

# CHAPTER 3

## Overview of the evidence

### The objectives of Schedule 3

3.1 Schedule 3 has been described as an integrity measure to correct competitive inequities between Australian-based and non-resident suppliers of certain rights and options.<sup>1</sup> It is also intended to close off the availability of input tax credits to foreign tour operators (FTOs) which do not also incur GST liabilities.

3.2 At the Committee's hearing, a representative of the Department of the Treasury expanded on these objectives:

...We see the measure in the bill as an integrity measure designed to remove a deficiency in the GST law that allows non-residents to make supplies of certain rights offshore not subject to any Australian GST, even though they are for things that will ultimately be consumed in Australia. As a result, sales by both Australian residents and non-residents cannot be subject to GST, whereas when they are sold by an Australian enterprise they will always be subject to GST. In this regard, it is the non-resident enterprises that may register for GST and claim input tax credits for acquisitions from Australian entities that include GST. This applies regardless of whether GST is being remitted on the further supply of these acquisitions. I think that has come through in all the submissions today. Basically, you are able to claim credits and not remit GST.

The main area of concern is the supply of Australian holiday packages...The amendments are designed to provide tax neutrality in the GST treatment of suppliers of Australian holiday packages, irrespective of whether they are supplied by resident or non-resident enterprises.

...The measure will also ensure that foreign tour operators cannot claim full input tax credits on the acquisition of Australian holiday packages without the need to remit an appropriate amount of corresponding GST upon the sale of those packages.<sup>2</sup>

3.3 While there was widespread acceptance of the objectives of Schedule 3, the means by which it sought to implement its objectives attracted significant opposition.

3.4 The Committee will look briefly at concerns raised in this regard.

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1 The Hon. Mal Brough MP, Minister for Revenue and Assistant Treasurer, *House of Representatives Hansard*, 10 February 2005, p. 1.

2 Mr Raphael Cicchini, Manager, Goods and Services Tax Policy Unit, *Proof Committee Hansard*, 26 April 2005, pp. 51-2.

## Summary of the evidence

3.5 Schedule 3 brings 'a right of option to acquire another thing' into the GST system if 'the supply of the other thing would be connected in Australia'. Although a note to the proposed legislation says an Australian holiday package supplied overseas might be such a thing, the provision is arguably capable of a wider application. Such an observation was made in submissions and at the hearing with question being raised of whether it had been intended that GST would apply to offshore contracts involving, for example, insurance; product distribution rights; and media placement rights having an Australian connection, albeit a tenuous one in some instances.<sup>3</sup>

3.6 A more pressing concern raised by witnesses was the anticipated cost impacts of Schedule 3. Witnesses predicted that compliance costs for foreign tour operators would be so high as to encourage some of them to abandon the Australian tour package market while others would raise prices. Whichever option was taken, the consequences for the Australian packaged tour industry and subsequently, the Australian economy were expected to be damaging.

3.7 Questions were raised about the efficacy of the Australian Taxation Office's enforcement powers in overseas jurisdictions. It was proposed that, unless enforcement was possible, the amendments would be unworkable and create competitive inequities more extensive than those to be remedied.

3.8 Witnesses objected to the characterisation of the proposed amendments as an 'integrity measure'<sup>4</sup> and thus their application without a transitional period. In an industry where long-term forward contracts are the norm and tour prices are published between six to 12 months in advance,<sup>5</sup> the 10 February 2005 commencement date attracted particularly virulent opposition. Witnesses were concerned that the bill exposed non-resident tour operators to immediate GST liabilities without the benefit of a transitional period during which they could set up new systems and factor in additional costs to accommodate the changes. Again, adverse flow-on effects for Australian tourism were predicted.

3.9 The lack of government consultation regarding the proposed amendments and the fact that a regulation impact statement had not been prepared or considered necessary, attracted strong opposition.

3.10 The offshore reach of the proposed amendments drew criticism on policy grounds. The Institute of Chartered Accountants in Australia (ICAA), for example, could find no contractual or economic connection with Australia to justify extending

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3 The Institute of Chartered Accountants in Australia (ICAA), *Submission 1*, p. 2.

4 See, for example, the Hon Mal Brough MP, Minister for Revenue and Assistant Treasurer, *House of Representatives Hansard*, 10 February 2005, p. 1

5 Yon Sha Kai, *Submission 5*, p.3.

'...the reach of the GST...to tax the margin derived by a non-resident...on a transaction with other non-residents..., which occurs outside Australia'.<sup>6</sup>

3.11 Deloitte Touche Tohmatsu (Deloitte) argued that the extension of GST to non-resident entities was inconsistent with the Government's earlier policy statements. Deloitte referred to the Explanatory Memorandum for the *Indirect Tax Legislation Amendment Act 2000* which said at paragraph 3.30 that:

...the Government wants to ensure that it does not unnecessarily draw non-residents into the GST system...

and at paragraph 3.38 that:

...Extending the GST Free provisions will keep overseas entities out of the GST system. This will have compliance benefits for them as they will not need to become part of the Australian GST and keep records and lodge returns consistent with the system...<sup>7</sup>

3.12 Other witnesses said Australia stood alone in taking the approach in Schedule 3. Mr Denis McCarthy of PricewaterhouseCoopers (PWC) and representing the Interactive Travel Services Association (ITSA) said:

I am not aware of any system that actually brings, say, Australian tour operators into their system and requires that they account for GST or VAT in that country in the same way. If this bill goes through in its current form, it is effectively dragging into our system all foreign tour operators that make supplies greater than \$50,000 of Australian tours, in order to require that they comply with the Australian GST.<sup>8</sup>

3.13 Similarly, a representative of Deloitte who appeared on behalf of the Australian Tourism Export Council (ATEC), told the Committee:

For research that we have undertaken with our colleagues around the world we have asked a simple question: are you operating in a regime that requires a foreign tour operator to register in that regime? We have had one country, Egypt, come back with an indication that they have a form of tax that could require registration of foreign entities. But every other country where we have a Deloitte network has indicated that there is no requirement for a foreign tour operator to register in its jurisdiction.

...

Our network is over 100 countries.<sup>9</sup>

3.14 Econtech Pty Ltd estimated that the compliance costs involved would be higher than in Canada, New Zealand and the United Kingdom, for example, which

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6 ICAA, *Submission 1*, p. 2.

7 Deloitte, *Submission 4*, p. 38.

8 *Proof Committee Hansard*, 26 April 2005, p. E41.

9 Mr Nick Hill, *Proof Committee Hansard*, 26 April 2005, p. E13.

input-taxed supply. Furthermore, Econtech noted that Australian GST would apply to the FTO's mark-up and commented that it had been 'unable to find any other example where a destination country attempts to apply a GST/VAT' in this way.<sup>10</sup>

3.15 Several witnesses presented alternative legislative models which, they claimed, would achieve the objectives of Schedule 3 more effectively. The Committee reviews these in chapter 6.

3.16 In the next chapter, the Committee will review the evidence on the alleged damaging consequences of the proposed amendments, particularly with regard to their cost impacts and the flow-on effects for the Australian packaged tour industry. Following this, the Committee will look at enforcement issues and whether, in fact, Schedule 3 will work in practice.

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10 Department of Industry, Tourism and Resources, *Submission 7*, p. v.