THE IMPACT OF LEGISLATIVE CHANGES (2005) TO GST ON AUSTRALIAN HOLIDAYS PURCHASED THROUGH FOREIGN TOUR OPERATORS

This report was prepared for the
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Introduction

On 1 July 2000, the Federal Government introduced the New Tax System (NTS). A major component of NTS was the introduction of a 10 per cent goods and services tax (GST) on most items. In February this year, the Government introduced Tax Laws Amendment (2005 Measures No. 1) Bill 2005. One of the amendments relates to the application of GST to the purchase of Australian holidays through foreign tour operators (FTOs). Econtech has been commissioned by the Department of Industry, Tourism and Resources ("the Department") to model the impact of applying GST to the purchase of Australian holidays through FTOs under the amended legislation. At the time of writing, the legislation had been referred to the Senate Economics Committee for further consideration.

Background

The original intention of the GST legislation, in relation to foreign tourists, was to apply GST to goods and services that are consumed in Australia. Australian goods and services can be purchased on-shore (in Australia) or off-shore (overseas) by visitors. As shown in the table below, all purchases made on-shore (except international airfares) are subject to GST[1]. Off-shore purchases made by foreign tourists through Australian suppliers are also subject to GST (again, excluding international airfares). However, despite the original intention of the GST legislation, off-shore purchases made by foreign tourists through FTOs are not currently subject to GST – the amended legislation aims to correct this anomaly.

Table 1
Summary of GST Application to Tourism Products Sold to Inbound Tourists

	Off-shore FTOs	Off-shore Australian suppliers	On-shore spending
Accommodation	✓(a)	✓	✓
Airfares			
- domestic (c)	X	X	X
- international	X	X	X
Other	✓(b)	✓	✓

Notes:

X - means that GST does not apply to the corresponding good or service.

✓ - means that GST does apply to the corresponding good or service.

(a) Confirmed in November 2003.

(b) Under the amendments before the Senate Committee.

(c) Assumes this is a domestic leg of an international flight. If not, then GST applies in all cases.

So, under the amendment, 'other' purchases from FTOs would be subject to GST. This means that most off-shore purchases made by foreign tourists would be subject to GST, which would bring the GST treatment of sales to foreign tourists by FTOs into line with that of sales by Australian Tour Operators. Two important points to note are:

- international airfares, including domestic legs, would remain GST-free; and
- accommodation was already subject to GST before the amended legislation.

[1] As explained above, the exception to this is that tourists could be provided with a GST refund on purchases over $300 (purchased from a single business) on goods that were subsequently taken away with them when leaving Australia.

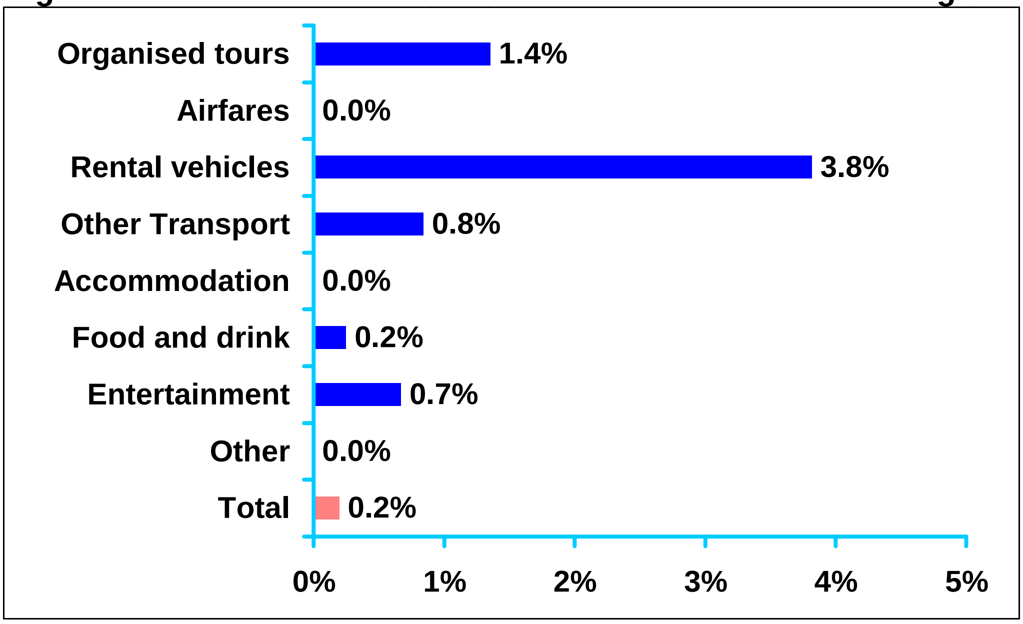
As such, in this study, Econtech has modelled the impact of the amendment relating to the application of GST to 'other' purchases of Australian tourism products.

Results

To model the impacts, Econtech has constructed a custom-built model to identify the change in the price of a visit to Australia that is likely to occur when moving from the current to amended legislation. In addition, Econtech has used its MM600+ model to identify the flow-through or indirect impacts on the rest of the economy.

Using information from the International Visitor Survey, Chart 1 shows the estimated impact of the amended legislation on the price of goods and services purchased by foreign tourists in a visit to Australia.

Chart 1
Change in the Price of a Visit to Australia under the Amended Legislation



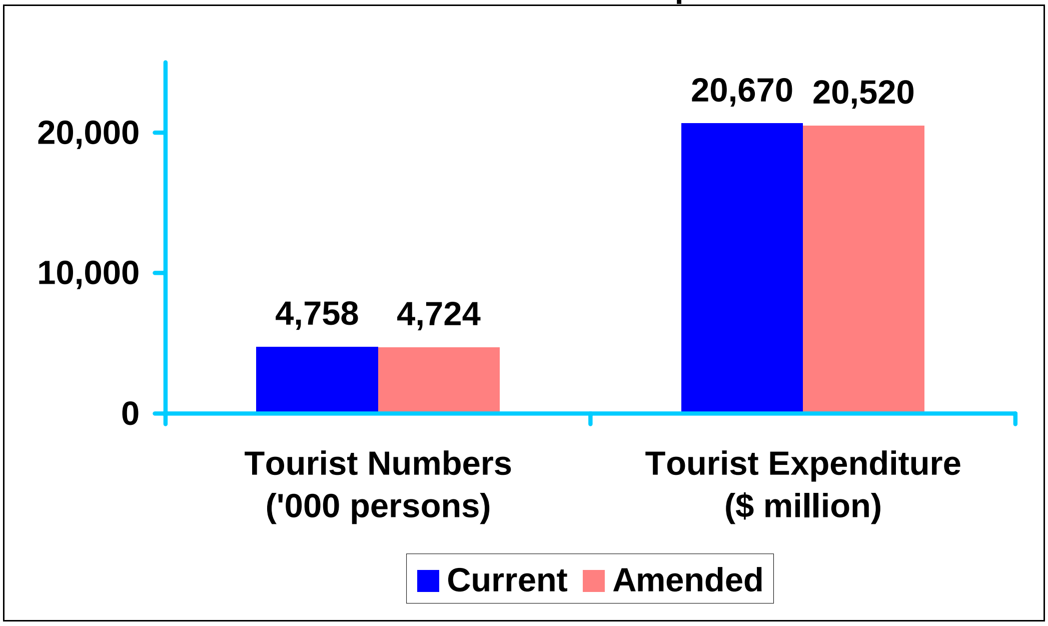
Source: Econtech estimates based on data from the International Visitors Survey.

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 legislation on the price of a visit to Australia from 1 per cent to 0.2 per cent.

The chart below shows how this 0.2 per cent increase in the cost of a visit to Australia under the amended legislation is expected to affect the number of inbound tourists and associated real spending. Inbound tourist numbers would be expected to fall by around 35,000 per year and real expenditure by $150 million per year, reflecting a loss of 0.7 per cent in tourist numbers.

Chart 2
Tourist Numbers and Real Expenditure



Sources: current data from the International Visitors Survey, amended estimates from Econtech's MM600+ model

The loss in travel exports flows through to modest losses in production for some industries and modest gains in other industries. In particular, while there is a fall in the production of industries that provide goods and services to foreign tourists (such as the Accommodation, Cafes and Restaurants industry), this leads to a small depreciation in the Australian dollar, which results in an offsetting increase in production in other trade-exposed industries (such as Agriculture, Mining and Manufacturing).

Compliance Issues

FTOs that currently claim input tax credits and remit GST on accommodation would already be registered for GST and be submitting BAS statements. So, Econtech does not envisage any significant additional compliance cost under the amended legislation, in terms of FTOs registering for GST.

However, there may be additional compliance costs associated with the estimation of the taxable proportion of tour packages. 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.

Distribution Channels

Tourists from long-haul countries (such as the USA and China) are more likely to involve a travel agent to book their Australian holidays compared to tourists from short-haul countries (such as New Zealand). Therefore, it is likely that the impact of the amended legislation would be stronger in long-haul markets.

Further, there are significant differences in the levels of competition for tourist services across the long-haul markets. Retailers in less competitive markets, such as China (reflected in a larger number of tourists per retailer), may be able to absorb some of the demand/price impacts better than those in the more highly competitive markets, such as the USA and UK.

Comparison with Other Countries

The table below summarises the different consumption tax treatments (GST/VAT) of on-shore consumption of tour package components for New Zealand, Canada and the UK. It then compares these different treatments to the GST treatment in Australia under the current and amended legislation.

As can be seen in Table 1, all four countries apply a consumption tax to the on-shore consumption of non-accommodation package components. That is, items such as entertainment, meals and transport services all incur GST/VAT in all four countries.

Australia, New Zealand and the UK also apply a consumption tax to accommodation services purchased as part of a pre-paid tour package. In contrast, Canada provides a rebate for GST paid on eligible short-term accommodation services.

Table 1
GST Treatment of Pre-paid Package Tours – Comparison with Australia

	Canada	New Zealand	UK	Australia (a)	Australia (b)
Accommodation	GST-free	Input-taxed	Input-taxed	Taxable	Taxable
Other on-shore consumption	Input-taxed	Input-taxed	Input-taxed	GST-free	Taxable

Notes:
(a) Treatment under the current legislation
(b) Treatment under the amended legislation.

While all four countries apply a consumption tax to many of the components of tour packages, the method by which they apply the tax differs.

- Under the amended legislation, Australia classes the sale of the on-shore components of a tour package to FTOs as a taxable supply. As such, FTOs are required to register for GST. Once registered, they must charge GST on the sale of the on-shore components of tour packages to foreign visitors and may claim any GST that they pay as input tax credits.
- In contrast, the Canadian, New Zealand and UK systems treat the sale of tour packages to FTOs as an input-taxed supply. As such, the residential supplier charges GST/VAT on the sale of tour packages to FTOs. The FTOs are not required to charge GST/VAT on the subsequent sale of the tour package to the foreign visitor, but are also not eligible to claim input tax credits on the GST/VAT that they pay on

the purchase of the tour package. This treatment also seems to be the common practice across other GST/VAT countries.

The differences in the two tax treatments (input-taxed vs. taxable) lead to differences in the cost of compliance and in the amount of tax collected.

- Where FTO's are required to register for GST by a particular country (such as Australia), the compliance costs of selling visits to that particular country will be higher than for visits to other countries who do not require FTOs to register because they purchase tour packages as an input-taxed supply (such as Canada, New Zealand and the UK).
- Further, while both systems apply GST/VAT to the wholesale price of the tour package, the Australian system differs by also applying GST to the mark-up added by FTOs. Econtech has been unable to find any other example where a destination country attempts to apply a GST/VAT to a foreign tour operator's mark-up.

1 Introduction

On 1 July 2000, the Federal Government introduced the New Tax System (NTS). A major component of NTS was the introduction of a 10 per cent goods and services tax (GST) on most items. In February this year, the Government introduced Tax Laws Amendment (2005 Measures No. 1) Bill 2005. One of the amendments relates to the application of GST to the purchase of Australian holidays through foreign tour operators (FTOs). At the time of writing, the legislation had been referred to the Senate Economics Committee for further consideration.

Econtech has been commissioned by the Department of Industry, Tourism and Resources ("the Department") to model the impact of applying GST to the purchase of Australian holidays through FTOs under the amended legislation.

The first step of this analysis is to summarise the changes between the "current legislation" (under *A New Tax System (Goods and Services Tax) Act 1999*) and the "amended legislation" (under the *Tax Laws Amendment (2005 Measures No. 1) Bill 2005*). The second step involves examining the implications of these changes in the following ways.

a. Estimate the effects on the price of Australian holiday packages sold by FTOs to inbound tourists.

b. Estimate how these price effects will impact on inbound tourist numbers and expenditure by inbound tourists.

c. Examine the requirements for FTOs to comply with the amended legislation.

d. Discuss the implications for distribution channels of FTOs and Inbound Tour Operators (ITOs).

e. Undertake an international comparison of the amended system with the GST system of other countries.

The Australian Tourism Export Council (ATEC) and Deloitte Touche Tohmatsu ("Deloitte") are concerned about the amended legislation. ATEC have conducted its own research into the impact that the amended legislation will have on tourism product prices, compliance costs and distribution channels. ATEC is concerned that if the GST is passed on to foreign tourists, it will force up the price of Australian tourist products, leading to a decline in the number of inbound tourists to Australia. On the other hand, if Inbound Tourist Operators (ITOs) (that sell holiday packages to FTOs) absorb some of the price increase, suppliers of tourism in Australia may be adversely affected. Deloitte is also concerned about the amended legislation. In particular, it is concerned about the compliance costs associated with the amendment. The concerns of Deloitte and ATEC are summarised in section 5 of the report.

This report is structured as follows.

- Section 2 outlines background information on the NTS Act and the amendment (step 1).
- Section 3 presents the general methodology used to model the impacts of GST on the purchase of Australian holidays by FTOs (step 2, parts a and b).
- Section 4 presents the modelled impacts of the amendment. This is accompanied by an explanation of those results (step 2, parts a and b).
- Section 5 discusses other implications of the amended legislation, including compliance issues and impacts on the distribution chain (step 2, parts c and d).
- Section 6 undertakes an international comparison of the amended system with the GST system of other countries in terms of tourism expenditure (step 2, part e).

While all care, skill and consideration has been used in the preparation of this report, the findings refer to the terms of reference of the Department of Industry, Tourism and Resources and are designed to be used only for the specific purpose set out below.

The specific purpose of this report is to model the impact of GST on the purchase of Australian holidays through foreign tour operators under the amended legislation.

The findings in this report are subject to unavoidable statistical variation. While all care has been taken to ensure that the statistical variation is kept to a minimum, care should be used whenever using this information. This report only takes into account information available to Econtech up to the date of this report and so its findings may be affected by new information.

2 Background

This section begins by providing background information about the Australian tourism industry. This is relevant because the amendment to the legislation that is being considered in this report directly relates to the tourism industry. The section then summarises the relevant aspects of the current and amended legislation (subsection 2.2). This is followed by an analysis of how GST is applied to FTOs under the current and amended legislation (subsection 2.3). The information in this section provides background information to the analysis conducted in latter stages of the report.

2.1 Tourism in Australia

The amended legislation directly relates to the Australian tourism industry. Tourism is an important industry, making a significant contribution to the Australian economy in terms of production, exports and employment.

Reflecting the importance of the tourism industry, the Australian Bureau of Statistics (ABS) developed a publication devoted entirely to this industry – the Tourism Satellite Account (ABS catalogue 5249.0). According to the 2002/03 Tourism Satellite Account, tourism accounted for $32 billion, or 4.2 per cent, of Australia's Gross Domestic Product (GDP) in 2002/03.[2]

Tourism is also important in terms of exports. According to the ABS Tourism Satellite Account, international visitors consumed nearly $17 billion in goods and services during 2002/03[3]. This means that tourism contributed 11.2 per cent to total exports of good and services in 2002/03. Only the mining and manufacturing industries made larger contributions to exports during 2002/03[4].

Tourism is also important in terms of employment. The ABS Tourism Satellite Account shows that tourism accounted for around 5.7 per cent of total employment during 2002/03. This equated to about 541,000 employed persons. About 26 per cent of those employed in tourism-related activities were in retail trade. The next most important tourism-related activities (in terms of employment) were the accommodation (18 per cent), and cafes and restaurants (10 per cent) industries[5].

Given the importance of the Australian tourism industry, the amended legislation has been considered in terms of its impact on that industry. Details of the current and amended legislation are now discussed.

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[2] Australian Bureau of Statistics, *Australian National Accounts: Tourism Satellite Account*, catalogue number 5249.0, 2002-03, table 1.
[3] ibid, table 11.
[4] Statistics are based on Econtech's MM2 model data, updated January 2005.
[5] Australian Bureau of Statistics, *Australian National Accounts: Tourism Satellite Account*, catalogue number 5249.0, 2002-03, table 16.

2.2 Legislation and Amendment

In 2000, the Australian Government introduced the New Tax System (NTS). A major component of the NTS was the introduction of a Goods and Services Tax (GST). According to the legislation, "GST is payable on taxable supplies and taxable imports"[6]. Australia's GST is a levied at each stage in the production and distribution process, but is intended to be passed on to final consumers. This is achieved by allowing businesses an 'input tax credit' on the GST they pay on inputs. In contrast, consumers cannot obtain an input tax credit for anything acquired or imported for private consumption.

A government report released in 1998 stated the following in relation to the application of GST to foreign tourists.

> *"Good and services consumed by tourists in Australia, such as meals and hotel accommodation will be taxable in the normal manner. International air and sea travel will be GST-free, as will any domestic air travel purchased overseas by non-residents. Tourists and Australian residents going overseas will be able to recover the GST they pay on goods purchased in Australia and taken away with them when they leave. Refunds will apply to purchases of at least $300 made from any one business within 28 days of departure. However, if the goods are subsequently brought back into Australia, then GST will be payable at that time."*[7]

Based on this statement, it is clear that the legislation originally intended that foreign tourists in Australia pay GST in the same way that Australian residents pay GST. The exception to this was that tourists could be provided with a GST refund on purchases over $300 (purchased from a single business) on goods that were subsequently taken away with them when they left Australia.

While the intention was for the purchases made by visitors to be subject to GST, the legislation was written in such a way that not all off-shore purchases of goods and services (to be consumed in Australia) were subject to GST. The legislation outlines how supplies that are connected with Australia should be treated in relation to GST. Specifically, under section 9-25(5) of *A New Tax System (Goods and Services Tax) Act 1999* ("the Act"), it states that "anything other than goods or real property is connected with Australia" (and therefore a taxable supply which is subject to GST) "if either:

a) the thing is done in Australia; or

b) the supplier makes the supply through an enterprise that the supplier carries on in Australia."

This definition does not capture some goods or services that are purchased off-shore and consumed in Australia. For example, if the supply of a good or service to be consumed in Australia is sold as a right or option then it is not considered to be 'connected with Australia' and therefore is not subject to GST.

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[6] A New Tax System (Goods and Services Tax) Act 1999, page 10.

[7] Circulated by The Honorable Peter Costello, M.P., Treasurer of the Commonwealth of Australia, *Tax Reform, Not a New Tax, A New Tax System*, August 1998, page 92.

Thus, under the current legislation, accommodation is the only good or service sold as part of a tour package that is subject to GST. This is because an entity selling Australian accommodation rights is supplying 'real property' that is 'connected with Australia'. As stated in Section 9-25(4) of the Act, "A supply of real property is connected with Australia if the real property, ... , is in Australia"[8]. A supply is subject to GST if it is "connected with Australia"[9]. Hence, accommodation rights are considered real property, and therefore 'connected with Australia', so they are subject to GST.

So, despite the original intention of the GST legislation, most off-shore purchases made by foreign tourists through FTOs are not currently subject to GST. To overcome this anomaly, the Government introduced the *Taxation Laws Amendment (2005 measures No.1) Bill 2005* (hereafter "the amendment") on 10 February 2005.

Under this amendment, which has been referred to a Senate Committee, all goods and services purchased from Australia and resold by FTOs are brought into the GST net (except for international airfares). The amended legislation adds to section 9-25(5) of the Act by stating that "anything other than goods or real property is connected with Australia if:

- neither a) nor b) applies;
- the thing is a right or option to acquire another thing; and
- the supply of the other thing would be connected with Australia."

This amendment has been added as part c) of section 9-25(5). Part c) applies to holiday packages for Australia that are purchased overseas. This brings into line the treatment of GST on goods and services sold by FTOs with that already applying to local tour operators. It also means that the legislation is now aligned with the original intention of the legislation in relation to foreign tourists.

2.3 How does GST apply under the Current and Amended Legislation?

As stated above, the original intention of the GST legislation in relation to foreign tourists was to apply GST on goods and services that are consumed in Australia. Australian goods and services can be purchased on-shore (in Australia) or off-shore (overseas) by visitors. As shown in the table below, all purchases made on-shore (except international airfares) are subject to GST[10] at the same rate as domestic consumers. Off-shore purchases (again, excluding international airfares) made by foreign tourists through Australian suppliers are also subject to GST at the same rate as domestic consumers.

[8] *A New Tax System (Goods and Services Tax) Act 1999*, Chapter 2, Part 2-2, Division 9, Section 9-25 (4)
[9] ibid, Division 9-5 (c)
[10] As explained above, the exception to this is that tourists could be provided with a GST refund on purchases over $300 (purchased from a single business) on goods that were subsequently taken away with them when leaving Australia.

Table 2.1
Summary of GST Application to Tourism Products Sold to Inbound Tourists

	Off-shore FTOs	Off-shore Australian suppliers	On-shore spending
Accommodation	✓(a)	✓	✓
Airfares			
- domestic (c)	X	X	X
- international	X	X	X
Other	✓(b)	✓	✓

Notes:

X - means that GST does not apply to the corresponding good or service.

✓ - means that GST does apply to the corresponding good or service.

(a) Confirmed in November 2003

(b) Under the amendments before the Senate Committee.

(c) Assumes that this is a domestic leg of an international flight. If not, then GST applies in all cases.

Under the current legislation, not all Australian goods and services purchased through FTOs are subject to GST. This is because the current legislation does not state that rights or options provided off-shore are subject to GST. Thus, under the current legislation, accommodation is the only good or service sold as part of a tour package that is subject to GST. In contrast, under the current legislation, other goods and services resold by FTOs are not considered in the same way.

The amendment adds a clause to the legislation stating that rights or options that are supplied off-shore are 'connected with Australia'. This means that, under the amended legislation, tourism goods and services would be considered 'connected with Australia' and would therefore be subject to GST. So the amendment applies GST to all goods and services (except international airfares purchased off-shore) that are purchased by a non-resident. For example, under the amended legislation, expenditure on food and drink, rental vehicles and entertainment made through FTOs would be subject to GST.

In summary, under the amended legislation 'other' purchases resold by FTOs would be subject to GST, which would bring the GST treatment of sales to foreign tourists by FTOs into line with that of sales by Australian Tour Operators.

3 General Methodology

In this study, Econtech has modelled the impact of the amendment to the legislation relating to the GST application on purchases of Australian tourism products. To model the impacts, Econtech has constructed a custom-built model to identify the change in the price of a visit to Australia that is likely to occur when moving from the current to amended legislation. In addition, Econtech has used its MM600+ model to identify the flow-through or indirect impacts on the rest of the economy. This section explains the scenarios that have been modelled (subsection 3.1) and the models used to estimate the impacts (subsection 3.2). The results, produced by the models that are explained here, are then presented in section 4.

3.1 Scenarios

To model the impacts of the amendment, Econtech has simulated two scenarios. One of these scenarios relates to the current legislation, and the other relates to the amended legislation. The modelling results from these scenarios have then been compared to assess the impact of introducing the amended legislation.

- The **Current Legislation** scenario assumes that accommodation is the only tourist good/service resold by FTOs that is subject to GST.
- The **Amended Legislation** scenario assumes that all tourist goods and services (except airfares) resold by FTOs are subject to GST at the same rate as domestic consumers.

The two scenarios are identical in their treatment of airfares and accommodation. The purchase of accommodation off-shore is subject to GST under both scenarios. The ATO has already issued rulings about GST applying to accommodation, so there is no change to the treatment of accommodation in terms of GST between the current and amended legislation. International airfares are not subject to GST, and domestic airfares are only subject to GST if purchased on-shore, or outside of a package tour from overseas.

The scenarios are different in the treatment of tourism goods and services other than accommodation and airfares purchased through FTOs. Under the current legislation scenario, items purchases through FTOs, other than accommodation and airfares, are effectively GST-free. In contrast, under the amended legislation scenario, these items are subject to GST.

3.2 Models Used To Estimate Impacts of Amendment

To model the impacts of the amended legislation, Econtech has constructed a custom-built model and fed the results from that model into an in-house model. Each of these models is explained below.

The custom-built model is used to identify the change in price of a visit to Australia that is likely to occur when moving from the current to amended legislation. The model estimates the change in the price of pre-paid Australian tourist goods and services purchased off-shore. As mentioned in Section 2, the amendment mostly affects package tours. So the custom-built model focuses on the change in the price of tour packages under the amended legislation.

Using data from a number of sources including the International Visitor Survey and the ABS Tourism Satellite Accounts, the model breaks down the total package tour fee into expenditure items, such as accommodation and airfares. Spending by international tourists with and without package tours is then aggregated by expenditure item.

The model then estimates the change in the price of goods and services purchased by foreign tourists in a visit to Australia that arises due to the amended legislation. The estimated change in price is shown in section 4.

Results from the custom-built model were then used to estimate the direct impacts of the amended legislation on the economy. To do this, the price changes estimates from the custom-built model were fed into Econtech's MM600+ model. This model then estimated the direct and flow-through or indirect impacts on the rest of the economy.

MM600+ is used to model the economy-wide and industry-wide impact of taxation reforms. Econtech's MM600+ model is a long-term computable general equilibrium (CGE) model of the Australian economy. MM600+ covers industry costs and prices as well as industry production and employment, and models market-clearing, long-term outcomes under optimising behaviour.

MM600+ distinguishes 672 products, making it six times more detailed than any comparable model. It achieves this high level of detail using unpublished input-output data obtained in an electronic format from the Australian Bureau of Statistics. So MM600+ provides highly detailed product results at the national and industry level. For more information about MM600+, see Appendix A.

The MM600+ modelling does not take into account the likely increase in tax compliance costs from the introduction of the GST on tourism products sold by FTOs. Therefore, the modelling results may be conservative.

4 Modelled Impacts of the Amendment

In this section, the impact of the amendment to the legislation has been modelled. This section begins by estimating the effects on the price of Australian holiday packages sold by FTOs to inbound tourists (subsection 4.1). It then estimates how these price effects will impact on inbound tourist numbers and expenditure by inbound tourists (subsection 4.2). Finally, the impact on relevant industries is estimated (subsection 4.3). So this section estimates the effects of the amendment on tourism prices, numbers and expenditure. In addition, there are other impacts from the amended legislation that have not been modelled. These impacts are examined outside of the modelling and are discussed in Section 5.

To analyse the impact of the amended legislation, Econtech has compared the results under an "amended legislation scenario" with a baseline scenario based on the activity under the current legislation (as discussed in Section 3).

4.1 Impact of Amended Legislation on Prices

As explained in section 3, the custom-built model estimates the change in price of a visit to Australia that is likely to occur when moving from the current to the amended legislation. The model uses expenditure data from the International Visitors Survey, as shown in Table 4.1.

Table 4.1
Expenditure by Foreign Tourists to Australia, Year ending Sept. 2004 ($m)

	Pre-paid expenditure				Spend in Australia (5)	**Total**
	On Package Tour		Not on Package Tour			
	package tours (1)	other items (2)	international airfares (3)	other items (4)		
Package tour	3,934					**3,934**
Organised tours		28		52	506	**586**
Domestic airfares		4		30	160	**194**
International airfares		0	4,781		217	**4,998**
Rental vehicles		10		48	232	**290**
Petrol and oil costs		0		0	177	**177**
Local public transport		0		0	364	**364**
Long distance transport		0		8	78	**87**
Food, drink & accomm.		5		48	489	**542**
Accommodation		8		100	1,782	**1,891**
Food and drink		0		1	2,544	**2,545**
Shopping to use in Aust		0		0	408	**408**
Shopping to take home		0		0	1,680	**1,680**
Gambling		0		0	169	**169**
Entertainment		1		6	330	**337**
Motor vehicles		0		0	266	**266**
Education		8		426	1,373	**1,807**
Phone, fax & postage		0		0	206	**207**
Other expenditure		5		22	161	**188**
Total	3,934	70	4,781	743	11,141	**20,670**

Source: International Visitor Survey data.

Table 4.1 shows the expenditure data split into the following five categories.

1. Pre-paid Package Tour expenditure.
2. Other items pre-paid in addition to the Package Tour.
3. Pre-paid International Airfares which are not part of a Package Tour.
4. Other items pre-paid by tourists who are not on a Package Tour.
5. Itemised expenditure in Australia.

Importantly, the table above shows that the total pre-paid expenditure by tourists who are on a package tour (categories 1 and 2) is less than 20 per cent of the total expenditure. As it is these categories that will incur the (10 per cent) GST under the amended legislation, this immediately limits the increase in the price of all purchases by foreign tourists (categories 1 to 5) to less than 2 per cent.

As discussed in Section 3, the first step in the modelling is to split the expenditure on pre-paid package tours (1) into the same expenditure items as recorded under the other categories (2) and (4). Econtech has examined a number of sources when undertaking this split.

- First, data from the International Visitor Survey on the proportion of pre-paid expenditure items by international tourists who are not on a package tour (categories 3 & 4) was examined. After removing items that were not generally sold as part of a package tour, this data showed that around 97 per cent of the remaining pre-paid items were airfares and accommodation;
- Second, data from the ABS Tourism Satellite Accounts[11] on average expenditure by international tourists was combined with estimates of the number of package items in each category. This showed that around 70 per cent of expenditure on items that are found in tour packages was for airfares and accommodation. However, this method is likely to understate the airfare and accommodation shares as the Tourism Satellite Accounts data incorporates all expenditure by international tourists, not just the share that is prepaid.
- Finally anecdotal evidence from travel agencies indicates that the split between air and land components of a tour package is generally around 60:40. Further, accommodation makes up most of the land component.

Taking these different sources into account, Econtech believes that the on-shore non-accommodation proportion of tour packages could be around 10 per cent. It is this 10 per cent that is assumed to be subject to GST under the amended legislation in the modelling.

[11] Table 12, *Australian National Accounts: Tourism Satellite Account*, catalogue 5249.0, Australian Bureau of Statistics, 2002–03.

The model then uses assumptions about the percentage of expenditure that is subject to GST under the current legislation and amended legislation as shown in Table 4.2.

Table 4.2
Share of Expenditure that is subject to GST

	Current legislation	Amended legislation
(1) Pre-paid Package Tour expenditure		
- Accommodation	100%	100%
- International Airfares	0%	0%
- Other	0%	100%
(2) Other pre-paid in addition to the Package Tour		
- 25% purchased through FTOs	0%	100%
- 75% purchased from Australian Suppliers	100%	100%
(3) Pre-paid International Airfares which are not part of a Package Tour	100%	100%
(4) Other items pre-paid by tourists who are not on a Package Tour	100%	100%
(5) Itemised expenditure in Australia	100%	100%

Note: Where GST applies, it is applied to individual items at the same rate as for domestic consumers

The assumptions under the current legislation are as follows.

- All items included in package tours (excluding accommodation) are bought through FTOs and treated as GST-free (category 1).
- 25 per cent of the other pre-paid items purchased in addition to the package tour are also bought through FTOs and treated as GST-free[12]. It is assumed that remaining 75 per cent are bought directly from Australian suppliers and so incur GST at the same rate as domestic consumers (category 2).
- All of the pre-paid items (excluding airfares) purchased by international tourists who are not on a package tour are bought directly from Australian suppliers, and so are subject to GST at the same rate as domestic consumers (category 4).

Under the amended legislation, it is assumed that the following applies.

- All items included in package tours (excluding airfares) are now subject to GST at the same rate as domestic consumers (category 1).
- All pre-paid items purchased by international tourists in addition to their package tour now have GST applied at the same rate as domestic consumers. That is, the 25 per cent of the other pre-paid items purchased in addition to the package tour (that are bought through FTOs) are now also subject to GST at the same rate as domestic consumers (category 2).
- All of the pre-paid items (excluding airfares) purchased by international tourists who are not on a package tour are still subject to GST at the same rate as domestic consumers (category 4).

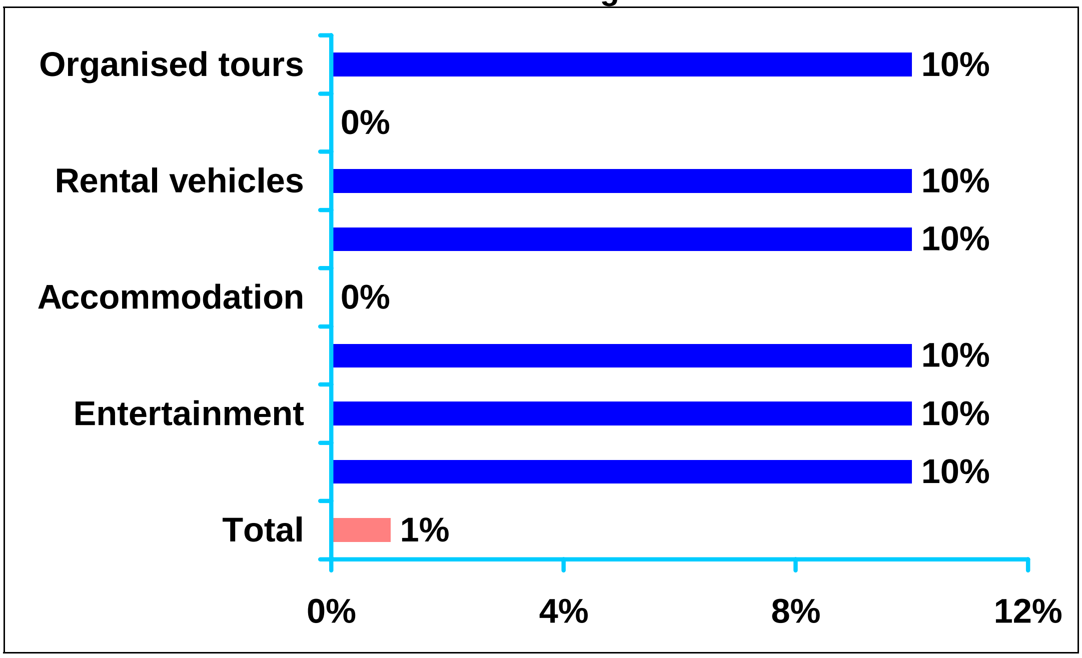
[12] This figure is a broad estimate only. It is based on discussions with the Department, who indicated that a large proportion of these pre-paid expenses are likely to have been bought directly from Australian suppliers if they were not included as part of a package. However, as these expenses are relatively small, this assumption has little impact on the overall results.

The modelling then calculates the expenditure by international visitors inclusive and exclusive of GST under the current legislation. The final step is to estimate the total expenditure under the amended legislation inclusive of GST.

i. Change in Price of Purchases made through FTOs

Chart 4.1 shows the estimated change in the price of individual expenditure items that are purchased through FTOs. As discussed above, this is assumed to include all pre-paid package tours and 25 per cent of the other pre-paid items purchased in addition to the package tours.

Chart 4.1
Change in the Price of Goods and Services Purchased through FTOs under the Amended Legislation



Source: Econtech estimates based on data from the International Visitors Survey.

Chart 4.1 shows that the overall price change for items purchased through FTOs by intending visitors to Australia is relatively small at only 1 per cent. This is because the GST treatment has not changed for the high value items that are purchased through FTOs. In particular:

- airfares are not subject to GST under both the current or amended legislation; and
- accommodation is subject to GST under both the current and amended legislation.

ii. Change in Price of All Purchases by Foreign Visitors

Table 4.3 splits the total expenditure by foreign tourists on a visit to Australia into expenditure which will only incur GST under the amended legislation (purchased through FTOs) and expenditure which was already subject to GST under the current legislation (purchased from Australian Suppliers). As discussed above, the “FTOs” group includes all expenditure on pre-paid package tours and 25 per cent of other pre-paid expenditure by tourists on package tours.

Table 4.3
Expenditure by Foreign Tourists to Australia, Year ending Sept. 2004 ($m)

	FTOs	Australian Suppliers	**Total**
Organised tours	91	579	**670**
Domestic airfares	18	193	**212**
International airfares	3,439	4,998	**8,437**
Rental vehicles	178	287	**465**
Petrol and oil costs	0	177	**177**
Local public transport	1	364	**365**
Long distance transport	40	87	**127**
Accommodation	88	2,249	**2,337**
Food and drink	69	2,725	**2,794**
Shopping to use in Aust	0	408	**408**
Shopping to take home	0	1,680	**1,680**
Gambling	0	169	**169**
Entertainment	24	337	**361**
Motor vehicles	0	266	**266**
Education	2	1,805	**1,807**
Phone, fax & postage	0	207	**207**
Other expenditure	1	187	**188**
Total	3,952	16,718	**20,670**

Source: Econtech estimates based on data from the International Visitors Survey.

Because airfares and accommodation are estimated to contribute to around 90 per cent of the 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.

Table 4.4 shows how this change in the price of purchases through FTOs flows through to a change in the total price of a visit to Australia. In particular, Table 4.4 shows the total foreign visitor expenditure inclusive of GST under the current and amended legislation.

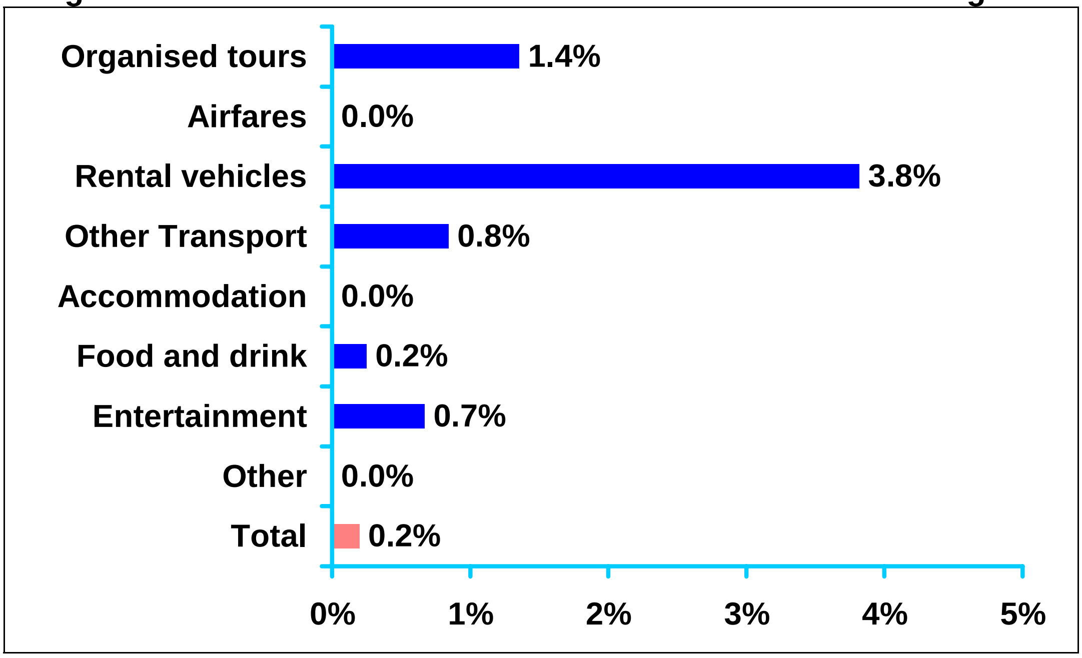
Table 4.4
Impact of the GST on Total Foreign Tourist Expenditure under the Current and Amended Legislation, Year ending Sept. 2004 ($m)

	Cost incl. GST - Current	Cost incl. GST - Amended	Change
Organised tours	670	679	1.35%
Domestic airfares	212	212	0.00%
International airfares	8,437	8,437	0.00%
Rental vehicles	465	482	3.82%
Petrol and oil costs	177	177	0.00%
Local public transport	365	365	0.03%
Long distance transport	127	131	3.18%
Accommodation	2,337	2,337	0.00%
Food and drink	2,794	2,801	0.25%
Shopping to use in Aust	408	408	0.00%
Shopping to take home	1,680	1,680	0.00%
Gambling	169	169	0.00%
Entertainment	361	364	0.67%
Motor vehicles	266	266	0.00%
Education	1,807	1,807	0.00%
Phone, fax & postage	207	207	0.00%
Other expenditure	188	188	0.06%
Total	20,670	20,710	0.20%

Source: Econtech estimates based on data from the International Visitors Survey.

The table above shows that, if the impact on the price of purchases made through FTOs is combined with the (unchanged) price of other tourist goods and services purchased by foreign visitors to Australia, the price of all goods and services purchased by foreign visitors is estimated to rise by 0.2 per cent. This is further illustrated in Chart 4.2, which summarises the estimated change in price of a range of tourism goods and services.

Chart 4.2
Change in the Price of a Visit to Australia under the Amended Legislation



Source: Econtech estimates based on data from the International Visitors Survey.

Chart 4.2 shows that the amended legislation is not expected to directly affect the price of either Air Transport Services or Accommodation. Rather, it focuses on the GST treatment of other items sold by FTOs to intending visitors to Australia.

The overall impact of the amended legislation on the price of other items purchased by foreign tourists varies significantly. This is because the overall price change is being driven largely by applying GST to items purchased as part of a packaged tour. If the total foreign tourist expenditure on an item is predominately made through FTOs, then the price impact will be larger than if the expenditure is predominately made through Australian Suppliers. This is simply because GST is already applied to items in the latter two categories, but not on the former category (pre-paid package tours).

For example, Chart 4.2 shows that rental vehicle prices incur the largest overall price rise, while food and drink prices show one of the smallest impacts. These impacts are driven by each item's share of total foreign tourist expenditure.

- Pre-paid rental vehicle expenditure through FTOs is estimated to be around 38 per cent of total foreign tourist expenditure on rental vehicles in Australia. Adding a 10 per cent GST to this 10 per cent share means that the average price of rental vehicles to foreign tourists rises by around 3.8 per cent.
- On the other hand, pre-paid expenditure of food and drink through FTOs is estimated to be only about 2 per cent of total foreign tourist expenditure on food and drink in Australia. Adding a 10 per cent GST to this 2 per cent share means that the average price of food and drink to foreign tourists rises by only 0.2 per cent.

Overall, because airfares and accommodation are estimated to contribute to around 90 per cent of the total expenditure 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, because purchases made through FTOs contribute to less than 20 per cent of the total expenditure by foreign tourists (80 per cent is made directly with ITOs or on-shore), this further dilutes the impact of the amended legislation on the price of a visit to Australia from 1 per cent to 0.2 per cent.

4.2 Impact on Inbound Tourist Numbers and Expenditure

The previous subsection showed that the amended legislation is estimated to raise the price of purchases made through FTOs by around 1 per cent. This, in turn, is expected to flow through to an overall increase in the price of a visit to Australia of 0.2 per cent.

As discussed in Section 3, the direct price impacts (estimated above) were fed into Econtech's MM600+ model. This model then estimated the direct and flow-through (or indirect impacts) on the rest of the economy. This subsection presents the results from MM600+. In particular, it shows the estimated impact that the price rise will have on travel exports, inbound tourist numbers, real tourist expenditure and the economy.

Increasing the price of package tours is expected to lead to a modest reduction in demand for package tours. The figure below shows how the price impacts flow through MM600+ to estimate a reduction in tourism export demand.

Figure 4.1
Calculation of Tourist Impacts

Change in price of tourist exports ($A) = 0.2%

Depreciation of $A = 0.02%

Change in price of tourist exports ($F) = 0.18%

Elasticity of tourist exports = -4

Change in volume of Total Tourist Exports = 0.18% x -4 = -0.73%

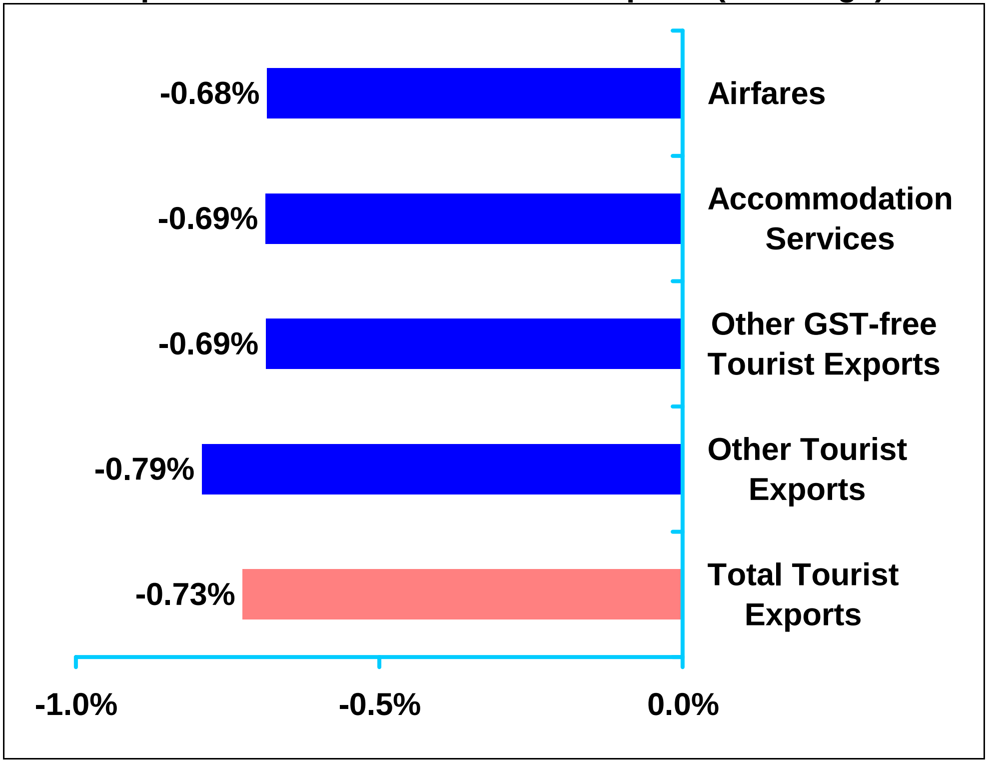
Note: Numbers may not exactly add up due to rounding.

The 0.2 per cent increase in the price (in Australian dollars) of tourism goods and services (exports) leads to a slight depreciation in the Australian dollar (estimated at 0.02 per cent). With a slightly weaker Australian dollar, this means that the increase in the price of tourist exports in foreign currency is slightly less than in Australian dollars, at approximately 0.18 per cent.

MM600+ estimates that the elasticity of tourist exports is around -4. This means a 1 per cent increase in the price of these exports leading to a 4 per cent reduction in demand. Thus, the 0.2 per cent increase in the price of tourist exports (in Australian dollars) is expected to lead to a 0.73 per cent fall in the volume of tourist exports.

Chart 4.3 shows how the increase in prices to foreign tourists is expected to impact on a range of travel exports.

Chart 4.3
Impact on the Volume of Travel Exports (% change)



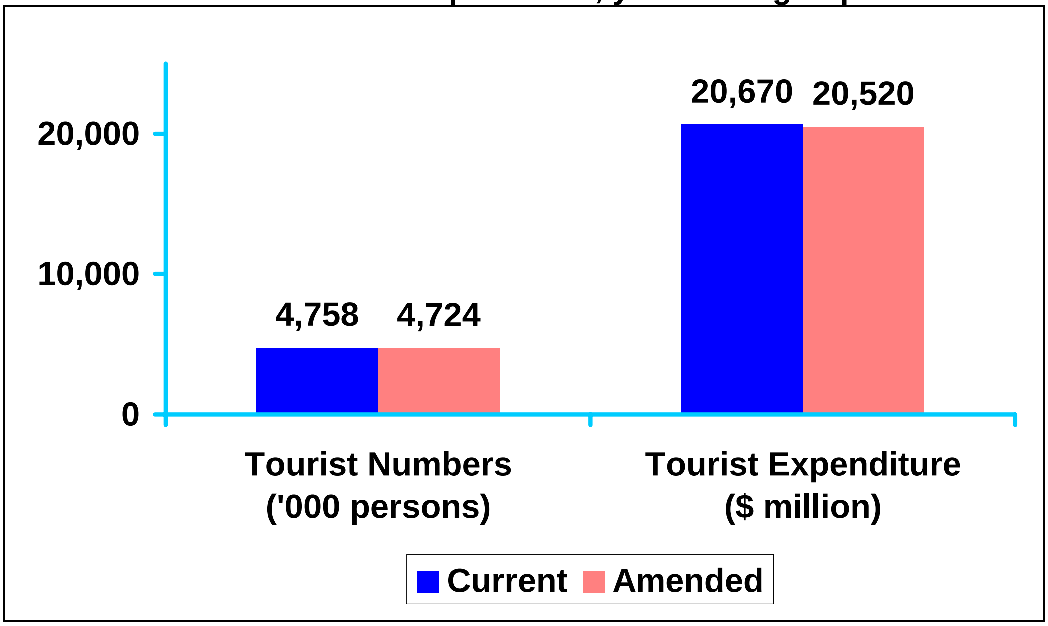
Source: Econtech MM600+ modelling based on data from the International Visitors Survey.

As discussed above, by increasing the cost of pre-paid package tours, this is expected to reduce the volume of travel exports by around 0.73 per cent. While this will generally lead to a similar fall in demand across the range of tourist items, there will be some switching between purchasing different items. Chart 4.3 shows that there is a slightly higher reduction (0.79 per cent) in the volume of items that are now subject to GST (Other Tourist Exports). In contrast, there is a slightly lower reduction in the items where the GST treatment has not changed (Airfares, Accommodation and Other GST-free Tourist Exports).

Overall, the volume of tourist exports is estimated to fall by 0.73 per cent due to the amended legislation.

The results from MM600+ can also be used to estimate the change in tourist numbers and real expenditure. Chart 4.4 shows the actual number of tourists and expenditure for the year ending September 2004 (current legislation) and how these figures are likely to have varied if the amended legislation had been in place over the same period.

Chart 4.4
Tourist Numbers and Real Expenditure, year ending September 2004



Sources: current data from the International Visitors Survey, amended estimates from Econtech's MM600+ model.

The number of inbound tourists and spending by foreign tourists is estimated to fall slightly under the amended legislation. Chart 4.4 shows that the number of inbound tourists is estimated to fall from 4,758,000 to 4,724,000. This represents a reduction of around 35,000[13] tourists per year, or 0.7 per cent. The chart also shows that real expenditure by foreign tourists in Australia is expected to decline by $150 million per year.

The loss in travel exports flows through to modest losses in production for some industries and modest gains in other industries. In particular, the reduction in tourist numbers and expenditure flows through to the tourism related industries including the Accommodation,

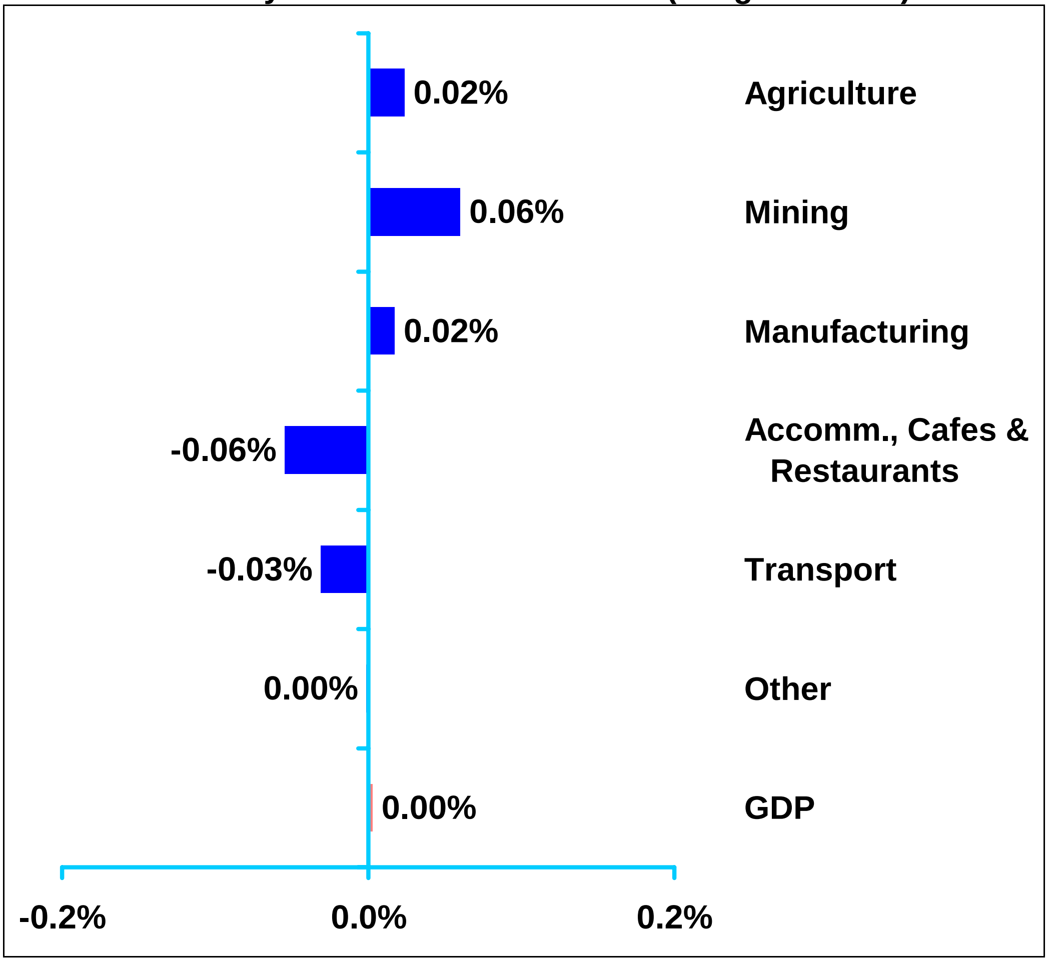
[13] This figure may not appear to sum due to rounding in total tourist numbers under the current and amended legislation.

Cafes and Restaurants industry and the Transport industry. In these industries, annual production is 0.06 per cent and 0.03 per cent lower, respectively, than under the current legislation (see Chart 4.5 on the following page).

The decrease in the volume of exports also leads to a modest depreciation in the Australian dollar. This, in turn, results in marginal production gains in trade-exposed industries, notably Agriculture, Mining and Manufacturing.

Thus, while there is a fall in the production of industries that provide goods and services to foreign tourists (such as the Accommodation, Cafes and Restaurants industry), this is offset by an increase in production in trade-exposed industries (such as Agriculture, Mining and Manufacturing).

Chart 4.5
Economy-wide Production Effects (1-digit ANZSIC)



Source: Econtech MM600+ modelling based on data from the International Visitors Survey.

5 Non-Modelled Impacts of Amendment

The previous sections analysed the impact of the amended legislation on prices, inbound tourism numbers and the economy. This section discusses the impact of the amended legislation on items that have not been modelled. Specifically, the impact of complying with the amended legislation (section 6.1) and the practical implications on distribution channels (section 6.2) is discussed.

5.1 Compliance with the Current and Amended Legislation

With the introduction of any new legislation, there are often concerns at the possible cost and complexities incurred by companies complying with the new legislation. The amended legislation is no exception.

Deloitte Touche Tohmatsu ("Deloitte") has raised several concerns relating to compliance under the amended legislation[14]. In its letter of 14 February, Deloitte raised three issues in relation to the amendment:

- there is no transition period;
- FTOs may be unable to alter prices to recover their tax liability in the short term; and
- the GST applied to package tours is likely to be different for different packages.

Deloitte is concerned that there is no transition period to enable FTOs to adjust their prices to account for the change in taxation. This is because the price of most tour packages is set for one year. So for some FTOs, they will not be able to pass the GST on to customers. Another of Deloitte's concerns is that FTOs may be unable to recover their tax liability in the period between the "Bill being introduced and receiving Royal assent" because they can not alter prices in this period. Deloitte also points out that the GST applied to package tours is likely to be different for different packages and tourists, depending on what is included in the package. Furthermore, foreign exchange rates change every day and will therefore alter the amount of GST payable in foreign currency terms.

The Australian Tourism Export Council (ATEC) is also concerned about the amended legislation. In terms of compliance, ATEC estimates that "depending on the size of the business, [the compliance burden to business] could amount to an extra 0.5% of the cost of tourism packages sold off-shore"[15]. ATEC also point out that there will be a cost to the taxpayer associated with enforcing the amended legislation.

These concerns need to be examined in light of both the existing compliance issues under the current legislation and any likely additional compliance issues under the amended legislation. To examine these issues, we will first step through some of issues under the current legislation and discuss whether these issues are likely to continue or if additional issues are likely to arise under the amended legislation.

[14] Deloitte Touche Tohmatsu, letter to The Honorable Fran Bailey, M.P., 14 February 2005.
[15] Australian Tourism Export Council, *The Impact on Australian Tourism Exports of the Application of GST on Foreign Tour Operators,* Interim Submission to the Australian Parliament, March 2005, page 5.

Under the current legislation, before November 2003, FTOs claimed GST input tax credits on all items including accommodation. In addition, they did not have any 'output tax liability'. In other words, they did not have to charge GST on any products that they sold to foreign visitors.

From November 2003, an interpretative decision by the ATO stated that accommodation rights supplied by non-resident tour operators were subject to GST[16]. FTOs were still able to claim GST input tax credits on all items. The GST payable on accommodation was calculated as follows.

accommodation proportion of tour package x value of tour package[17]

There were two difficulties with this approach.

- First, while the 'accommodation proportion of tour packages' component was generally in Australian dollars, the 'value of total package' component was made up of items costed in Australian and foreign currency. Given that exchange rates change daily, the GST payable also changed daily. This made it difficult to calculate the GST payable.
- Second, the overall cost of tour packages depend on a range of factors. In particular, the accommodation component differs depending on whether the tourist is sharing accommodation with a partner. If so, the accommodation cost is likely to be less than for a tourist who is travelling alone.

These differentials mean that calculating GST payable on tour packages varies considerably. It must be calculated separately for each tourist.

On 10 February 2005, an amendment to the NTS legislation was introduced. While this legislation has not been passed by the Senate, it has been passed through the House of Representatives. Under the amendment, FTOs have an 'output tax liability' on most tourist products purchased by foreign tourists. The main exception is for domestic and international airfares (purchased off-shore). These airfares are to remain GST-free, in line with the treatment of off-shore travel for Australians.

FTOs are still able to claim GST input tax credits on all taxable items. The GST payable is calculated as follows.

Taxable proportion of Tour Package x value of tour package[18]

The 'taxable proportion of tour package' excludes the cost of airfares and other items that are GST-free to Australian residents. The difficulty of compliance in terms of exchange rate movement remains under the amended legislation. The difficulty in terms of estimating the taxable proportion of the tour package is increased under the amended legislation. The taxable proportion was isolated to accommodation costs under the current legislation, but it has now expanded to a wider range of items under the amendment.

[16] ATO, ATO Interpretative Decision, GST and Supply of Accommodation Rights by a Non-Resident Tour Operator, 13 November 2003.
[17] *A New Tax System (Goods and Services Tax) Act 1999*, Chapter 4, Part 4-2, Division 96, Section 96-10 (1)
[18] ibid

These compliance issues face FTOs who resell Australian package tours. As this report is concerned with any additional compliance costs associated with the amended legislation, we must now try to isolate the additional costs/savings under the amended legislation, compared to the current legislation.

FTOs that currently claim input tax credits and remit GST on accommodation would already be registered for GST and be submitting BAS statements. So, Econtech does not envisage any significant additional cost under the amended legislation, in terms of FTOs registering for GST.

However, as discussed above, there may be additional costs associated with the estimation of the taxable proportion of tour packages. 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 tourist purchases 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.

As part of this project, it was not possible to model or accurately quantify the compliance costs associated with the changes. However, as a guide, at the time of the introduction of the GST the ACCC generally allowed businesses to pass on compliance costs of around 0.1 per cent in their prices. All GST registered businesses in Australia with taxable supplies must collect GST on those taxable supplies and claim a credit for any GST that they pay on inputs. They do this by regularly submitting a BAS statement.

Under the current legislation, FTOs are only required to collect GST on the accommodation component of tour packages, so their GST compliance costs would be less than for the typical Australian business. However, under the amended Australian GST legislation, the supply of all on-shore components of tour packages by FTOs will become taxable. As a result, FTOs will have to undertake a similar level of administration tasks as GST registered Australian businesses. Thus, the GST compliance cost incurred by FTOs is expected to rise slightly under the amended legislation.

In contrast, other GST/VAT countries do not require FTOs to register for GST/VAT. This is because they treat tour packages sold by FTOs as input-tax supplies (see Section 6 for more information). This means that the FTOs are not required to collect and remit GST/VAT but are also not allowed to claim any input tax credits on their purchase of tour packages.

5.2 Distribution Channels

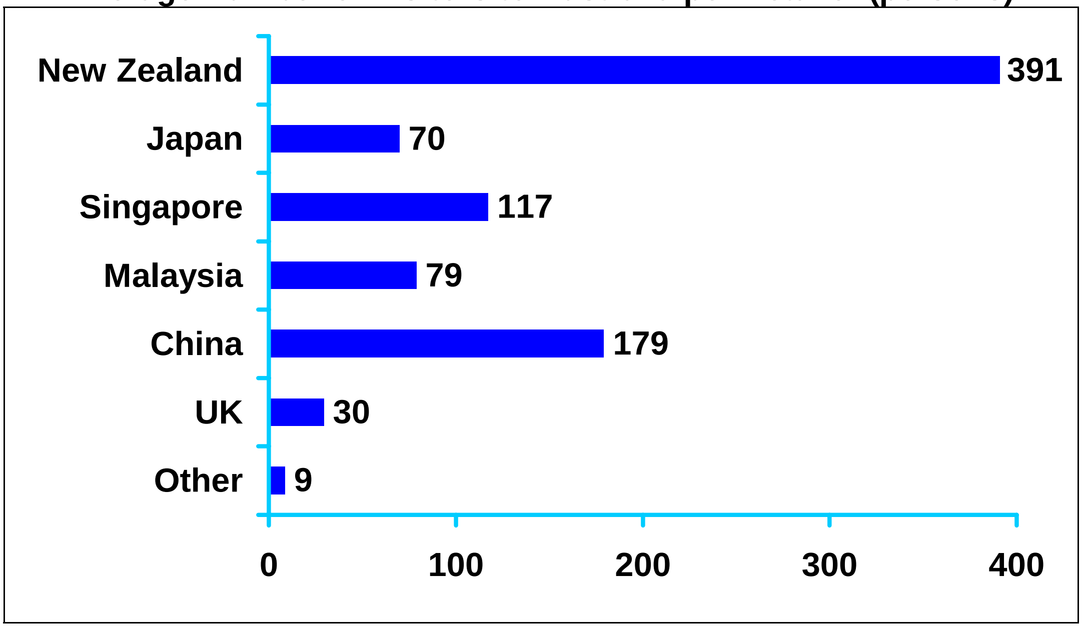
Australian holiday packages are sold to foreign tourists by online operators (i.e. through the internet) or retail travel agents. Retail travel agents purchase Australian holiday packages directly from ITOs, or from FTOs that have purchased the packages from an ITO. This subsection analyses the impact of the amended legislation on the distribution channel of Australia holiday packages.

Some retail travel agents in foreign countries specialise in selling Australian tourist goods and services. These are referred to as ‘Australia specialists’. The Department advises that 60-80 per cent of business conducted by Australia specialists involves selling travel to Australia. Another group of retail travel agents are Tourism Australia trained ‘Aussie specialists’, who also sell Australian tourism products. However, there is no data available on the extent of Australian sales by this group of specialists.

In this analysis, visitor numbers have been assessed against the number of retail travel agents in different countries. The charts below show the average number of inbound visitors to Australia per retail travel agent in the corresponding country.

Chart 5.1 shows that the number of visitors from New Zealand (per retail travel agent) is higher than other countries. However, tourists that visit Australia from countries that are geographically close to Australia (“short-haul”) are less likely to purchase holiday packages through travel agents. Discussions with Tourism Research Australia revealed that a large proportion of tourists from short-haul countries travelled to Australia repeatedly. This means that they are less likely to require the assistance of a travel agent when booking their holiday. For example, Tourism Research Australia estimates that 94 per cent of travel by New Zealanders to Australia is repeat travel. So the numbers presented in Chart 5.1 are not representative of the average number of visitors that book through a travel agent.

Chart 5.1
Average Number of Visitors to Australia per Retailer (persons)

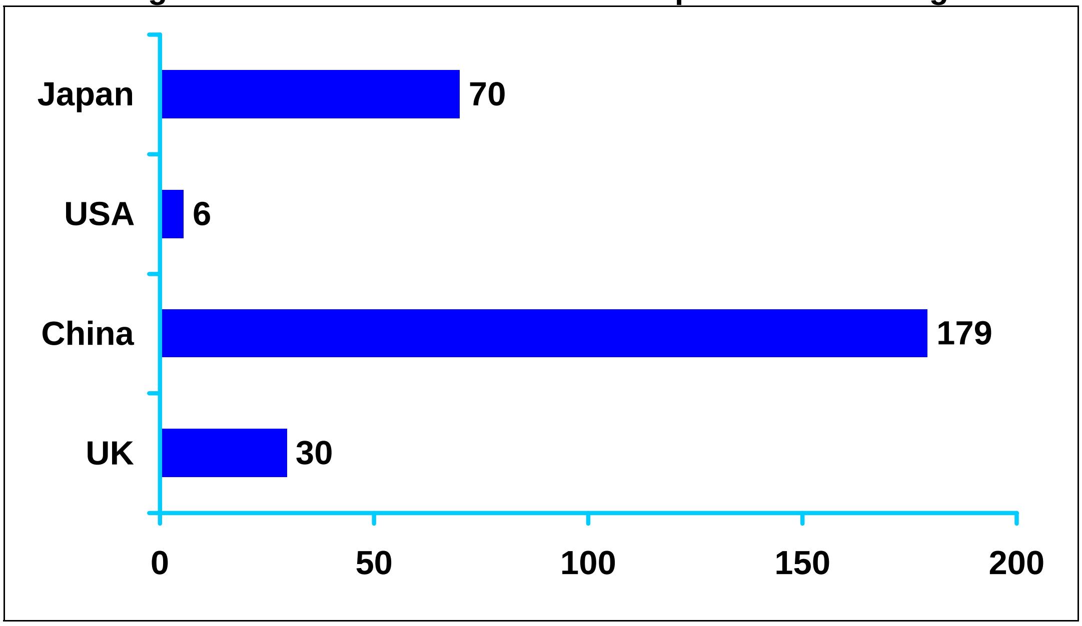


Source: Econtech estimates based on data provided by Tourism Research Australia.

To get a better idea of the number of visitors that book through a travel agent, the average visitor numbers from some of the countries that are not geographically close to Australia ("long-haul") are presented in Chart 5.2.

Tourists travelling from countries that require long-haul travel, such as the USA, UK, China or Japan, are more likely to use a travel agent to book holidays to Australia, compared to tourists travelling from countries closer to Australia (such as New Zealand). Chart 5.2 presents the average number of visitors to Australia from long-haul countries. This chart shows that the average number of tourists from China is significantly higher than other long-haul countries.

Chart 5.2
Average Number of Visitors to Australia per Retailer: Long haul



Source: Econtech estimates based on data provided by Tourism Research Australia.

As mentioned above, tourists from these long-haul countries are more likely to involve a travel agent to book their Australian holidays. Therefore, it is likely that the impact of the amended legislation would be stronger in these markets. For example, retail travel agents in China that sell Australian holiday packages are more likely to incur additional administration costs due to the high volume of tourists that use their services for holidays in Australia. By comparison, travel agents in New Zealand may be less affected by the amendment because less New Zealand tourists book Australian holidays through travel agents.

Importantly, the analysis above should be examined in line with the estimated change in tourist numbers. This will then keep the overall impacts on the distribution channels in perspective. Section 4 showed an estimated fall in international visitors of around 35,000 persons or 0.73 per cent. If it is assumed that the fall in visitors is confined to our four long-haul countries shown in Chart 5.2, this equates to a modest 3.4 per cent fall in visitors from these countries.

Chart 5.2 can also be used to compare markets across the different long-haul countries. This chart shows that there are significant differences in the levels of competition for tourist services across the long-haul markets. For example, while there are slightly more visitors to Australia from the USA and UK markets compared to China, there are also a lot more retailers servicing these markets. Thus, individual retailers in the USA and UK service fewer tourists, on average, than individual retailers in China. Retailers in less competitive markets, such as China (reflected in a larger number of tourists per retailer), may be able to absorb some of the demand/price impacts better than those in the more highly competitive markets, such as the USA and UK.

Finally, we can also examine the likely impact on retailers in Australia retailers compared to FTOs. Under the current legislation, Australian tour operators charge GST on holiday packages and then remit this tax to the ATO. In contrast, while FTOs can claim input tax credits for the GST they pay on Australian holiday packages, they are not required to charge GST when they resell these holiday packages to foreign tourists. So if an Australian tour operator and an FTO are selling the same tour package for the same GST exclusive price, the package sold by the FTO is cheaper to foreign tourists. This is because the FTO does not have to add GST to the price, while the Australian tour operator does. Thus, it is likely that foreign tourists are more attracted to purchasing Australian holiday packages from FTOs than Australian tour operators.

Table 5.1
Claiming and Remitting GST under the Current and Amended Legislation.

	Claim input tax credits	Remit GST
Australian Tour Operator		
- current	✓	✓
- amended	✓	✓
Foreign Tour Operator		
- current	✓	X
- amended	✓	✓

source: Econtech

Under the amended legislation, this competitive advantage will disappear. As shown in Table 5.1, under the amended legislation, FTOs will now be required to collect and remit GST. So Australian tour operators and FTOs will both claim input tax credits and remit GST. Prior to any price mark-ups, the price of tour packages sold by Australian tour operators and FTOs will be the same.

6 International Comparison of GST

In this section, the different tax treatments (GST/VAT) of tour packages resold by FTOs in three other countries are presented. The GST treatments applied in these countries are then compared to Australia.

Before examining the tax applied on a country by country basis, it is important to first define the three alternative GST treatments.

- Taxable – GST/VAT is payable and the supplier is entitled to input tax credits for inputs relating to the supply.
- GST/VAT-free – no GST/VAT is payable but the supplier is entitled to input tax credits for inputs relating to the supply.
- Input-taxed – no GST/VAT is payable and the supplier is not entitled to input tax credits for inputs relating to the supply.

Under the current legislation, elements of Australian tour packages (excluding accommodation) are effectively GST-free. That is, FTOs have been claiming input tax credits relating to the supply of the tour components, but have not been charging GST on the components when reselling the package to the foreign visitors (with the exception of the accommodation component).

Under the amended GST legislation, the components of Australian tour packages will become taxable. That is, the FTO will still be able to claim input tax credits relating to the supply of the tour components, but will now be required to charge GST on the components when reselling the package to the foreign visitors (with the exception of airfares).

6.1 Canada

Under Canadian tax law, most goods and services supplied in Canada (except in Nova Scotia, New Brunswick, and Newfoundland and Labrador) incur a 7 per cent GST. Similar to Australia, visitors to Canada are required to pay GST on taxable goods and services consumed in Canada. However, foreign visitors may be eligible for a refund of the GST paid on some items.

Foreign visitors can generally claim a refund of the GST paid on goods that are taken home. In contrast, any goods that are consumed or left in Canada will generally not qualify for a refund. For example, there is no refund on items such as entertainment, meals, transport services, cruise ship cabins or train berths.

However, there is one major exception to this general rule. Visitors and unregistered FTOs[19] may be eligible for a rebate for the GST paid on short-term accommodation, as defined under s 252.1 of the *Excise Tax Act* (ETA).

[19] FTOs are not required to register for GST if they are simply reselling Canadian tour packages to foreign visitors (and are, hence, not considered to be carrying on business in Canada).

Unregistered FTOs are initially charged GST when purchasing short-term accommodation or tour packages which include short-term accommodation. These FTOs may then recover the tax paid if they meet the criteria outlined in s 252.1(3) of the ETA.

(a) *a particular non-resident person who is not registered under Subdivision d of Division V is the recipient of a supply of short-term accommodation, camping accommodation or a tour package that includes short-term accommodation or camping accommodation,*

(b) *the accommodation or tour package is acquired by the person for supply in the ordinary course of a business of the person of making such supplies,*

(c) *a supply of the accommodation or tour package is made to another non-resident person and payment of the consideration for that supply is made at a place outside Canada at which the supplier, or an agent of the supplier, is conducting business, and*

(d) *the accommodation is made available to a non-resident individual.*

While it is simple to distinguish the GST attributed to purchases of accommodation only, it is not so easy to separate out GST on accommodation when it is provided as part of a tour package. Tour packages usually combine short-term accommodation with other services (such as meals, transportation and sightseeing) into one all-inclusive price.

The Canadian ETA recognises that it may be difficult to determine the exact amount of the total tour package price that is attributed to accommodation. As such, the legislation provides a simple method to estimate the amount of GST available for refund under s 252.1(5)(b).

- If a tour package includes short-term accommodation for every night of the tour runs, then the visitor/FTO can usually claim one half of the full amount of GST paid for the tour package.
- However, if the tour package does not include eligible short-term accommodation in Canada for every night of the package, then the refund must be adjusted. For example, if only four nights of eligible accommodation are provided in a five nights in Canada tour package, the refund would be 4/5 of the one half of the tax paid.

In many cases, the visitor/FTO may have already been credited the tax refund as part of the total price paid for the tour package. This means that the visitor/FTO will not need to separately apply for the GST rebate.

While the Canadian system is designed so that foreign visitors effectively pay GST on most tour package components, this is not implemented through the FTO collecting and remitting GST.

Under the Canadian system, the sale to the FTO is treated as an input-taxed supply. This means that GST is incorporated in the price when the tour package is sold to the FTO, but can not be claimed back by the FTO. Thus the GST would be subsequently passed on to the foreign visitor as part of the overall tour price.

Under this system, the FTO would not need to be registered as they would not be collecting or remitting GST to Canada. However, the Canadian Government would still be receiving GST on the transaction, but at the point of sale between the residential supplier and the FTO.

6.2 New Zealand

Most goods and services supplied in New Zealand incur a 12.5 per cent GST. Similar to Australia, the policy intent of the New Zealand GST is to tax domestic consumption of services, regardless of whether a resident or non-resident has purchased them.

In 1998/99 the New Zealand Government undertook a tax policy review of the Goods and Services Tax Act 1985 ("the NZ GST Act"). This review culminated in the release of the document *GST: A Review*, which outlined proposals for changes resulting from the review.

One of the proposals was that the NZ GST Act should be amended to ensure that GST is also charged on the supply of services that are physically performed in New Zealand but are purchased by a non-resident while off-shore. For example, this type of purchase relates to pre-paid New Zealand tour packages by non-resident tourists.

The Inland Revenue GST Guide[20] explains that

> *Services performed under contract to a non resident who is outside New Zealand, but provided to a third party that is in New Zealand, are not eligible for zero rating.*

This means that if an FTO purchases accommodation in New Zealand and then resells this accommodation as part of a travel packages, then the supply of accommodation is not eligible for zero-rating (and, consequently, incurs GST). This is because it is reasonably foreseeable that another person will receive the services in New Zealand.

In a commentary on the Taxation (Annual Rates and Remedial Matters) Bill[21], the New Zealand Minister of Finance/Minister of Revenue provided the following example.

> *A non-resident tour operator pre-purchases accommodation and transport in New Zealand from New Zealand suppliers and sells travel packages for tours of New Zealand to non-residents using this accommodation and transport. The New Zealand suppliers would charge GST at 12.5 percent on the supplies of accommodation and transport made to the non-resident tour operator, as those services will be consumed in New Zealand by the non-resident tourists.*

This means that, under the New Zealand GST legislation, the on-shore components of package tours are subject to GST.

However, similar to the Canadian system, the New Zealand system does not require the FTOs to collect and remit GST. This is because the sale to the FTO is treated as an input-taxed supply. This means that GST is incorporated in the price when the tour package is sold to the FTO, but can not be claimed back by the FTO. Thus the GST is collected at the point of sale between the residential supplier and the FTO. The GST would be subsequently passed on to the foreign visitor by the FTO as part of the overall tour price.

[20] *GST Guide – A guide to working with GST*, Inland Revenue Tee Tari Taake, IR 375, March 2002, p39. (http://www.ird.govt.nz/resources/file/eb37c801b2852ed/ir375.pdf)
[21] *Taxation (Annual Rates and Remedial Matters) Bill – Commentary on the Bill,* Hon Bill English, Minister of Finance/Minister of Revenue, p17. (http://www.taxpolicy.ird.govt.nz/publications/files/tararcpf.pdf)

6.3 European Countries

The European Economic Community introduced a value-added tax (VAT) to replace a variety of production and consumption taxes which had previously been applied by members of the European Community ("EC Member States"). Similar to a GST, a VAT is a consumption tax. The rate at which the VAT is applied varies across the EC Member States, as shown in the table below.

Table 6.1
VAT Rates for the Member States as at September 2004

Member States	Code	Super Reduced Rate	Reduced Rate	Standard Rate	Parking Rate
Belgium	BE	-	6	21	12
Czech Republic	CZ	-	5	19	-
Denmark	DK	-	-	25	-
Germany	DE	-	7	16	-
Estonia	EE	-	5	18	-
Greece	EL	4	8	18	-
Spain	ES	4	7	16	-
France	FR	2.1	5.5	19.6	-
Ireland	IE	4.4	13.5	21	13.5
Italy	IT	4	10	20	
Cyprus	CY	-	5	15	-
Latvia	LV	-	5	18	-
Lithuania	LT	-	5/9	18	-
Luxembourg	LU	3	6	15	12
Hungary	HU	-	5 / 15	25	-
Malta	MT	-	5	18	-
Netherlands	NL	-	6	19	-
Austria	AT	-	10	20	12
Poland	PL	3	7	22	-
Portugal	PT	-	5 / 12	19	-
Slovenia	SI	-	8.5	20	-
Slovakia	SK	-	-	19	-
Finland	FI	-	8 / 17	22	-
Sweden	SE	-	6 / 12	25	-
United Kingdom	UK	-	5	17.5	-

Source: VAT Rates Applied in the Member States of the European Community, European Commission Directorate-General Taxation and Customs Union Tax Policy, DOC/2008/2004 – EN, September 2004.

The main VAT legislation (the Sixth VAT Directive, 1977) contained special rules for applying VAT to travel agents and tour operators. These special rules were designed to simplify the VAT collection processes for travel agents who sold tour packages that spanned a number of different EC Member States.

Without these special rules, an EC travel agent who put together a package of tour services from various EC Member States would need to register in each EC Member State to claim back the VAT paid on each service included in the package. The travel agent would then charge VAT on the full price of the package including their margin.

However, this process is simplified under the special rules contained in the 1977 legislation. These special rules include the introduction of the Tour Operator Margin Scheme (TOMS). The TOMS effectively treats the purchase of services that are combined into a tour package as one Input-Taxed supply.

- This means that the travel agent pays VAT to each EC Member State for the services that are provided in that Member State.
- The travel agent can not claim back this VAT, but is also not required to charge VAT on the cost of the package.
- But, in contrast to normal input-taxed supplies, the travel agent is required to charge and remit VAT on their margin (the difference between the cost of the package and the price the agent sells the package for).

In terms of sales of package tours to EC residents, there is concern that the TOMS distorts competition between EC tour operators and operators outside of the EC. "Under these circumstances, the Commission proposes that tour operators established outside the EC should also be VAT registered when selling package tours to those established in the EC and that they pay the tax in the EC Member State where the customer is established."[22]

TOMS does not apply to supplies made to business customers for subsequent resale by them (that is, wholesale supplies).

This section is designed to provide a brief analysis of the VAT treatment in European countries. However, there is limited information available on the general treatment of sales of EC package tours to FTOs for resale to foreign tourists. But, taking the UK as an example, HM Customs and Excise explains that non-EC businesses can not claim a refund on "goods and services, such as hotel accommodation, you have bought for resale which are for the direct benefit of travellers"[23].

As such, it appears that the treatment of European tour packages bought by FTOs and resold to foreign tourists is similar to the treatment in Canada and New Zealand. That is, FTOs are charged VAT on their purchases and are unable to claim this back. This falls again into the category of an Input-Taxed supply.

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[22] http://europa.eu.int/scadplus/leg/en/lvb/l31051.htm

[23] *Refunds of VAT in the EC for EC and non-EC businesses*, HMCE Reference:Notice 723 (June 2003), http://www.hmce.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_InfoGuides&propertyType=document&id=HMCE_CL_000860#P11_702

6.4 Comparison with Australia

The table below summarises the different consumption tax treatments (GST/VAT) of on-shore consumption of tour package components for New Zealand, Canada and the UK. It then compares these different treatments to the GST treatment in Australia under the current and amended legislation.

As can be seen in Table 6.1, all four countries apply a consumption tax to the on-shore consumption of non-accommodation package components. That is, items such as entertainment, meals and transport services all incur GST/VAT in all four countries.

Australia, New Zealand and the UK also apply a consumption tax to accommodation services purchased as part of a pre-paid tour package. In contrast, Canada provides a rebate for GST paid on eligible short-term accommodation services.

Table 6.1
GST/VAT Treatment of Pre-paid Package Tours – Comparison with Australia

	Canada	New Zealand	UK	Australia (a)	Australia (b)
Accommodation	GST-free	Input-taxed	Input-taxed	Taxable	Taxable
Other on-shore consumption	Input-taxed	Input-taxed	Input-taxed	GST-free	Taxable

Notes:

(a) Treatment under the current legislation

(b) Treatment under the amended legislation.

However, while all four countries apply a consumption tax to many of the components of tour packages, the method by which they apply the tax differs.

- Under the amended legislation, Australia classes the sale of the on-shore components of a tour package to FTOs as a taxable supply. As such, FTOs are required to register for GST. Once registered, they must charge GST on the sale of the on-shore components of tour packages to foreign visitors and may claim any GST that they pay as input tax credits.
- In contrast, the Canadian, New Zealand and UK systems treat the sale of tour packages to FTOs as an input-taxed supply. As such, the residential supplier charges GST/VAT on the sale of tour packages to FTOs. The FTOs are not required to charge GST/VAT on the subsequent sale of the tour package to the foreign visitor, but are also not eligible to claim input tax credits on the GST/VAT that they pay on the purchase of the tour package. This treatment also seems to be the common practice across other GST/VAT countries.

The differences in the two tax treatments (input-taxed vs. taxable) lead to differences in the cost of compliance and in the amount of tax collected.

- Where FTO's are required to register for GST by a particular country (such as Australia), the compliance costs of selling visits to that particular country will be higher than for visits to other countries who do not require FTOs to register because they purchase tour packages as an input-taxed supply (such as Canada, New Zealand and the UK).
- Further, while both systems apply GST/VAT to the wholesale price of the tour package, the Australian system differs by also applying GST to the mark-up added by FTOs. Econtech has been unable to find any other example where a destination country attempts to apply a GST/VAT to a foreign tour operator's mark-up.

Appendix A – MM600+ Model Description

MM600+ is a long-term CGE model of the Australian economy that models a long-run equilibrium. MM600+ provides a detailed snapshot of activity in the Australian economy at a point in time. The model is based on a very detailed picture of the industrial structure of the economy that can only be found in the IO tables published by the ABS.

In this report, the impact of the amendment under *A New Tax System (Goods and Services Tax) Act 1999* has been simulated using MM600+.

MM600+ has important features that make it well suited for the analysis in this report:

- it is highly detailed, distinguishing 672 products that are produced by 108 industries. This makes it six times more detailed than any comparable model;
- for each of the 672 products, it produces comprehensive results including for production, employment, consumption, trade flows and prices;
- it also estimates the effects on key macroeconomic aggregates such as consumer prices, the exchange rate, GDP and annual consumer living standards;
- it fully incorporates the New Tax System (NTS), including modelling the GST treatment of each of its 672 products, and 24 other indirect taxes;
- it also includes an tariff for each of the 672 products, which enables the economy-wide effects of the abolition of all TCF, automotive and general tariffs to be modelled;
- it allows for the substitution effects triggered by changes in the prices of goods and services. For example, on the production side of the economy, MM600+ allows for substitution between:

  (i) labour and capital;

  (ii) different types of capital inputs such as motor vehicles, computers and buildings;

  (iii) local and export destinations for sales;

  (iv) imports and local sources of supply of goods and services; and

  (v) different forms of fossil fuels, including black coal, brown coal, and natural gas.
- it generates results for specific regions within Australia. Specifically, MM600+ produces estimates of changes in production and employment across 23 regions and it makes an important distinction between traded and non-traded industries;
- it is set up to achieve budget neutrality in alternative ways. The default swing fiscal instrument, which is used in this report, is income tax, and the alternative swing fiscal instrument is GST; and
- it provides valid measures of changes in consumer welfare or living standards based on compensating and equivalent variations so that policy changes can be correctly evaluated in terms of the public interest.

MM600+ models a long-run equilibrium (approximately 5 to 10 years), using a standard set of assumptions. These assumptions fully recognise the various long-run constraints operating on the economy, and so avoid any overstatement of the sustainable gains/losses from economic developments. These long-run constraints are as follows.

- *Profit maximisation:* the representative business in each industry chooses inputs and outputs to maximise profit subject to prices and a production function exhibiting constant returns to scale. This involves choosing inputs of capital and labour and outputs for the local and export markets.
- *Labour market equilibrium:* in the long-run the labour market is assumed to attain equilibrium, so that an economic shock has no lasting effect on total employment. This assumption is implemented by fixing the level of total employment.
- *External balance:* in the long-run net liabilities to the foreign sector must follow a sustainable path. This assumption is implemented by setting the trade balance equal to the cost of servicing payments on foreign-owned capital — the real exchange rate needed to achieve this outcome is determined by the model.
- *Budget balance:* in the long-run the budget balance must be sustainable. Specifically, in MM600+ the government budget is assumed to be in balance. It is necessary to designate a swing fiscal policy instrument to achieve that outcome. Generally, the rate of tax on labour income is used as the swing fiscal policy instrument.
- *Private saving:* in the long-run the level of private sector saving and associated asset accumulation must be sustainable. Further, one potential problem with long-run models is that saving (i.e. sacrificing present consumption for future consumption) can appear artificially attractive, because the model results show the gain in future consumption but not the sacrifice of present consumption. To address both of these issues, saving is held constant in MM600+ by fixing the quantity of capital that is owned locally.

For more information on MM600+, download the model documentation from Econtech's web-site (www.econtech.com.au).