The Institute of Chartered Accountants in Australia

22 March 2005

Peter Hallahan
Committee Secretary
Senate Economics Committee
Department of the Senate
Parliament House
Canberra ACT 2600

E-mail: economics.sen@aph.gov.au

Dear Sir,

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

The Institute of Chartered Accountants in Australia ("ICAA") is writing to express concerns in relation to Taxation Laws Amendment (2005 Measure No.1) Bill 2005 ("the Bill"), in particularly Schedule 3: supply of rights or options offshore. We also note that on 9 March 2005 the Senate referred the Bill to the Economics Legislation Committee for inquiry and to report back by the 10 May 2005.

The ICAA is the leading professional accounting organisation in Australia, representing 40,000 members in public practice, commerce, academia, government and the investment community. The ICAA's members are advisers to businesses at all levels, from small and medium sized businesses to the largest global corporations operating in Australia and overseas.

The ICAA is of the view that there is a need for further exploration of the full potential impact of the legislation and how to limit its application to the situations intended by the Government. We encourage further consultation with the profession before the legislation is finalised, and would be happy to assist in this regard.

The ICAA has the following comments in relation to the Bill.

Schedule 3 – Supplies of rights or options offshore

Paragraph 3.2 of the Explanatory Memorandum ("EM") to the Bill identifies the broad purpose of the amendments contained in Schedule 3 as follows:

"The policy intent of the goods and services tax (GST) legislation broadly is to tax private consumption of most goods, services and other things in Australia, including imports. However, a deficiency has been identified in the GST Act under which certain rights or options provided offshore are not subject to GST, even when they are for goods, services and other things that will be consumed in Australia."

27–29 Napier Close
Deakin ACT 2600
Tel: 1300 137 322
Fax: 02 6282 9800

L1/200 Mary Street
Brisbane QLD 4000
Tel: 07 3233 6500
Fax: 07 3221 0856

L11/1 King William Street
Adelaide SA 5000
Tel: 08 8113 5500
Fax: 08 8231 1982

TCCI, 30 Burnett Street
North Hobart TAS 7000
Tel: 1800 014 555
Fax: 03 9670 3143

L3/600 Bourke Street
Melbourne VIC 3000
Tel: 03 9641 7400
Fax: 03 9670 3143

Grd/28 The Esplanade
Perth WA 6000
Tel: 08 9420 0400
Fax: 08 9321 5141

The Institute of Chartered Accountants in Australia
ABN 50 084 642 571
Incorporated in Australia Members' Liability Limited
Level 14, 37 York Street Sydney NSW 2000

GPO Box 3921 Sydney NSW 2001

Tel: 1300 137 322 / 61 2 9290 1344
Fax: 61 2 9262 1512

www.icaa.org.au

Clause 2.5 of the EM subsequently identifies the main group of non-residents that are able to make supplies in these circumstances as non-resident tour operators. While it is within Parliament's prerogative to correct such a deficiency, we submit that there are some serious policy issues and unintended consequences, which arise as a result of the amendments.

Policy issues

The effect of the introduction of paragraph 9-25(5)(c) on non-resident tour operators is to make the price of the land content of Australian tours (including accommodation, meals, coach travel and excursions) as charged to foreign tourists (while overseas) subject to GST.

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.

We further submit that while it may be within the Commonwealth's power to impose GST on transactions between non-residents of Australia, which occur outside Australia, the Commonwealth does not have any power to enforce such a GST liability. This raises a policy issue of whether Parliament should impose laws, which cannot be enforced for lack of jurisdiction.

In addition, the imposition of GST on these transactions places directors of foreign companies in the invidious position of either flouting the Australian laws or of submitting to the Australian jurisdiction and bearing the cost of the GST as a reduction in their margin (or if passed on to customers, as a reduction in their price-competitiveness in comparison with foreign tour operators which choose not to register).

Moreover, given that the targeted taxpayers would be outside the reach of the Tax Office's education and compliance programs, it is conceivable that, while some overseas-based tour operators may be non-compliant by choice, many will be non-compliant out of ignorance. In either case, it will be very difficult for the Tax Office to take affirmative actions to address this situation.

Unintended consequences

In addition, we submit that the introduction of s9-25(5)(c) has unintended consequences, including bringing the following supplies, which are not currently subject to GST, within the net of supplies "connected with Australia":-

1. Reinsurance contracts between a non-resident entity and another entity, involving Australian property, assets and risks. For example, an Australian insurer acquires reinsurance from Lloyds of London in relation to the insurance of the QVB building in Sydney. The supply of the reinsurance will be connected with Australia pursuant to s9-25(5)(c).

2. Insurance re events that may happen in Australia. For example, Travelsafe Co (a non-resident) sells the right to Australian travel insurance to Tourism Co (a non-resident company offering tours to Australia, inclusive of travel insurance). The supply by Travelsafe Co will be connected with Australia pursuant to s9-25(5)(c).

3. The sale of rights between a non-resident entity and another entity for product distribution, merchandising and franchise agreements in Australia. For example, Oz Juice Co sells its distribution rights in Queensland to Foreign Co, a non-resident

company. Foreign Co in turn sells the distribution rights to Qld Co, an Australian entity. The sale of the distribution rights by Foreign Co will be connected with Australia pursuant to s9-25(5)(c).

4. The supply of rights between two non-resident entities for media placements in Australian media. For example, an Australian magazine sells rights to media placements in its May 2005 edition to a non-resident media outlet. The non-resident media outlet in turn sells these rights to its non-resident clients. The supply of these rights by the non-resident media body to its non-resident clients will be connected with Australia pursuant to s9-25(5)(c).

In these examples, the Australian recipient might well be able to claim an offsetting input tax credit, in which event there would be no net gain to the Revenue, but the amendments would nevertheless create an administrative burden on the overseas supplier in requiring it to register and to charge and account for GST.

It is evident from these examples that the amendments contained in Schedule 3 will have widespread consequences, which do not appear to have been considered by Parliament (at least, in so far as is suggested by the EM to the Bill). Significantly, these consequences would not produce much further GST revenue (if any), but would entail considerable compliance obligations on the affected overseas entities.

Alternative approaches

We suggest that these problems could be overcome by adopting a narrower legislative approach to target the deficiencies the Bill is intended to address. A number of alternative options are proposed as follows:

1. input-tax the supply of Australian tour packages by non-resident tour operators to non-resident tourists;

2. limit the existing GST registration requirements in Division 25 to those entities which are carrying on, or intending to carry on, an enterprise within Australia; or

3. grant the Commissioner a discretion to not register (or to deregister) non-residents, which do not carry on an enterprise within Australia with the result that the non-resident would be taken as not being required to be registered.

Option 1

As the EM to the Bill indicates that the amendments in Schedule 3 are mainly targeted at non-resident tour operators, the problems set out above could be overcome by introducing a provision to prevent non-resident tour operators from claiming input tax credits, rather than adopting the heavy-handed approach taken in Schedule 3. This could be achieved by input-taxing the supply of Australian tour packages by non-resident tour operators to non-resident tourists.

Alternatively, if the amendments are intended to address other concerns, which are not apparent from the EM to the Bill, we suggest that other approaches to amendment (such as Options 2 and 3) are available which do not affect the existing liability provisions (and which do not cause the difficulties raised above).

Option 2

Option 2 would involve changing all references in Division 23 of the GST Act to “carrying on an enterprise” to “carrying on an enterprise in Australia”. As the non-resident tour operators do not carry on enterprises 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, we suggest that a new sub-section be inserted in s23-5 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 s9-25(5)".

A further provision would be required to permit 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 or marketing in Australia to win export sales to Australia) to register in order to claim back the input tax credits on qualifying business expenses incurred. Alternatively, a system similar to the VAT Reclaim system utilised in some overseas countries, could 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 here.

Option 3

Option 3, which is based on the amendment recently introduced in the NZ GST Act, may be a simpler mechanism to adopt than Option 2 as it does not change the structure of the GST Act, but allows the Commissioner the discretion to not register (or to deregister) non-residents who do not carry on an enterprise in Australia, with the result that the non-resident would not have a GST input tax entitlement as the exercise of the discretion would result in the non-resident not being required to be registered.

Application of amendments: The need for transitional relief

If none of these approaches are adopted and the amendments are to proceed in their present form, we strongly recommend that transitional provisions apply to the application of the changes outlined in the Bill.

In particular, as these measures are aimed at the tourism industry, we note that it is a recognised feature of this industry that tour operators lock in prices in advance for each tourism season (usually the 12 months from April to the following March of each year).

While we do not know for certain whether the foreign tour operators pass on the benefit of any input tax credits claimed to their customers in reduced prices, given the competitive nature of the industry, we would expect that most foreign tour operators would have factored in the credits in their tour package prices.

If this is the case, the imposition of the Schedule 3 amendments without a transitional period would result in the foreign tour operators being subject to GST on the price of the tour packages, but with no opportunity to take this into account in their prices – thus resulting in the burden of the GST being borne by the foreign tour operators with no opportunity of recouping this sum from their tourist customers. As a result, the GST would effectively be a tax on business, rather than a tax on consumption.

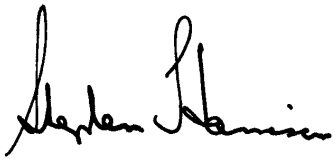
Even if some foreign tour operators retain some or all of the GST credits as part of their margin, the imposition of the Schedule 3 amendments without a transitional period would result in these foreign tour operators being subject to GST on their margin (or more) with no opportunity to recoup it.

Accordingly, in order to address this inequity we strongly recommend that transitional provisions be introduced to the effect that the application of the amendments be deferred at least until 1 April 2006.

In this regard, there is a precedent for deferring the application date. When the Tax Office changed its position regarding the GST to be charged and accounted for on the margins charged by Australian tour operators ("ITOs") to foreign tour operators in November 2003, the Tax Office deferred the application of its new position until 1 April 2005. It did so in recognition of the pricing arrangements in the tourism industry and of the fact that, without such deferral, an inappropriately unrecoverable GST liability would be imposed on the ITOs.

Should you wish to discuss any issues further, please do not hesitate to contact me on 9290 5609, Ali Noroozi on 9290 5623 or Adrian Firmstone on 9247 2299.

Yours sincerely



Stephen Harrison
Chief Executive Officer