CHAPTER 5

Will Schedule 3 achieve its objectives?

Introduction

5.1 As discussed earlier, the Government's stated intentions regarding the proposed amendments are to achieve competitive neutrality between non-resident tour operators and their Australian-based counterparts; and to extend the coverage of the GST so that foreign tour operators (FTOs) will no longer be able to claim input tax credits on tour components without also incurring GST liabilities.

5.2 If these objectives are to be achieved in practice, all FTOs meeting registration criteria must be registered. The proposed legislation must also be enforceable. These two factors are critical for reasons discussed in this chapter.

Registration and the scheme of the GST system

5.3 Under the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), an entity carrying on an enterprise with annual turnover of $50,000 or more must be registered.

5.4 Registration imposes the obligation on an entity to collect and remit GST but also entitles the entity to claim input tax credits in relation to GST remitted. In a supply distribution chain, entities apply GST down the line and recoup GST through input tax credits so that it is the consumer of the good or service supplied who ultimately bears the cost of the GST liability.

5.5 For the system to work, all entities in a supply chain must be registered, as Deloitte explains in the following passage:

> The fundamental scheme of GST law is to tax the value added at each stage of the distribution chain in respect of supplies which are consumed in Australia…
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> The fundamental legislative scheme dictates that the value which is added by the FTO…should be taxed by a mechanism which, when added to GST remittances by earlier links in the chain, ultimately leads to a GST liability of 10% of the value of the taxable supply. This mechanism is achieved by crediting the GST paid by the FTO when acquiring the right and requiring output tax when the FTO supplies the right.
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> The credit mechanism is based upon the evidence chain of tax invoices…

> Any break in this evidence chain leads to double taxation as the credit entitlement is dependent upon the procurement of the fundamental evidence, the tax invoice.[1]

5.6 Where a registered entity acquires, for example, a wholesale tour package from an unregistered supplier, there will be a break in the GST 'chain'. The registered entity will consequently be liable to remit the full GST on the acquisition and sale values of the tour package without recourse to input tax credits regarding the acquisition. In effect, the registered entity will be taxed twice.

5.7 A representative of the Australian Taxation Office told the Committee that 'a possibility of double taxation may occur' where the chain of tax invoices had been broken. In such an instance, he said, the tax office would:

> …look to see if there is other documentation that can substitute for tax invoices where it is apparent that GST has been paid on the purchase of those goods as part of the original supply.[2]

5.8 However, for a registered FTO buying from an unregistered FTO where the latter has not remitted GST on the transaction to the tax office, documentation will not relieve the registered FTO of the obligation to pay GST on the full sale value of the supply or confer an entitlement to input tax credits.

5.9 Although the Committee heard from the Treasury that this could arise in domestic as well as overseas transactions, the difference is that, in the former case, the Australian Taxation Office has enforcement mechanisms to compel compliance.

5.10 In offshore jurisdictions, enforcement is not an option. As a representative of the Australian Taxation Office advised the Committee, the tax office has 'no jurisdiction…to compel overseas operators to meet their obligations'.

5.11 If non-compliant FTOs cannot be forced to register, is it likely that they will register voluntarily?

Will non-resident entities register voluntarily?

Awareness of requirements

5.12 In the first instance, FTOs will have to be made aware of Australian GST requirements before registration is a possibility.

5.13 A departmental representative told the Committee that the Australian Tax Office 'would ensure that there was an understanding of what is required' using

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1 Deloitte Touche Tohmatsu, *Submission 4,* p. 23.

2 Mr Stephen Vesperman, Australian Taxation Office, *Proof Committee Hansard*, 26 April 2005, p. E57.

existing networks and associations to assist.[3] However, bearing in mind the wide overseas coverage of Schedule 3, the Committee is not confident that the message will reach, or be understood by, all eligible FTOs. On this point, the Committee refers to the comments of Mr Denis McCarthy who appeared at the hearing on behalf of the Interactive Travel Services Association (ITSA):

> …[the tax office] needs to identify what its client base is—I use the term 'client' in the tax office context—so that the tax office can advise them of what their obligations are. I think it is relatively easy to do this in the context of companies that have a permanent Australian establishment. How the tax office will identify who has a liability for this tax throughout the world and then let them know what their obligations are and how they can comply, I submit, will be almost impossible to do comprehensively and properly.[4]

5.14 Similarly, as the following comments made by a representative of the Australian Tourism Export Council (ATEC) indicate, the task of identifying relevant FTOs will be challenging indeed:

> …we are talking about a highly competitive, highly globalised industry here. This is not the coal industry, where 10 or 12 countries dig up coal and send it offshore. We are talking about just about every country in the world offering a tourism product, and it is an extremely competitive product. In terms of the number of entities that may be captured within this legislation…we are talking about tens if not hundreds of thousands of individual entities selling the Australian tourism product offshore on a daily basis…[5]

Cost impacts of registration

5.15 For FTOs aware of their obligations, were there advantages in registration to encourage FTOs to enter and comply with the GST system voluntarily?

5.16 According to the evidence, voluntary registration would be unlikely because of the financial and competitive advantages of non-compliance.

5.17 A representative of the Department of the Treasury envisaged that the financial benefits of avoiding registration would be fairly small.[6] However, witnesses from industry groups predicted that the potential cost impacts of Schedule 3 would be substantial.

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3 Mr Stephen Vesperman, *Proof Committee Hansard*, p. E61.

4 Mr Denis McCarthy, PWC, representing ITSA, *Proof Committee Hansard*, 26 April 2005, p. E39.

5 Mr Matt Hingerty, *Proof Committee Hansard*, 26 April 2005, p. E10.

6 Mr Raphael Cicchini, Department of the Treasury, *Proof Committee Hansard*, 26 April 2005, p. E60.

5.18 As discussed in the previous chapter, compliance costs as well as the retrospective application of GST liabilities from 10 February 2005 were the major areas of concern.

5.19 To the extent that cost impacts would be sufficient to provide an incentive for non-compliance, the general consensus among witnesses was that it would.

Competitive disadvantages of registration

5.20 Apart from the immediate cost impacts of registration, witnesses saw competitive advantages in non-compliance which, with the limitations of offshore enforcement, would accrue mainly to non-resident entities. As a representative of ATEC explained to the Committee:

> …the full force of the Australian law can be applied to [domestic entities]. The tax office can undertake audits. They can undertake raids. They can require documentation to be produced. But in the case of the export sector they are unable to do that, it would appear. And, to the extent that they are unable to do it, it generates a motivation and environment whereby those who can get an unfair competitive advantage will do so and disadvantage those who abide by the rule of law. That is something that this legislation does…[7]

5.21 Similarly, a representative of the Institute of Chartered Accountants in Australia (ICAA), told the Committee that:

> …Because the tax office cannot enforce this law outside of Australia, it will make compliance by foreign tour operators optional and, because it is optional, there will be adverse competitive and profit consequences for foreign tour operators who choose to comply with this legislation…[8]

5.22 According to CPA Australia, listed companies, under pressure from their audit committees to comply with requirements, would be among those entities placed at a competitive disadvantage.[9]

5.23 If this outcome were to ensue, it would clearly frustrate the intention of the proposed legislation to achieve competitive neutrality between Australian-based and non-resident tour operators. Furthermore, as the following exchange suggests, it appears that a price advantage conferred by registration under the present system would be reversed:

> **Mr Hill**—At the moment, an unregistered tour operator would be at a price disadvantage because a registered tour operator is still entitled to a net credit. Although they have an output tax in respect of their accommodation,

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7 Mr David Mazitelli, ATEC, *Proof Committee Hansard*, 26 April 2005, pp. E9-10.

8 Mr Adrian Firmstone, representing the ICAA, *Proof Committee Hansard*, 26 April 2005, p. E19.

9 *Submission 9*, p. 1.

they are nevertheless entitled to credits in respect of all Australian components, which would include airport transfers, prepaid meals and attractions—the sorts of things that are packaged into the tour. So an unregistered tour operator at the moment would be at a slight cost disadvantage compared to a registered tour operator.

Senator MURRAY—Given that they are at a slight cost disadvantage at the moment, why would they choose not to register? Is it compliance? Is it lack of knowledge? Is it such a low margin that it does not matter?

Mr Hill—In some cases their level of activity, in terms of the part of their business that is Australian based, is not sufficient for them to worry about it. In other cases they are particularly concerned about the double tax consequences that would arise from them registering. Because they have no credits to claim, they only have a liability. I think they are ducking just below the radar even though the tax office opinion is that they do have a GST liability on that accommodation.

Senator MURRAY—If this legislation is passed, will foreign tour operators who do not register have a price advantage or disadvantage over those who do register?

Mr Hill—If the legislation is passed, those who do not register will have a price advantage over those who are registered.

Senator MURRAY—At present they have a price disadvantage?

Mr Hill—Yes.[10]

Offshore legal requirements for registration

5.24 In response to the Committee's suggestion that FTOs would be obliged under their own internal governance requirements (or the regulatory requirements imposed by their home countries) to comply with Australian law, a representative of ICAA agreed that this might be the case but still envisaged a high level of non-compliance:

> …there would be a lot of foreign tour operators who would be compliant simply for the reasons that you give. They may have links with Australia. Some of them will be affiliates of Australian companies. Some of them will have boards who simply desire to comply with the laws of whatever countries impact upon them. Not all foreign tour operators are listed companies. Not all foreign tour operators are in the position where they would feel compelled to be obedient to the laws of a foreign country and the ability of the Tax Office to impose this legislation on them, I would suggest, is non-existent. It is something that cannot be enforced legally. It will end up being enforced in some cases simply because of the ethics or morality of the companies concerned who decide that they should be compliant. There are plenty who will decide not to be.[11]

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10 Mr Nick Hill, Deloitte Touche Tohmatsu, *Proof Committee Hansard*, 26 April 2005, p. E35.

11 Mr Adrian Firmstone, representing the ICAA, *Proof Committee Hansard*, 26 April 2005, p. E28.

5.25 ATEC commented that some FTOs might have no choice but to comply with Schedule 3 and, in this regard, referred to listed entities in the USA governed by the *Sarbanes-Oxley Act 2002*.[12]

5.26 These FTOs could either comply with Schedule 3 and incur potentially significant retrospective GST liabilities and compliance costs or ignore requirements and jeopardise their listed status. The question here was whether these businesses should have to pay Australian taxes on offshore transactions in the first place and whether their failure to do so should expose them to serious penalties under their own laws.

The Committee's conclusions

5.27 Under the GST Act, it is through registration that Australian and non-resident suppliers incur obligations and qualify for entitlements.

5.28 The proposed legislation in Schedule 3 appears to assume that the entities to which it will apply are presently registered or will become registered.

5.29 The Committee accepts the evidence that the incentives for avoiding registration are substantial. Furthermore, where there is no enforcement regime to compel compliance, many FTOs will be unlikely to register or, if already registered, may be prepared to risk non-compliance.

5.30 The Committee also agrees that 100 per cent registration needs to be achieved to preserve the integrity of the GST system and ensure that:

- compliant entities dealing with non-compliant entities in a distribution chain will be not be double taxed; and
- FTOs will not enjoy a competitive advantage over their Australian-based counterparts.

5.31 While the Committee does not dispute the objectives of the proposed legislation, it is satisfied that other legislative options should be explored with a view to minimising cost impacts; operational distortions; and competitive inequities.

5.32 The Committee also questions whether non-resident businesses should be exposed to potentially serious penalties under their domestic laws for non-compliance with an Australian law that imposes tax on transactions occurring outside Australia.

5.33 In the next chapter, the Committee reviews a number of legislative proposals submitted by witnesses as alternatives to Schedule 3.

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12 *Submission 3*, p. 11.