Australian Government

The Board of Taxation

REVIEW OF THE APPLICATION OF GST TO CROSS-BORDER TRANSACTIONS

Discussion Paper

the board of taxation

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July 2009

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FOREWORD

The Board of Taxation (Board) has been asked by the Government to review the application of GST to cross-border transactions, in particular, the extent of non-resident participation in the Australian GST system. This review follows a number of recommendations flowing from the Board's recent review of the legal framework for the administration of the GST.

Whilst Australia's current approach to applying GST to cross-border transactions is consistent with the key principles underpinning the GST regime, concerns have been raised that it unnecessarily draws in non-residents which brings with it additional compliance costs. The GST registration process can be very onerous for those non-residents that have no identity in Australia under other taxes or other laws. Where non-resident suppliers choose not to register the result can range from non-taxation of business to business transactions to embedded taxation which adversely impacts on Australia's international competitiveness.

The Government has requested that the Board consult with relevant stakeholders and report to the Government on improvements to the design of the GST system necessary to ensure that cross-border transactions are treated in an efficient and effective manner. A particular focus will be the involvement of non-residents in the Australian GST system with a view to simplifying the design.

In making any recommendations the Board is required to:

- have regard to the design features of the GST as a multi-stage value added tax;
- ensure that any possible changes do not undermine the integrity of the GST in aiming to tax private consumption in Australia; and
- ensure that its recommendations have regard to the likely impact on revenue.

The terms of reference for conducting the review are reproduced in Chapter 1.

This paper provides an outline of key principles guiding the taxation of cross-border transactions, how Australia currently imposes GST on such transactions and concerns that have been raised with the current approach, and explores some options for streamlining the current approach.

Consultation with industry and other affected stakeholders and submissions from the public, will play an important role in shaping the Board's recommendations to the Government.

The Board has requested that comments regarding this review be made by 4 September 2009 to enable the Board to finalise its report in the timeframe requested by Government.

Eric Mayne
Chair of Working Group
Board of Taxation

CHAPTER 1: INTRODUCTION

BACKGROUND

1.1 On 11 June 2008, the then Assistant Treasurer announced that he had asked the Board of Taxation to undertake a review of the legal framework for the administration of the GST.

1.2 The focus of that 2008 review was:

- streamlining and improving the operation of the GST;
- reducing compliance costs; and
- removing anomalies.

1.3 The Board extensively consulted with stakeholders including small and large businesses, professional bodies and State and Territory Governments. The Board provided its report to the Government in December 2008.

1.4 During its review, the Board received a number of submissions raising concerns about the complexity and uncertainty associated with the GST treatment of cross-border transactions but was unable to canvass this matter in detail. Therefore, the Board recommended to Government that these issues be considered further.

1.5 On 12 May 2009, the Government announced the release of the Board of Taxation's report on its review of the legal framework of the administration of the GST and announced that it supported most of the Board's 46 recommendations.

1.6 Relevantly, the Government announced that it had asked the Board to undertake a review of the application of the GST to cross-border transactions and consult widely with stakeholders. This review was in response to recommendations 26-28 of the Board's report. In essence these recommendations were that:

- the Government should consider reviewing the application of the GST to cross-border transactions with a view to simplifying and reducing the number of non-residents in the system (recommendation 26).
- the Commissioner should consider further streamlining the proof of identity and proof of enterprise requirements for non-residents in the circumstances where the risk to revenue is low (recommendation 27).

- a resident entity which acts for a non-resident but falls short of being an agent under the current provisions should be able to apply the features of the GST non-resident agency provisions. This may include a commission agent or a sub-contractor who does things on behalf of the non-resident. The non-resident and the resident entity would both have to agree (recommendation 28).

- non-residents that do not account for their taxable supplies or importations and their creditable acquisitions or importations because of the current or expanded agency provisions, should no longer have to register for GST (recommendation 29).

TERMS OF REFERENCE

1.7 The terms of reference for the review of the GST to cross-border transactions are:

- The Board of Taxation should consult with relevant stakeholders and report to the Government on improvements to the design of the GST system necessary to ensure that cross-border transactions are treated in an efficient and effective manner. A particular focus will be those design features underpinning the involvement of non-residents in the Australian GST system with a view to simplifying the design.

- The review should include, but not be limited to, consideration of:

  – the extent to which non-residents should be drawn into the operation of the GST;

  – the role of resident agents acting for non-residents and whether there is scope to broaden it; and

  – ways to simplify and reduce compliance and administrative costs associated with cross-border transactions.

- The Board should have regard to the design features of the GST as a multi-stage value added tax and should also ensure that any possible changes do not undermine the integrity of the GST in aiming to tax final consumption in Australia. In considering any changes, the Board should ensure that its recommendations have regard to the likely impact on revenue.

- The Board should consult widely and report to the Government by the end of February 2010 on the outcome of its consultations and its recommendations.

THE REVIEW TEAM

1.8 The Board has appointed a Working Group of its members comprising Eric Mayne (Chairman), Curt Rendall and Richard Warburton to oversee its review of the application of the GST to cross-border transactions. The Working Group is being

assisted by an Expert panel and members of the Board's Secretariat, and officers from the Treasury and the Australian Taxation Office are also assisting in its consideration of the issues.

REVIEW PROCESSES

Consultation

1.9 As outlined in the terms of reference the Board is to consult with all stakeholders that have an interest in the application of GST to cross-border transactions. This process will include written submissions from interested stakeholders and targeted consultations.

Submissions

1.10 The Board is inviting written submissions to assist with its review. To assist those making submissions, the Board has prepared this discussion paper which:

- provides some background to how and the framework under which, GST is applied to cross-border transactions;
- examines issues relating to the application of GST to cross-border transactions; and
- explores various options to improve the application of GST to cross-border transactions.

1.11 Submissions should address the terms of reference set out in paragraph 1.7 and the issues and questions outlined in this discussion paper (a full list of questions is at Appendix B). It is not expected that each submission will necessarily address all of the issues and questions raised in the discussion paper. The closing date for submissions is 4 September 2009. Submissions can be sent by:

Mail to: The Board of Taxation
C/- The Treasury
Langton Crescent
CANBERRA ACT 2600
Fax to: 02 6263 4471
Email to: taxboard@treasury.gov.au

1.12 The Board intends to publish submissions on its website as they are received, unless the submitter has requested that the submission remain confidential. Stakeholders making submissions should note that Board members and members of the Board's review team will have full access to all submissions to this review.

Consultation meetings

1.13 The Board also proposes to hold targeted consultation meetings with selected stakeholders who have made submissions. The purpose of these meetings will be to clarify aspects of these submissions and to explore possible responses to issues raised in these submissions.

CHAPTER 2: GENERAL PRINCIPLES FOR TAXING CROSS-BORDER TRANSACTIONS IN AUSTRALIA

2.1 An essential feature of Australia's GST regime is to tax consumption by final consumers where this consumption takes place in Australia and to provide relief from taxation for business to business transactions. GST generally applies to goods, services and intangibles acquired outside of Australia for consumption in Australia. Goods, services and intangibles exported from Australia are treated as GST-free. This is referred to as 'the destination principle'. That is, GST is levied on consumption that occurs within Australia, regardless of the origin of the supply.

2.2 This view was clearly enunciated in the Explanatory Memorandum (EM) to the GST legislation [1]:

> The GST is a broad based indirect tax introduced by the Government to replace the wholesales sales tax and a number of State indirect taxes. Broadly speaking, the GST is a tax on private consumption in Australia. The GST taxes the consumption of most goods, services and anything else in Australia, including things that are imported. Generally the GST will not apply to consumption outside Australia, which is why the GST does not apply to exports.
>
> This is generally achieved by:
>
> - imposing tax on supplies made by entities registered for GST; but
> - allowing those entities to offset the GST they are liable to pay on supplies they make against input tax credits for the GST that was included in the price they paid for their business inputs.

2.3 The approach taken by Australia is in keeping with that broadly adopted by other countries with a GST or Value Added Tax (VAT) and with the principles the OECD (through the Committee of Fiscal Affairs) has recommended[2]:

> For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption:

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1 EM to the A New Tax System (Goods and Services Tax) Bill 1998, Chapter 1, Executive Summary.

2 Organisation for Economic Co-operation and Development (OECD), International VAT/GST Guidelines, Centre for policy studies, Feb 2006. Guidelines for implementing these principles are a work in progress and have been considered further in the context of two subsequent discussion papers.

> The burden of value added taxes themselves should not lie on taxable business except where explicitly provided for in legislation.

2.4 It should be mentioned that, at this stage, the OECD has focussed its attention on the cross-border trade in services and intangibles but its work, and the guidelines being developed, are equally relevant in the cross-border trade in goods.

2.5 While one policy principle is to ensure that GST applies to consumption of goods or services acquired from outside Australia, another policy objective is to not impose unnecessary cost on non-resident suppliers:

> In addition, the Government wants to ensure it does not unnecessarily draw non-residents into the GST system[3].

2.6 This policy objective needs to be balanced against ensuring the revenue integrity of the GST system and the primary objective of ensuring that the private consumption of goods and services from offshore is taxed in the same way as similar things acquired domestically. There is a concern that the current approach is leading to non-taxation in some circumstances and embedded tax in others.

Non-taxation of services and intangibles

2.7 Since the introduction of GST in July 2000 there has been significant growth in the international trade in services and intangibles. This has been particularly so in the areas of telecommunications and computer technology. This has meant a corresponding increase in the consumption by Australians of things originating from offshore, both as a business input and for private consumption purposes.

2.8 However, it is often difficult to apply the 'destination principle' to the taxation of supplies of services and intangibles as it is difficult to identify with certainty whether the consumption is taking place in Australia. For this reason, jurisdictions generally adopt proxies for determining the place of consumption, the main rule being where the consumer is located. However, the significant growth in the international trade in services has increasingly blurred the ability to identify the place of consumption. As a result, there is consumption taking place in Australia that is not being taxed.

Embedded taxation

2.9 A feature of Australia's GST system is the use of the 'invoice-credit' mechanism which seeks to tax the valued added at each stage of the production chain on a transaction by transaction basis. To ensure that no GST is borne by businesses (other than those making input taxed supplies) on their inputs, businesses are required to

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3 EM to Indirect Tax Legislation Amendment Bill 2000, paragraph 3.30.

register for GST to claim a refund of the GST paid. This design feature results in many non-residents being drawn into Australia's GST regime.

2.10 This gives rise to administrative costs for non-residents and integrity concerns for the Tax Office, which has limited jurisdictional control over non-residents. If non-residents do not register and claim their input tax credits, there is the potential for GST to be 'embedded' in the price of the supply.

OECD initiative

2.11 The OECD has established a Technical Advisory Group (TAG) to assist the OECD Committee of Fiscal Affair's Working Group 9 in forming guidelines on how best to apply the above principles to the importation of services and intangibles. The Australian Government is contributing to this work and the Board will continue to monitor any developments during this review. This Board will consider any recommendations coming from this review against the key design principles of the GST and the principles being developed by the OECD.

CHAPTER 3: OPERATION OF THE CURRENT GST LAW IN AUSTRALIA

3.1 If non-resident businesses supply goods, services or other things (such as rights) for consumption in Australia, they may have an obligation to register for GST and remit GST on any taxable supplies they make, after offsetting the GST paid on their business inputs. Non-resident businesses can also register voluntarily for GST and may do so to recover GST incurred on their business acquisitions in Australia even if they do not make any taxable supplies.

3.2 A registration system is used for the administration of the GST to ensure that GST is remitted by those required to do so and to provide relief for GST imposed on acquisitions by businesses of goods and services.

3.3 The GST liability normally is imposed on the entity making the taxable supply or taxable importation. In many instances a GST liability can be imposed on a non-resident business that does not have an establishment or representative in Australia. For example, if a non-resident supplier of services either sends its employees to Australia or engages a domestic subcontractor to perform the services, those services are done in Australia and a GST liability is imposed on the non-resident if the other requirements for making a taxable supply are met.

TAXABLE SUPPLIES

3.4 There are a number of elements necessary for a supply to be a taxable supply. The most relevant elements in cross-border transactions are that:

- the supply is connected with Australia;
- the supplier is registered or required to be registered for GST; and
- the supply is not GST-free or input taxed.

3.5 The 'connected with Australia' rules essentially establish the jurisdictional boundary of the GST. The rules for determining when a non-resident is making a supply that is 'connected with Australia' differ depending upon whether the supply is one of goods, real property or something other than goods or real property.

3.6 The residency status of the supplier or whether the supply is between business entities is not relevant in determining if a supply is a taxable supply. However, the

residency status of the recipient of the supply can be relevant in determining if the supply is GST-free.

Supply of goods

3.7 A supply of goods is connected with Australia if:

- goods are delivered, or made available, in Australia;
- goods are removed from Australia; or
- the supplier imports the goods into Australia or installs or assembles the imported goods in Australia.

3.8 In general, a supply of goods is a GST-free export if the goods are exported by the supplier before, or within 60 days after, receiving any consideration for the goods or, if on an earlier day, the supplier issues an invoice for the goods.

Supply of real property

3.9 A supply of real property is connected with Australia if the real property, or the land to which the real property relates, is in Australia.

3.10 Real property is defined widely and includes the supply of a hotel room.

3.11 A supply of real property situated in Australia can never be a GST-free export.

Supplies of things other than goods or real property

3.12 A supply of anything other than goods or real property (generally services or intangibles such as rights) is connected with Australia if:

- the thing is done in Australia;
- the supplier makes the supply through an enterprise that the supplier carries on in Australia; or
- neither of the above applies and the thing supplied is a right or option to acquire another thing and the supply of that other thing would be a supply connected with Australia.

3.13 Certain supplies of services or intangibles are GST-free because of their relationship with goods or real property situated outside Australia. For example, a supply of services or rights directly connected with goods or real property situated outside Australia is GST-free. The repair of goods from outside of Australia whose destination is outside of Australia is a GST-free supply of services.

3.14 A supply of a thing (other than goods or real property) that is made to a non-resident who is not in Australia when the thing supplied is done (for example, when the service is performed) is generally GST-free. However, those supplies are not GST-free if the supply is provided to another entity in Australia. The supply by Aussie Repair in example 1 below is an example of this. Aussie Repair's supply made to World Cranes, a non-resident entity, is not GST-free because the repair services are provided to Crane Owner Co, another entity in Australia.

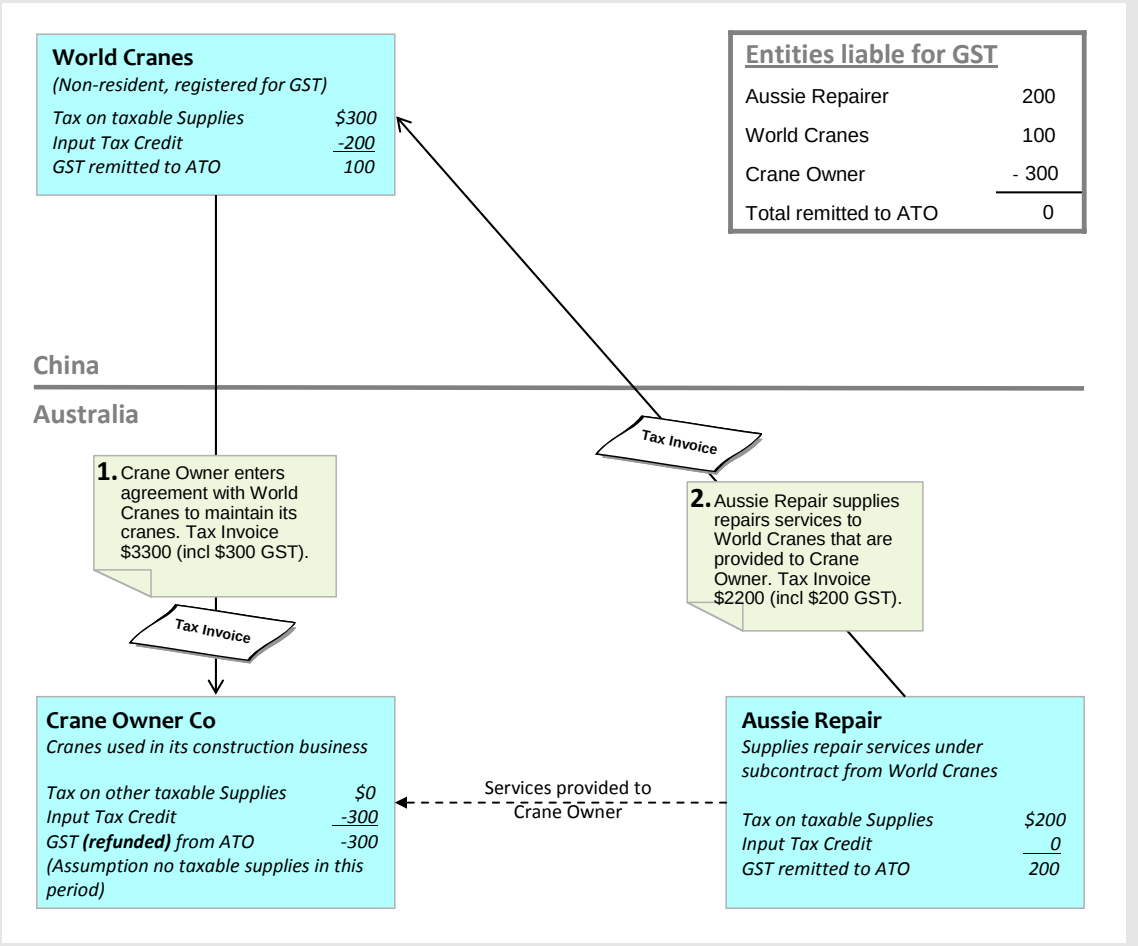
3.15 Supplies made to residents who are not in Australia when the thing supplied is done may also be GST-free if the effective use or enjoyment of that supply takes place outside Australia.

3.16 A supply of rights is GST-free if those rights are for use outside Australia or if the recipient is a non-resident and is outside Australia when the thing supplied is done.

3.17 Other supplies of services that are specifically GST-free include international transport of goods and passengers, travel agency services in arranging overseas supplies and certain supplies relating to international mail.

3.18 Example 1 illustrates how a cross-border business to business transaction is treated using the example where a non-resident supplies repair services in Australia and those repair services are performed by a subcontractor.

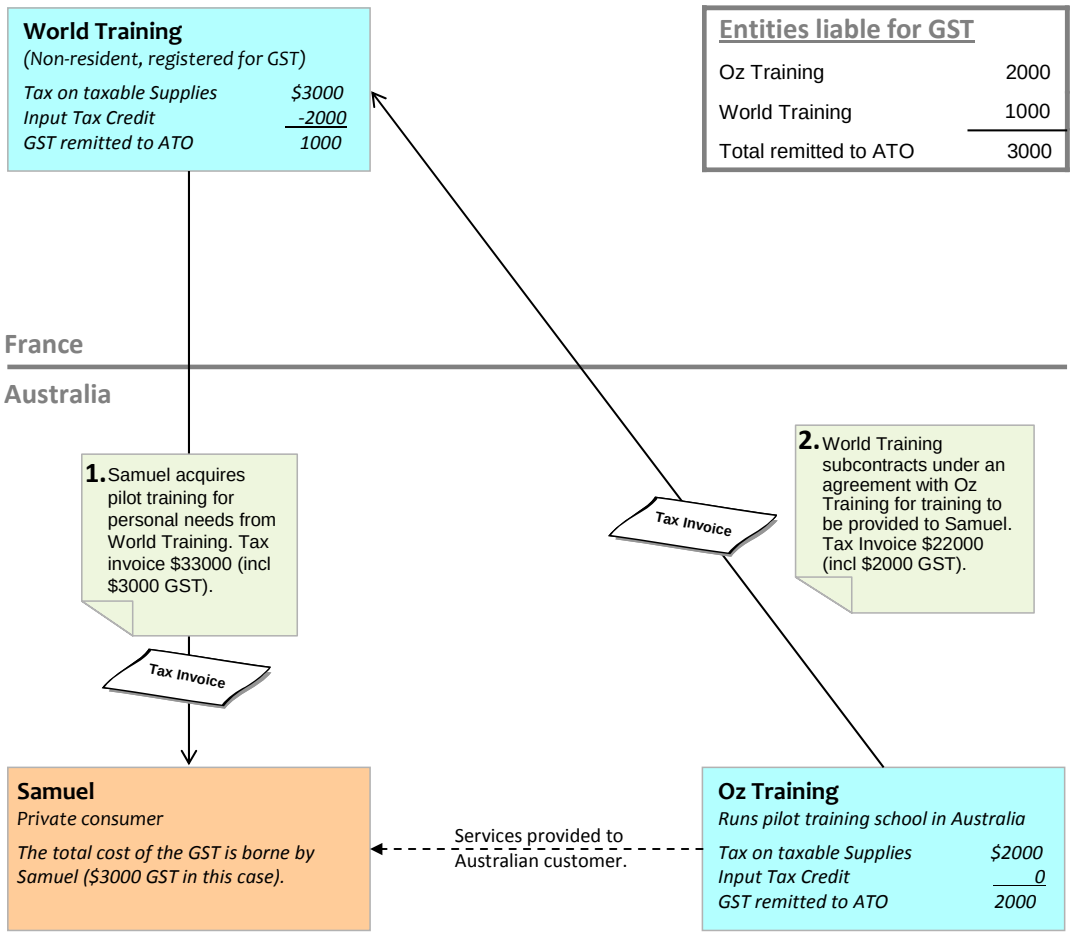
Example 1: Repair services subcontracted and provided to an Australian Business



3.19 The supplies by World Cranes are connected with Australia because the services are done in Australia, albeit by Aussie Repairs and it is not GST-free because the recipient is in Australia. Similarly, the supply by Aussie Repairs is connected with Australia because the services are done in Australia and it is not a GST-free supply because the services are provided to Crane Owner in Australia. Thus, both supplies are taxable.

3.20 The operation of the GST law is the same irrespective of whether the services are provided to an entity that is a registered business (like Crane Owner Co in Example 1) or a private consumer as in the following Example 2.

Example 2: Training services subcontracted and provided to Final Consumer



3.21 The supplies by World Training are connected with Australia because the services are done in Australia, albeit by Oz Training and the supply is not GST-free because Samuel is in Australia when the training is provided. The supply by Oz Training is also connected with Australia because the services are done in Australia and it is not GST-free because the services are provided to Samuel in Australia.[4] Thus, again both supplies are taxable.

3.22 Subject to the non-resident exceeding the GST registration threshold it is required to register for GST, account for GST on its taxable supplies, and recover GST associated with its business inputs.

4 The training services being supplied by Oz Training are assumed not to qualify as GST-free education services under Subdivision 38-C of the GST Act.

TAXABLE IMPORTATIONS

Goods

3.23 GST is imposed on the importation of goods into Australia that are entered for home consumption, except to the extent the GST Act specifies the importation is non-taxable. The entry for home consumption is generally the trigger for GST liability.

3.24 It is possible that an importation of goods can involve both a taxable supply and a taxable importation.

3.25 The entity that makes the taxable importation must pay the GST payable on the taxable importation. The amount of GST is 10% of the value of the taxable importation. The value of the taxable importation essentially is the customs value of the goods plus the cost of bringing the goods to Australia, including transport, insurance, customs duty and wine equalisation tax (if any).

3.26 GST on a taxable importation is usually paid to the Australian Customs Service before goods are released from Customs control.

3.27 To ensure that GST is effectively borne by final consumers, an input tax credit for the GST paid on imported goods is available where the importer is registered or required to be registered and the goods are imported in carrying on their enterprise, unless the importation relates to making input taxed supplies or is of a private or domestic nature.

Services and intangibles

3.28 Supplies of things other than goods or real property that are not connected with Australia are colloquially referred to as 'imported services'. Imported services where the recipient is not entitled to a full input tax credit (for example, financial institutions) are taxable supplies and a reverse charge system applies whereby the GST payable on the supply is payable by the recipient of the supply, not the supplier.

NON-TAXATION OF SUPPLIES CONSUMED IN AUSTRALIA

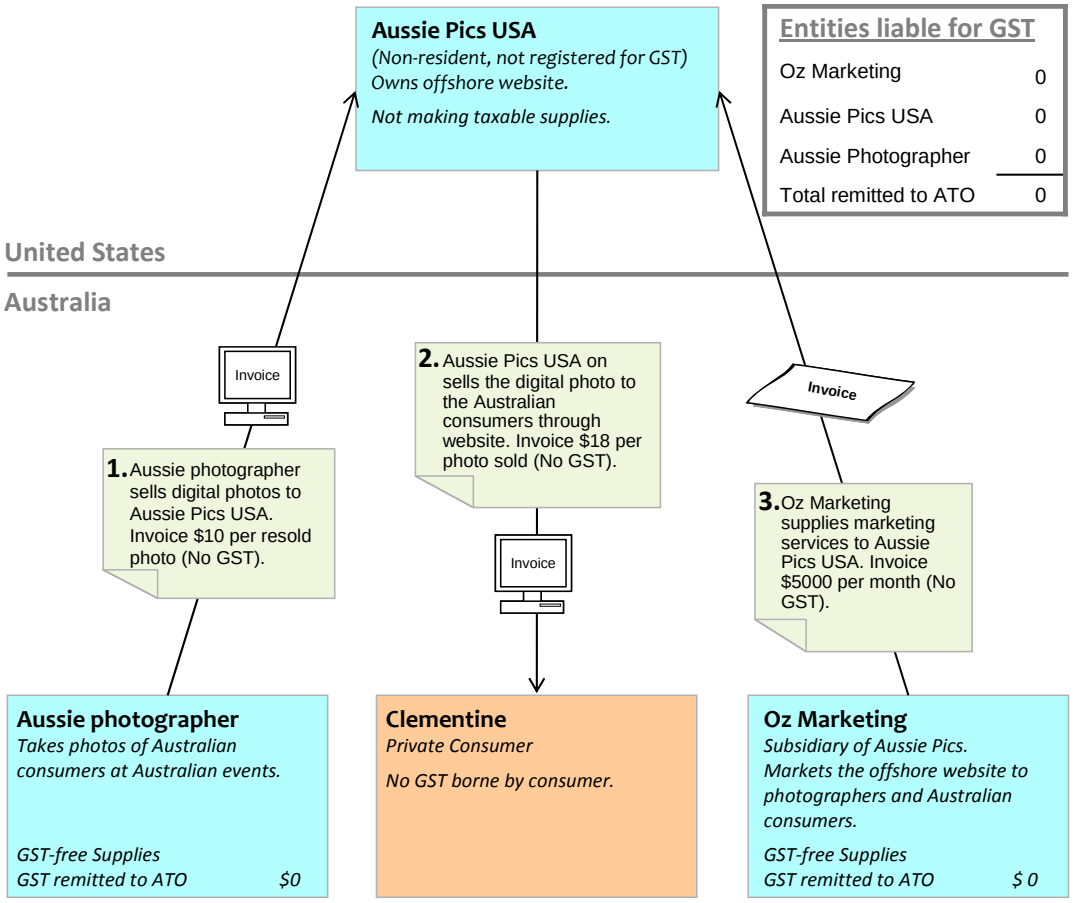
3.29 While the GST Act aims to tax the consumption of goods and services in Australia, including things that are imported, there are instances where supplies or importations of these things are not subject to GST because of practical and administrative difficulties, for example:

- goods imported through the post that are valued at less than $1,000; or
- the supply by an offshore supplier of intangibles, such as software and music files, and services over the internet made to a private consumer.

3.30 Under Australia's obligations under international conventions or treaties, GST is not imposed on certain supplies, for example, mail delivery services supplied to a foreign postal authority for articles posted outside of Australia are GST-free.

3.31 Example 3 shows a flow of supplies where the current GST law does not result in any GST being collected despite consumption taking place in Australia.

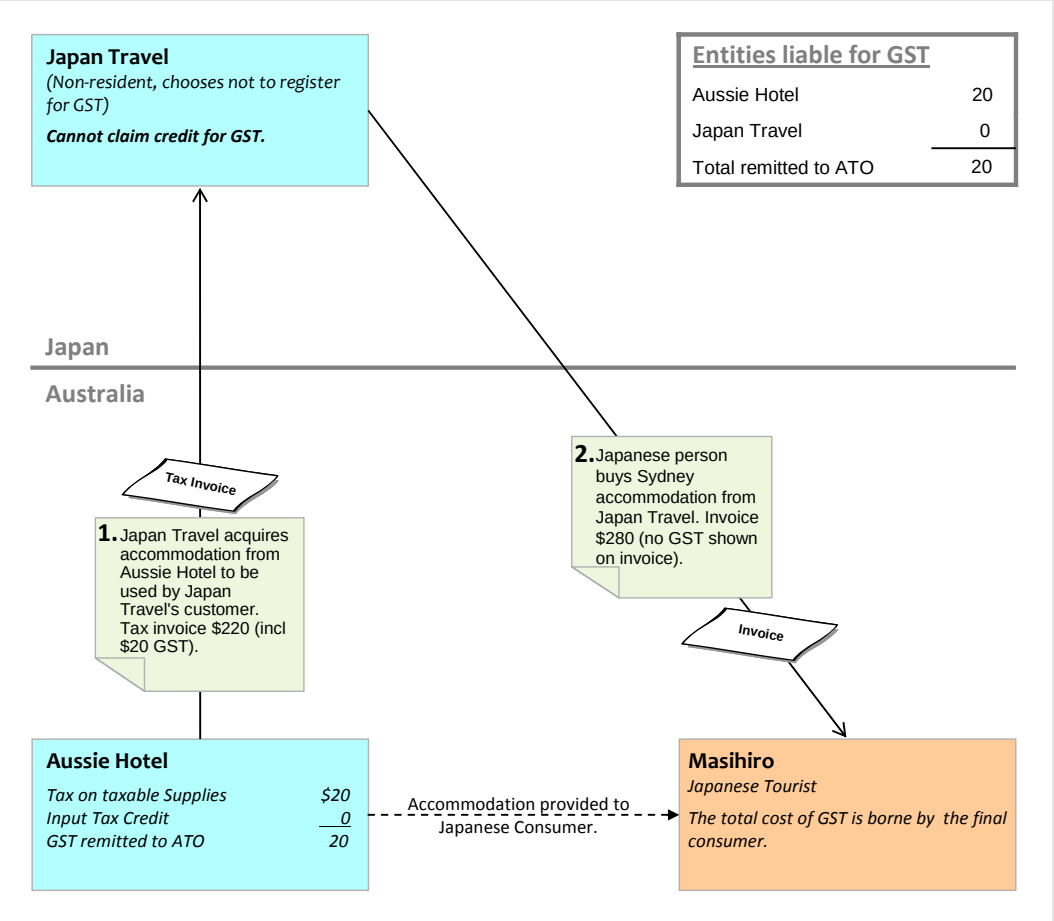
Example 3: On-line supplies that are not taxable supplies



3.32 The supply of marketing services by Oz Marketing to Aussie Pics USA is a GST-free supply as the supply is made to Aussie Pics USA, a non-resident who is not in Australia, and the supply is not provided to another entity in Australia. The supply by Aussie Pics USA is not a taxable supply because it is not connected with Australia as the supply is not done in Australia or made through an enterprise carried on in Australia. However, the supply by Aussie Pics USA is consumed by a private consumer in Australia.

3.33 Under amendments to the law in 2005[5] certain supplies from offshore are now effectively input taxed, at the option of the supplier. Example 4 shows the effect of these amendments on the supply of rights to accommodation in Australia.

Example 4: Supplies and acquisitions of accommodation by a foreign tour operator



3.34 The supply of rights to accommodation by Japan Travel is connected with Australia because it is a supply of real property in Australia. However, the supply is excluded in calculating whether Japan Travel satisfies the registration turnover threshold. Accordingly, Japan Travel is not required to register for GST. In this case, as Japan Travel chooses not to register, the GST on its acquisition from Aussie Hotel cannot be claimed back. Japan Travel is effectively treated as an input taxed supplier.

5 Act 77 of 2005. These amendments were essentially introduced to deal with tour packages sold by foreign tour operators.

3.35 However, if Japan Travel chose to register for GST, the supply of accommodation to its customers is treated as a taxable supply and input tax credits can be claimed for the acquisitions of accommodation from Aussie Hotel.

GST COLLECTION AND REFUNDS

3.36 GST normally is payable by the supplier of a taxable supply.

3.37 A non-resident who is registered for GST, or required to be registered for GST, is also required to lodge a business activity statement (BAS) with the Tax Office. Refunds of GST to non-resident businesses can only be made through registration and lodgement of a BAS.

3.38 The Tourist Refund Scheme (TRS) was introduced in July 2000 to enable eligible tourists travelling abroad to claim a refund of GST on goods they purchase in Australia and take with them. All overseas tourists and Australians travelling abroad are eligible to participate in the scheme with the exception of operating air and sea crew.

Registration

3.39 The registration requirements for non-resident businesses are similar to those for any Australian business.

3.40 A non-resident that carries on an enterprise is required to be registered if its GST turnover is at or above $75,000 (or $150,000, for a non-profit body). Those with a turnover below these thresholds can nevertheless register voluntarily.

3.41 Supplies that are disregarded in working out the GST turnover for registration purposes are:

- supplies that are not connected with Australia;
- supplies of a right or option to acquire another thing, the supply of which would be connected with Australia (but not if the supply of the right or option is made through an enterprise carried on in Australia or is done in Australia); and
- supplies of a right or option to use commercial accommodation in Australia that is not made in Australia and that is made through an enterprise that the supplier does not carry on in Australia.

3.42 GST-free supplies count towards the GST registration turnover. Therefore, it is possible that an entity may be required to register for GST even though the only supplies it makes are GST-free.

3.43 To register, non-residents must provide certain documentation as evidence that they are carrying on the enterprise for which they are seeking GST registration. They

are also required to provide evidence of their identity as the non-resident entity, or of their identity as a representative, such as a director, of the non-resident entity.

3.44 The requirements for non-residents to establish proof of identity are broadly equivalent to those for residents. However, all documents must be certified as true copies by an Australian embassy, high commission or consulate, or by a competent authority in the relevant country (if the country has signed the Hague Apostille Convention[6]) and have these documents Apostille'd.[7]

3.45 Entities that are eligible for an ABN apply for this at the same time as they apply for GST registration. However, non-residents who do not carry on an enterprise in Australia nor make supplies that are connected with Australia are not entitled to an ABN even when they are registered for GST.

3.46 In an attempt to reduce the burden on non-residents Australia's GST regime includes a number of mechanisms to make it easier for non-residents to meet their GST obligations. These include reverse charging of GST and making resident agents that act for a non-resident responsible for the GST consequences of what the non-residents do through their agent.

Reverse charge — voluntary and compulsory

3.47 In cases where a non-resident does not have a presence in Australia the GST payable on their taxable supply can, in limited circumstances, with the agreement of the recipient of the supply, be 'reverse charged' to the recipient. 'Reverse charged' means that the GST payable on the supply is payable by the recipient rather than the supplier.

3.48 A non-resident need not register for GST if the only supplies it makes are made under one or more reverse charge agreements.

3.49 If a non-resident makes a supply of services or rights that are not connected with Australia to a registered Australian business that is not entitled to claim a full input tax credit in respect of that acquisition, the GST on the supply is compulsorily reverse charged to the Australian business. This measure addresses the potential bias that would otherwise arise for the Australian businesses to import services and rights from non-residents who would not be required to charge GST on their supplies, unlike similar services supplied domestically for which they could not fully recover the GST charged.

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6 The Hague Convention of 5 October 1961 Abolishing the Requirement of Legalisation for Foreign Public Documents.

7 Apostille'd means a type of certification issued by a 'competent authority' designated by the state in which the document was issued.

Resident agent

3.50 If a resident is an agent for a non-resident principal who is registered or required to be registered and taxable supplies or taxable importations are made by the principal through the agent, the GST payable on these transactions is payable by the agent and not by the principal.

3.51 *Agent* is not a defined term under the GST law and accordingly, common law concepts of the agency relationship are relevant. Under the common law, an agent is a person who is authorised, either expressly or impliedly, by another person to act for the principal, so as to create or affect legal relations between the principal and third parties.

3.52 However, non-residents that meet the registration threshold are required to be registered even if they are acting through a resident agent. The resident agent also needs to register if they are acting for a non-resident that is registered or required to be registered for GST in Australia. An agent will need to make reasonable inquiries to establish whether the non-resident principal is registered or required to be registered for GST.

Treaties

3.53 Where Australia has a treaty with another country, and the treaty covers Exchange of Information (EOI) in relation to GST, then the Commissioner of Taxation can request from the revenue authority of that country information relating to GST that directly or indirectly identifies an entity. Currently, Australia has tax treaties that contain agreements for EOI on GST matters with New Zealand, Mexico, Finland, Norway, South Africa and Japan. The treaty with France is awaiting activation.

3.54 Australia, currently, has international tax treaties that contain a mutual assistance article for the collection of tax debts with New Zealand, South Africa, Finland, France and Norway. However, only the mutual assistance article with New Zealand has been activated.

CHAPTER 4: ISSUES RAISED BY AUSTRALIA'S APPROACH TO CROSS-BORDER TRANSACTIONS

4.1 Australia's GST regime is broadly consistent with the principles identified in Chapter 2. The Australian GST system uses the destination principle to tax consumption in Australia. That is, GST is generally levied on consumption that occurs within Australia, regardless of the origin of the supply. Under the Australian GST regime, business to business transactions receive relief from taxation by allowing businesses to register. Once registered, businesses (both domestic and non-residents) recover GST on their business inputs by claiming input tax credits unless they make input taxed supplies.

4.2 Australia's approach seeks to collect the appropriate amount of revenue from cross-border transactions in a manner that also creates a level playing field between domestic and international suppliers of goods and services in Australia.

4.3 As noted in Chapter 1, the Board received a number of submissions raising concerns about the complexity and uncertainty associated with the GST treatment of cross-border transactions. Those submissions suggested Australia's current approach does not efficiently collect the appropriate amount of revenue from cross-border transactions, unnecessarily drawing non-residents into the GST system. Specifically, submissions raised the following four areas of concern relevant to this Review:

THE BREADTH OF THE GST LAW IN RESPECT OF ITS APPLICATION TO NON-RESIDENT SUPPLIERS

4.4 Submissions raised concerns regarding the registration system for non-residents:

- The Australian GST net is said to be cast too broadly capturing non-residents with no physical presence in Australia and in particular non-resident businesses who are dealing with registered Australian businesses. Compliance costs associated with registering non-residents for GST and lodging BASs may outweigh any gain in net GST revenue.

- Greater use should be made of a reverse charge mechanism for supplies by non-residents who have no presence in Australia.

4.5 Evidence provided by the Tax Office indicates that there are limited non-residents registered for GST (i.e. some 13,200 non-residents are currently registered for GST, accounting for just 0.5% of total GST registrations).

4.6 Notwithstanding the relatively small number of non-residents that have sought registration[8] information is not available on how many may be required to be registered and have either chosen not to or are unaware of their obligations to do so.

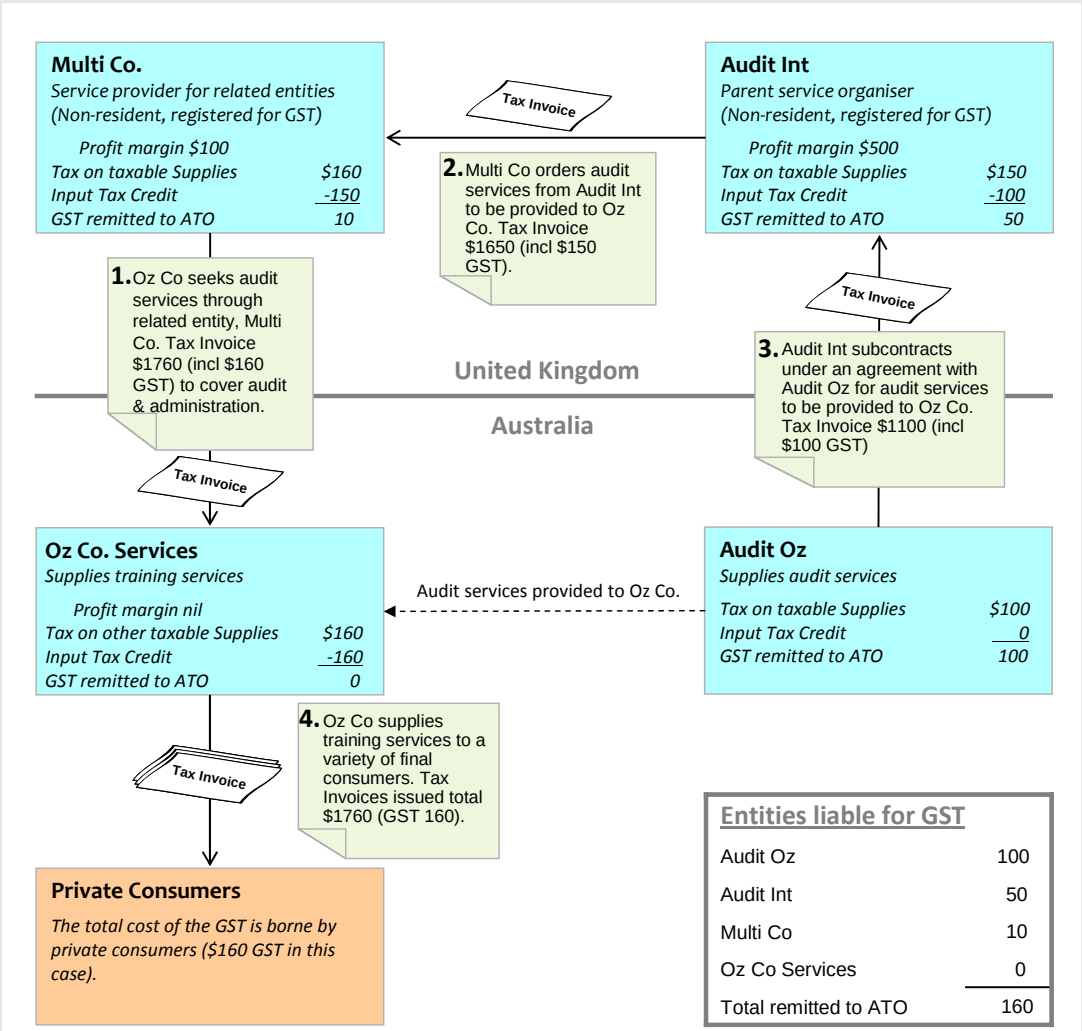
4.7 Under the current system, non-residents can be liable for GST on supplies that are a business input for another business. The business is generally entitled to an input tax credit in respect of a non-resident's GST liability. Example 5 below shows that provided each entity, including non-residents, register for GST, remit GST on their taxable supplies and claim their input tax credit on their business inputs, Australia's GST system captures the appropriate amount of GST and this is ultimately borne by the final consumer.

4.8 However, what is evident from the Example 5 below is the breadth of our GST laws in using non-residents to play a role in capturing the GST that is ultimately borne by a private consumer in Australia. The $160 in Example 5 that is borne by the final consumer is remitted to the Taxation Office by the two non-resident entities, Audit Int and Multi Co, and Audit Oz who supplies services to a non-resident. OZ Co is entitled to an input tax credit which in effect represents the GST liability that is imposed on the other entities.

4.9 Not only does this draw non-residents into the GST regime but also to the extent that non-residents are deterred from registering, or fail to register for GST in Australia it will result in embedded GST as their failure to recover the GST on their dealings with other businesses will be passed on in higher prices for the outputs of those businesses.

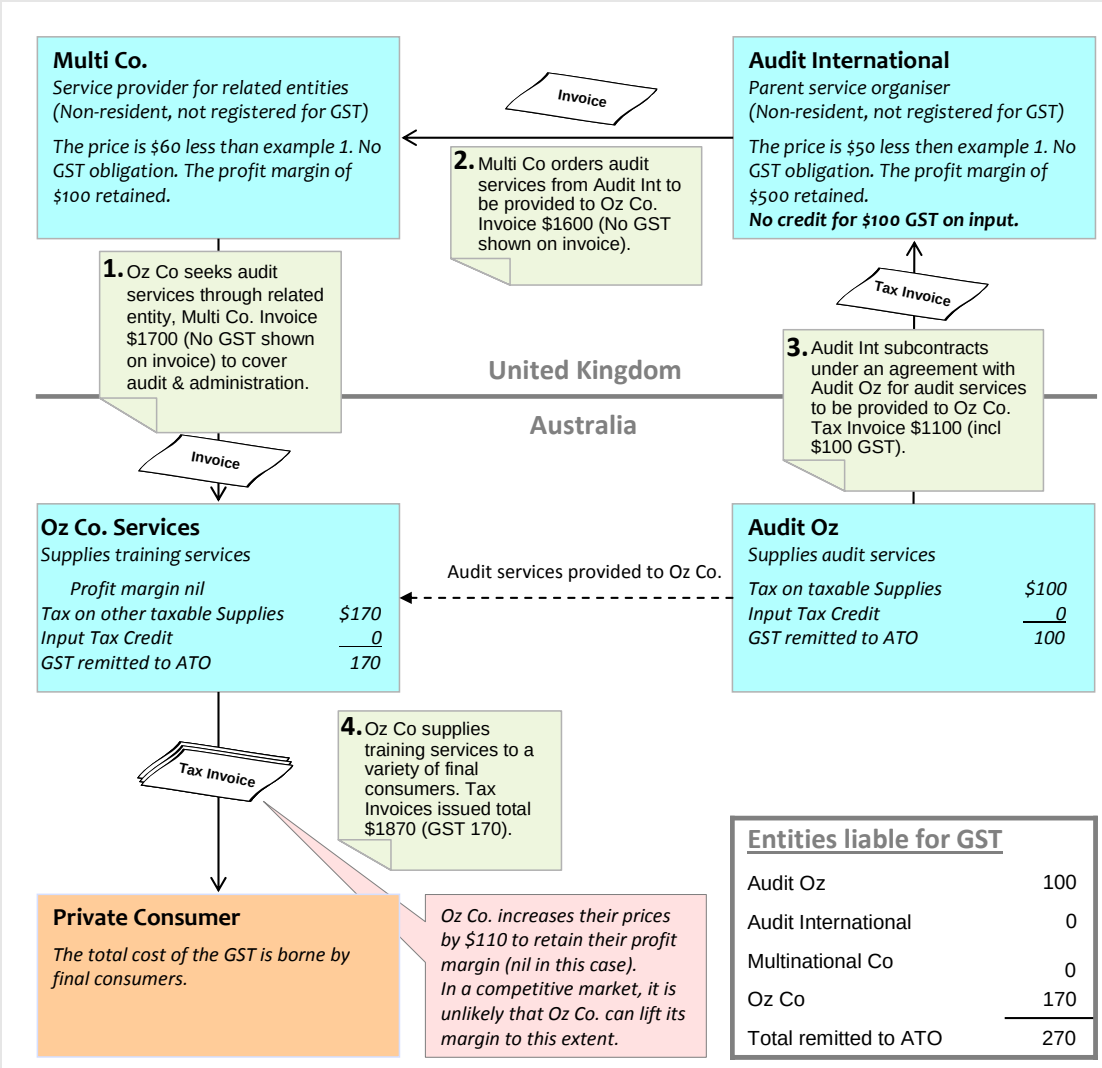
8 It could be expected that many multi-national entities will account for their GST obligations through other related entities carrying on an enterprise in Australia.

Example 5: Subcontracting arrangements and all Businesses Registered



4.10 The diagram below (Example 6) shows that if any one of the non-residents fails to register for GST there will be some embedded GST flowing through into the price of their subsequent supply. This has the potential to make Australia less competitive internationally. In situations where Australian businesses may be price takers, non-resident purchasers may force Australian suppliers to absorb the GST in their costs.

Example 6: Subcontracting arrangements where non-residents not registered



4.11 A voluntary reverse charge mechanism was introduced into the GST law, in recognition of the practical difficulties of non-resident's registering for GST, particularly when the non-resident has no presence in Australia. The voluntary reverse charge mechanism allows a registered recipient (Australian or non-resident), by agreement with the non-resident, to take on the GST obligations of the non-resident. However, submissions to the Board's earlier Review indicated this does not adequately address these issues. In Example 6, there are two non-residents and it would not be possible for both to avoid registering for GST by using the reverse charge provisions. Moreover, since each is being charged GST on their inputs which they would like to recover, using the voluntary reverse charge and choosing not to register would result in embedded tax. The voluntary reverse charge is therefore of benefit to non-residents that make taxable supplies in Australia without making any corresponding creditable acquisitions.

4.12 Another reason why the voluntary reverse charge rules are considered inadequate may be that if Australian registered businesses are not entitled to a full input tax credit for the GST on a taxable supply made by the non-resident to the Australian business, they are reluctant to enter into a voluntary reverse charge agreement even though the monetary outcome to them would be the same as if the non-resident charged GST and a partial input tax credit was claimed by the Australian business.

REGISTRATION OF NON-RESIDENTS

4.13 Submissions also raised a number of concerns regarding the registration system for non-residents:

- The GST registration system is too slow and is difficult to comply with in practice.
- There is no direct refund system available to non-residents for non-residents who only register to claim input taxed credits.
- A consequence of requiring registration may be that the non-resident is also required to pay GST on small supplies that are connected with Australia, even though the non-resident is not required to be registered.
- GST registration by itself does not entitle a non-resident to an ABN registration.

NON-RESIDENT AGENCY PROVISIONS

4.14 Concerns were also raised with the non-resident agency provisions as follows:

- The limited circumstances in which these provisions apply.
- The need for non-residents to register even where a resident agent is required to take on their GST obligations.
- The reluctance of non-residents to utilise the provisions for fear of being seen to have an income tax permanent establishment.

COMPETITIVE NEUTRALITY

4.15 Concerns have also been raised that competitive neutrality may not always be achieved. Many supplies of services and intangibles made to non-residents are not GST-free because they are 'provided' to a resident. This can make Australian businesses uncompetitive by forcing Australian businesses to absorb the GST cost rather than passing it on in their prices to non-residents. Alternatively, the GST becomes embedded in the on-supply if the non-resident businesses choose not to register for GST in Australia in order to claim input tax credits.

4.16 Competitive neutrality may also not be achieved if supplies of things (other than real property) made by non-resident suppliers with no presence in Australia to private consumers in Australia are not connected with Australia and not taxable. The failure to apply GST to these supplies can result in inequities and impact on the competitiveness of domestic suppliers. Overseas on-line suppliers of services, intangibles and low value goods to final consumers in Australia may have a significant competitive advantage over Australian based suppliers, who will generally be required to add GST to their products. For example, the treatment of information and products supplied on-line from overseas, such as downloadable music, will often have a different GST treatment to the purchase of the same information from an Australian supplier.

4.17 The importation of some goods is also not subject to GST and may also distort competitive neutrality. For example, an Australian consumer could order a CD from a non-resident who sends the CD through the mail. Provided the goods are 'low value goods' (that is under $1,000) no GST or customs duty will apply.

4.18 If the supply by the non-resident to the private consumer is connected with Australia because the thing supplied, for example services, is done in Australia either by the non-resident supplier through its employees or by Australian subcontractors, those supplies are taxable supplies. While GST on that supply is payable by the non-resident if the supplier is required to be registered, there are practical difficulties in seeking to enforce compliance with the Australian GST law.

4.19 Appendix A provides a summary of the major views expressed in submissions to the Board's earlier Report on its review of the legal framework of the administration of the GST.

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

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

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?

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?

CHAPTER 5: POSSIBLE OPTIONS FOR CHANGE

5.1 This chapter considers some possible options for change. These have been discussed under four broad headings:

- Issue 1: the broad application of the 'connected with Australia' provisions;
- Issue 2: introducing a direct refund scheme;
- Issue 3: scope of the GST-free rules; and
- Issue 4: consumption in Australia on which GST is not currently captured.

The options discussed are not necessarily mutually exclusive and may be combined to achieve the desired outcomes.

ISSUE 1: THE BROAD APPLICATION OF THE 'CONNECTED WITH AUSTRALIA' PROVISIONS

5.2 Where the supply by a non-resident is connected with Australia the non-resident supplier is generally liable for any GST payable on that supply. Exceptions occur where the non-resident supplier and the Australian recipient agree to reverse charge the GST liability and also where the non-resident supplier makes the supply through a resident agent.

5.3 The broad application of the 'connected with Australia' provisions in the GST Act draws many non-resident entities into the Australian GST system and as discussed in Chapter 4 this can lead to inefficient outcomes. In addition those provisions also limit the scope of the compulsory reverse charge provisions. For instance, where the supply of a service or intangible by a non-resident is 'connected with Australia' then the supply in most circumstances will not be subject to the compulsory reverse charge provisions.

5.4 Comments are sought on options that:

- limit the application of the 'connected with Australia' provisions. in respect of certain cross-border business to business supplies;
- maintain the current 'connected with Australia' provisions but shift the GST liability from the non–resident to a resident business; or

- a combination of the above.

Practices in other jurisdictions

5.5 In most jurisdictions around the world a compulsory reverse charge is the preferred collection method for business to business supplies where the non-resident supplier does not have a business presence in the country of consumption.

5.6 Both New Zealand and Canada have rules determining what supplies are considered to be made in their country (connected with their country) and then have other rules determine what supplies are zero-rated (GST-free). This two step approach is similar to Australia's approach. However, under both New Zealand and Canada's connection rules most supplies by a non-resident without a business presence in their country are not 'connected' and therefore their compulsory reverse charge provisions apply to that supply.

5.7 Under New Zealand GST law any business which receives a supply of imported services, or any other person (including a private individual) who receives a substantial supply of imported services, is potentially liable to pay GST on the supply through a reverse charge. The mechanics of the New Zealand GST law requires reverse charging in circumstances where the recipient does not make greater than 95 percent taxable supplies in a 12 month period. Accordingly, the New Zealand reverse charging rules are not considered on each transaction but rather applied having regard to the types of transactions that the recipient makes.

5.8 In New Zealand imported services are generally deemed to be made in New Zealand by the *recipient* of the supply and therefore the recipient must count these supplies in calculating whether it is required to register for GST. Imported services may therefore result in a New Zealand business that was not registered being required to be registered. Additionally, private individuals who do not carry on a business but who import a significant amount of services in a 12 month period would be required to register for GST if the registration threshold is exceeded taking into account those imported services.

5.9 Generally, a supply of property or services made outside Canada is not subject to GST[9]. The supplies of a non-resident without a business presence in Canada are considered to be made outside of Canada. However, GST may apply to property or services acquired by a resident outside Canada and subsequently imported into Canada. While tax is not collected at the border for taxable importations of intangible personal property or services, resident recipients of such supplies may be required to reverse charge the tax. This applies to both registered and unregistered residents of Canada.

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9 The Canadian consumption tax covers both their GST and Harmonised Sales Tax. However in this paper we have only referred to it as GST.

5.10 Europe does not have a two step approach. Instead they have place of supply rules. For a supply that has a place of supply in a member country of the European Union the VAT on the supply is only payable by a non-resident supplier where it is made through a business presence (with some exceptions). Member states of the European Union reverse charge many cross-border supplies. The effect of reverse charging means any VAT liability is placed on a recipient with a business presence in a member state as opposed to a supplier without a presence. Currently, a member state *may* legislate to reverse charge taxable supplies of goods or certain services carried out by a business not established in the member state in which the VAT is payable. However, from January 2010 Member states are *required* to legislate to reverse charge where a taxable person receives *services* from a supplier that does not have a business presence within the territory of the member state.

5.11 Under European Law the reverse charge is required in all circumstances even where the recipient is fully entitled to claim the VAT back as an input tax credit.

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

5.12 This option seeks to limit the scope of the connected with Australia rules for supplies by non-residents to Australian businesses without impacting on the amount of GST that should be collected.

5.13 Under this option supplies made by a non-resident that does not have a business presence in Australia would not be connected with Australia if that supply is made to an Australian business. This approach would mean that supplies of services and intangibles no longer connected with Australia may still be a taxable supply under the compulsory reverse charge provisions[10]. Under those provisions supplies by a non-resident made to an Australian registered business are not required to be reverse charged if the acquisition was solely for a creditable purpose.

5.14 Even though supplies by non-resident businesses may no longer be taxable[11] this does not mean the applicable GST is not captured. For example, if an Australian registered business is the recipient of that supply, there is no input tax credit to claim as GST would not be charged by the non-resident. The practical effect is that an Australian business that makes taxable supplies will remit to the Tax Office a GST liability that covers their own value added and that of the non-resident. In example 5 in Chapter 4 this means that Oz Services remits to the Tax Office $160 as they are no longer entitled to an input tax credit of $160.

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?

10 Division 84 of the GST.

11 Because the supply is not connected with Australia and the compulsory reverse charge provisions does not apply.

Other issues to consider in regards to option 1

Supplies between non-resident businesses

5.15 Supplies connected with Australia may also be made between non-resident businesses where the contract requires something to be done in Australia (see transaction 2 of example 5 in Chapter 4 where the supply of the audit is being done in Australia). Consideration could be given to limiting the connection with Australia rules to exclude these supplies.

5.16 Under the current regime both non-residents in example 5 are required to register for, and pay any GST owing, and claim offsetting input tax credits for no net GST revenue.

5.17 Therefore option 1 could be expanded to limit the application of the connection rules for supplies that are made between non-resident businesses that do not have a business presence in Australia.

The compulsory reverse charge provisions

5.18 Option 1 should mean a greater number of supplies of services and intangibles will be subject to the compulsory reverse charge provisions currently in the existing law where the recipient of that supply acquires those things for a partly creditable purpose. Consideration could be given to modifying the existing compulsory reverse charge provisions and this is discussed under option 2.1.

Option 2: Shifting the GST liability of non-residents to Australian businesses

5.19 Greater efficiencies in collecting GST on cross-border transactions may be achieved within the current 'connected with Australia' provisions by transferring a GST liability that is currently imposed on a non-resident without a business presence in Australia to an appropriate Australian business. This would make it unnecessary for non-residents to enter our GST system and the Tax Office is able to verify and enforce compliance by the Australian business that is within its jurisdiction.

5.20 There are a number of approaches this could take and these are considered separately but all could have application.

Option 2.1: Shifting the GST liability of non-residents to resident businesses through compulsory reverse charge

5.21 Currently in Australia the compulsory reverse charge provisions only apply to the supply of services and intangibles made by a non-resident to a recipient business who acquires the supply other than for a fully creditable purpose, that is, the recipient business wholly or partly uses the supply in making input taxed supplies. Voluntary

reverse charge provisions can apply to all types of supplies including goods and real property but have not, as noted earlier, been widely used.

5.22 This option considers making the existing voluntary reverse charge provisions compulsory. Compulsory reverse charge rules could apply to taxable supplies made by a non-resident to a registered Australian business.

5.23 Similar to New Zealand, the compulsory reverse charge framework could apply to entities that are carrying on an enterprise but are not registered for GST (because they fall under the registration threshold). The imported supply would be counted in the recipient's registration turnover threshold. Therefore an Australian business that is not required to register for GST because they currently do not exceed the GST registration threshold of $75,000[12] may become required to register for GST once the imported supply is taken into account. The reverse charge option would then apply. The non-resident would not be liable to pay GST on this supply nor count the supply towards its GST registration threshold.

5.24 Where a recipient is required to reverse charge but is also entitled to a full input tax credit then compulsory reverse charge can place a significant compliance burden on the recipient for no net gain to revenue. Such transactions are excluded from the reverse charge under option 1 by removing such supplies from being connected with Australia.

5.25 For a recipient that predominantly makes input taxed supplies they may prefer to reverse charge all supplies at the time of acquisition and then assess their eligibility to an input tax credit at a more appropriate time.

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

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

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

Option 2.2: Transfer GST liability to an Australian subsidiary

5.26 Another option is to transfer the GST liability to a registered Australian business that is not the recipient of the supply. In some circumstances, it may be appropriate to

12 $150,000 for non-profit entities.

look to the Australian subsidiary to account for the GST obligations of its non-resident parent. Even though a non-resident company does not have a presence in Australia, such as a permanent establishment, in some cases it may be appropriate to take into account the business relationship that exists between an Australian subsidiary and its non-resident parent.

5.27 For example, sometimes an Australian subsidiary is predominantly engaged in making supplies to its non-resident parent for input into a supply made by that non-resident to a recipient in Australia. In this circumstance the subsidiary could be made responsible for the GST liability of its parent company.

5.28 A non-resident that utilises the services of an Australian subsidiary to make supplies to Australian businesses could be seen to be no different from an Australian business supplier.

5.29 However, as this option would transfer the non-resident's GST liability to the subsidiary, this could potentially affect creditors of the subsidiary adversely by imposing a debt on an entity where that entity did not create the obligation.

5.30 This option could be applied to goods, services and intangibles. If the option is applied to goods it would need to be ensure that it could not lead to double taxation, that is, both as a taxable importation and then as a taxable supply.

5.31 The option could be restricted to supplies of goods made available by a non-resident within Australia which are currently taxable supplies. In some situations a subsidiary may for instance, be used to source those goods.

Q5.5 Under option 2.2, should a non-resident with a subsidiary in Australia be treated the same as a resident Australian business for GST purposes?

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

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?

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

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

Option 2.3: Expanding the non-resident agency provisions

5.32 In its report to the Government on the 2008 GST review, the Board recommended that the current GST agency provisions could be better utilised to reduce the number of non-residents in the GST system (recommendation 28).

5.33 Under New Zealand GST Law persons who carry on a taxable activity for and on behalf of absentee principals are deemed to be an agent of the principal in respect of the taxable activity, are required to make returns, and are liable for any tax charged or levied in respect of the taxable activity[13]. The term absentee means[14]:

- any person (except for a company) who is out of the country for the time being;
- any company incorporated offshore, which does not have a fixed or permanent place of business in New Zealand in its own name; and
- any company incorporated offshore which is declared by the Commissioner to be an absentee.

5.34 The current Australian non-resident agency provisions could be broadened to allow an entity that acts for a non-resident but falls short of being an 'agent' under the current provisions, to apply the features of the provisions. This option could allow a commission agent or a subcontractor who does things on behalf of the non-resident to be responsible for the GST obligations of the non-resident's supplies, acquisitions and importations. The non-resident and the resident entity would both have to agree for the provision to apply. This option could be considered in conjunction with option 2.2 which considers circumstances where a subsidiary could be liable to account for the GST obligations of its non-resident parent.

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

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

5.35 Consideration could be given to allowing a non-resident without a business presence in Australia to have a tax representative similar to the tax representative under European Law.

5.36 Under European Law a tax representative can be appointed when the person liable for the VAT is an entity not established in the Member State in which the VAT is due. Additionally, where there are no mutual assistance laws between the State where the entity is established and the Member State, the Member State may take measures to

13 Subsection 59(2) of GST Act 1985, NZ Law
14 Subsection 59(1) of GST Act 1985, NZ Law

insist that the person liable for the VAT is to be a tax representative appointed by the non-established entity.

5.37 This option could be voluntary and targeted at non-residents liable for GST that do not have a business presence in Australia or a business relationship with an Australian business. This tax representative would be jointly and severally liable for the non-resident's GST liability and also required to meet the non-resident's GST obligations.

5.38 The tax representative could be any person that is nominated by the non-resident and would not necessarily have any involvement in the supplies that are made by the non-resident.

5.39 Appropriate integrity measures would be required for options 2.3 and 2.4. These integrity measures could include:

- the resident entity agreeing to take responsibility for acquisitions, supplies, importations and adjustments of the non-resident even when those supplies are not made through the entity;
- a surety where appropriate to reduce the risk that there is an uncollectible GST debt although recognizing that the provision of a surety may come at a cost; and
- the tax representative lodging a separate BAS for each non-resident that they have volunteered to act for.

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?

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

ISSUE 2: INTRODUCE A DIRECT REFUND SCHEME

5.40 Currently, in order to recover any GST incurred by a non-resident in carrying on business in Australia, the non-resident must register for GST.

5.41 Allowing non-residents to directly claim a GST refund would avoid GST becoming an embedded cost to business.

Practices in other jurisdictions

5.42 Under European VAT law direct refunds are available to entities not established in the country in which they incur VAT on goods and services. However, Member states may make the refunds conditional upon the granting by third states of comparable advantages regarding turnover taxes (reciprocity conditions). Not all Member states impose the reciprocity principle to the VAT Refunds.

5.43 Both the United Kingdom and Germany have a direct refund system. Entities must complete an application form, stipulate that they do not make taxable supplies within that country, provide a certificate from the country in which the entity is established verifying the entity is registered as a trader under a tax number, provide the original invoices and import documents with the application. Additionally the application must be within 6 months of the end of the year in which the VAT was incurred. The minimum period for application must be for a 3 month period (unless occurred toward end of year). The refund is to be paid within 6 months of receipt of the application.

5.44 New Zealand does not have a direct refund system. Additionally, unlike Australia, the New Zealand law does not allow a non-resident business to claim an input tax credit unless it relates to a taxable activity carried on in New Zealand.

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

5.45 If options are pursued that reduce the number of non-residents who are required to register for GST then consideration needs to be given as to whether an alternative mechanism is required to allow such non-resident businesses to recover GST that they incur on their acquisitions in Australia without being required to register for GST.

5.46 Submissions to the Board's earlier review raised a concern that when registering to claim back credits a non-resident is then required to charge GST on any supplies it makes that are connected with Australia, even when these supplies in total are well below the registration threshold.

5.47 An approach is to allow non-residents to be entitled to a direct refund for the GST incurred for a creditable purpose similar to schemes operating overseas.

5.48 Perhaps a further category of GST registration could be introduced such as 'GST Refund Application' which does not carry with it the obligation to pay GST on any supplies where the non-resident business is not required to register.

5.49 However, introducing a direct refund system could require integrity checks on every application, whereas currently the registration process forms the main part of the integrity check.

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

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?

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

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?

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

ISSUE 3: THE SCOPE OF THE GST-FREE RULES

5.50 A supply other than goods or real property that is made to a non-resident who is not in Australia when the thing supplied is done (for example, when the service is performed) is generally GST-free. However, those supplies are not GST-free if the supply is *provided* to another entity in Australia. The law does not distinguish between the *provision* of the supply to an Australian registered business or an Australian private consumer. In both instances, the GST-free status of the supply is negated and this outcome was illustrated in examples 1 and 2 in Chapter 3. In example 1, the supply of repair services made to a non-resident who is not in Australia is not GST-free because it is provided to an Australian business. In example 2, the supply of training services that is made to a non-resident who is not in Australia is not GST-free because it is provided to Samuel, an Australian private consumer.

Practices in other jurisdictions

5.51 In New Zealand, services are zero-rated (that is, GST-free) when supplied to a non-resident who is outside New Zealand at the time the service is supplied.

5.52 However, supplies of this type are not eligible for zero-rating if the supply is provided to a third party that is in New Zealand and it is reasonably foreseeable that entity in New Zealand will not receive the performance of the services in the course of making taxable or exempt (input taxed) supplies.

5.53 The New Zealand provision specifically lists employees and office holders of a non-resident company as being entities other than the company itself.

5.54 Under the European Directive the supply of a specified list of intellectual and professional services to customers outside the European Union is taxable in the place the customer is established.[15]

5.55 Under the Canadian GST law a supply of a service made to a non-resident person may be zero-rated. However, this is not the case if a service is made to an individual who is in Canada at any time when in contact with the supplier in relation to the supply or a service is rendered to an individual while the individual is in Canada.

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

5.56 Under this option a supply of services or intangibles that is made to a non-resident but provided to a registered Australian business could be made GST-free if the GST can be captured by the Australian business by for example limiting the connection with Australia rules (option 1) and reverse charging (option 2.1).

5.57 In example 5, where Oz Co Services is registered for GST, the $160 of GST that should be borne by the final consumer can be captured by Oz Co Services. In principle, the supply by Audit Oz need not be subject to GST because the correct GST is captured when Oz Co Services makes its supply to the final consumer.

5.58 In considering this option it may be necessary to consider the onus that will be placed on the Australian supplier in determining whether the supply is provided to a registered Australian business. Whilst this may be reasonably straight forward in many circumstances, for example, this could be determined by obtaining the ABN of the providee, it will be more complicated when such supplies are provided to employees or office holders. For example, where an Australian business contracts with a non-resident for the provision of services to an employee of a non-resident or another business in Australia, the supplier would need to determine if the supply is provided to the employee in their professional capacity or in their personal private capacity.

5.59 Where the circumstances are complex, an option is to treat the supply as taxable rather than require the supplier to establish if the supply is GST-free or not.

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?

15 Refer to Article 56 of Council Directive 2006/122/EC. From 1 January 2010, these place of supply rules will appear in Article 59, following amendments to the Directive by 2008/8/EC.

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?

Option 3.2: Supplies for consumption outside Australia

5.60 Supplies made between domestic suppliers are generally subject to the normal domestic rules of a multi-stage tax in that the supplier charges GST and it is up to the recipient to determine their entitlement to an input tax credit. However, if a supply is made to a domestic entity but provided to another entity outside Australia that supply can be GST-free.

5.61 That is, the supply of a service between two domestic registered businesses is GST-free when the service is provided to another entity outside of Australia. [16]

5.62 If under option 3.1 it is accepted the 'made' and 'provided' rules are no longer to apply to supplies made to a non-resident but provided to an Australian registered business, it is necessary to consider whether the made and provided rules between two registered domestic businesses should continue.

5.63 Supplies made between two Australian GST registered entities could be made taxable supplies even though the supply is provided to another entity outside of Australia. The registered recipient could determine their entitlement to an input tax credit. However, in circumstances where the Australian recipient makes input taxed supplies the acquisition could be treated as being made for a creditable purpose where the consumption of the supply is outside of 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?

ISSUE 4: CONSUMPTION IN AUSTRALIA ON WHICH GST IS NOT CURRENTLY CAPTURED

5.64 As noted in Chapter 4, low value transactions and many on-line supplies and acquired from non-residents are not subject to GST. This has raised concerns that competitive neutrality may not always be achieved, with potentially adverse outcomes for some Australian small businesses.

16 GST-free under item 3 in the table in subsection 38-190(1) because of the application of subsection 38-190(4).

5.65 Australian registered businesses supplying services domestically will generally be required to charge GST. However a similar supply made by a non-resident that is not connected with Australia will not attract GST when supplied to a private consumer. This can place the Australian supplier at a competitive disadvantage.

Practices in other jurisdictions

5.66 Member countries of the European Union have broadened their tax base to include non-residents without a business presence that make certain types of supplies. For electronically supplied services, telecommunication and broadcasting services flowing directly to a consumer within the European Union (business to consumer supply) the European Union makes the non-resident supplier liable for the VAT. The non-resident supplier is required to register for VAT in one of the member states and account for VAT made to the consumer.

5.67 New Zealand law imposes GST on a non-resident who does not have a presence in New Zealand in the following business to private consumer supplies:

- when the goods are in New Zealand at the time of the supply; and
- when services are physically performed in New Zealand.

5.68 Additionally, New Zealand imposes a reverse charge requirement on large imports of services by private consumers. That is, a private consumer who acquires supplies from a non-resident where the cumulative value exceeds the GST registration threshold[17] in New Zealand is required to register and reverse charge the GST on the transaction.

5.69 Under New Zealand law, a non-resident who has a business presence in New Zealand is deemed to be a resident and therefore is treated in the same way as New Zealand resident businesses.

Option 3.3: Reverse charge for private consumers

5.70 The application of a reverse charge to private consumers may impose significant compliance costs on private consumers and would be very difficult to administer. Other jurisdictions generally do not try to do this. New Zealand, however, reverse charges private consumers who import a large amount of services in a calendar year.

5.71 While we understand that the level of voluntary registration in New Zealand is high they acknowledge that it is not practically possible for authorities to identify all small-scale acquisitions of imported services by unregistered persons.

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17 The GST registration threshold in New Zealand is currently NZ$60,000.

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?

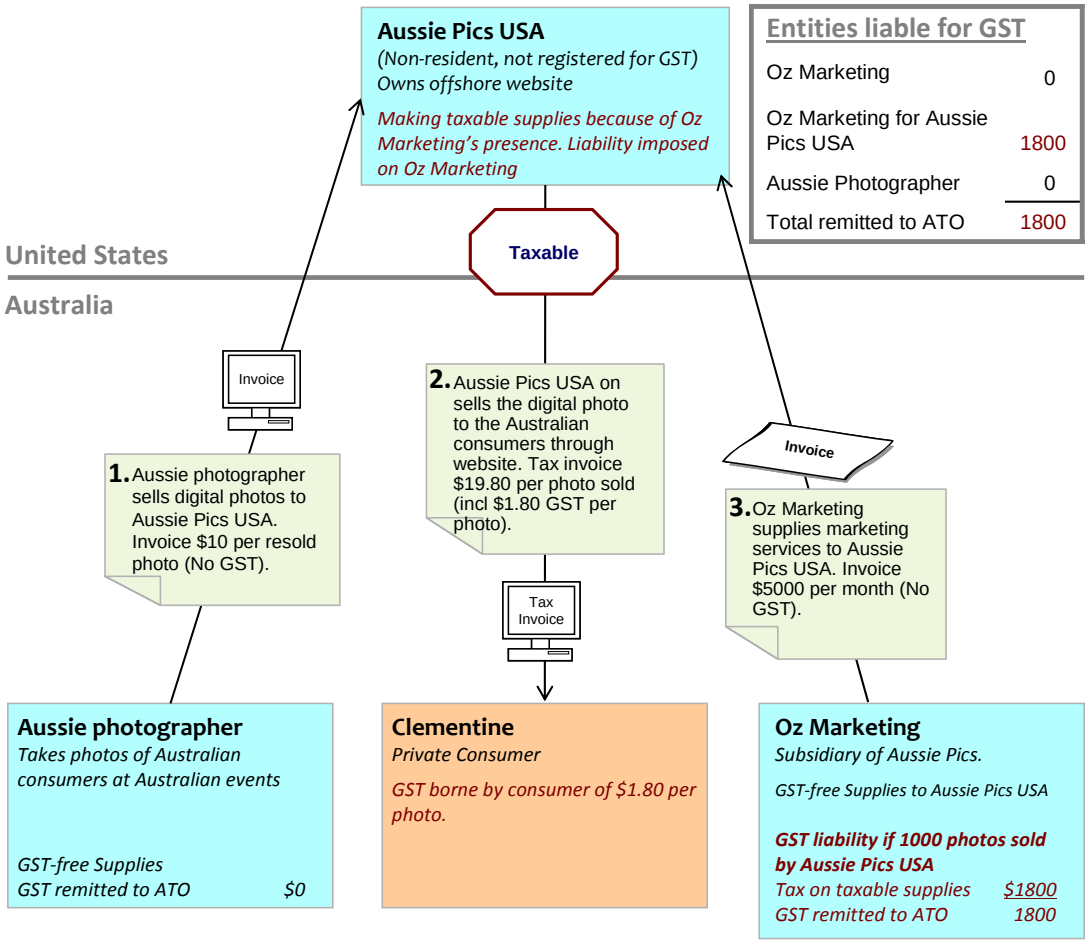
Option 3.4: Changing the connection rules and GST liability transferred to an Australian subsidiary

5.72 This applies option 2.2 for supplies that are not currently taxable supplies. The connection with Australia rules would need to be broadened to capture these supplies and the GST liability transferred to an Australian subsidiary.

5.73 Example 7 shows how this option could apply for the supply of an intangible by a non-resident on-line supplier[18]. Option 2.2 (transfer GST liability to an Australian subsidiary) is applied to transaction 2 (where the connection rules have been broadened to make this a taxable supply).

18 This example is based on the scenario set out in example 3 in Chapter 3.

Example 7: Example 3 with option 2.2 and 3.4 superimposed



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

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

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

5.74 A reduction in the low value import threshold could allow more comprehensive taxation of private consumption in Australia.

5.75 Goods imported into Australia with a value under $1,000 are not subject to GST on importation. This threshold was raised from $250 to its current level from 12 October 2005 and applies equally to businesses and private consumers.

5.76 New Zealand has a NZ$400 (AUD$317) low value threshold whereby goods below that value imported into New Zealand are not subject to any GST on importation. Canada also has a low value importation threshold but this is set at C$20 (AUD$22).

5.77 While a lower threshold would mean more business to consumer supplies are subject to GST this would need to be balanced against higher compliance costs for both Australian consumers and businesses and those administering the collection of GST.

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

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

CHAPTER 6: SPECIFIC ISSUE OPTIONS

6.1 In last year's review the Board received a number of submissions about the registration procedures for non-residents being very onerous and the Board made a recommendation regarding these procedures (see 6.7 below).

6.2 Also, there are currently instances under the GST Act where a non-resident is required to register for GST where they have no GST liability.

REGISTRATION PROCEDURES FOR NON-RESIDENTS

6.3 A registration system is used for the administration of the GST to ensure that GST is remitted by those required to do so and to provide relief for GST imposed on acquisitions of goods, services and other things. Non-resident businesses making taxable supplies are required to be registered, and recipients of taxable supplies may need to register to claim input tax credits.

6.4 Under the current system there are many non-residents that have a requirement to register for GST that are not otherwise required to be recognised in Australia. For example, many of these businesses and the individuals behind the businesses will not have or need a Tax File Number. Accordingly, when these businesses seek GST registration they are starting from a position where the Tax Office has no information about their enterprise and they are required to prove the existence of their enterprise activities and their people. A quote from a submission from the Board's 2008 GST review was:

> Although we understand the need for the ATO to balance compliance difficulties with the integrity of the system, it is unacceptable to have a system which on one hand actively brings non-resident entities into its net but on the other makes it very difficult and time consuming to have those entities registered. Such a system can materially impact the ability to undertake and complete cross border transactions as well as discourage compliance with the law as currently interpreted by the ATO. [Corporate Tax Association]

6.5 The options that have been canvassed in the previous chapter are looking at more efficient ways of collecting GST in cross-border transactions. If these options can be implemented it will mean many non-residents will no longer be brought into Australia's GST system because of the following:

- their GST liability in making taxable supplies has been shifted to a more appropriate business based in Australia; or

- the supplies that non-resident businesses receive will be GST-free in a greater number of circumstances.

6.6 Reducing the number of non-residents that need to be in the GST system automatically reduces the number of non-residents that have to go through the registration process. Notwithstanding, it may be possible, subject to assessing the integrity and revenue risks, to further streamline the GST registration process to reduce compliance costs for those non-residents still wishing to register or who are required to do so.

Streamline recommendation from 2008

6.7 In its report to Government dated December 2008 the Board recommended (recommendation 27) that the Commissioner of Taxation should consider further streamlining of the registration process in the following situations where the risk to revenue is low:

- entities joining Australian registered groups, where the representative member is an Australian publicly listed company. However, appropriate identity checks would be required when the entity leaves the group for it to remain registered;

- companies or their subsidiaries listed on a recognised overseas stock exchange ;

- entities that are from countries that have an exchange of information agreement with Australia that covers indirect tax laws, if the revenue body covered by the agreement is able to verify the existence of the entity and that it carries on an enterprise; and

- entities that are from a comparable taxing regime if the relevant revenue authority is able to verify the existence of the entity and that it carries on an enterprise.

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?

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

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)?

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

REMOVAL OF THE TECHNICAL REQUIREMENT TO REGISTER FOR GST

6.8 There are instances under the GST Act where a non-resident is required to register for GST even if they have no GST liability. The options discussed below consider the situations in which this arises and possible solutions in removing the need for the non-resident to register.

Option 4: Non-residents making GST-free supplies

6.9 GST-free supplies are not excluded when determining whether an entity is required to register for GST. Accordingly, if a non-resident only makes GST-free supplies they are required to register for GST when they make supplies connected with Australia greater than $75,000 per annum ($150,000 for a non-profit entity).

6.10 Where the non-resident does not have a GST liability because it only makes GST-free supplies, consideration could be given to excluding the GST-free supplies in determining if that non-resident is required to register.

6.11 However, if the non-resident makes other supplies this could have the effect of making these other supplies not subject to GST because the total of those supplies is less than $75,000 per annum.

6.12 Alternatively, in this circumstance, both the GST-free supplies and those other supplies could be taken into account in determining whether those other supplies should be subject to GST. A similar approach is used in Division 83 of the GST Act for voluntarily reverse charged supplies, whereby other supplies not subject to reverse charge remain taxable.

Q6.5 What would be the most appropriate method of excluding these non-residents from being required to be registered for GST?

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?

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

Option 5: Non-residents using an agent

6.13 Recommendation 29 from the Board's 2008 Report considered that non-residents who are not accountable for their taxable supplies, acquisitions or importations because of the current agency provisions (or if expanded as per options 2.3 or 2.4) should no longer have to register for GST.

6.14 However, the Board acknowledged the non-resident would still need to be regarded as being registered or required to be registered for all purposes of the GST Act, if it has an agent or representative who is responsible for its GST obligations.

6.15 For those resident agents that are currently subject to the non-resident agency provisions, this option would mean that the non-resident need not register if the only supplies and acquisitions the non-resident makes are made through the resident agent. While they should not need to register, their non registration should not affect whether their supplies are taxable or acquisitions are creditable. This would remove the compliance cost of registration, without affecting whether their supplies and acquisitions are within the GST system. These agents only have to lodge a single BAS that includes their own GST obligations and that of their non-resident principal.

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?

APPENDIX A: VIEWS CONTAINED IN SUBMISSIONS TO THE BOARD'S EARLIER REVIEW INTO THE ADMINISTRATION OF THE GST

There were many submissions that raised concerns about the breadth of Australia's GST law that requires a large number of non-residents to be part of the GST system.

> … the Australian GST is over-inclusive of non-residents and needs to be modified to take a more practical approach by using the reverse charge mechanism for supplies by non-resident suppliers who are not established in Australia. In addition, it relies too heavily on a general application of proxies and will inevitably need to move to a greater subdivision of rules to apply specific proxies to particular types of supply. [Rebecca Millar]

Submissions raised concerns that the supplies that are regarded as being connected with Australia are too broad:

> … the GST net is being cast unnecessarily wide to capture non-residents with no physical presence in Australia and who are dealing with registered Australian businesses to register and account for Australian GST liabilities and claim back GST credits. This causes a significant compliance burden which seems unnecessary given that there is little or no net effect on the revenue. [The Institute of Chartered Accountants in Australia]

> The ATO's broad interpretation of section 9-25(5) of the GST Act (the 'connection with Australia' rules for services and intangibles), makes many foreign businesses reluctant to register for Australia's GST ... While this view prevails and the GST law remains in its current form, many foreign businesses will remain outside the GST system, forgoing refunds of GST they would otherwise be entitled to claim. [PricewaterhouseCoopers]

Additionally, submissions were concerned with competition and compliance costs issues where supplies of intangibles made to non-residents that are not GST-free:

> The ATO's current interpretation of subsection 38-190(3) as outlined in GSTR 2005/6 is completely at odds with the Government's stated intention regarding non-residents and their participation in the Australian GST system and goes well beyond the purpose of the provision, which was to prevent business to consumer (ie: consumption) expenditure from escaping the GST net.

> The outcome of the ATO's approach is a negative one, whichever way you look at it. Corporates are often faced with non-residents who refuse to pay the GST, which results in the corporate having to bear the cost. The other side of this coin is where the added GST impost results in the non-resident sourcing the supply from another offshore market, resulting in lost trade to the Australian economy. Where the non-resident accepts the higher cost but decides not to embark on the process of registration, the price of the

> Australian service is higher than it would be otherwise, which is clearly an inappropriate outcome. Alternatively, where the non-resident chooses to enter the system, the non-resident, the corporate and the ATO are subject to additional compliance (and for the ATO, audit) costs, including the onerous POI requirements mentioned previously. [Corporate Tax Association]

The current law is complex.

> As of 4 August 2008, 769 pages of the consolidated versions of the rulings focus on international issues with 543 pages dealing with section 38-190 of the GST Act. The GST Act has been overtaken by the numerous explanations proffered in relation to international issues. [Taxation Institute of Australia]

The GST law requires many non-resident entities to register for GST because the non-residents are making taxable supplies or they are acquiring taxable supplies in carrying on their enterprise or both. Submissions suggested that given the breadth of the GST law's inclusion of non-residents, the registration procedures should be simplified:

> Although we understand the need for the ATO to balance compliance difficulties with the integrity of the system, it is unacceptable to have a system which on one hand actively brings non-resident entities into its net but on the other makes it very difficult and time consuming to have those entities registered. Such a system can materially impact the ability to undertake and complete cross border transactions as well as discourage compliance with the law as currently interpreted by the ATO. [Corporate Tax Association]

The GST law allows non-residents who are registered or required to be registered to make taxable supplies or taxable importations into Australia through an agent. Submissions suggested the non-resident agency provisions should be amended to reduce compliance costs for non-resident businesses operating in Australia:

> In our view, a non resident that makes all their supplies and acquisitions through a resident agent should not be required to register for GST. Such GST registration imposes an additional compliance burden on non residents doing business in Australia for no apparent benefit. [Greenwoods & Freehills]

Under the current law, for a non-resident entity to claim a refund of GST paid, they must register, or to a limited extent, use the Tourist Refund Scheme. Submissions recommended the refund provisions be amended to facilitate non-resident businesses:

> In our view, a foreign business's entitlement to a refund of Australian GST is an important feature of our GST system … However, the mechanism through which foreign businesses can access refunds of Australian GST could be considerably improved if the GST law provided a refund process that resides outside the GST registration process for foreign businesses that are not required to register. [Price Waterhouse Coopers]

Entities that are eligible for an ABN apply for this at the same time as they apply for GST registration. However, non-residents who do not carry on an enterprise in Australia nor make supplies that are connected with Australia are not entitled to an ABN. In undertaking public consultation on its earlier Report a concern was raised about whether it was appropriate for a non-resident entity to be denied an ABN when it is registered for GST.

APPENDIX B: SUMMARY OF THE POSSIBLE OPTIONS FOR CHANGE AND 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?

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

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?

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?

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?

Option 2.1: Shifting the GST liability of non-residents to residents through compulsory reverse charge

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

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

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

Option 2.2: Transfer GST liability to an Australian subsidiary

Q5.5 Under option 2.2, should a non-resident with a subsidiary in Australia be treated the same as a resident Australian business for GST purposes?

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

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?

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

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

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?

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?

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

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?

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?

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

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, what how long should this period be? If so, how long should this period be?

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

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?

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?

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?

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?

Option 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?

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

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?

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

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?

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

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)?

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

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?

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?

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

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?