The Senate

Economics Legislation Committee

Tax Laws Amendment (2005 Measures No. 1) Bill 2005

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CHAPTER 1

Tax Laws Amendment (2005 Measures No. 1) Bill 2005

Background

1.1 The Tax Laws Amendment (2005 Measures No. 1) Bill 2005 was introduced into the Senate on 7 March 2005 after its passage through the House of Representatives on 16 February 2005.

1.2 On 9 March 2005, on the recommendation of the Senate Standing Committee for the Selection of Bills (Selection of Bills Committee), the Senate referred the bill to the Economics Legislation Committee for inquiry and report by 10 May 2005.[1]

1.3 The Senate subsequently granted extensions of time for reporting until 22 June 2005.

The bill's provisions

1.4 Of the bill's four schedules, the Selection of Bills Committee cited Schedules 3 and 4 for further investigation. The Economics Legislation Committee has consequently concentrated on these two schedules in its inquiry.

1.5 Schedule 3 of the bill amends the *A New Tax System (Goods and Services Tax) Act 1999* so that GST will apply where a non-resident makes an offshore supply of a right or option to goods and services for consumption in Australia. The new arrangements will apply to supplies made on or after the day on which the bill was introduced into the Parliament, namely, 10 February 2005. Non-resident tour operators in particular will be affected.

1.6 Schedule 4 of the bill introduces a maximum tax offset of $500 on the income tax liability of workers aged 55 years and over.

Conduct of the inquiry

1.7 The Committee advertised the inquiry nationally and posted details on its internet site. In addition, the Committee wrote to the Department of the Treasury, the Department of Tourism, Industry and Resources, and a number of organisations advising them of the inquiry and inviting them to make submissions.

1.8 The Committee received ten submissions and three supplementary submissions. These are listed in Appendix 1.

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1 Selection of Bills Committee, *Report No. 2 of 2005*, 9 March 2005, p. 1.

1.9 The Committee held a public hearing at Parliament House in Brisbane on Tuesday, 26 April 2005. Witnesses who presented evidence at this hearing are listed in Appendix 2.

1.10 The Hansard of the Committee's hearing, copies of all submissions and information provided on request to the Committee are tabled with this report. These documents, plus the Committee's report, are also available on the Committee's web site at http://www.aph.gov.au/senate/committee/economics_ctte/index.htm.

1.11 The Committee thanks those who participated in this inquiry.

CHAPTER 2

Outline of Schedule 3

Introduction

2.1 The goods and services tax (GST) is a tax on private consumption in Australia. Under GST legislation,[1] GST is payable on 'taxable supplies' that are 'connected with Australia'.[2]

2.2 At present, the connection with Australia is satisfied if goods are supplied within Australia; goods are supplied which are exported from or imported into or assembled in Australia; there is a supply of real property located in Australia; and the supply of anything other than goods or real property is 'a thing…done in Australia' or supplied through an enterprise which the supplier carries on in Australia.[3]

What the amendments will do

2.3 Schedule 3 inserts paragraph (c) into subsection 9-25(5) to extend the meaning of 'connected with Australia' to include a 'supply of anything other than goods or real property' if:

- the thing is a right or option to acquire another thing; and
- the supply of the other thing would be connected with Australia.[4]

2.4 A note included with the amendment says:

> Example: A holiday package for Australia that is supplied overseas might be connected with Australia'.[5]

Reverse-charging rules

2.5 Divisions 83 and 84 of the GST Act provide for the payment of GST by the recipient of 'taxable supplies' in certain instances. Under both divisions, the recipient must be registered or required to be registered for GST purposes.[6]

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1 *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

2 Section 9-5. Part 2.2, Division 9 defines taxable supplies; states who is liable for the GST; and describes how the GST is calculated.

3 Section 9-25.

4 Proposed subparagraphs 9-25(5)(c)(ii) and (iii).

5 Note to proposed paragraph 9-25(5)(c).

6 Paragraph 83-5(1)(c) and subsection 84-5(1).

2.6 Amendments to Division 83 will preserve the existing provisions but add the requirement that the recipient of the supplies carries on a business in Australia. According to the Explanatory Memorandum, the amendment will ensure that there should be an Australian presence through the recipient before the supplier and the recipient enter into a reverse-charging agreement.[7]

2.7 The Explanatory Memorandum says about Division 84 that:

> The policy intent of this Division is to ensure that there will be GST imposed on supplies of things, other than goods or real property, that could be made from outside Australia if the thing is going to be used in Australia other than solely for a creditable purpose. That is, if the thing is going to be used, solely or partly, for a private purpose or for making input taxed supplies. The reverse charge mechanism overcomes the difficulties that may arise in seeking to collect the GST from an offshore supplier.[8]

2.8 Amendments to Division 84 extend the reverse-charging rules to supplies other than goods or real property that are connected with Australia because of paragraph 9-25(5)(c). Therefore the supply can either be a supply 'not connected with Australia' or a supply connected with Australia because it is the supply of a thing that is 'a right or option to acquire another thing' and 'the supply of the other thing would be connected with Australia'.[9]

2.9 Subsection 84-10(3) has been inserted to clarify that GST will be payable under section 84-5 if a supply is a taxable supply under both sections 84-5 and 9-5.

Schedule 3 commencement date

2.10 The Schedule 3 amendments will apply to supplies made on or after the day on which the bill was introduced into Parliament—that is, 10 February 2005.[10]

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7 Explanatory Memorandum, p. 21, para. 3.19.

8 Explanatory Memorandum, p. 20, para. 3.11.

9 Proposed subparagraphs 9-25(5)(3)(ii) and (iii).

10 Schedule 3, Item 17.

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.[1] 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.[2]

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.[3]

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'[4] 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,[5] 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'.[6]

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…[7]

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.[8]

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.[9]

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.[10]

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.

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

CHAPTER 4

Cost impacts and their consequences

Introduction

4.1 The Explanatory Memorandum states that the compliance cost impact for 'Australian enterprises' as a result of Schedule 3 is not expected to be significant. Although Schedule 3 targets rights and options supplied offshore by non-resident entities—specifically foreign tour operators (FTOs)—there has been no assessment of cost impacts on or connected with these entities.

4.2 Evidence to the Committee suggests that the cost impacts for FTOs, whether registered or becoming registered under the proposed legislation, will be substantial, the main concerns being that:

- the 10 February 2005 starting date for Schedule 3 and the failure to provide a transition period, will deny many FTOs the opportunity to pass on GST charges to consumers;
- registration could expose FTOs to GST liabilities on the accommodation components of tours sold since 1 July 2000;
- compliance costs for FTOs will be substantial; and
- the Australian packaged tour industry and Australian tourism generally will see tourists and FTOs abandon the Australian market for other, less expensive destinations.

4.3 The Committee will examine the evidence regarding these cost impacts and their potential wider implications in this chapter.

Lack of a transitional period

4.4 The retrospective application of Schedule 3 and the lack of a transitional period attracted particularly virulent opposition. The principal objection was that, in an industry where forward pricing was the norm and tour prices had been published as far ahead as March 2006, FTOs would be forced to bear the GST as a business cost until new, GST-inclusive prices could be charged.

4.5 Mr Nick Hill, appearing with the Australian Tourism Export Council (ATEC), said in this regard that:

> This bill, if passed, becomes effective from 10 February, but the brochures that were distributed globally for the tourism period 1 April 2005 through to 31 March 2006 were published back in November and distributed in

> December and January. The brochures are already out there with their pricing in them.[1]

4.6 Yon Sha Kai[2] said that its members had published prices up to March 2006 and that even where it might be possible to raise prices, the 'market reality' was that the competitive nature of the industry ruled out such an option.[3]

4.7 The Interactive Travel Services Association (ITSA) argued that the imposition of GST liabilities without allowing for their recovery was inconsistent with the 'design and intent of a GST/VAT system that GST should not be a cost to business'. In this regard, ITSA referred to the principles espoused by the OECD in its publication, *The Application of Consumption Taxes to the International Trade in Services and Intangibles*.[4]

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

> We see it as absolutely inappropriate that these businesses…will not be in a position to recover this GST. They are locked into their existing contracts without the opportunity to change them and they will have to put in systems and processes just to accommodate the Australian tax obligation.[5]

4.9 It is clear that the design and intent of the *A New Tax System (Goods and Services Tax Transition) Act 1999* (GST Act) recognises that the GST should not be an impost on business. For this reason, the Act allows businesses to claim input tax credits on previously taxed supplies to ensure that business is not taxed but, rather, the final consumer of the supply.

4.10 Furthermore, as Deloitte contended, transitional periods have been granted in the past specifically to enable businesses to revise long-term contract prices in the light of GST changes. Deloitte referred to the 5-year GST-free concession granted to Australian business to revise long-term contract pricing when the GST regime was first introduced. It added that, following the Australian Tax Office's ruling in November 2003 regarding the GST treatment of Inbound Tour Operators' (ITO) margins, a 15-month transitional period was granted so that tourist operators could

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1 *Proof Committee Hansard*, 26 April 2005, p. E8.

2 Yon Shai Kai describes itself as an 'association of the four largest Japanese inbound operators in Australia: JALPAK, Kintetsu International Express, Nippon Travel Agency and JTB Australia. *Submission 5*, p. [1].

3 *Submission 5*, p. [2].

4 *Submission 8* (made by PricewaterhouseCoopers on behalf of the Interactive Travel Services Association), p. 4.

5 Mr Adrian Firmstone, *Proof Committee Hansard*, 26 April 2005, p. 23.

'align the commencement of the ruling with the tourism calendar, which is 1 April to 31 March'.[6]

4.11 The justification for the immediate commencement of the provisions was that they were an 'integrity measure' to adjust competitive inequities and also to correct a deficiency whereby registered FTOs could claim input tax credits without bearing any GST liabilities.[7]

4.12 Witnesses disagreed with this characterisation and argued that the scope of the provisions extended far beyond merely correcting an unintended consequence of the GST legislation. Mr Adrian Firmstone, representing the ICAA, said in this regard that:

> [Schedule 3] goes beyond fixing the problem. It is more than an integrity measure—it goes to imposing a new liability on a class of people who are not in Australia. It is much more than an integrity measure. As to the way in which it has been dealt with, if it were just an integrity measure, the legislation would have focused just on the availability of import tax credits to the foreign tour operators. This has gone much further than that.[8]

Retrospective cost impact for newly registered FTOs

4.13 In addition to their concerns that FTOs would incur GST liabilities that could not be recovered by raising prices for published tours or by claiming input tax credits, witnesses argued that compliance requirements to accommodate Schedule 3 would generate significant costs.

4.14 At the hearing, the Department of the Treasury explained that, in assessing compliance cost impacts:

> …We did not look at the aspect of those not in the system now that should be in the system. Rather, we looked at the existing law and asked, 'What are we imposing above that?' The answer was: 'Above that we are imposing a tax on a few extra items.'[9]

4.15 Certainly, with international airfares and connected domestic flights being GST-free and accommodation provided by registered tour operators presently attracting GST, the 'few extra items' would generally not constitute the major GST

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6 *Submission 4*, pp. 11-12 and Mr Nick Hill, *Proof Committee Hansard*, 26 April 2005, p. E29.

7 See, for example, statements by the Hon. Mal Brough MP, Minister for Revenue and Assistant Treasurer, *House Hansard*, 10 February 2005, p. 1. At the Committee's hearing, a representative of the Department of the Treasury told the Committee that the fundamental objective of Schedule 3 had been to correct a 'leakage of the revenue' although its coverage might have gone further than this. Mr Raphael Cicchini, *Proof Committee Hansard*, 26 April 2005, pp. E53-4 and 63.

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

9 Mr Raphael Cicchini, Department of the Treasury, *Proof Committee Hansard*, 26 April 2005, p. E58.

expense in a packaged holiday. These items would include coach fares; hire car costs; meals; admission prices to venues; and so on.[10]

4.16 Consequently, Treasury's approach would appear to be reasonable especially in view of Schedule 3's envisaged application to those registered entities which presently pay GST on the accommodation component of packaged tours. However, as a representative of Deloitte stated, some FTOs are not presently registered because they are not required to be. Should they become registered to meet the new requirements of Schedule 3, it is possible that they will find themselves with GST liabilities on the accommodation components of tours sold as far back as 1 July 2000. The circumstances giving rise to this are explained thus:

> …there is a wholesale market that occurs offshore. One foreign tour operator sells to another foreign tour operator. So you have got a foreign tour operator that only buys off other foreign tour operators. The first foreign tour operator was registered for GST and was claiming the credits approved by the tax office. The ones that were not making acquisitions from Australian suppliers were not registered because the commissioner had ruled that those suppliers were out of scope. So, when the tax office introduced the ruling on 28 November, all of those that were claiming the credits were protected retrospectively against any adjustment, but their customers—the other FTOs that bought from them—immediately had a retrospective liability for four years.[11]

4.17 For these FTOs, the cost impact from GST liabilities alone, without taking into account the start-up compliance costs involved, could be significant.

Compliance costs

4.18 Much of the opposition to Schedule 3 was founded on the premise that compliance with the new provisions would require substantial modifications to existing systems and, for newly registered entities, the installation of new systems.

4.19 Yon Sha Kai referred to some of the practical 'complications' involved—presumably for FTOs not already registered:

> …how to handle foreign exchange, cash flow issues such as timing of the GST liability versus receipt of payments from the customer and claiming input tax credits from suppliers, substantial costs in changing systems to record the GST liability, particularly where the system would then have to handle the consumption tax in Japan and GST in Australia, and education of staff in Japan to name a few.[12]

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10 In the discussion on tourism later on in this chapter, a study by Econtech Pty Ltd assesses the GST-free and accommodation components to constitute about 90 per cent of total tour costs. However, ATEC contended that the components could vary so that 90 per cent would not necessarily be an accurate figure.

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

12 *Submission 5*, p. 3.

4.20 ATEC argued that where an FTO entered the GST system by becoming registered, there would be additional compliance costs not only for the FTO but also for 'consolidators and ITOs' having business dealings with the FTO:

> Application of the GST on FTOs will…necessitate FTOs reworking their business systems so that they can handle the preparation of the Business Activity Statements…that go hand-in-hand with the application of the new tax. This in turn will mean that the invoicing procedures for consolidators and ITOs will also need to change.[13]

4.21 PriceWaterhouseCoopers, representing ITSA, argued that compliance costs for FTOs would be 'considerable' given the many and varied tasks involved in compliance:

> …Non-residents will have to invest significant resources in understanding their Australian GST obligations. They will have to train their own staff—in other words, non-resident staff—in the nuances of the Australian GST and other taxation obligations. They will need to develop or reprogram systems in order to account for output tax. They will need to implement a process to identify and claim appropriate amounts of input tax credits and to obtain and ensure they obtain valid tax invoices in order to claim credits. They will need to design, prepare and produce valid tax invoices or compliant tax invoices. They will need to prepare a monthly or quarterly business activity statement, establish an Australian bank account and implement a process in order to deal with the ATO remotely.[14]

4.22 Deloitte claimed that compliance costs for FTOs whether already registered or outside the present GST system, would be 'of a magnitude greater than those faced by all Australian businesses in the lead up to the introduction of GST in July 2000'.[15] For FTOs whose Australian tours constituted only a minimal portion of their overall business, compliance would constitute a 'particular burden'.[16]

4.23 Deloitte said that, in the absence of Australian Tax Office guidance, FTOs were exposed to particular difficulties in calculating GST on any given tour price which depended on, and varied according to, the different components of a tour package and the circumstances of acquisition and supply. Deloitte referred to travel insurance; domestic airfares; input-taxed accommodation; supplies from unregistered vendors and tour incidentals as among the package components which posed GST difficulties and commented that:

> …Even adopting a case by case approach will not assist the FTO in fulfilling their GST obligations as the GST liability is payable to the ATO before the taxable ratio can be determined. The 'attribution rules' under the

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13 *Submission 3*, p. 6.

14 Mr Denis McCarthy, *Proof Committee Hansard*, 26 April 2005, p. E38.

15 *Submission 4*, p. 22.

16 *Submission 4*, p. 7.

> GST law require the FTO to pay GST at the time of sale but the taxable ratio cannot be determined until after the conclusion of the tour when the actual AUD$ costs of the tour are determined by the FTO.[17]

4.24 In a supplementary submission, Deloitte took issue with the Department of the Treasury's position that compliance costs for registered entities would not be high, the basis for which a Treasury representative explained at the hearing:

> …there is an existing obligation under the law for foreign tour operators that make supplies of $50,000 or more that are connected with Australia to be registered, to claim their input tax credits and to remit GST. The amendments would apply to 10 per cent, by value, of additional amounts of Australian tourism packages. So, under the existing law, we did not feel that there would be a significant impact on registered businesses, although there would be some impact on the businesses that are not registered.[18]

4.25 Deloitte argued that FTOs already within the system would have to make a 'total change in compliance approach' to accommodate their change in status from a net GST refund to a net liability position. Deloitte referred to several adjustments which it considered would be required:

> Booking systems will need to be linked to accounting systems, methodology for the projection of GST liabilities will need to be developed and aligned with pricing models and accounting systems, instalment payment arrangements will need to be recorded within the income recognition modules in the accounting systems and parallel clearing accounts introduced.[19]

4.26 While cost impacts of themselves might be pertinent to the selection of one regulatory approach over another, evidence to this inquiry claimed that GST cost impacts would have wider, adverse implications for the Australian packaged tour industry.

Impact on tourism

4.27 Even for FTOs already in the system, the prevailing view was that the cost impacts arising from Schedule 3 would also be significant—not only because FTOs would incur retrospective GST liabilities which they might not be able to recoup but also because of the complexities and expense involved in complying with the new requirements.

4.28 Arguments were raised that these cost impacts would produce competitive inequities and make Australia a less profitable destination for FTOs and a more expensive place to visit for foreign tourists. This outcome, in turn, would threaten the

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17 *Submission 4*, p. 15.

18 Mr Philip Bignell, *Proof Committee Hansard*, 26 April 2005, p. E58.

19 Deloitte Touche Tohmatsu, *supplementary submission 4A*, pp. 2-3.

viability of the Australian packaged tour industry at a time when it was just recovering from a number of setbacks.

4.29 Most witnesses took the view that FTOs would respond to higher business costs ensuing from the proposed amendments by raising tour prices or otherwise abandoning the Australian packaged tour market for other, more profitable destinations.

4.30 The Association of British Travel Agents Ltd (ABTA) was one proponent of this view but also argued that higher costs could encourage tour operators to offer inferior products to consumers:

> The effect would be felt particularly by the bonded tour operating sector which compared to the DIY or self-packaging market requires a level of margin sufficient to cover this relatively high cost as well as other consumer protection that such operators are obliged to give customers, i.e. the proposed regime could likely result in more UK tourists visiting Australia without proper financial protection, a consequence which we could not support.[20]

4.31 Similarly, ATEC predicted that the quality of the Australian tourism product would suffer as suppliers sought to cut costs by dealing with 'unrealistically cheap and unethical ITOs [inbound tour operators] and product suppliers, many of them engaged in allegedly illegal consumer practices'. ATEC said this was 'a very real current threat' and had prompted the Queensland Government to pass the *Tourism Services Act 2003* to enable it to deal with this problem.[21]

4.32 Yon Sha Kai commented that Australia had to compete with other comparable destinations for the tourist dollar in an environment where price and value for money were major determinants of choice. Yon Sha Kai said that a rising cost base in Australia and the difficulties for tour operators in staying price competitive with other destinations had already translated into a drop in bookings of approximately 30 to 40 per cent for the 2005 April and June quarters. In what Yon Sha Kai described as an 'already contracting Australian market', it predicted that costs arising from the proposed amendments would force tour operators to increase their prices or abandon the Australian market altogether.[22]

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20 *Submission 2*, p. 2.

21 *Submission 3*, p. 13. The *Tourism Services Act 2003* regulates the conduct of inbound tour operators in Queensland and gives the Government power to ban 'rogue' operators from conducting their business in Queensland. Targeted conduct includes grossly inflating the prices of goods and services (restaurant meals; tickets to events) or charging for goods and services that are otherwise available at no charge to the general public. Media Release by Queensland Tourism and Fair Trading Minister, 'Rogue tour operators to be banned' 7 October 2003 at http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/RWPD78E84FE3B59F00E4A256DB9001A2343?OpenDocument&L1=News.

22 *Submission 5*, p. 2.

4.33 A representative of the Hotel Motel Accommodation Association Victoria also predicted FTOs' abandonment of the Australian market, arguing that the financial and procedural burden entailed in GST compliance provided 'every incentive for [FTOs] to simply substitute in their packages alternative destinations that do not have these higher compliance and transaction costs'.[23]

4.34 While much of the opposition to the proposed amendments was based on the argument that the GST would result in increased business costs which, in turn, would lead to price rises and ultimately threaten the viability of the Australian packaged tour industry, evidence of price impacts was limited.

4.35 ATEC initially estimated price increases of between 4 and 4.5 per cent but revised this estimate to between 3 and 7 per cent. Five worked examples for tour packages offered in ATEC's USA, UK and Japanese markets were provided in support of the revised estimates.[24]

4.36 In contrast to ATEC's estimates and the views expressed in much of the evidence that cost increases would be significant enough to cause a downturn in the Australian packaged tour industry, modelling conducted by Econtech Pty Ltd suggested only very minor impacts on price and inbound tourism.

4.37 The Econtech study, commissioned by the Department of Industry, Tourism and Resources and presented with the Department's submission, modelled the likely impacts of the proposed legislation on the tourism sector and, among other things, concluded that:

- the cost of tourists' purchases through FTOs would rise by 1 per cent with an overall cost impact per tourist visit of 0.2 per cent; and
- the cost of organised tours would rise by 1.4 per cent.[25]

4.38 In the following excerpt, Econtech explains how these figures were arrived at:

> Because airfares and accommodation are estimated to contribute to around 90 per cent of the total cost of purchases made through FTOs, adding a 10 per cent GST to the remaining 10 per cent of purchases adds only 1 per cent to the overall price of purchases from FTOs by intending visitors to Australia.
>
> In addition, purchases made through FTOs contribute to less than 20 per cent of total expenditure by foreign tourists (80 per cent is made directly with ITOs or on-shore). This further dilutes the impact of the amended

23 Mr Chris Cudsi, *Proof Committee Hansard*, 26 April 2005, p. E15.

24 *Supplementary submission 3A*, p. [2] and attachments 1-5.

25 *Submission 7*, pp. 13-14 of Econtech Pty Ltd study, *The Impact of Legislative Changes (2005) to GST on Australian Holidays purchased through Foreign Tour Operators*, 11 April 2005.

> legislation on the price of a visit to Australia from 1 per cent to 0.2 per cent.[26]

4.39 Drawing on these figures, Econtech estimated that the volume of tourist numbers would fall by 0.7 per cent [around 35,000 inbound tourists and expenditure of $150 million annually], which it predicted would flow through to 'modest losses' in tourism-related industries. However, when assessing the overall economic impact, Econtech predicted a fall in production in tourism-related industries, an accompanying small depreciation in the Australian dollar and an 'offsetting increase' in other 'trade-exposed' industries such as agriculture, mining and manufacturing.[27]

4.40 Econtech said that the more competitive markets for tourist services such as the United States of America and the United Kingdom would be less able to absorb price impacts. In addition, tourist numbers from long-haul markets were expected to fall given the higher likelihood that FTOs would arrange this travel.[28]

4.41 The following comments made by a representative of the Department of Industry, Tourism and Resources suggest that a downturn in the long-haul segment could have adverse, longer-term implications:

> [FTOs] are 'quite important for first-time travellers'. Through doing this research we have found that it is often the case that people's first experience of travelling overseas is through a foreign tour operator. Once they gain confidence in travelling to another country then they are more likely to use the internet or other means to source their holidays.[29]

4.42 While Econtech did not envisage 'any significant compliance cost…in terms of FTOs registering for GST', it proposed that additional costs might be associated with pricing of tour packages. In this regard, it said:

> Rather than simply identifying the accommodation component of packages, the amended legislation requires FTOs to identify all items that are subject to GST. This may be time consuming given that some tourism products are not subject to GST. For example, international airfares are not subject to GST, but restaurant meals are subject to GST. Thus, the amendment may add to the time spent on administrative tasks. However, as part of this project, it was not possible to model or accurately quantify the compliance costs associated with the changes.[30]

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26 *Submission 7*, p. ii of Econtech Pty Ltd study, *The Impact of Legislative Changes (2005) to GST on Australian Holidays purchased through Foreign Tour Operators*, 11 April 2005.

27 *Submission 7*, pp. 15-18 of Econtech Pty Ltd study, *The Impact of Legislative Changes (2005) to GST on Australian Holidays purchased through Foreign Tour Operators*, 11 April 2005.

28 *Submission 7*, p. iv of Econtech Pty Ltd study, *The Impact of Legislative Changes (2005) to GST on Australian Holidays purchased through Foreign Tour Operators*, 11 April 2005.

29 Mr David Hughes, *Proof Committee Hansard*, 26 April 2005, p. E47.

30 *Submission 7*, p. iii of Econtech Pty Ltd study, *The Impact of Legislative Changes (2005) to GST on Australian Holidays purchased through Foreign Tour Operators*, 11 April 2005.

4.43 Certainly, Econtech's conclusions regarding the additional costs likely to be entailed in pricing are consistent with claims made by several witnesses. Deloitte, for example, referred to 'complex issues' associated with tour pricing such as variable taxable value of tour packages; variations in package profiles; impacts of currency fluctuations and adjustment events; and difficulties associated with the attribution of GST as expected to increase compliance costs.[31] However, as reported earlier, Deloitte also contended that compliance costs for registered FTOs would increase as a result of the proposed legislation.

4.44 At the hearing, the Committee invited comment on Econtech's estimates in an attempt to reconcile their predictions of relatively negligible price impacts with concerns expressed in several submissions that price increases would threaten the viability of the Australian packaged tour industry in offshore markets.

4.45 Most responses were to the effect that Econtech's models of average impacts and impacts across the industry as a whole were not necessarily appropriate when looking at the Australian packaged tour industry. Arguments were raised that averaging did not factor in variables associated with tourist profiles; the content of packaged tours offered by FTOs; and timing or pricing, for example.

4.46 A representative of ATEC commented in this regard that:

> I think we and Econtech are talking about different fruit here. Econtech is not talking about the price effect on tour packages; it is talking about the impact on FTOs on the basis of the totality of the FTOs' operations and on the export industry as a whole. What we are saying is that, within that whole, there are smaller segments of it and the tour package segment is a very important and high-yielding segment of the Australian tourism industry. For first-time travellers, the likelihood of a tour package being the way in which they would visit Australia is a lot higher than for travellers who have been here before. What we are saying is that the price effect on tour packages is of the order of magnitude that we have identified—between four and 4.5—but we have examples that run higher than that. That is not inconsistent with what Econtech is saying, in our analysis of the Econtech work.[32]

4.47 Similarly, Deloitte told the Committee that:

> …I do not really believe that average impact is the significant impact to examine. Each country has different impacts in terms of pricing and timing. If we look at a UK-to-Australia based tour, the low season cost of an airfare is £450 and the high season cost of an airfare is £1,350. So therefore, depending on what time of year it is, the non-taxable component is quite a different percentage than the taxable component…[33]

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31 *Submission 4*, pp. 14-19.

32 Mr David Mazitelli, ATEC, *Proof Committee Hansard*, 26 April 2005, p. E12.

33 Mr Nick Hill, *Proof Committee Hansard*, 26 April 2005, p. E33.

4.48 Tipping points, namely, the point at which price will drive tourists to other destinations, were raised as another factor that should be considered when assessing impacts on the tourist industry.

4.49 Deloitte said, for example, that 'market-by-market price impact plus tipping point…are instrumental in calculating impact on tourism numbers'.[34] ATEC said that price sensitivity was such in some markets that a tipping point, once reached, would produce a 'rapid fall off in demand'.[35]

4.50 As far as variables within tour packages are concerned, ATEC commented that:

> …a tour package comprises two or more travel components, such as airfares and ground services (hire cars, coach transport, meals etc) and other components such as accommodation, optional tours and insurances. …increasingly, tour packages are purchased by international visitors without an airfare component being included since travellers are making use of frequent flyer points or special, low cost, airfare deals. To a lesser extent this also applies to the accommodation component. To the extent that this occurs, it results in a larger increase in the price of those packages that have a relatively higher non-accommodation component.[36]

4.51 In addition to the more specific debate on price impacts and tourism numbers, much of the evidence to the inquiry referred to more general concerns about the proposed legislation and its impact on the Australian packaged tour industry.[37]

4.52 ATEC predicted that smaller wholesalers and resellers concentrating on Australia's niche tourism market in rural and regional areas, would be particularly hard hit with the result that there would be 'much less differentiation in the international offering'. Such an outcome, ATEC claimed, ran counter to 'the stated aims of the Australian Government in its Tourism White Paper and in the *Tourism Australia Act 2004*'.

4.53 In addition, it was ATEC's view that Schedule 3 posed a threat to the viability of highly successful international marketing strategies such as the 'Aussie Specialists' program and the Australian Tourism Exchange trade show,[38] both developed by Tourism Australia.[39]

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34 Mr Nick Hill, *Proof Committee Hansard*, 26 April 2005, p. E33.

35 *Submission 3*, p. 6. In a supplementary submission lodged after the Committee's hearing, ATEC revised its estimated price increases to between 3 and 7 per cent depending on the structural profile of the tour package. *Submission 3A*, p. 3.

36 *Supplementary submission 3A*, p. 3.

37 *Submission 3*, p. 12, *Submission 4*, p. 29, *Submission 5*, p. 3; *Submission 6*, p. 1.

38 ATEC says that ATE is 'reputed to generate some $2 billion in sales of Australian tourism product every year'. *Submission* 3, p. 12.

39 *Submission 3*, p. 14.

4.54 Witnesses argued that difficulties in securing compliance by all FTOs would amplify existing competitive distortions[40] in an industry 'barely recovering' after the 'negative shocks' generated by events such as September 11, the SARS outbreak, international terrorism and so on.[41]

4.55 Some witnesses argued that, from a policy perspective, tourism products sold to overseas tourists were essentially exports and, as such, should be GST free. A representative of the Hotel Model Accommodation Association of Victoria contended that the proposed legislation was discriminatory against all tourism exports, except air travel, with there being no explanation of the rationale provided for the differences in tax treatment.[42]

4.56 The ICAA was unequivocal that there was no policy justification for Schedule 3 and said:

> …it is most inappropriate from a policy perspective that the reach of the GST should extend to tax the margin derived by a non-resident of Australia on a transaction with other non-residents of Australia, which occurs outside Australia. Such a margin has no contractual or economic connection with Australia and should not be subject to the GST.[43]

The Committee's views

4.57 The Committee accepts that the proposed legislation is likely to have undesirable cost impacts on FTOs by exposing them to immediate GST liabilities and high start-up and ongoing compliance costs.

4.58 The Committee also considers that the characterisation of Schedule 3 as an 'integrity measure' thereby providing justification for its application from 10 February 2005 cannot be supported. While it accepts and supports the initiative to correct what is a clear shortcoming in the GST legislation, the Committee does not consider that Schedule 3 can be described as just an integrity measure.

4.59 In these circumstances, the Committee believes that a more equitable commencement date should be negotiated with affected parties to ensure they will not have to bear GST liabilities as a business cost. A transitional period should also factor in the time required for establishment of the necessary compliance systems and the Australian Tax Office's formulation of guidance papers to ensure an orderly and consistent adoption of new requirements.

4.60 The Committee notes the comments from the relevant industry bodies that they were not consulted about the proposed legislation. Given the possible adverse

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40 Mr David Mazitelli, ATEC, *Proof Committee Hansard*, 26 April 2005, p. E13.

41 Mr Chris Cudsi, *Proof Committee Hansard*, 26 April 2005, p. E15.

42 Mr Chris Cudsi, *Proof Committee Hansard*, 26 April 2005, p. E15.

43 *Submission 1*, p. 2.

implications for the Australian packaged tour industry and the importance of tourism to Australia's economy, the Committee believes an investigation of the potential impacts should have been conducted. Although the Department of Industry, Tourism and Resources commissioned a study into the likely impact of Schedule 3 on Australian tourism, this was done after introduction of the bill into Parliament.[44]

4.61 As Ms Kerry Rooney advised the Committee, the Department of Industry, Tourism and Resources had not been consulted about the legislation nor had it conducted any analysis of witnesses' claims that its impacts would be inconsistent with the objectives of the Tourism White Paper.[45]

4.62 The Committee has no reason to question the integrity of the Econtech report and, in fact, found it most useful in its assessment of the evidence regarding impacts on tourism. However, the Committee notes the comments of several witnesses that more specific analyses of the Australian tour package industry taking into account different market places; seasonal fluctuations; variations in tourist profiles; tipping points and so on would have produced different results.

4.63 On the basis of the evidence, the Committee concludes that, before Schedule 3 is re-considered by the Parliament, the Department of the Treasury, the Australian Taxation Office and the Department of Tourism, Industry and Resources should conduct a thorough analysis of its likely impact on the Australian packaged tour industry. In coming to this view, the Committee took into account the substantial contribution which Australian tourism makes to the national economy. Figures taken from the ABS Tourism Satellite Account cited in Econtech's report say, for example, that for the 2002-03 year:

- tourism for the year accounted for $32 billion, or 4.2 per cent, of Australia's GDP;[46]
- international visitors consumed nearly $17 billion in goods and services[47], a contribution of 11.2 per cent to total exports of goods and services;[48] and
- tourism accounted for around 5.7 per cent of total employment equating to about 541,000 employed persons of whom about 26 per cent were in retail

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44 Department of Tourism, Industry and Resources, *Proof Committee Hansard*, 26 April 2005, p. E44.

45 Department of Tourism, Industry and Resources, *Proof Committee Hansard*, 26 April 2005, p. E44.

46 Australian Bureau of Statistics, *Australian National Accounts: Tourism Satellite Account*, catalogue number 5249.0, 2002-03, table 1.

47 Australian Bureau of Statistics, *Australian National Accounts: Tourism Satellite Account*, catalogue number 5249.0, 2002-03, table 11.

48 Econtech says that only the mining and manufacturing industries made larger contributions to exports during 2002/03 based on Econtech's MM2 model data, updated January 2005.

trade; 18 per cent in accommodation and 10 per cent in cafe and restaurant industries.[49]

4.64 In the next chapter, the Committee reviews the proposed legislation against claims that it will be unenforceable and, in effect, will not work.

49 Australian Bureau of Statistics, *Australian National Accounts: Tourism Satellite Account*, catalogue number 5249.0, 2002-03, table 16.

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…
>
> 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.
>
> 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.

CHAPTER 6

ALTERNATIVE MODELS

Introduction

6.1 The major objectives of this legislation are to correct competitive inequities between Inbound Tour Operators (ITOs) based in Australia and Foreign Tour Operators (FTOs) who are competing for the foreign tourist dollar; and to close off the availability of input tax credits to FTOs which do not also incur GST liabilities. The availability of input tax credits to registered FTOs without an associated GST liability means that competing ITOs must either accept lower margins than those available to FTOs, or else be forced to charge higher prices.

6.2 While all organisations that made submissions or gave evidence agreed that the principle underlying the bill was sound, none agreed that the solution proposed in the bill for correcting the problem was the most appropriate. A range of alternative models were proposed. All are either described as input taxing proposals, or have an effect that is similar in practice. All seek to minimise compliance requirements, particularly for offshore entities, while ensuring that the sale of things intended for consumption in Australia is subject to GST, consistent with the policy intent of the GST legislation. The models proposed vary in relation to the point in the supply chain at which input taxing would apply, and also produce different amounts of revenue. Some models put forward by different organisations have similar features.

6.3 Any model considered should satisfy a number of objectives if it is to be considered as a practical alternative to what is proposed in the bill. Based on the range of opinions expressed in evidence, the following criteria appear to be appropriate:

- redress the current shortcomings in the GST legislation and ensure that GST is payable on the supply of goods, services or other things connected with Australia;
- be able to be effectively administered and enforced by the ATO;
- ensure that equity between Australian ITOs and FTOs is maintained as much as possible;
- minimise compliance costs for Australian ITOs, FTOs and the ATO; and
- comply with World Trade Organisation (WTO) requirements.

6.4 The organisations that put forward detailed alternative models were:

- Australian Tourism Export Council (ATEC);
- Institute of Chartered Accountants of Australia (ICAA); and
- PricewaterhouseCoopers/ITSA.

6.5 A number of other organisations also submitted models for consideration which were similar to those listed, and these are described at the end of the chapter.

6.6 The approach taken by the Committee in this chapter is to show, for reference purposes, the nature of the competitive advantage enjoyed by registered FTOs now, how the model in schedule 3 of the bill is expected to work, and then to review the features of each alternative model put forward, examining how each would perform in relation to common chains of supply of tours to foreign tourists, and the apparent advantages and disadvantages of each.

The current legislation

6.7 The current legislation allows FTOs to register for GST and claim input tax credits in relation to their purchase of tour rights, but does not compel them to remit GST when the tour is sold to a foreign tourist. This gives FTOs a large competitive advantage over Australia-based ITOs, a situation that the bill is intended to address. The example below illustrates the nature of this advantage.

Example 1 – Supply of a right to a tour under the current legislation

Assume that Australian company OZtrips supplies the rights to an Australian tour to (i) an Australian Inbound Tour Operator (ITO) or (ii) an FTO, that then on-sells the tour to a foreign tourist. In the example, it is assumed that each entity that on-sells the rights adds an after tax margin of 20 per cent. For the purposes of the example, the tour contents are assumed to be wholly taxable for GST purposes.

(i) OZtrips sells tour rights to ITO for $200 + $20 GST, total $220, and remits $20 GST to the ATO.

ITO factors in an input tax credit of $20, reducing the price for the tour rights to $200.

ITO adds margin of 20% ($40), sells to foreign tourist for $240 + $24 GST, total $264.

ITO claims an input tax credit of $20 and remits $4.00 GST to the ATO.

ITO profit is $40.00, total GST remitted by OZtrips and ITO for the transaction is $24.

(ii) OZtrips sells tour rights to a registered FTO that is utilising the loophole in the legislation for $200 + $20 GST, total $220.

Registered FTO factors in an input tax credit of $20, reducing the price for the tour rights to $200.

Registered FTO adds margin of 20% ($40), sells to foreign tourist for $260, and claims input tax credit of $20 but doesn't charge or remit GST. (This assumes that the tour package does not contain Australian accommodation but instead is made up of ground transport, entertainment etc. The ATO

considers that rights to accommodation supplied by FTOs should be subject to GST under the current law.)

Registered FTO profit is $60 (margin plus input tax credit), total GST remitted in relation to the transaction is $20 (ie: that remitted by Oztrips).

The model proposed in the bill

6.8 Schedule 3 of the bill, if passed without amendment, will require FTOs with turnover related to business in Australia in excess of $50 000 to register for GST and remit GST in a manner similar to that now required of Australian resident tour operators.

6.9 The advantages of this approach are that it treats Australian ITOs and FTOs equally, and if FTOs are compliant (ie: register), charges the full amount due on the supply of the rights to the foreign tourist. However, much depends on whether FTOs register. If they do not, unregistered FTOs may still enjoy a competitive advantage over those who do register.

Example 2 – Supply of a right to a tour using the model in the bill

Assume that Australian company OZtrips supplies the rights to a tour to (i) an ITO or (ii) an FTO, that then on-sells the tour to a foreign tourist. In the example, it is assumed that each entity that on-sells the rights adds a margin of 20 per cent. For the purposes of the example, the tour contents are assumed to be wholly taxable.

(i) OZtrips sells tour rights to ITO for $200 + $20 GST, total $220, and remits $20 GST to the ATO.

ITO factors in input tax credit of $20, reducing the price for the tour rights to $200.

ITO adds margin of 20% ($40), sells to foreign tourist for $240 + $24 GST, total $264. ITO claims input tax credit of $20, remits $4.00 GST to the ATO.

ITO profit is $40, total GST remitted for the transaction is $24.

ii) OZtrips sells tour rights to registered FTO for $200 + $20 GST, total $220.

Registered FTO factors in right to an input tax credit of $20, reducing the price for the tour rights to $200.

Registered FTO adds margin of 20% ($40), sells to foreign tourist for $240 + $24 GST, total $264. Registered FTO claims input tax credit of $20, remits $4.00 GST to the ATO.

Registered FTO profit is $40, total GST remitted for the transaction is $24.

The following example assumes that the FTO is non-compliant and has not registered.

(iii) OZtrips sells tour rights to unregistered FTO for $200 + $20 GST, total $220. OZtrips remits $20 GST to the ATO.

Unregistered FTO pays OzTrips $220. If the unregistered FTO added a 20% margin, ($44), the selling price to the foreign tourist would be $264. The unregistered FTO is not entitled to claim an input tax credit, and does not charge the tourist GST.

Unregistered FTO profit would be $44, total GST remitted in relation to the transaction is $20 (ie: that remitted by Oztrips).

In this example, the unregistered FTO is able to sell for the same price as the other operators but receives a higher dollar margin than the registered operator ($44 compared to $40), and would have the capacity to undercut the registered operators on price, giving the unregistered operator a competitive advantage.

ATEC model

6.10 The Committee understands that this model was developed by the Australian Tourism Export Council (ATEC) and consulting firm Deloitte Touch Tohmatsu, a representative of which gave evidence with ATEC at the public hearing held in Brisbane. The model is described most completely in the ATEC submission and is referred to as the ATEC model. In this section. ATEC put forward two alternatives, both of which were based on input taxing.

Alternative 1 – ATEC's preferred model

6.11 This model is an 'input tax' model which taxes the supply of a third party right where the right is to be sold to a non-resident. ATEC's model utilises the first sale to the non-resident enterprise as the appropriate point in the supply chain to commence input taxing. The model proposes that division 40 of the GST Act be amended to input tax the supply of rights to a non-resident which entitle the recipient of the right to acquire a holiday related supply from an Australian resident enterprise. This is only to apply where the supplier of the right is a separate and distinct enterprise to the ultimate supplier. Only the direct costs (accommodation, meals etc) and not the indirect costs (administration etc) will be subject to input taxing.[1]

1 ATEC, *Submission 3*, p. 14.

6.12 The model uses a narrowly based definition of a holiday right. In its proposed amendments, ATEC defines the supply of a right to a holiday to be:

> (a) the supply of a right to transport, accommodation, meals, attractions, and other holiday related supplies where the supplier of the right is an entity which will not be making the underlying supplies to which the right relates, and
> (b) the underlying rights will be ultimately used for the purposes of recreation or entertainment not connected with the carrying on of an enterprise.[2]

6.13 From evidence given by Mr Nick Hill of Deloitte Touche Tomhatsu (Deloitte), representing ATEC, it is apparent that this model envisages that entities supplying the rights to offshore clients will have their supplies input taxed so that they will not be able to claim any credits in relation to the supply of the rights:

> What we suggested to overcome that problem was to input tax all tour package arrangers who are selling to offshore customers. So, whether you are an Australian resident foreign tour operator or a non-resident foreign tour operator, you would be input taxed.[3]

6.14 ATEC argues that according equal treatment to both resident and foreign enterprises should overcome Treasury concerns about WTO protocols which require foreign and resident taxpayers to be treated the same. ATEC also argued that its approach produces only nominal compliance issues, resolves the Government's revenue problem, is consistent with the way other jurisdictions deal with the tourism sector and doesn't expand the scope of the GST to other industry sectors in foreign jurisdictions.[4]

6.15 The text of ATEC's proposed amendments is included at Appendix 3.

Example 3 – Supply of a right to a tour using ATEC alternative 1

Assume that Australian company OZtrips supplies the rights to a tour to (i) an ITO or (ii) an FTO, that then on-sells the tour to a foreign tourist.

(i) OZtrips sells tour rights to ITO for $200 + $20 GST, total $220 and remits $20 GST to the ATO.

ITO's purchase of the tour rights is input taxed, as the tour is to be sold offshore. No input tax credits can be claimed by any subsequent purchaser.

ITO adds a margin of 20% ($44), sells to foreign tourist for $264. No GST is payable as the supply of the rights were input taxed.

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2 ATEC, *Submission 3*, p. 15.

3 Mr Nick Hill, Deloitte Touche Tohmatsu, *Proof Committee Hansard*, 26 April 2005, p. E37.

4 ATEC,*Submission 3*, p. 14.

ITO's profit is $44, and the total GST remitted in respect of the transaction is $20 – that is, the GST previously remitted by OZtrips.

(ii) OZtrips sells tour rights to FTO for $200 + $20 GST, total $220 and remits $20 GST to the ATO.

FTO's purchase of the tour rights is input taxed, as the tour is to be sold offshore. No input tax credits can be claimed by any subsequent purchaser.

The FTO adds a margin of 20% ($44), sells to foreign tourist for $264. No GST is payable as the supply of the rights were input taxed.

FTO's profit is $44, and the total GST remitted in respect of the transaction is $20 – that is, the GST previously remitted by OZtrips.

ATEC Alternative 2

6.16 ATEC Alternative 2 is also an 'input tax' model. This model includes a broader definition of holiday right not focused purely on recreational travel – business related travel (conventions, business trips, incentives etc) would be included.[5] It includes an 'optional taxing' option, allowing the tour operator, foreign or Australian, to elect to be taxable both in respect of the right and in respect of the on-supply – an 'opt-in' approach.

6.17 ATEC advised that it believed that entities that carry on their business in the business related travel sector will chose the taxing option and thus overcome any unintended consequence of applying the input tax model to a definitional framework broader than the recreational travel market.[6]

Example 4 – Supply of a right to a tour using ATEC alternative 2

Assume that Australian company OZPAKS supplies the rights to supply convention packages to a tour operator (BIZTRAV), where the entity making the supply (ie: BIZTRAV) elects to have its supplies of rights treated as taxable supplies, and that entity on-sells the tour to a foreign traveller. It makes no difference whether BIZTRAV is a local or foreign operator. For the purposes of the example, the package is assumed to be comprised wholly of taxable supplies.

OZPAKS sells rights to BIZTRAV for $200 + $20 GST, total $220, and remits $20 GST to the ATO.

BIZTRAV has elected to be taxable (ie: will levy and remit GST but is eligible to claim input tax credits).

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5 ATEC, *Submission 3*, p. 18.

6 ATEC, *Submission 3*, p. 18.

BIZTRAV factors in a right to an input tax credit of $20, reducing the price for the tour rights to $200.

BIZTRAV adds its margin of 20% ($40), sells to a foreign tourist for $240 + $24 GST, total $264.

BIZTRAV claims input tax credit of $20, remits $4.00 GST to the ATO. BIZTRAV profit is $40, total GST remitted for the transaction is $24.

6.18 The Committee's analysis of the ATEC proposal indicates that it does offer a method of addressing the current loophole that allows FTOs to claim input tax credits but not remit GST, as well as maintaining competitive neutrality between ITOs and FTOs. A possible shortcoming of the approach is that because supplies are subject to input taxing early in the chain of supply, less revenue will be collected than would be the case if margins are taxed, as is proposed in the bill. This is an inevitable result of input taxing a supply before value is added.

Institute of Chartered Accountants of Australia models

6.19 The Institute of Chartered Accountants of Australia (ICAA) proposed four options, all of which were input tax models in which input tax credits are denied to non-resident tour operators. Each model uses a different method to achieve the same objective, specifically the removal of FTOs from the GST system.

- Option 1 – input tax supplies of tours by Foreign Tour Operators (FTOs) so that the FTOs are denied input tax credits in relation to the supplies;

- Option 2 – limit registration to people carrying on an enterprise in Australia – which would exclude FTOs from claiming input tax credits;

- Option 3 – Grant the Commissioner a discretion to register people. The effect seems to be similar to PWC/ITSA option 3, except that it is the Commissioner who registers or de-registers, whereas in the PWC model, this rests with the individuals concerned;

- Option 4 – Leave the amendments in the bill in their present form but provide the non-resident supplier a right to elect that its supplies of Australian tour packages be input-taxed. The ICAA stated that this option is a variation of option 1 and has precedent in Subsection 40-E of the GST Act.[7]

6.20 The ICAA advised that all of its approaches focused on what was considered to be the fundamental problem, the input tax credit entitlement currently available to

7 ICAA, *supplementary submission 1a.*

FTOs. The ICAA argued that its alternative approaches do not seek to tax nonresidents on money they make overseas, pose any enforcement issues for the ATO or have unintended consequences for other industries, shortcomings which they considered existed in the schedule 3 proposal.[8]

ICAA Option 1

6.21 ICAA's option 1 proposes to input-tax the supply of Australian tour packages by non-resident tour operators to non-resident tourists.

Example 5 – Supply of a right to a tour using ICAA option 1

Assume that Australian company OZtrips supplies the rights to a tour to (i) an Australian ITO or (ii) an FTO that then on-sells the tour to a foreign tourist.

(i) OZtrips sells tour rights to ITO for $200 + $20 GST, total $220, and remits $20 GST to the ATO.

ITO is a resident tour operator, so is eligible to claim input tax credits. ITO factors in its right to an input tax credit of $20, reducing the price for the tour rights to $200.

ITO adds its margin of 20%, ($40) and sells the tour to a foreign tourist for $240 + $24 GST, total $264.

ITO claims input tax credit of $20 and remits $4.00 GST to the ATO. ITO's profit is $40, total GST remitted to the ATO in relation to the transaction is $24.

(ii) OZtrips sells tour rights to FTO for $200 + $20 GST, total $220 and remits $20 GST to the ATO.

FTO is a non-resident tour operator, so the supply of the tour to FTO is input taxed. No input tax credit can be claimed by FTO.

If FTO adds a margin of 20%, ($44) it sells to foreign tourist for $264, the same price as ITO. However, no GST is payable.

FTO profit is $44. Total GST remitted in respect of the transaction is $20 (ie: that remitted by OZtrips).

If FTO elects to sell the tour for the same cash margin as ITO ($40), it has the capacity to undercut ITO, giving FTO a competitive advantage.

6.22 In support of this approach, the ICAA advised the Committee that:

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

> …the GST charged by the Australian service providers and paid to the tax office still flows through to the prices of products, because it flows through to the cost of the tour operator and the tour operator cannot claim it back. Then, in passing it on to their customer, the GST flows through. So it brings back the balance, as we said initially, between tours provided by foreign tour operators and tours provided by tour operators in Australia.[9]

ICAA Option 2

6.23 Option 2 proposes to limit registration to people carrying on an enterprise in Australia, effectively exclude FTOs from registering and so claiming input tax credits. This option would effectively be limited to FTOs because of a compensating GST reclaim facility which is proposed to operate in tandem with this approach. The effect on non-resident tour operators (FTOs) would be identical to that shown in example 5.

6.24 Mr Firmstone advised that there were a number of problems associated with this approach which would necessitate the implementation of a GST reclaim facility:

> There are overseas residents who do business in Australia and, as a matter of policy, we want to give them GST relief. If we were to take away the option or ability of these people to register, we would need to find another way of accommodating them, such as what happens in Europe with a VAT reclaim system, or something of that nature.[10]

ICAA Option 3

The third option put forward by the ICAA is to grant the commissioner a discretion to not register, or to de-register, non-residents that do not carry on a business in Australia. The result of this option would be that the non-resident would be taken as not being required to be registered.[11] A de-registered or unregistered non-resident would not have an entitlement to claim input tax credits, nor be required to charge and remit GST.

6.25 The ICAA stated that this is a simpler option than its second option, as it does not change the structure of the GST Act. They advised that this system had recently been introduced into New Zealand.

6.26 The option would operate the same way as shown in the example above, with the same financial outcomes. The only difference is that the FTO is not entitled to claim input tax credits because the commissioner has either de-registered or not registered them, as compared to the criteria applied in option 1 (input tax credits denied because the supplier of the tour to non-resident tourists is a non-resident tour operator) or option 2 (not carrying on a business in Australia so not entitled to register).

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9 Mr Adrian Firmstone, ICAA, *Proof Committee Hansard*, 26 April 2005, p. E21.

10 Mr Adrian Firmstone, ICAA, *Proof Committee Hansard*, 26 April 2005, p. E21.

11 ICAA, *Submission 1*, p. 3.

6.27 The Committee considers that the ICAA's options offer a possible solution to the problem identified by the Government and reduce the disadvantage suffered by ITOs under current conditions. However, under these proposals it appears that FTOs still enjoy a competitive advantage over ITOs that inevitably arises when one group pays GST on its margins and another does not.

PricewaterhouseCoopers/ITSA – optional registration model

6.28 PricewaterhouseCoopers, who gave evidence on behalf of a client, the Interactive Travel Services Association (ITSA – a group representing overseas online travel businesses) put forward what they described as an 'option to register' model, rather than an input taxing model, although the effects are similar. Under this proposal, non-residents may opt to remain outside the GST system without accruing a liability for Australian GST. PricewaterhouseCoopers explained that:

> By remaining outside the system, they incur GST on their inputs, but do not and cannot claim input tax credits.[12]

6.29 PricewaterhouseCoopers advised that in some circumstances, such as when supplies are being made business to business, entities may wish to opt into the system. If they do so, they would be entitled to claim input tax credits but would also be liable to output tax.

6.30 PricewaterhouseCoopers also submitted that if this approach was adopted by the Government, it should be extended to the provision of accommodation rights, allowing non-residents to remain outside of the GST system if they so elected:

> …rights to hotel and similar accommodation should also fall within the same provisions so that we do not have a situation where the tax office still seeks to tax rights to hotel accommodation under the definition of 'real property' in the GST law yet other travel related services fall within these provisions. Both of them should fall within the one and then, ideally, nonresidents should be outside the system.[13]

6.31 The following example shows how the PricewaterhouseCoopers/ITSA model would operate in three circumstances, namely in respect of an Australian inbound tour operator (ITO), a non-resident tour operator (FTO) that elects to remain outside of the GST system; and a non-resident tour operator (FTO) that elects to be part of the GST system.

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12 Mr Denis McCarthy, PricewaterhouseCoopers, *Proof Committee Hansard*, 26 April 2005, p. 37.

13 Mr Denis McCarthy, PricewaterhouseCoopers, *Proof Committee Hansard*, 26 April 2005, p. 37.

Example 6 –PricewaterhouseCoopers/ITSA 'option to register' model

Assume that Australian company OZtrips supplies the rights to a tour to (i) an ITO, or (ii) a non-resident FTO that elects to remain outside of the GST system, or (iii) a non-resident FTO that that elects to remain in the GST system, and each on-sells the tour to a foreign tourist.

In the example, it is assumed that each entity that on-sells the rights adds a margin of 20 per cent.

(i) OZtrips sells tour rights to ITO for $200 + $20 GST, total $220, and remits $20 GST to the ATO.

ITO factors in an input tax credit of $20, reducing the price it paid for the rights to $200.

ITO adds a margin of 20% ($40), and sells to a foreign tourist for $240 + $24 GST, a total of $264.

ITO claims input tax credit of $20 and remits $4.00 GST to the ATO.

ITO profit is $40, total GST remitted in relation to the transaction is $24.

(ii) OZtrips sells tour rights to non-registered FTO for $200 + $20 GST, total $220, and remits $20 GST to the ATO.

The non-registered FTO adds its 20% margin, ($44) and sells to a foreign tourist for $264.

The non-registered FTO is not entitled to claim an input tax credit, but does not charge the tourist GST.

Non-registered FTO profit is $44, total GST remitted in relation to the transaction is $20 (ie: that remitted by OZtrips).

(iii) OZtrips sells tour rights to registered FTO for $200 + $20 GST, total $220, and remits $20 GST to the ATO.

The registered FTO is entitled to claim an input tax credit but must charge the tourist GST. The registered FTO factors in an input tax credit of $20, reducing the price it paid for the rights to $200.

The registered FTO adds its margin of 20% ($40), and sells to foreign tourist for $240 + $24 GST, totalling $264.

The registered FTO claims the input tax credit of $20 and remits $4.00 GST to the ATO.

> The registered FTO's profit is $40, the total GST remitted in relation to the transaction is $24.

6.32 In these examples, the PricewaterhouseCoopers/ITSA model would be similar in its effects to the input tax models put forward by the ICAA. If the non-registered FTO elected to sell at the same price as a registered or Australia-based operator ($264) it would still receive a higher cash margin than Australia-based operators ($44 compared to $40). If the non-registered operator elected to reduce its cash margin to match that of the registered operators, it would have the capacity to undercut them on price.

6.33 PricewaterhouseCoopers submitted that its proposed solution provided a more effective means of addressing the problem identified by the government while not unnecessarily drawing unregistered non-residents into the GST system:

> …our proposed solution is fair to both resident and nonresident suppliers of the relevant rights caught by the legislation, subject to the amendment on accommodation…it maintains the integrity of the tax and can effectively be administered by the ATO.[14]

6.34 PricewaterhouseCoopers advised the Committee that ITSA members were currently outside the GST system as they were not registered and are incurring GST on their inputs but not claiming input tax credits. Consequently, adoption of the proposed model would maintain the status quo for this group and there would be no resulting need to make price adjustments.[15]

6.35 The Committee considers that the PricewaterhouseCoopers/ITSA model should be consistent with WTO requirements, as offshore operators have the option of being treated identically to Australian operators in relation to their access to input tax credits. Further, the model appears to require minimal amendments to the GST legislation.

6.36 However, the Committee notes that as is the case for the input tax models, less GST would be payable on the supply than would be the case if the bill is adopted in its current form,. Further, it appears that the model also confers a competitive advantage over registered Australia operators on unregistered FTOs. As in some other models, this results from not taxing margins added outside of Australia. PriceWaterhouseCoopers contended that this was appropriate:

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14 Mr Denis McCarthy, PricewaterhouseCoopers, *Proof Committee Hansard*, 26 April 2005, p. E37.

15 Mr Denis McCarthy, PricewaterhouseCoopers, *Proof Committee Hansard*, 26 April 2005, p. E39.

> We submit that this represents the appropriate amount of GST on the amount value added in Australia. It does not impose GST on the amount value added offshore.[16]

Other models

6.37 Several other models were proposed in general terms to the Committee. These included:

- Deloitte Touche Tohmatsu, while not advocating a particular model in its submission, noted that every other VAT/GST jurisdiction resolves the identified deficiency in the GST legislation by restricting the input tax entitlement of non-resident entities. Deloitte acknowledged that this approach can have unintended consequences, but the 'these are often resolved by special narrowly focussed refund/reclaim mechanisms'. Deloitte estimated that this approach would produce 85 per cent of the revenue expected from the approach in the bill;[17]
- The Association of British Travel Agents proposed a system similar to the Tour Operators Margin Scheme (TOMS) which operates in the European Union;
- The Hotel Motel Accommodation Association of Australia associated itself with the ATEC model;
- The Certified Practicing Accountants of Australia proposed an amendment to Division 11 of the GST Act to ensure that non-resident travel agents or tour wholesalers are unable to claim input tax credits on the acquisition of rights tour packages that relate to Australia. This model appears to be similar to ICAA Alternative 1;
- Ernst and Young, on behalf of the Queensland Tourism Industry Council, proposed treating the supply of all Australian Tour packages by FTOs as input taxed supplies. This model also appears to be similar to ICAA Alternative 1.

16 Mr Denis McCarthy, PricewaterhouseCoopers, *Proof Committee Hansard*, 26 April 2005, p. E37.

17 Deloitte Touche Tohmatsu, *Submission 4*, pp. 38-9.

CHAPTER 7

Conclusions and recommendations

7.1 The Committee strongly supports the initiative in Schedule 3 to close the loophole in the GST legislation which allows certain foreign tour operators to register for GST and claim input credits without also being required to remit GST on their sales.

7.2 While the Committee understands that operators using this loophole were acting lawfully, it is clearly not within the policy intent of the GST legislation for this to happen. Use of this loophole disadvantages all registered tour operators, particularly those based in Australia, as well as those foreign operators who have not registered and have not been claiming input tax credits.

7.3 However, the Committee believes that the evidence it has received raises doubts about whether the model proposed in Schedule 3 is the best solution to the problem. In theory, it would produce the most equitable solution for both Australian and foreign operators if all operators who were required to comply with the requirements to register did so. However, the evidence received by the Committee indicates that there may be a number of practical difficulties with the approach that were not apparent when the bill was drafted.

7.4 The Committee notes that a number of witnesses have questioned whether the ATO will be able to administer the legislation efficiently if the schedule is passed without amendment. Doubts have been raised about whether the ATO would be able to enforce the requirement to register on foreign operators with no Australian presence.

7.5 If significant numbers of foreign operators ignore the legislation and fail to register, then it appears that those operators who do register will be in a less competitive situation than those who are registered. This is because those who do register will be required to meet the compliance costs associated with the schedule, which in some cases may be considerable, as well as being required to remit GST on their profit margins.

7.6 As shown in the examples put forward in submissions and in the examples in Chapter 6, this works in favour of the unregistered operators. Those who presented evidence agreed that many operators will choose not to register.

7.7 Compliance costs were a major concern to many who gave evidence. While compliance costs and their effects are difficult to quantify, there are clearly concerns held that in some markets, these costs may be such that the operators will either ignore the provisions or withdraw from the market. The effect on tourist numbers projected by the Econtech model may prove to be conservative. This would be an undesirable outcome for an industry which is an important source of employment and income for

many Australians, and which is also still recovering from a number of international shocks such as those caused by increases in international terrorist activity, and the SARS crisis.

7.8 With these issues in mind, the Committee has carefully considered whether any of the models put forward in submissions or evidence would provide a more satisfactory solution than that in Schedule 3. All have some advantages and disadvantages.

7.9 All of the models put forward close off the loophole that exists in the current legislation. None would require operators to account in full for the margins added to packages before the final sale of a tour to an incoming tourist. There are a number of perspectives on this. The first, as expressed in the schedule, is that margins should be fully accounted for. The second, as expressed by PricewaterhouseCoopers/ITSA (PWC/ITSA), is that it is not appropriate to tax value added offshore, and the appropriate tax to pay is that paid when the rights are initially sold to an offshore operator.

7.10 All of the models considered reduce or eliminate the disadvantage currently suffered by Australian registered tour operators. The Committee notes that ATEC is of the view that the other alternative models still place the Australian operators at a small disadvantage. However, the degree of this disadvantage, if it exists, is difficult to predict. It is also offset by the reality that most incoming tourists are likely to purchase tour packages from agents in their home countries, and these agents may be expected to be subject to the taxation arrangements of those countries. Further, Australian operators will have access to other input tax credits not available to FTOs, further eroding any likely disadvantage.

7.11 All of the models put forward are administratively simple compared to that in the schedule. Compliance costs for FTOs are minimal in all models, and there are no enforcement issues for the ATO. Of all the models, the Committee considered that the PWC/ITSA 'optional registration' model is superior in this regard, requiring minimal change to the GST legislation and presenting few compliance difficulties for either operators or the ATO.

7.12 This model does appear to leave Australian registered operators at a small disadvantage to FTOs. This is an unavoidable consequence of Australian operators being part of the GST system, whereas under the PWC/ITSA model, FTO margins are only taxed up until the point where the rights are sold overseas. The Committee is unconvinced that these disadvantages, though apparent in the limited worked examples in Chapter 6, would be significant in reality. If margins are less than in the examples, the difference diminishes. Further, it should be recognised that incoming tourists will generally buy tourism packages from agents in their home countries, and the slight price differential is unlikely to cause these tourists to buy their packages elsewhere. Lastly, the Committee is also persuaded by the PWC/ITSA argument above (see paragraph 7.9).

7.13 On balance, the Committee favours the PricewaterhouseCoopers/ITSA model. This model requires only a relatively simple amendment to the GST legislation, and is minimally disruptive, preserving the status quo for the very large number of FTOs that are not currently registered.

7.14 A further issue that the Committee considers requires attention is the commencement date for the legislation. If the legislation passes, it will inevitably result in some FTOs being required to raise prices when prices for the coming year have already been set. The Committee is of the view that if the model in schedule 3 is to be adopted, the start up date should be deferred until February 2006 to allow appropriate adjustments to be made. However, the Committee refrains from making a recommendation in this regard, as it is not in a position to judge whether there are other imperatives which demand an earlier commencement date.

Recommendation

7.15 The Committee **recommends** that Schedule 3 not proceed in its current form. The Committee **recommends** that the Government bring forward replacement amendments to implement the alternative model proposed by PriceWaterhouseCoopers and ITSA. The Committee has attached proposed amendments submitted for consideration by PriceWaterhouseCoopers/ITSA at Appendix 5 of this report.

CHAPTER 8

MATURE AGE WORKER TAX OFFSET

Introduction

8.1 Tax offsets are amounts that can be subtracted from a person's tax liability, thus reducing the total tax payable. They differ from tax deductions by being applied after the amount of the tax liability is calculated.

8.2 Schedule 4 of the bill introduces a tax offset for workers aged 55 years and over. It amends the *Income Tax Assessment Act 1997* to provide a maximum offset of $500, subject to 'net income from working' requirements.

8.3 The Government announced the initiative in its 2004 election policy statement *Mature Age Worker Tax Offset* released on 9 September 2004. The offset is designed to 'reward and encourage mature aged workers to stay in the workforce' [1] as a part of preparing and planning for the ageing of Australia's population.

Conduct of the inquiry into schedule 4

8.4 The Committee did not receive any submissions in relation to schedule 4 of the bill, and the schedule was not considered at the public hearing in Brisbane. A series of questions were placed on notice by committee members, and a written response to these was received from Mr Philip Gallagher, PSM, Manager, Retirement and Income Modelling unit, Department of the Treasury. The Committee thanks Mr Gallagher for his assistance.

Features of the mature age worker tax offset

8.5 Eligibility for the offset is based on age (over 55 years) and, what is termed in the bill, 'net income from working'. That is, the income must be derived mainly as a reward for the taxpayer's personal effort or skills or must be income from a business that the taxpayer carries on, less any relevant deductions. It will not be available to those whose net income from working is greater than $58,000 for the 2004-05 income year (or $63,000 for the following income year).

8.6 The offset will phase in at five per cent from the first dollar of net income from working, so that the full $500 offset is achieved when net income from working reaches $10,000. In 2004–05, the offset will phase out at five per cent from $48,000, so that no offset is available when net income from working exceeds $58,000.

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1 Press Release, Prime Minister, *Mature Aged Worker Tax Offset*, 9 September 2005.

8.7 Although the offset is calculated on the basis of net income from working, it will act to reduce the taxpayer's tax liability on their total taxable income. It will apply to assessments for the 2004–05 income year and later income years.

Net income from working

8.8 In brief, 'net income from working' is the total amount of assessable income derived as a reward for personal effort or skills, less any relevant deductions. It will be defined in the *Income Tax Assessment Act 1997 Act* (section 61-570) as assessable income for the year consisting of the following:[2]

a) personal services income;[3]

b) income from a business that the taxpayer carries on—this includes a business that a taxpayer carries on as a sole trader or in partnership;

c) farm management withdrawal amounts; and

d) reportable fringe benefits total,

less the sum of any expenses that the taxpayer can deduct for the income year, to the extent that they are related to their assessable personal services income or assessable income from a business that the taxpayer carries on.

8.9 Any income which is exempt from taxation or non-assessable is not included.

8.10 Note that personal services income includes the following:

- salary or wages;
- income of a professional person practising on his or her own account without professional assistance;
- income payable under a contract which is wholly or principally for the labour or services of a person;
- income derived by consultants;
- income derived by a professional sports person or entertainer from the exercise of his or her own skills (not including income from product endorsements); and
- other income from working such as commissions, bonuses and fees paid to directors or office holders.

8.11 Certain amounts of income are specifically excluded from the definition of 'net income from working'. These amounts relate to eligible termination payments;

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2 Explanatory Memorandum, p. 25.

3 Personal services income is income that is mainly a reward for an individual's personal efforts or skills. It does not include income such as social security payments, veterans' affairs payments or superannuation pensions and annuities.

payments received on retirement or termination of employment in lieu of long service leave and annual leave; and amounts of passive income.[4]

8.12 The offset will operate in combination with the existing $6,000 tax-free threshold and the Low Income Tax Offset. Taken together, this means that eligible workers aged 55 or more will pay no tax on their earned income up to $10,323.[5]

8.13 The offset cannot reduce a taxpayer's basic income tax liability below zero. it will add to the value of other offsets, but does not affect their value or income testing. It is not transferable between members of a couple.

Beneficiaries

8.14 Treasury estimates that 1.08 million persons will be eligible to receive the offset in 2004-05, and 1.13 million persons in the three subsequent years.[6]

Cost to revenue

8.15 When the measure was announced in September 2004, the cost to revenue was estimated to be $1.039 billion over the forward estimates period (ie 2004–05 to 2007–08). This amount was revised to $1.440 billion in the Explanatory Memorandum to the bill.[7]

8.16 The Minister for Revenue and Assistant Treasurer, the Hon. Mal Brough MP, explained the cost revisions as resulting from the development of the definition of 'net income from working' as follows:[8]

> … the government's decision is to allow taxpayers who are earning income from working in a partnership to be eligible for the offset and to allow wage and salary earners to deduct relevant deductions in order to calculate net income from working. This treatment is consistent with that of personal services income and business income …

8.17 At the Additional Estimates hearings in February 2005, the Treasury said revisions in costings were necessary to accommodate clarifications of policy intent in

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4 Passive income includes: dividends, annuities, interest income, rental income, royalties, amounts received from the assignment of intellectual property, capital gains and passive commodity gains, certain attributable income relating to trust estates, and certain amounts relating to controlled foreign companies and foreign investment funds.

5 Press Release, Prime Minister, *Mature Aged Worker Tax Offset*, 9 September 2004.

6 Written response provided by Mr Philip Gallagher of Treasury to written questions on notice, 6 June 2005.

7 Explanatory Memorandum, p. 5.

8 House of Representatives, *Hansard*, 16 February 2005, p. 111. [Brough]

the definition of 'net income from working' and to better reflect the changing age structure in the Australian population.[9]

8.18 The Treasury has estimated that the Australian Taxation Office's implementation costs will be $0.3 million in 2004–05 and $1.8 million in 2005–06.[10]

Committee comment

8.19 The Committee notes OECD research that suggests that it may be more difficult to reverse retirement decisions, once taken, than it is to encourage people still in employment to delay retirement.[11] Those most weakly 'attached' to the labour force tend to be more likely to initiate early retirement before age 65.

8.20 The demographic challenges facing Australia over the next few years as the population ages are considerable. Encouraging mature age workers to remain in the labour force for longer will help meet these challenges. Measures such as the mature age offset which aim to strengthen mature age workers' 'attachment' to the labour force and thus encourage them to delay their retirement, are clearly required.

Recommendation

The Committee recommends that the Senate pass the Tax Laws Amendment (2005 Measures No. 1) Bill 2005.

Senator George Brandis
Chair

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9 Economics Legislation Committee, *Proof Committee Hansard*, Additional Estimates, 17 February 2005, p. 91. [Gallagher]

10 The Treasury, *Costing of Election Commitments – Mature-Aged Worker Tax Offset*, 17 September 2004, viewed on 6 April 2005, at: http://www.treasury.gov.au/documents/888/HTML/docshell.asp?URL=007_Mature_Age_Tax_Offset.htm

11 OECD, *Employment Outlook 2003*, Paris, Chapter 2, *The Labour Mobilisation Challenge: Combating Inactivity Traps and Barriers to Moving Up Job Ladders*, referred to in *Budget Strategy and Outlook 2003-04*, Budget Paper No. 1, Statement 4: *Sustaining Growth in Australia's Living Standards*, p. 4-10.

Inquiry into the Tax Laws Amendment (2005 Measures No. 1) Bill

Report of Senator Stephens and Senator Murray

Outcome of the Committee Hearing on 26 April

Submissions made to the Committee by key representatives and advisers to the tourism export sector put forward strong arguments that the bill in its current form would create significant adverse impacts.

The testimony of witnesses at the hearing on 26 April 2005 strongly supported the arguments made in these submissions. Taken together the oral evidence and the submissions present an overwhelming case against passing the bill in its current form.

The hearings incorporated some rather unusual eventualities that are worthy of being reported to the Senate through this report.

1. Senator Watson appeared to be in receipt of some crucial information relating to the number of foreign tour operators (FTOs) affected by the proposed measure. This information was not made available to the Committee, nor was it produced in evidence or via submissions to the Committee. Still, the large number of FTO's alluded to by Senator Watson (some 400 according to the transcript), bolstered arguments made by some sector representatives that the overall impact of the measure may have been underestimated by officials from the Treasury.

2. The nature of the questioning of witnesses by Senators Brandis and Watson appeared to be favourable towards the bill being amended to deal with concerns raised by inquiry participants. Senator Brandis invited witnesses to propose amendments to the bill (especially the ICAA).

3. Senator Watson's questioning of Treasury officials secured the response that the bill was more far reaching than simply an integrity measure designed to close the loophole whereby FTOs could claim input tax credits without paying GST on elements of a foreign tour package. This directly contradicts statements made by the Minister that the bill is an integrity measure only, placing officials' statements at variance of those of the Minister.

4. Deloittes, in a supplementary submission following the hearing, called for the bill to be returned to the House and recommended that the revenue figures be clarified. While such a course is not expedient, we call on Treasury to issue a revised costing as a matter of urgency.

Deficiencies in the current bill

There seemed to be broad agreement from industry participants and professional and advisory bodies in relation to the adverse impacts of the Bill. They can be grouped into three main categories.

1. The scope of bill.

The bill appears to go beyond redressing the concern that the some FTOs are claiming input tax credits without a GST liability. Naturally, we support the policy intent of closing this loophole. Still, this must be done without the adverse unintended consequences that appear to flow from the way the bill has been drafted utilising the critical definition of 'connection with Australia' for assessing the GST liability. This appears to create the opportunity for goods/services that will not be consumed in Australia to be subject to the GST through the imposition of GST on the wholesaler's margin which appears to fall within the definition of 'having a connection with Australia' under the bill.

We find the best summary of the position is put by ICAA:

> Given that GST is intended to be a tax on Australian private domestic consumption, it is not inappropriate for the charges by the Australian service providers of accommodation, meals, etc which are consumed in Australia to bear GST which is not refundable to the foreign tour operator or to the overseas tourist. However, it is most inappropriate from a policy perspective that the reach of the GST should extend to tax the margin derived by a non-resident of Australia on a transaction with other non-residents of Australia, which occurs outside Australia. Such a margin has no contractual or economic connection with Australia and should not be subject to GST.[1]

2. Timing of the Bill's introduction and the lack of consultation.

We accept that there is a significant element of forward purchasing of rights in the supply of accommodation packages by foreign tour operators.

> With respect to the recovery issue, the impact on the FTOs arises mainly from the operation of advance pricing arrangements associated with tourism marketing. As FTOs typically market their Australian tours, in brochures and other mediums, at least 6 months in advance of the tour actually taking place there is little or no opportunity for an FTO to increase the price of tours offered with a commencement date on or after 10 February 2005. Therefore, for the duration of the advance fixed price period, FTOs will, in all likelihood, need to absorb the impact of the GST.[2]

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1 Submission 1, The Institute of Chartered Accountants in Australia, p. 2.

2 Submission 4, Deloitte Touche Tohmatsu Ltd, p. 10.

Given these timing issues, and the complexity of aspects of the bill, the proposed legislation should have been circulated in exposure draft form. We contend that any revenue leakage that may have occurred through the input tax credit claimed during the period when the Bill was being considered in draft form, would have been justified by producing clearer and more enforceable legislation. Fiscal pressures cannot ever be an excuse for imperfect legislation, especially when the Budget remained in very substantial surplus.

3. The lack of enforceability of the Bill

ATO officials admitted during the hearing that the ATO does not have the legal power to conduct an audit on FTO operating a foreign jurisdiction. This is an clear admission that the law is not enforceable. A law that is unenforceable a priori, is poor jurisprudence, a fortiori.

4. Possible breaches of the Trade Practices Act

Concerns have also been raised about possible breaches of the Trade Practices Act associated with advertising a price without the GST for which the GST is subsequently added. The Treasurer has in fact indicated recently that he will be legislating on component pricing to ensure that a single inclusive price is advertised. This concern needs to be dealt with and the Minister should respond to this issue in the Committee stage of the Senate's consideration of the bill.

Options to amend the Bill

Amendments to this Bill have been proposed by industry experts. We take this opportunity to thank those how have included such amendment in their submissions. The proposed changes fall broadly into two groups. The first is to apply an input taxing model which effectively removes the FTOs from the GST system leading to no GST liability and no input tax credits (ATEC, IACA, Deloitte). The further rules based model of PWC would apply a special definition of 'connected with Australia' for non-resident entities as an exception to the basic rule that applies in GST law.

Both models could achieve the desired outcome of reducing the scope the bill to the primary policy intent of closing the loophole associated the FTOs getting input tax credits. We can accept either model, and call on the Government to return to the debate on the Bill in the Senate with an amendments that gives effect to one of these two proposed models.

The proposed amendments involving the PWC model do solve the problems in the tax law in a much better manner than the original bill and should be supported.

However, Opposition and Democrats Senators note that this opting out approach to the GST system for FTOs will not apply to domestic tour operators. This is a distortionary outcome in the tax law. The Government should come forward with further amendments to address this.

Conclusions of Opposition and Democrats Senators

We are of the view that the proposed amendments are a satisfactory manner to solve the problem addressed but:

1. amendments should have been provided with greater time for review and with an supplementary explanatory memorandum; and

2. the amendments will create non-neutrality of treatment between domestic and foreign tour operators. The Government needs to address this concern.

Senator Ursula Stephens
Deputy Chair

Senator Andrew Murray

Appendix 1

Submissions received

1	The Institute of Chartered Accountants in Australia
1A	The Institute of Chartered Accountants in Australia
2	The Association of British Travel Agents Ltd
3	Australian Tourism Export Council
3A	Australian Tourism Export Council
4	Deloitte Touche Tohmatsu Ltd
4A	Deloitte Touche Tohmatsu Ltd
5	Yon Sha Kai
6	Hotel Motel Accommodation Association Victoria
7	Department of Industry Tourism and Resources
8	Interactive Travel Services Association (submitted by PricewaterhouseCoopers)
9	CPA Australia
10	Queensland Tourism Industry Council (submitted by Ernst & Young)

Additional information

Item 1	'Illustration of competitive problem caused by the proposed GST amendment'—working examples submitted by the Institute of Chartered Accountants in Australia at the Committee's public hearing on 26 April 2005.
Item 2	Facsimile dated 29 April 2005 from the Hotel Motel Accommodation Association Victoria responding to the Committee's request for information at the public hearing on 26 April 2005.
Item 3	Answers to questions on notice taken at the Committee's public hearing on 26 April 2005 and submitted by the Australian Taxation Office on 10 May 2005.

Appendix 2

Public hearings and witnesses

Tuesday, 26 April 2005—Brisbane

Australian Tourism Export Council
Mr David Mazitelli, Chairman
Mr Matthew Hingerty, Managing Director

Hotel Motel Accommodation Association Victoria
Mr Christopher Cudsi, Senior Economist

The Institute of Chartered Accountants in Australia
Mr Adrian Firmstone, Chairman, Indirect Taxes Committee
Mr Ali Noroozi, Tax Counsel

Deloitte Touche Tohmatsu Ltd
Mr Nick Hill, Director
Mr Douglas Tredinnick, Principal, Indirect Tax Group

Department of Industry, Tourism and Resources—Business Development Group, Tourism Division
Ms Kerry Rooney, General Manager
Mr David Hughes, Team Leader, Economic Analysis Team

PricewaterhouseCoopers on behalf of Interactive Travel Services Association
Mr Denis McCarthy, Director, Indirect Taxes
Mr Dylan Morgan, Senior Manager, Indirect Taxes

Australian Taxation Office—Interpretation and Large Enterprise Compliance Group, Goods and Services Tax Division
Mr John Meyer, Acting Assistant Deputy Commissioner
Mr Stephen Vesperman, Senior Assistant Deputy Commissioner
Mr Robert Olding, Senior Tax Counsel

Department of the Treasury—Revenue Group
Mr Raphael Cicchini, Manager, GST Policy Unit
Mr Philip Bignell, Senior Advisor, Indirect Tax Division

APPENDIX 3 –

ATEC – SUGGESTED AMENDMENTS

1. ATEC's alternative model 1

Proposed amendment to Division 40:

40-XX Holidays sold to non-residents

The supply of a right to a holiday is input taxed if;

(a) the supply is to an entity which is not carrying on an enterprise in Australia and;

(b) no declaration is received from that entity confirming that the supply should be treated as taxable.

For the purposes of this sub section, the supply of a right to a holiday means:

(a) the supply of a right to transport, accommodation, meals, attractions, and other holiday related supplies where the supplier of the right is an entity which will not be making the underlying supplies to which the right relates, and

(b) the underlying rights will be ultimately used for the purposes of recreation or entertainment not connected with the carrying on of an enterprise.

Proposed amendment to Section 11-15

An acquisition is not treated, for the purposes of paragraph 2 (a), as relating to the making of supplies that would be input taxed if;

(a) the only reason it would (apart from this subsection) be so treated is because it relates to making holiday supplies; and

(b) the acquisition is not an acquisition cost directly related to the acquisition of holiday rights which are input taxed pursuant to Division 40 XX.

Consequential amendments:

ATEC acknowledged that the model and definitional framework needed to be 'worked through'. ATEC put forward the following suggestions for consequential amendments:

Section 11-15 (3)- this section requires amendment to ensure that non-resident enterprises are not otherwise excluded from the model because the supplies that they make are made through an enterprise which is not carried on in Australia;

Section 9-25 (5)- this section requires amendment to ensure that the supply of a holiday right is defined as connected with Australia. Failure to do so would render the Input Tax amendment inoperative; and,

Section 9-30 (4)- requires modification to extend restriction to the supply of holiday rights in addition to the existing restriction relating to financial supplies.

2. ATEC's alternative model 2

Proposed amendment to Division 40:

40-XX Holidays sold to non-residents

(1) The supply of a right to a holiday is input taxed if;

(a) the supply is to an entity which is not carrying on an enterprise in Australia and;

(b) no declaration is received from that entity confirming that the supply should be treated as taxable, and

(c) the entity making the supply of the right to a holiday has not chosen to have its supplies of such rights treated as taxable supplies.

(2) An entity which choses to have its supplies treated as taxable pursuant to sub paragraph (1) cannot revoke this choice within 12 months after the day on which it made this choice.

For the purposes of this sub section, the supply of a right to a holiday means:

(a) the supply of a right to transport, accommodation, meals, attractions, and other holiday related supplies where the supplier of the right is an entity which will not be making the underlying supplies to which the right relates.

APPENDIX 4

INSTITUTE OF CHARTERED ACCOUNTANTS IN AUSTRALIA (ICAA) – SUGGESTED AMENDMENTS

Option 1: Input taxing the supply of Australian tour packages by foreign tour operators to non-resident tourists

Under this option, non-resident suppliers of Australian tour packages or components thereof would not be able to claim input tax credits on acquisition of these. The ICAA suggests that this would be achieved by inserting into the GST Act the following provision:-

40-XX Australian holidays supplied by non-residents

(1) A supply of an *Australian holiday is ***input-taxed*** if:

(a) the supplier is a *non-resident; and

(b) the supplier is not *carrying on an *enterprise in Australia.

(2) For the purposes of subsection (1), the supply of an Australian holiday includes a right to any one or more of transport, accommodation, meals, attractions and other holiday-related supplies in Australia where:-

(a) the supplier will not be making to the person undertaking the Australian holiday the underlying supplies to which the right relates; and

(b) the underlying supplies will be used by the person undertaking the Australian holiday for purposes not connected with the *carrying on of an *enterprise by the recipient of the supply.

Option 2: Limiting the existing GST registration requirements to entities carrying on (or intending to carry on) an enterprise within Australia

ICAA's Option 2 involves substituting the references to "carrying on an enterprise" in sections 23-1, 23-5 and 23-10 of the GST Act to "carrying on an enterprise in Australia". As the non-resident tour operators do not carry on enterprise in Australia, they would not be entitled to register. The result of this would be that foreign tour operators would cease to have a GST input tax credit entitlement.

In addition, to ensure that entertainers or sportsmen/women who perform in Australia will continue to be subject to GST, the ICAA suggest that a new sub-section be inserted after section 23-5 stating that:

> For the avoidance of doubt, you are *carrying on an *enterprise in Australia if you make supplies that are *connected with Australia within section 9-25(5)".

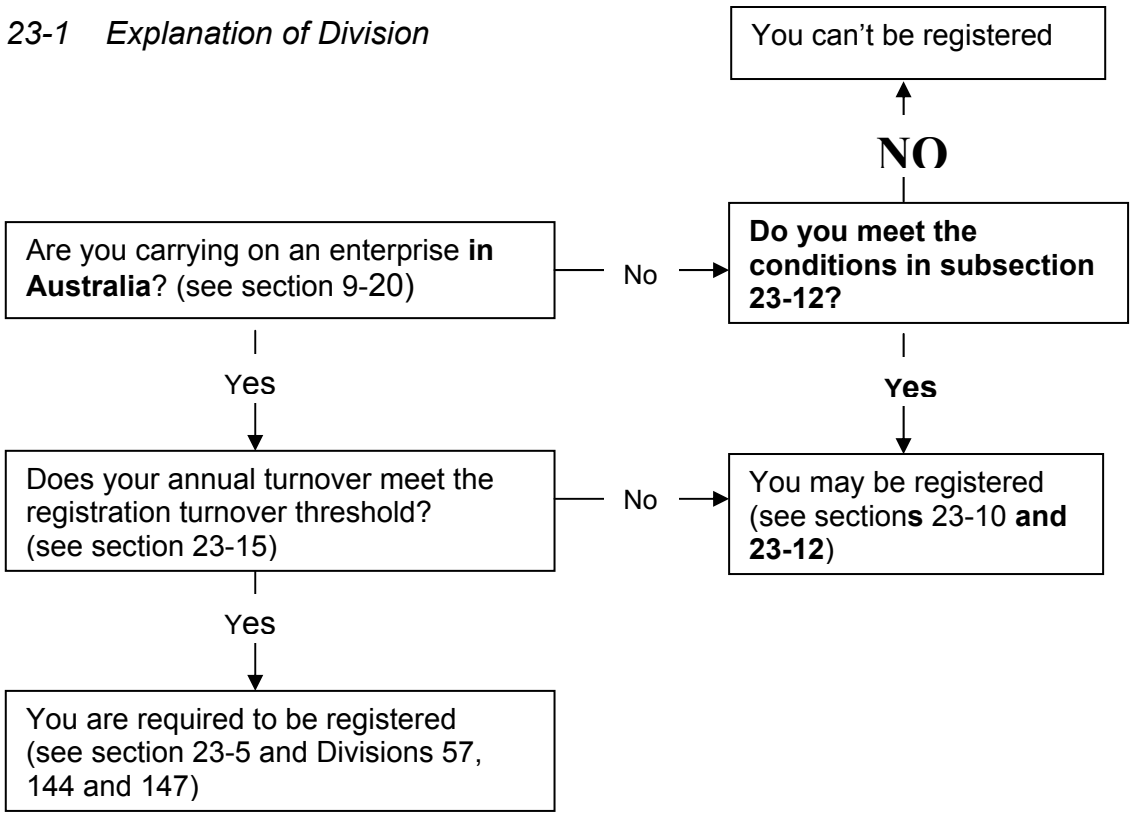
In order to allow entities which are considering investing in Australia or which do business in Australia (e.g. negotiating the acquisition of products to be exported from Australia) to claim input tax credits on qualifying business expenses incurred, the ICAA suggest that either:-

1. a provision be inserted to allow registration in these limited circumstances; or

2. a system similar to the VAT Reclaim system utilised in some overseas countries, be set up to permit businesses which do not carry on an enterprise in Australia to claim back GST on qualifying business expenses which they incur in Australia.

Method 1

If the issue is resolved under the first of these methods, the ICAA suggest that section 23-1 be amended as indicated below in bold and that a provision be inserted as indicated below:



23-12 Entities not carrying on enterprise in Australia which may be registered

(1) You may be *registered under this Act if you are a non-resident and you make or intend to make *qualifying acquisitions in Australia in the course of carrying on an enterprise (whether or not your turnover is at, above or below the *registration turnover threshold).

(2) For the purposes of subsection 23-12(1), qualifying acquisitions means acquisitions which:

(a) are effectively used and enjoyed by you; and

(b) are not supplied by you to another entity.

The ICAA notes an unresolved problem associated with this option, noting that FTOs could use this to get registered and then claim ITCs, unless ITCs are also limited for non-residents who are not carrying on enterprise in Australia to qualifying expenses. The ICAA advised that time pressures had not permitted them to draft provisions appropriate for this purpose.

Method 2

Alternatively, if the issue is resolved under the second of those methods, the ICAA suggest a new Division "*Division 169 – Non-Resident Business Refund Scheme*" with the following provisions:-

169-1 What this Division is about

If you are a non-resident and you carry on an enterprise but not in Australia, you may be entitled to a refund of the GST that was payable on certain acquisitions made by you in Australia.

Non-Resident Business Refund Scheme

(1) If:

(a) you are a non-resident; and

(b) you do not carry on an enterprise in Australia; and

(c) you make a *qualifying acquisition in Australia in the course of carrying on an enterprise; and

(d) the supply to you of the qualifying acquisition is a *taxable supply;

the Commissioner must, on behalf of the Commonwealth, pay to you an amount equal to:

(e) the amount of the GST payable on the supply; or

(f) such proportion of that amount of GST as is specified in the regulations.

(2) The amount is payable within the period and in the manner specified in the regulations.

(3) For the purposes of subsection 169-5(1), a qualifying acquisition means an acquisition which:

(a) is effectively used and enjoyed by you; and

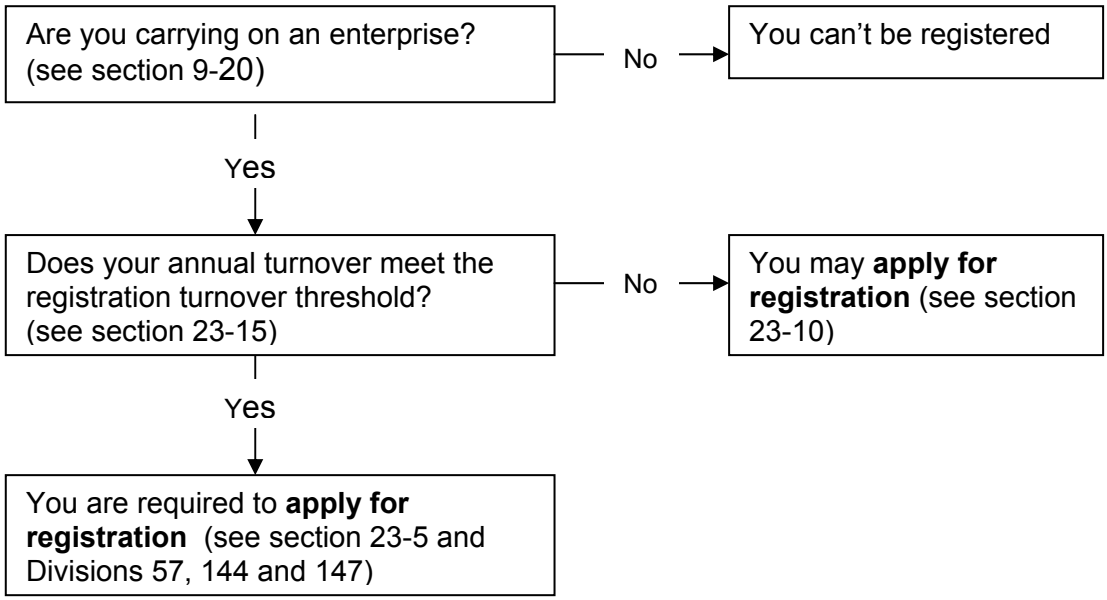
(b) is not supplied by you to another entity.

Details of the scheme should be set out in GST Regulations in terms similar to those of regulations 168-5.04, 168-5.05, 168-5.11 to 168-5.17 (inclusive).

Option 3: Commissioner's discretion to not register non-residents that do not carry on an enterprise within Australia

Under this option, the Commissioner would be granted a discretion to not register or to de-register non-residents who do not carry on an enterprise in Australia. The exercise of this discretion would result in the non-resident not being able to claim input tax credits. To implement this option, the ICAA suggest that Division 23 be amended as indicated in **bold** below and insert provisions into Subdivisions 25-B and 25-C as set out below:-

Explanation of Division



*Who is required to **apply to** be registered*

Insert "to apply" before the words "to be registered" in the title and in the body of the section.

*23-10 Who may **apply to** be registered*

Insert "to apply" before the words "to be registered" in the title and both subsections 23-10(1) and (2).

25-8 When the Commissioner has a discretion to not register you

(1) The Commissioner has a discretion to not *register you if:

(a) you are a *non-resident; and

(b) you are not *carrying on an *enterprise in Australia.

(2) In exercising the discretion in subsection 25-8(1), the Commissioner must have regard to:

(a) whether you intend to *carry on an *enterprise in Australia;

(b) whether you are making supplies to non-residents where the use and enjoyment of the supplies or, if the supplies are rights, the underlying supplies to which the rights relate takes place in Australia; and

(c) any other relevant matters.

(3) The Commissioner must notify you in writing of any decision he or she makes in relation to you under this section. If the Commissioner decides to register you, the notice must specify the following:

(a) the date of effect of your registration;

(b) your registration number; and

(c) the tax periods that apply to you.

25-58 When the Commissioner has a discretion to cancel your registration

(1) The Commissioner has a discretion to cancel your *registration if:

(a) you are a *non-resident; and

(b) you are not *carrying on an *enterprise in Australia.

(2) In exercising the discretion in subsection 25-58(1), the Commissioner must have regard to:

(a) how long you have been *registered;

(b) whether you previously *carried on an *enterprise in Australia, the nature of that enterprise and the length of time for which it was carried on;

(c) whether you intend to *carry on an *enterprise in Australia;

(c) whether you are making supplies to non-residents where the use and enjoyment of the supplies or, if the supplies are rights, the underlying supplies to which the rights relate takes place in Australia; and

(d) any other relevant matters.

(3) The Commissioner must notify you in writing of any decision he or she makes in relation to you under this section. If the Commissioner decides to cancel your *registration, the notice must specify the date of effect of the cancellation.

Option 4: Leaving the amendments in their present form, but providing to the non-resident supplier the right to elect that its supplies of Australian tour packages be input-taxed

While this option was not articulated in the ICAA's submissions to the Committee, it was subsequently raised by an ICAA member and is considered by the ICAA to have merit. It is a variation on Option 1 and has a precedent in Subdivision 40-E of the GST Act in relation to supplies made by school tuckshops.

If this option is adopted, the ICAA suggests that subsection 9-25(5), as currently drafted, should be extended as follows:

A supply of anything other than goods or * real property is *connected with Australia* if:

(a) the thing is done in Australia; or

(b) the supplier makes the supply through an *enterprise that the supplier *carries on in Australia; or

(c) all of the following apply:

(i) neither paragraph (a) nor (b) applies in respect of the thing;

(ii) the thing is a right or option to acquire another thing;

(iii) the supply of the other thing would be connected with Australia.

Example: A holiday package for Australia that is supplied overseas might be connected with Australia under paragraph (5)(c).

The ICAA considered that in addition, a new Subdivision will need to be inserted into Division 40:

Subdivision 40-G – Non-resident suppliers of rights

40-180 Non-resident suppliers of rights

(1) A supply connected with Australia under section 9-25(5)(c) is input taxed if:

(a) the supply is made by a non-resident through an enterprise that is not carried on in Australia; and

(b) the recipient of that supply is a non-resident; and

(c) the supplier chooses to have all supplies it makes through that enterprise that are connected with Australia under section 25(5)(c) treated as input taxed.

(2) A non-resident supplier may make the choice referred to in subsection 40-180(1)(c) at any time prior to the lodgment of a GST return in which the supplies are reported.

(3) However, the non-resident supplier:

(a) cannot revoke the choice within 12 months after the day on which the non-resident made the choice; and

(b) cannot make a further choice within 12 months after the day on which the non-resident revoked the previous choice.

APPENDIX 5

PRICEWATERHOUSECOOPERS/ ITSA AMENDMENTS

PricewaterhouseCoopers, on behalf of the Interactive Travel Services Association (ITSA), proposed to use the words in the proposed subsection 9-24(5)(c) as the basis of a new special 'connected with Australia' rule that only applies in certain circumstances. They noted that there is a precedent in GST law for this.

They proposed that the special rule not apply if:

(a) the supplier makes the relevant supply through and enterprise it carries on outside Australia, and

(b) the supplier is not registered (or otherwise required to be registered) for GST purposes.

ITSA/PWC gave the following example of how the new special rule might be enacted:

New Special Rule

(1) "A supply of anything other than goods and real property is connected with Australia if all of the following apply:

(i) neither paragraph (a) nor (b) of subsection 29-25(5) applies in respect of the supply of the thing;

(ii) the thing is a right or option to acquire another thing;

(iii) the supply of the other thing would be connected with Australia."

(2) However, subsection (1) will not apply if:

(a) the supplier makes the supply through an enterprise that is not carried on in Australia; and

(b) the supplier is not registered or otherwise required to be registered for GST purposes.