre (reflected in the work of the Australian Financial Centre Forum).

#### **4.5 Tax policy**

The core tenet of the GST as a consumption tax is that it should be levied on consumers and cascading of tax, along with the inefficiencies this introduces, should be avoided. The cross-border GST rules could be modified to improve efficiency, minimise the tax that falls on business and reduce the extent of tax cascading that occurs in practice.

In summary, reform of GST cross-border rules to reduce compliance costs and improve access would be a worthwhile building block amongst many in facilitating economic development.



## 5. Answers to Specific Questions

### Chapter 4: Issues raised by Australia's approach to cross-border transactions

#### Q4.1 What has inhibited the take up of voluntary reverse charge agreements?

In the experience of AFMA members Division 83 is not applicable to most financial service arrangements. This is because many non-resident transactions are only "connected with Australia" due to a resident agent in Australia introducing the non-resident service provider to their customer (the Australian agent would potentially be considered a broker or commission agent that does not have the authority to negotiate or conclude contracts on behalf of the non-resident). The non-resident, therefore, makes a supply "through an enterprise that the supplier carries on in Australia" (under the extended application of the permanent establishment concept through Subsection 9-25(6)(b)) and Division 83 cannot apply.

As mentioned in Section 1 above, if, in line with developing OECD principles, B2B supplies were taxed practically using the definition of permanent establishment in the Income Tax Act to determine carrying on a business in Australia; using business contracts as a proxy to determine place of consumption; and the reverse charge rules under Division 84 to tax those non-resident services that relate to input taxed supplies, then in AFMA's view Division 83 should be repealed as it is essentially of no use.

#### Q4.2 Are the non-resident agency provisions unnecessarily limited?

AFMA members consider Division 57 should only really be an option for B2C transactions. Australia should align its cross-border taxing rules for B2B transactions with the OECD principles and mainly seek to tax B2B supplies using a reverse charge mechanism.

#### Q4.3 Do the non-resident agency provisions impose too much direct liability on the resident Australian agent? If so, how could the non-resident principal pay the correct amount of GST?

AFMA considers that if B2B transactions are effectively taxed under Division 84 then Division 57 can be used to tax B2C transactions.

#### Q4.4 Is your business being adversely impacted by on-line supplies and low value transactions? If so, what changes would you suggest to the current approach?

Online brokerage accounts with non-resident brokers to trade foreign shares compete with local brokerage houses seeking to provide the same services. Currently, if a retail investor in Australia (who is not registered for GST)

trades foreign shares using an online account with a non-resident broker, then they will not be subject to GST on the brokerage service.

In contrast, if the Australian retail investor uses a local broker as an agent to facilitate the trade on an offshore exchange through that same non-resident broker then the Australian investor would suffer GST under the ATO's interpretation of the current GST law. Clearly, neutrality has been compromised and it is quite obvious that in reality the service is "done" offshore and should not be taxed. For B2C transactions where services are actually done offshore there should be an overriding principle that ensures neutrality so as not to disadvantage local agents facilitating the service.

## **Chapter 5: Possible options for change**

### ***Option 1: Limit the application of the connected with Australia provisions***

**Q5.1** Would this approach reduce the number of non-residents that are unnecessarily drawn into the GST system? Does it raise any unintended consequences?

Yes. It would reduce the number of non-residents unnecessarily drawn into the Australian GST system. AFMA members fully endorse this approach for B2B transactions and encourage the Government to better align its taxing rules with OECD principles particularly in respect of proxies for place of consumption in respect of B2B supplies. AFMA also recommends that Division 83 and Division 96 be repealed or significantly amended. Division 96 essentially transgresses generally accepted GST/VAT principles that have been established in major OECD countries to assist the administration of the tax for businesses. GST is supposed to be a practical tax that is easy to administer for businesses. The unnecessary and artificial fragmentation of single supplies should be resisted as it makes Australian law overly complex for little, if any, gain to the revenue.

**Q5.2** Should the compulsory reverse charge only apply where the acquisition is not for a fully creditable purpose?

Yes. GST should be a practical tax that is easy to administer. There is no advantage to the revenue and a definitive administrative disadvantage in requiring what would otherwise be fully creditable acquisitions to be reverse charged.

**Q5.3** Should the compulsory reverse charge only apply to all supplies or just services and intangibles?

AFMA members generally are only concerned with services and intangibles so express no view on this question.

Q5.4 Should the compulsory reverse charge apply to both registered and non-registered Australian businesses or only to registered Australian businesses?

AFMA cannot comment on this question, as it is not aware of the scope of non-registered business that may be importing services. However, it may be difficult for the ATO to administer the regime if non-registered businesses are required to reverse charge and the revenue collected may be immaterial.

***Option 2.2: Transfer GST liability to an Australian subsidiary***

This approach is regressive and not aligned to the way other OECD countries are heading in respect of taxing cross-border transactions. It does not support neutrality of treatment since a company without a subsidiary would have a competitive advantage over a company that has a subsidiary in Australia. This approach would cause enormous difficulties for multinational banks in Australia and will adversely affect Australia's regional competitiveness. AFMA members strongly advise against such an approach.

Q5.6 What business relationships between a subsidiary and its non-resident parent could this option apply to most appropriately?

AFMA strongly advises that this approach would compromise Australia's ability to attract regional financial services to its shores.

Q5.7 Should this option apply to entities other than subsidiaries, such as subcontractors, who assist in delivering the non-resident's supply to an Australian recipient?

AFMA members do not support this approach and believe it is out of step with the direction the OECD is heading.

Q5.8 What type of supplies could this option apply to?

AFMA members do not support this approach and believe it is out of step with the direction the OECD is heading.

Q5.9 Would this option be simple for taxpayers to comply with?

No. It would be difficult to administer for both the taxpayer and the ATO.

***Option 2.3: Expanding the non-resident agency provisions***

Q5.10 Are commission agents or sub-contractors likely to take up this option? If not, why not?

AFMA considers that Australia should align its regime with OECD principles. The concept of using commission agents as a taxing entity is generally unworkable for most multinational corporations with businesses located all

over the world. This is a simplistic approach that does not take account of the global nature of trade particularly in the financial services sector. AFMA members endorse Option 1.

***Option 2.4: Non-residents be allowed to have a tax representative***

Q5.11 Should options 2.3 and 2.4 apply instead of other options that reduce the need for non-residents to be in our GST system or should these options be used to supplement those circumstances where other options are ineffective?

AFMA considers that Australia should align its regime with OECD principles. The concept of using options 2.3 and 2.4 for non-residents is generally unworkable for most multinational banks with businesses located all over the world. This is a simplistic approach that does not take account of the global nature of the financial services sector bearing in mind the EU does not tax arranger/intermediary services. AFMA members endorse Option 1.

Q5.12 Should options 2.3 and 2.4 be compulsory rather than voluntary?

Option 2.3 and 2.4 are not conducive to doing business in Australia and should be resisted except where there is no alternative. For B2B services it should be absolutely resisted as it reduces Australia's competitiveness.

***Option 3: Non-residents not required to be registered for GST could be allowed a direct refund of any GST***

Q5.13 Should the GST law provide a direct refund mechanism? If so, under what circumstances?

AFMA members endorse this approach. Australia should align its regime with the EU VAT system which ultimately will be the major influence on OECD policy.

Q5.14 Is a direct refund system necessary if the number of non-residents in the GST system is reduced under the options in this chapter?

Yes. Even if the number of non-residents in the GST system is reduced this approach is conducive to doing business in Australia and competing globally.

Q5.15 Should a direct refund system be based on reciprocal agreements with other countries as is the case in some European countries?

No. Such an approach whilst understandable is not conducive to doing business in a country and is not endorsed by AFMA members.

Q5.16 Should there be a more restrictive time limit for non-resident refund claims (as is the case in some foreign jurisdictions)? If so, how long should

this period be?

No. Australia should seek to encourage business by adopting an approach which is consistent with time limits for resident corporations.

Q5.17 Should it be restricted to certain supplies as in some foreign jurisdictions?

No. Australia should seek to encourage business by adopting an approach which will encourage all businesses.

***Option 3.1: Supplies made to a non-resident but provided to a registered Australian business be GST-free***

Q5.18 Will the Australian supplier be able to readily identify situations where it provides a supply to a registered Australian business? In what circumstances might this prove difficult?

For most transactions in the financial services industry it should be relatively straightforward to determine whether the ultimate beneficiary of the service is a registered Australian business or an individual. Generally, most financial services require the financial institution to know who the beneficial customer is for various regulatory reasons. Accordingly, such an information requirement should not be difficult to implement for a financial institution given they are required to obtain certain information already to perform most services. Compared to the uncertainty and potential for double taxation in the current rules, it would be a requirement that AFMA members would willingly accept.

Q5.19 Could this option be expanded to include supplies provided to employees or office holders of an Australian business or non-resident business? If so, how?

The provision of services to employees is essentially an immaterial issue. If the Government wants to legislate for this issue then AFMA members will support it providing the preferred B2B option in 5.18 is adopted.

***Option 3.2: Supplies for consumption outside Australia***

Q5.20 Do you consider that it is more appropriate that these supplies are taxable supplies with the registered recipient determining their entitlement to an input taxed credit?

No. AFMA members support the view that, as a general principle, where services are consumed outside Australia then GST should not apply to the transaction irrespective of who pays for it. The only thing this option would achieve is increased administration costs. There seems very little point to making the supply taxable when even a financial service provider would be

entitled to recover the GST. If one contrasts this option to the B2B rule endorsed by AFMA, the latter is a proxy for the purposes of minimising GST cascading and unnecessary legal complexity for what are becoming increasingly common transactions for Australian business. It is aimed at business efficiency with no loss to the revenue. There is no point in increasing administrative cost for businesses for no gain to the revenue.

***Option 3.3: Reverse charge for private consumers***

Q5.21 Should Australia consider imposing a reverse charge on supplies to private consumers if those supplies exceed a threshold? How could this be enforced?

AFMA members express no opinion on this matter other than to suggest that any B2C option should be carefully modelled to ensure the cost of administering the option will be significantly outweighed by the benefits of increased neutrality for small business and tax collected. AFMA would also reiterate that Australia should seek to align its policies more with OECD principles.

***Options 3.4: Changing the connection rules and GST liability transferred to an Australian subsidiary***

Q5.22 Should option 3.4 apply to goods, services and intangibles?

AFMA members do not support this option. This approach is not consistent with OECD principles and is definitely not suitable for B2B transactions. Even for B2C transactions imposing the GST obligations on Australian resident subsidiaries causes significant regulatory and prudential issues for the local directors of the subsidiary. Option 3.5 is preferable for B2C supplies.

Q5.23 Should the option be restricted to on-line supplies or apply more broadly?

AFMA members do not support this option, for the same reasons presented in our answer to question 5.22.

***Option 3.5: Review the low value threshold limit of \$1,000***

Q5.24 Is the importation threshold at an appropriate level? If not what should this be?

AFMA members express no opinion on this issue.

Q5.25 Should there be a connection between low value import threshold for GST purposes and for customs duty purposes?

AFMA members express no opinion on this issue.

## Chapter 6: Specific issue options

### **Registration procedures for non-residents**

Q6.1 Would further streamlining of the registration process for non-residents still be necessary if the circumstances where non-residents need to register is significantly reduced because the options in Chapter 5 are implemented?

Yes. The current administrative procedures are impractical and essentially unworkable for multinational businesses. Australia needs to set policies in these areas that encourage businesses to comply with the law with a minimum of disruption to their business.

Q6.2 Are there alternative ways of streamlining the registration process?

Satisfactory proof of existence should be the requirement. For large multinational businesses that are well known globally the rules should be less stringent than an entity that is not so well known. The onus of proof could also be scaled depending on where the entity is incorporated. The onus of proof could be greater for those companies incorporated in less well regulated countries than those incorporated in highly regulated countries.

Q6.3 For those non-residents that may need to stay in the GST system what do you see as the most appropriate method for administering their involvement? Instead of streamlining registration procedures would it be more appropriate to have a direct refund system (option 3) or a tax representative (option 2.4)?

AFMA members would endorse a streamlined registration process for non-resident entities that need to register for GST. However, option 3 should be available for those entities that may be making GST-free or input taxed supplies and option 2.4 should be available for non-residents who prefer a representative to administer their Australian GST obligations.

Q6.4 Would any of the above situations introduce integrity risks, particularly those relating to revenue and identity fraud?

All options have integrity issues. Generally, however, it should be possible to put controls in place to minimise these risks. Obviously the refund system would have greater risks of fraud than option 3 or option 2.4. There will definitely need to be measures in place to ensure whoever administers the system accurately confirms the existence of the non-residents but these measures should be tailored to differentiate large global businesses from small business.

### **Option 4: Non-residents making GST-free supplies**

Q6.5 What would be the most appropriate method of excluding these non-

residents from being required to be registered for GST?

AFMA proposes that the making of GST-free supplies should be excluded from the registration threshold. The Australian registration threshold of \$75,000 is so low that restricting it to taxable supplies would probably not make any great difference to revenue collection but would greatly relieve administrative risk for non-residents entities. This is particularly so, as non-resident entities that make GST-free supplies will voluntarily register if they incur significant GST on inputs.

Q6.6 Should the GST-free supplies made by a non-resident be included in the registration threshold but only to determine whether other supplies that are not GST-free should be subject to GST?

No. As discussed in our answer to question 6.5, we believe the making of GST-free supplies should be excluded from the registration threshold.

Q6.7 Alternatively, should the GST-free supplies made by the non-resident be excluded when determining the non-residents requirement to register?

Yes. See above.

***Option 5: Non-residents using an agent***

Q6.8 What would be the best method of removing the non-resident's requirement to register without undermining the taxable or creditable status of the supply or acquisition made by the non-resident?

As discussed in 6.5 – there is unlikely to be any significant effect to revenue if GST-free supplies were excluded from the registration threshold.



## 6. Concluding Comments

The current GST rules create significant tax complexity and compliance costs for Australian business and reduce Australia's competitiveness. In addition, the risk of being caught within the 'in Australia' tax net for GST purposes deters some non-residents from participating in the Australian financial markets. There are clearly matters that should be addressed and we encourage the Board to recommend that solutions are implemented as a matter of priority.

International developments are also highly relevant to Australia, given the significant interdependency between global economies, and more especially global financial services markets. Overseas jurisdictions have acted to amend consumption tax rules to provide more certain, consistent and efficient outcomes for cross-border transactions. The EU has agreed to alter the general rule for B2B services, which will switch from the place where the supplier is established to the place where the recipient is established. In essence, this approach requires a taxable customer to "self assess" VAT for an intermediary service provided to it from an entity in another country.

Reforms adopted in Australia should be consistent in their outcome with the improvements that are being adopted on a coordinated basis internationally. We support Treasury's ongoing involvement and active contribution to the OECD's work in this area. We agree with the Board's intention to consider any recommendation it may make in completing the Review against the key design principles of the GST and the principles being developed by the OECD. In this context, we encourage you to consider the recommendations for reform that we make in this submission.

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