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

29 April 2005

Dear Mr Hallahan

Supplementary Submission: ***Tax Laws Amendment (2005 Measures No. 1) Bill 2005*****, Schedule 3 ("the Bill")**

Deloitte Touche Tohmatsu ("Deloitte") accepts the invitation issued by the Chairman of the Committee, Senator Brandis, during the hearings held in Brisbane on Tuesday 26 April 2005, to lodge a supplementary submission for consideration by the Committee in connection with its deliberations on the Bill.

Senator Brandis, requested supplementary submissions to:

- clarify matters raised during Tuesday's hearings; and
- provide the opportunity to respond to evidence given by other witnesses at the hearings.

Supplementary submissions were requested to be lodged with the Committee Secretariat by Friday 29 April 2006.

Deloitte has had the opportunity to review other submissions lodged with the Committee and to hear the oral evidence presented to the Committee. We believe that the following additional information and analysis will prove significant in assisting the Senate Committee.

The Economic Impact and Revenue Integrity Measures

<u>Economic Projections</u>

The Explanatory Memorandum to the Bill projects the annual financial impact of the amendment to be $140 million rising to $150 million in 2007-08. The Treasury and ATO Officers present at the hearing did not provide any additional information to clarify the basis of this revenue estimate but did confirm that no Regulation Impact Statement had been prepared because the measure was viewed as a revenue integrity issue.

The Econtech Model, commissioned by the Department of Industry, Tourism and Resources is, to our knowledge, the only economic analysis of the measures contained in the Bill that seeks to express the impact of the measures across the entire Foreign Tourism Industry Sector[1].

Other modelling presented (including our own) is more in the nature of a price impact assessment based upon data extracted or estimated from specific taxpayers or categories of taxpayer.

The Econtech Model summarises the overall price impact on the Tourism market as 0.2% and a price impact on organised tours as 1.4%[2]. In terms of the total additional GST impact, the modelling projects $40 million as being the full year impact based upon data relating to the Year ending September 2004[3], this relating to five elements of prepaid expenditure summarised at Appendix 1.

It is apparent to Deloitte that there is a great deal of disparity between the Econtech projection of $40 million additional GST revenue and the Treasury estimate of $140 million.

<u>Projections based on Historic Data</u>

It is our recollection that Senator Watson stated that the historic revenue impact was approximately $160 million in refunds claimed by the 400 GST registered Foreign Tour Operators. We believe that these were the figures quoted but have not had the opportunity to verify them with the Hansard transcript.

The $160 million in past refunds paid to tour operators relates to the period 1 July 2000 (the commencement date for GST) through to the present day, a period of almost five years. We assume that the majority of these refunds relate to the periods prior to 28 November 2003 when no output tax was sought by the ATO on the accommodation component. Even so, this is still a period of approximately three and a half years and thus extrapolates to a revenue leakage of less that $50 million per year.

The Treasury Officials have stated that the amendment only seeks to tax the non accommodation element which is currently outside of the scope of the GST Law. They have further estimated that this amount represents no more than 10% of the cost of a tour package. One must presume that the $160 million in refunds paid to date relate principally to the accommodation GST which has been previously resolved and no longer presents a revenue leakage.

A simple extrapolation of the historic data would suggest that the revenue to be gained from the taxing of non accommodation components is more in the order of $10 million per annum

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[1] Table 4.1, page 9, Expenditure by Foreign Tourists to Australia, Year ending Sept. 2004 ($m)
[2] Chart 4.2 page 14 The Impact of Legislative Changes (2005) to GST on Australian Holidays Purchased Through Foreign Tour Operators. Econtech Pty Ltd 11 April 2005
[3] Table 4.4 page 14 The Impact of Legislative Changes (2005) to GST on Australian Holidays Purchased Through Foreign Tour Operators. Econtech Pty Ltd 11 April 2005

yet the Treasury estimate for a full year is $140 million in revenue. It is of note that the Econtech model projects the additional revenue to be derived from the organised tour sector to be $9 million per annum on the non accommodation elements (refer Appendix 1).

We submit that the Treasury estimate of financial impact of the Bill is not only in conflict with the Economic modelling undertaken by Econtech but seems to be inconsistent with the historic information on revenue leakage which was presented at the Committee Hearing. The revenue impact outlined in the Explanatory Memorandum is $140 million for a full year yet the total GST refunds for a five year period, relating to both the accommodation and non accommodation components, is $160 million.

Compliance Cost of Amendment

The overwhelming response from the Industry Groups presenting to the Committee was one of significant concern regarding the cost of compliance for this measure.

Deloitte understands that a manual calculation methodology is currently adopted by all Tour Operators to deal with the computation of input tax credits and the computation of output tax. This approach is acceptable as these taxpayers are, under the current law, always in a net GST refund position and thus not exposed to General Interest Charge if unable to establish their actual refund position within the normal 21 day lodgement requirements.

The amendment will change the status of these taxpayers from net refund to net liability. It is our view that the change in status will necessitate a total change in compliance approach. 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.

Treasury Officials, in response to questions from the Committee regarding this issue, stated that they did not believe that the additional compliance cost was significant.

The ATO indicated that approximately 400 Foreign Tour Operators are currently registered for GST and the majority of them are accounting for GST on the accommodation component. Extending the tax calculation to the additional elements, which they estimated at 10% (presumably concurring with the Econtech analysis) should not pose a significant burden on these operators.

There is obviously a significant divergence of opinion on the likely compliance cost of the measure. The Industry Groups expressing uniform concern regarding the cost of establishing systems and procedures and the ongoing compliance cost of computing the their tax liabilities for mixed supplies impacted by exchange rate fluctuations and tourist profiles.

We do not concur with the Treasury ATO view regarding the nominal aspect of compliance with the Bill.

Alternate Solutions

There was general concurrence from the Industry Groups on the need to address the Revenue leakage but with a very different mechanism to that suggested by Treasury. The Industry Groups have recommended mechanisms which deny the GST credit to the Foreign Tour Operator. The Input Taxed Model or The Optional Registration Models not only have the effect of denying the GST credit entitlement but are in harmony with the approach used in other countries. The only revenue differential of these models over the mechanism proposed in the Bill is in respect of the margin that the Foreign Tour Operator makes on the sale of the rights. The Bill seeks to tax this margin, the Industry models seek to merely limit the entitlement that exists to claim Input Tax Credits.

The Industry Groups have promoted these alternative models on the basis of resolving the revenue leakage and presenting no compliance burden for non-resident enterprises.

Assessing the merits of any proposed amendment necessitates a comparison between the revenue to be generated and the resulting compliance and administration costs.

The alternate models resolve the revenue leakage without a compliance cost, or any ATO administration costs in enforcing a measure against non resident entities.

The proposed amendment resolves the revenue leakage, applies an additional GST burden on the foreign entities income and involves a significant compliance and administrative cost.

Deloitte submits that an appropriate assessment of the Regulation impact of the Bill should measure the additional compliance and administration costs against the additional GST revenue that the Bill imposes on the foreign entities margin. This margin would seldom exceed 20% of the underlying cost of the tour package components.

We submit that this analytical approach would likely show that the additional revenue which the Bill seeks to collect would be more than offset by the lost GST revenue that has been predicted by Econtech as a factor in assessing the economic impact of these measures.

Summary

We submit that there is substantial doubt regarding the financial impact of this Bill and that the likely revenue impact needs to be accurately assessed and measured against the projected additional compliance cost obligations that are of primary concern to all of the Industry groups.

We urge the Senate Committee to take the above additional analysis into consideration when resolving their recommendation regarding the Senate position on this Bill.

We strongly believe that the Schedule 3 to the Bill should be referred back to the Lower House with the Senate recommendation that the revenue impact be further analysed and alternate measures for resolving the revenue leakage be explored by Treasury in consultation with effected Industry groups.

Yours faithfully

Nick Hill
Director, Deloitte Touche Tohmatsu Ltd