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Senate Economics Legislation Committee
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19 April 2005

Dear Sir

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

Submission on behalf of Interactive Travel Services Association

We act on behalf of the Interactive Travel Services Association ("ITSA") for the purpose of making submissions to the Senate Economics Committee ("the Committee") in relation to the proposed amendment to the GST law contained in Schedule 3 of the Bill.

ITSA is an industry body that represents on-line travel businesses who maintain their principal place of business in the United States. It is our understanding that the Bill would be applicable to ITSA members. If the Bill is applicable to ITSA members they may be treated as tour operators for the purposes of the Bill. For purposes of this submission only, we will treat the Bill as applicable to ITSA members.

ITSA members are not registered for the purposes of the Australian GST law and therefore may be subject to GST on the acquisition of taxable goods, real property, services and intangibles and to the extent they are deemed to acquire rights subject to the Bill. ITSA members have not sought to exploit the GST law by registering for GST and claiming input tax credits.

Executive summary

ITSA submits that the Bill, which is applicable to tour operators, would have a significant adverse impact on ITSA members and is not good tax policy. In summary, the proposal to extend the tax burden to non-resident entities which provide services outside of Australia:

- is inconsistent with our understanding of the GST/VAT treatment in other jurisdictions, notably in the EU, Canada and New Zealand;
- fails to fully address competitive inequities;

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- through its retrospective application places an undue burden on entities to which it applies, and;
- creates substantial compliance cost for those entities to which it is applicable, particularly in relation to:
 - the costs of complying with the proposed amendments, and in particular the complex systems and process changes needed to be undertaken to comply with the Australian GST; and
 - the ability to recover many of the direct and indirect GST costs incurred as a consequence of a 10 February 2005 commencement date.

ITSA further submits that the proposed amendments will make it very difficult for the Australian Taxation Office (“ATO”) to fairly administer the new law.

We understand that the proposed amendments are intended to address incidents whereby some non-resident entities (not ITSA members) registered for GST purposes, claimed input tax credits but did not account for output tax on the supply of certain rights redeemable in Australia. The outcome of this was that GST was not paid on consumption in Australia.

ITSA submits that a more equitable solution to the deficiency in the current legislation is to ensure that provisions similar to those proposed only apply to a non-resident entity (with no physical presence in Australia) that is registered for GST purposes. If a non-resident is not registered (or required to be registered) it will incur GST on its inputs but will not be entitled to recover the GST charged as an input tax credit. It is important to note that this “solution” does not compel non-residents to register for GST purposes on account of them supplying the relevant rights. We have outlined our proposed solution in greater detail in this submission.

Policy intent – Taxing consumption in Australia

We understand that the “deficiency” arises from the Australian GST law allowing non-resident entities to register and claim input tax credits, yet not clearly address their liability for output tax. ITSA members have not registered for GST purposes in Australia and have borne GST on the facilitation of accommodation and travel related services to be supplied in Australia. The GST borne by ITSA members has been calculated on an amount representing the value added in Australia.

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As a general principle, we agree with the broad policy intent that the GST is a tax on consumption in Australia. The decision by ITSA members to remain outside the Australian GST system meant that GST should be applied to private final consumption in Australia – on the supply made by the hotel or other resident supplier - rather than to the value added by the ITSA member outside of Australia. In these circumstances, we contend that GST has been paid on an appropriate value, representing the amount of value added in Australia.

Competitiveness – a level playing field

We agree that there has been a competitive advantage for non-resident entities that registered for GST purposes, claimed input tax credits but did not account for GST on the supply of the relevant rights. ITSA members did not register for GST purposes and as such were not in a position to recover GST charged by Australian suppliers.

It is important to note that it is not just Australian resident suppliers that have been disadvantaged. ITSA members and other unregistered non-resident suppliers have also been commercially disadvantaged. ITSA therefore supports the Australian Government's desire to provide a "level playing field".

Retrospective Taxation Issues

If the Bill passes in its current form, we submit that a date of effect of 10 February 2005 effectively amounts to inappropriate retrospective taxation as many affected parties only became aware that they potentially have a liability to account for Australian GST after 10 February 2005. Many others are still unaware.

Those ITSA members to which the Bill would be applicable did not realise until after 10 February 2005 that they have a potential Australian GST liability on hotel bookings dating back to such date. Consequently, there is an immediate cost impact for the affected ITSA members in relation to the retrospective application of the Bill.

Since modifying systems and processes for the invoicing and collection of GST relative to these bookings will take considerable time, the non-resident tour operators will continue to bear a direct GST cost which cannot be recovered from consumers. We submit that such an outcome is

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inconsistent with the design and intent of a GST/VAT system¹ that GST should not be a cost to business.

The proposed solution would overcome the issue of retrospectivity because the amendments would only apply to tour operators that are registered for GST.

Compliance Costs

The Bill effectively requires non-resident entities with no physical presence in Australia to comply with the Australian GST law in the same way as an Australian resident entity. The cost of complying with such a complex law remotely is considerable.

The travel industry is a volume business. Consequently, the GST will impact a large number of transactions by ITSA members both on the acquisition and supply side. This will necessitate significant changes to their online booking, purchasing and sales (billing) and financial systems and processes. To ensure an ITSA member complies with its Australian GST obligations, the member would, at the very least, need to undertake the following:

- invest significant resources to understand its Australian GST obligations;
- train non-resident staff in the nuances of the Australian GST and other taxation obligations;
- develop or reprogram systems (if possible) and implement processes to calculate the amount of Australian GST payable on the relevant supplies;
- implement a process to identify and claim the appropriate amount of input tax credits and obtain valid tax invoices from suppliers;
- design, prepare and produce (if possible) compliant tax invoices;
- prepare and lodge monthly or quarterly Business Activity Statement ("BAS");
- establish an Australian bank account; and
- implement processes and procedures to deal remotely with any queries the ATO may have.

When the GST was introduced in Australia, businesses had a manageable 19 month implementation period (between 2 December 1998 and 1 July 2000). By contrast, non-resident

¹ Refer OECD document "The application of consumption Taxes to the International Trade in Services and Intangibles" paragraph 20 (CTPA/CFA(2005)9/REV1)

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entities are expected to implement the proposed GST changes without any transitional period. We submit this is unfair and discriminatory.

ITSA estimates, after substantial set up costs have been incurred; each company of each ITSA member that is subject to the Bill will incur substantial annual tax, legal and accounting costs.

Administration Issues for the ATO

In order to properly administer a tax law, the ATO must be able to do the following:

- identify who is affected by the relevant law,
- effectively advise those affected of their obligations,
- ensure appropriate systems and processes are in place to allow those affected to comply and,
- if necessary, enforce the relevant laws.

The proposed change to the GST law appears to be drafted without due consideration to the practical difficulties the ATO will face in administering the law.

In particular, the identification of non-resident tour operators who may have a GST liability that may accrue for a considerable period of time.

One must question how the ATO proposes to enforce the law change against non-resident entities that elect to remain outside the Australian GST system. We assume that it will be unable to do so but it is hardly satisfactory to introduce a law change that the ATO is unlikely or unable to enforce.

Comparative analysis to other indirect tax jurisdictions

Currently, approximately 135 countries have a GST, VAT or similar consumption tax as part of its tax system². Other than New Zealand (who we understand do not seek to enforce their rules), we are not aware of any other GST or VAT system that require Australian tour operators supplying rights to be redeemed in a foreign tax jurisdiction to be registered and account for GST/VAT in that jurisdiction.

² OECD report "The application of consumption Taxes to the International Trade in Services and Intangibles" (CTPA/CFA(2005)9/REV1)

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In the case of Canada and the United Kingdom (the rest of the European Union adopts similar rules); neither jurisdiction seeks to tax supplies made by non-residents outside of the jurisdiction of the non-residents supply. Rather, GST/VAT is imposed on the supply by a resident entity to the foreign tour operator who is generally not entitled to register and recover the GST/VAT so charged.

Proposed Solution

We are of the view that the original policy intent of the GST law can be given effect with significantly less impact on non-resident entities with no physical presence in Australia by making some changes to the amendments proposed.

The features of our proposed change to the Bill are as follows:

1. The words used in the proposed subsection 9-25(5)(c) form the basis of a special 'connected with Australia' rule (rather than one of the basic rules) that only applies in certain circumstances (such as when a non-resident registers for GST purposes). There is precedent in the GST law for this³.
2. However, we propose that the special rule will not apply if:
 - (a) the supplier makes the relevant supply through an enterprise it carries on outside Australia, and
 - (b) the supplier is not registered (or otherwise required to be registered) for GST purposes.

The purpose of this exclusion is to allow unregistered non-resident entities that do not have a presence in Australia to remain outside the Australian GST system without incurring an Australian GST liability in relation to the relevant supplies. As they are unregistered they

³ Division 85 of the GST Act is a special 'connected with Australia rule for telecommunication supplies effectively used or enjoyed in Australia. However, this rule does not apply if:

- The supplier makes the supply through an enterprise carried on outside Australia, and
- The Commissioner determines that it is not administratively feasible to collect GST on the supply (or class of supplies).

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will not be entitled to claim input tax credits in relation to the GST charged on the acquisition of the relevant rights

3. If, conceptually, you agree with our proposal, the following consequential amendments should be considered.
 - The GST treatment of rights to accommodation should be covered by these new special rules. Currently, the ATO is of the view that rights to accommodation are covered by the definition of "real property" in the GST Act⁴. While the ATO view is debatable, it makes sense to ensure that all supplies of rights to be redeemed in Australia (whether they relate to accommodation or other services) are covered by the new provisions. This can be achieved by amending the definition of "real property" to exclude rights to hotel and other similar accommodation.
 - Non-residents that are currently registered for GST purposes but have no physical presence in Australia (i.e. they make the supply of the relevant right through an enterprise carried on outside Australia) should have the option to deregister so that they are on an equal footing with non-resident entities that are not registered and do not intend to register.

By way of example, a new special rule may be enacted as follows:

New Special Rule

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

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

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

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

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

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

⁴ GSTD 2004/3 GSTD 2004/3 *Is a supply of rights to accommodation a supply of real property for the purposes of the A New Tax System (goods and services) Tax Act 1999?*

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

Under our suggested amendment to the Bill, non-resident entities with no physical presence in Australia will not be required to register and account for GST where they supply the relevant rights. If a non-resident entity elects to register for GST purposes, they will be required to account for GST on the supply of the relevant rights, but will be entitled to claim input tax credits for the GST charged on acquisitions that relate to making the supply of these rights.

We submit that this suggested amendment is fair to both resident and non-resident suppliers of the relevant rights. It addresses the mischief that the Government is seeking to address in a more effective way, without unnecessarily drawing unregistered non-residents into the GST system. Furthermore, it maintains the integrity of the tax as it can be effectively administered by the ATO.

If you wish to discuss any aspect of this submission please feel free to call Denis McCarthy on (02) 8266 5229 or Dylan Morgan on (02) 8266 7397.

Yours sincerely



for.
Denis McCarthy
Director