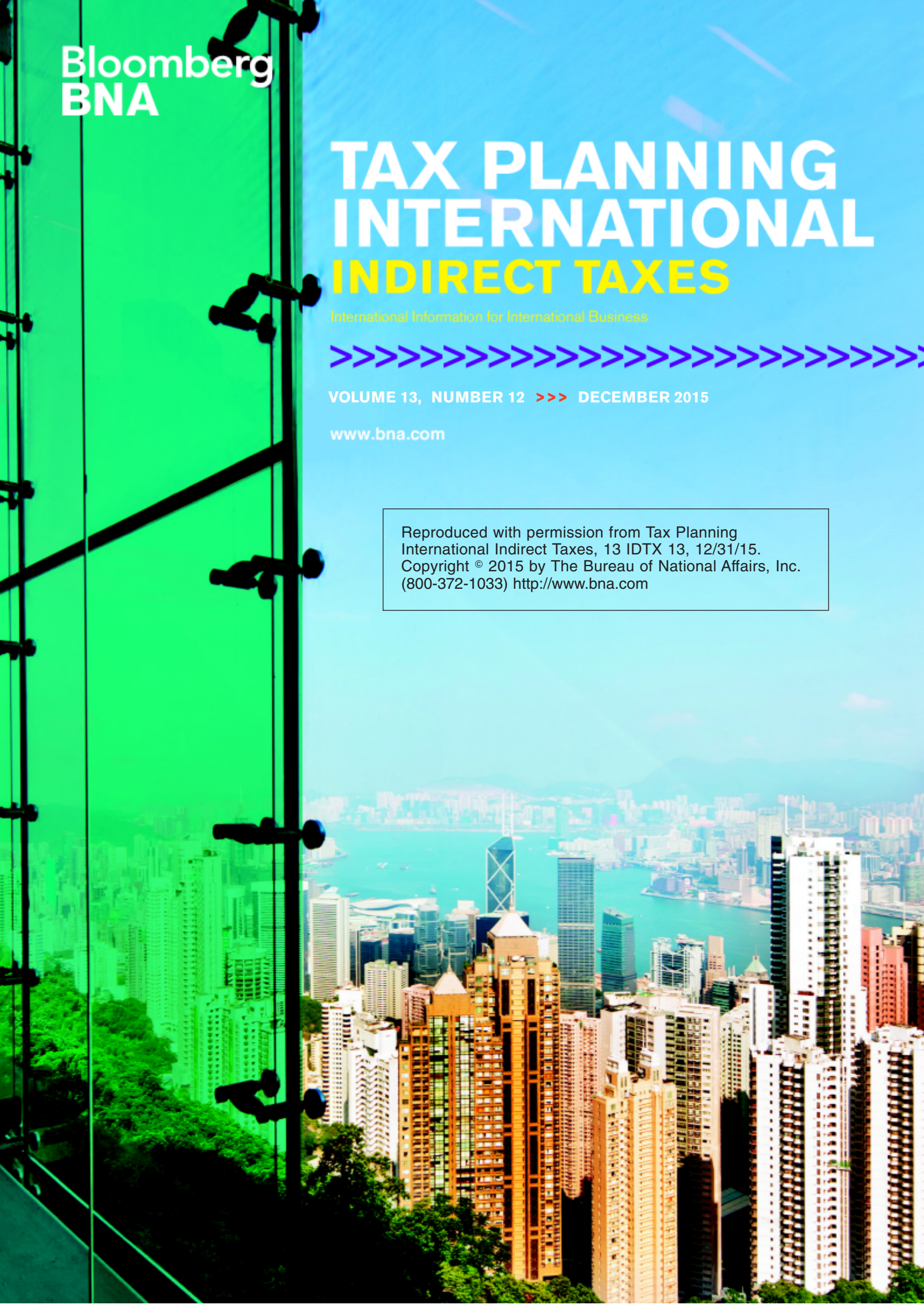

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Australian GST Reform: Cross-Border Transactions

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Three GST reform measures recently announced by the Australian Government will impact cross-border transactions, and in particular inbound supplies made from outside Australia.

I. Overview of Reform Measures

The Australian Government has announced three goods and services tax ("GST") reform measures that will impact cross-border transactions, and most particularly inbound supplies made from outside Australia. If enacted, the reforms will address the following:

- **Measure 1**: Extend GST to cover inbound intangible supplies made by nonresident suppliers to "Australian consumers";
- **Measure 2**: Reduce the need for nonresidents to register for GST in Australia (to either remit GST or claim credits) as a result of business-to-business ("B2B") transactions which are ultimately revenue neutral;
- **Measure 3**: Extend GST to cover sales by nonresident and Australian suppliers of low value goods (value less than AU$1,000) which are imported via parcel. This is particularly relevant for goods that are sold online from outside of Australia.

Each of these measures[1] is discussed further below.

A. When Will the Measures Commence?

See Table 1 overleaf for start dates for the transitional provisions for Measures 1 to 3.

B. What Consultation Materials are Available?

The government has released a second round of consultation draft legislation and associated explanatory material in relation to Measure 1. The same documents also include the first round of consultation legislation and explanatory materials in relation to Measure 2.

The consultation materials for Measures 1 and 2 are available from The Treasury[2] website and the submissions period in respect of Measures 1 and 2 closed on October 21, 2015.

The only publicly available information in respect of Measure 3 is a transcript of a press conference held by the former Treasurer, Joe Hockey, available on the Australian Government[3] website. It is anticipated that consultation materials relating to Measure 3 will be released in coming weeks.

C. How Likely is it That These Measures Will Proceed?

Any reforms to the GST base or GST rate (currently 10%) must be enacted by the Australian Commonwealth Government (Federal Government). However, pursuant to an Inter-Governmental Agreement, the Commonwealth Government can only enact such legislation if all eight Australian State and Territory Governments have agreed to the reforms. While the Inter-Governmental Agreement is not legally binding on the Commonwealth Government, this convention has been adopted in relation to GST reform measures impacting the rate or base since the tax was first introduced on July 1, 2000.

The States and Territories have universally agreed to Measures 1 and 3, both of which involve broadening the current GST base. The Commonwealth Government has referred to these changes as "Integrity Measures" aimed at protecting the GST revenue base. All additional revenue raised will be distributed by the

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Table 1

	Start date	Transitional provisions
Measure 1	July 1, 2017	Transitional provisions will apply to "periodic and progressive" supplies that commenced before July 1, 2017 and which continue after that date. Transitional provisions may also apply in respect of supplies made under written agreements entered into prior to 7:30 pm on May 12, 2015 (i.e. the time and date the measure was announced as part of the Federal Budget), subject to certain conditions being satisfied.
Measure 2	July 1, 2017	Details of any transitional provisions have not been released at the time of writing.
Measure 3	July 1, 2017 (However, the government has indicated this measure could commence earlier than this date.)	Details of any transitional provisions have not been released at the time of writing.

Commonwealth Government to the States and Territories in accordance with the Inter-Governmental Agreement.

Measure 2 is intended to reduce GST compliance costs for nonresident suppliers and the Australian Tax Office. It is expected to be revenue neutral.

Notwithstanding the prolonged reform start date of July 1, 2017, which occurs after the next Federal election (to be held no later than November 2016), it is the author's view that these three reform measures are highly likely to proceed. This is particularly so given that the States and Territories have unanimously agreed to Measures 1 and 3.

II. Measure 1: Inbound Intangible Supplies

Prior to the release of the Federal Budget in May 2015, the former Treasurer, Joe Hockey, announced that GST would be extended to intangible supplies made by nonresident suppliers. This has been widely cited in Australian media reports as the "Netflix Tax", in reference to the fact that Netflix does not currently pay GST on its streaming media services supplied to Australian customers.

A. Current GST Law

In high level terms, Australian GST usually only applies to supplies that are "connected with the Indirect Tax Zone". The "Indirect Tax Zone" is defined to be "Australia", but excludes Australia's external territories (for example, Christmas Island).

Generally speaking, intangible supplies made by nonresident suppliers will be connected with the Indirect Tax Zone if:

- the "thing" supplied is "done" in Australia (e.g. services are performed in Australia, or rights are provided in Australia); or
- the supply is made through an enterprise carried on in Australia (this may be relevant if supplies are made through a nonresident's permanent establishment ("PE") in Australia).

B. Proposed Reform

If enacted, the amending legislation will extend the "connected with the Indirect Tax Zone" tests to include supplies made to a recipient who is an "Australian consumer".

Based on the consultation draft legislation, the expression "Australian consumer" is expected to be defined as an entity that is a resident of Australia (excluding Australia's external territories) and which is either:

- not GST registered, nor required to be GST registered; or
- a registered entity which acquires the intangible supply for a purpose other than wholly or partly for carrying on the entity's enterprise.

Broadly speaking, the intention is to widen the GST net to capture inbound intangible supplies made to:

- individuals who are not GST registered; and
- businesses which may be GST registered, but which have made an intangible supply for a wholly non-business purpose (this will likely be mostly relevant for sole traders and other small businesses conducted by individuals).

1. What are Intangible Supplies?

The proposed reforms will apply to supplies of "anything other than goods or real property", which captures all manner of intangible supplies. In this respect, the amendments will apply to:

- digital content (including games, software, e-books, music, etc.);
- services that are performed remotely from outside of Australia (such as advertising or other services);
- contractual rights supplied from outside of Australia. This may capture both intellectual property rights and also rights to access software platforms as part of "software as a service" arrangements.

2. Who is Liable to Pay the Tax?

GST is generally payable by the entity that makes a taxable supply. However, the proposed amendments instead provide that where an "inbound intangible consumer supply" is made through an "electronic distribution platform", the GST is payable by the operator of the electronic distribution platform (and not the supplier).

For these purposes, an electronic distribution platform may potentially include a website, internet portal, gateway, store or marketplace through which supplies are made to Australian consumers via means of electronic communication. For example, this may apply to software applications that are sold by nonresident suppliers to Australian consumers through an online app store.

In the latest consultation draft legislation, it has been made clear that an electronic distribution platform does not include:

- a telecommunications carriage service; or
- a service consisting of:
  - — providing access to a payment system; or
  - — processing payments; or
  - — providing vouchers the supply of which is not taxable supplies (relevant for face value vouchers which are equivalent to money and not subject to GST when sold).

The proposed amendments do provide for some circumstances in which the supplier, rather than the operator of the electronic distribution platform, will be liable for the GST. This might occur where the identity of the supplier is clear from an invoice that has been issued to the recipient and the operator has minimal involvement (i.e. the operator is not involved in charging, authorizing delivery or setting terms and conditions for the supply).

It is also recognized that in some instances a supply may be made through multiple electronic distribution platforms. Where that is the case, the intention is for only one of the operators to be liable for GST on the supply. The draft legislation sets out rules to be applied for determining which operator is liable (in most instances it will be the first operator to receive the consideration or authorize charging for the supply).

3. What are "Inbound Intangible Consumer Supplies"?

Broadly, this expression is defined in the draft legislation to be intangible supplies made to Australian consumers, ***except*** where:

- the intangible supply is "done" wholly in the Indirect Tax Zone; or
- the supplier makes the supply through an enterprise that it carries on in Australia (for example, a nonresident supplier makes a supply through a PE that it has in Australia).

4. Will the Reforms Apply to Intangible Supplies made to GST Registered Entities?

Generally speaking, and subject to the exception mentioned below, the proposed reforms will not apply to supplies made to GST registered entities. This reflects that most GST registered entities will be entitled to full input tax credits (GST credits) for their acquisitions, negating any revenue benefit in charging GST on supplies made to such recipients.

Entities which are not entitled to full input tax credits are generally required to account for GST on inbound intangible supplies under existing special rules (the "reverse charge" rules).

An exception to the general proposition above will arise if an intangible supply is made to a GST registered entity which does not make the acquisition wholly or partly in the course of carrying on its enterprise. This is because GST registered entities which make such acquisitions will meet the definition of an "Australian consumer".

For example, this may be relevant if an individual, who is a sole trader, is GST registered. Assume the individual acquires some intangible supplies (such as downloads of games or streaming media services) wholly for private purposes unrelated to the individual's business activities. In these circumstances, a supply is being made to an "Australian consumer" (as defined in the current draft legislation). Consequently GST may be applicable, albeit the individual is GST registered.

5. Will Nonresident Suppliers/Platform Operators Caught by the Proposed Rules Need to Register for GST Purposes?

Nonresident suppliers and platform operators which make supplies that are connected with the Indirect Tax Zone and which have a value in excess of the GST registration turnover threshold (currently AU$75,000 in a 12-month period), will be required to register for GST purposes.

It should be noted that where the operator of an electronic distribution platform is treated as having made an inbound intangible consumer supply, the value of that supply will count towards the operator's GST registration turnover threshold.

As a practical matter, where a supplier makes inbound intangible consumer supplies through a GST registered operator of an electronic distribution platform, GST will apply to all such supplies even if the value of the supplier's own supplies which are connected with the Indirect Tax Zone do not exceed AU$75,000. This means all inbound intangible consumer supplies made by small businesses through large GST registered operators of electronic distribution platforms will be subject to GST (unless a specific GST exemption applies).

As a part of the proposed reforms, nonresident suppliers which make inbound intangible consumer supplies may elect to be a "limited registration entity". If this election is made, the entity:

- will not be entitled to an Australian Business Number; and
- will not be entitled to input tax credits (GST credits) for creditable acquisitions; and
- must have quarterly tax periods.

The main advantage of electing to be a limited registration entity is that the registration application process and GST reporting requirements will be considerably less onerous than those required for an entity with a full GST registration.

6. What Happens if a Supplier or Platform Operator Cannot Determine Whether a Recipient of a Supply is an "Australian Consumer"?

As a safe harbor, suppliers and operators will not be liable for GST under the proposed reforms if they have taken "all reasonable steps" to obtain information on whether a consumer is an "Australian consumer" and, after doing so, reasonably believe the consumer is not an Australian consumer.

The latest draft legislation includes provisions intended to make it clear that suppliers and platform operators can rely on information obtained through their usual business systems and processes in forming their reasonable belief.

7. Will Australian Consumers Avoid the Additional GST Cost on Inbound Intangible Consumer Supplies by Denying their Residency Status?

The explanatory materials note that Australian consumers who engage in the conduct of making false representations about their Australian residency

status to defeat the proposed amendments may commit an offense under Section 8U of the Taxation Administration Act. However, that provision is only likely to be imposed for the most serious and deliberate false representations.

As an alternative to prosecuting Australian consumers for this offense, the reform measures will also introduce new administrative penalties that may be imposed by the Australian Tax Office. The proposed penalty scale is as follows:

- 60 penalty units (currently AU$10,800) if the statement is intentionally false and misleading;
- 40 penalty units (currently AU$7,200) if the statement was found to be reckless;
- 20 penalty units (currently AU$3,600) if the false or misleading statement resulted from a lack of reasonable care.

8. What is the Position if a Supply is made to an Australian Consumer, but the Consumer is Outside Australia when the Supply is made?

As explained above, under the reform proposals, any intangible supply could be connected with the Indirect Tax Zone if it is made to an Australian consumer. This would also capture intangible supplies made to Australian consumers who are outside of Australia when the relevant supply is made.

To ensure that Australian GST does not apply inappropriately, it is proposed that intangible supplies made to Australian consumers outside of Australia will generally be "GST-free" supplies (i.e. not subject to GST).

Consistently, the GST registration threshold provisions will be amended so that supplies which are connected with the Indirect Tax Zone under the proposed amendments, but which are also GST-free, do not count towards the AU$75,000 registration threshold.

9. Are Nonresident Suppliers and Platform Operators Required to Issue Tax Invoices?

Under the draft legislation, tax invoices are not required for taxable supplies that are solely "inbound intangible consumer supplies" (as defined in the draft legislation—see above).

III. Measure 2: Reducing the Need for Nonresidents to Register for GST in Respect of Business-to-Business Transactions

A. Reducing Registration Requirements for Supplies

Generally speaking, supplies are only taxable and subject to GST if the supply is connected with the Indirect Tax Zone. There are separate tests that may apply to determine whether a supply is connected with the Indirect Tax Zone, depending on the nature of the "thing" being supplied. Specific tests apply for goods, real property and intangibles.

The Commonwealth Government has recognized that these tests are broad and capture some supplies made by nonresidents which should ideally be kept outside of the Australian GST net. This is relevant for B2B transactions which are revenue neutral. Requiring nonresidents to register for GST as a consequence of making such supplies results in unnecessary compliance costs for both the nonresident suppliers and the Australian Tax Office (which can ultimately result in increased costs for consumers or taxpayers).

To address this, it is proposed that new provisions will be introduced which will specify that certain supplies are not connected with the Indirect Tax Zone (and which will override the general provisions).

Based on the consultation draft legislation, the supplies that will be deemed not to be connected with the Indirect Tax Zone include the following:

- inbound intangible supplies which are:
  - — "done" in the Indirect Tax Zone; and
  - — made to an entity that is potentially liable to reverse charge GST on the supply;
- intangible supplies made between nonresidents (and which satisfy certain requirements);
- certain supplies involving the installation or assembly of goods for recipients that are potentially liable to reverse charge GST in respect of those services;
- certain transfers of ownership of leased goods (for example, aircraft) between nonresidents;
- supplies made by way of continuing leasing following a qualifying transfer of leased goods between nonresidents.

The draft legislation also contains new provisions for calculating the price of installation and assembly services. Those provisions will be relevant where the GST on the supply of installation and assembly services is reverse charged and the recipient needs to calculate its GST liability for those services.

B. Reducing Registration Requirements for Acquisitions

Under current GST law, intangible supplies that are made to nonresidents who are outside of Australia (which are not directly connected with real property or work performed on goods in Australia) are GST-free and not subject to GST.

However, this GST-free exemption does not apply if the nonresident directs the supplier to provide the intangible supplies to another entity that is in Australia (for example, a subsidiary, agent or customer). Broadly speaking, the rationale for this is that the intangible supply has not been exported, but rather has been consumed in Australia and should be subject to GST.

Where the GST-free exemption is not available, the nonresident recipient needs to register for GST if it wants to claim an input tax credit for any GST amounts charged to it. If a nonresident does register and claim credits, the supply is revenue neutral.

The current provisions also place a significant GST compliance burden on Australian suppliers. Australian suppliers may be requested by nonresident recipients to invoice for their supplies on a GST-free basis. Where a supplier has had interactions with people or other entities in Australia in connection with making the supply, the supplier may be concerned that the GST-free exemption does not apply. The supplier may need to investigate further to determine the GST position. In some instances, disagreements may arise between suppliers and nonresident recipients regarding the GST treatment of relevant supplies.

To address these issues, it is proposed that supplies which are made to nonresidents, but provided to entities in Australia, will continue to be GST-free if:

- the entity to whom the supply is provided in Australia is GST registered; or

- the supply is provided to an individual who is an employee or officer of a "potentially chargeable entity" (i.e. entity that may be required to reverse charge GST); or
- the supply is provided to an entity that is an employee or officer of the nonresident recipient, and the nonresident recipient's acquisition is:
  — solely for a creditable purpose; and
  — not a "non-deductible expense" (as that expression is defined in the GST Act).

In addition to the above, the draft legislation also includes provisions that will extend the current GST-free exemptions to cover work performed on goods in Australia, where that work is performed to satisfy the nonresident recipient's obligations under a warranty relating to the goods (and other requirements are satisfied). Again, this amendment is intended to reduce the need for nonresidents to register for GST in Australia simply to claim input tax credits (given the supplies are revenue neutral if the nonresident does register and claim credits).

IV. Measure 3: Reducing the Low Value Goods Threshold for Importations

Generally speaking, GST does not presently apply where low value goods are imported into Australia via parcel. The current low value goods threshold is AU$1,000. There are some exceptions to this general rule (for example, the threshold does not apply where the goods imported are alcohol or tobacco).

This threshold is particularly relevant where goods are purchased online and shipped to Australia via a parcel delivery service.

Many Australian retailers consider that this threshold creates an uneven playing field. This is because GST registered retailers which sell the same goods in Australia are liable for GST, regardless of the value of the goods being sold. In contrast, suppliers (including both nonresident and Australian suppliers) which sell goods from outside Australia with a value of less than AU$1,000 are not subject to this tax.

Some State and Territory Governments have also expressed concerns that the current threshold is eroding the GST base, as the volume of goods that Australians purchase online from overseas continues to increase.

To address these concerns, the Commonwealth Government has announced that the low value threshold will be abolished with effect from July 1, 2017 (or possibly an earlier date if the reforms can be implemented sooner).

In order that parcels do not need to be stopped and assessed by Customs, the government is proposing that the supplier of the goods will be liable for the GST. This will presumably only apply to goods that have a value less than AU$1,000. Under current law, the GST on taxable imports that have a value exceeding AU$1,000 is payable by the importer (which may be a different entity to the supplier).

At the time of writing, no consultation draft legislation or explanatory materials have been released. Consequently, it is unclear whether the reforms will apply to all relevant supplies of goods (including supplies made to businesses), or whether the reforms will only apply to supplies made to Australian consumers.

Consistent with the reforms that have been outlined above in relation to Measure 1, it seems likely that where the goods are sold via an online marketplace, the operator of the online marketplace will be liable for any applicable GST. This should reduce the number of nonresidents required to register for GST as a result of the reforms, while also enhancing enforcement and collection prospects.

V. What Should Impacted Suppliers be Doing Now?

These reforms will impact both nonresident suppliers (Measures 1, 2 and 3) and Australian resident suppliers (Measures 2 and 3). Any suppliers which may be impacted should:

- closely monitor the consultation process and provide submissions on any issues of concern;
- model the impacts and determine whether there are appropriate ways to mitigate or reduce any increased costs for their business;
- determine whether any transitional arrangements may apply to existing contracts or supply arrangements;
- consider whether supply contracts (or terms and conditions) may need to be amended to allow GST costs to be passed on to recipients; and
- consider whether existing finance systems need to be modified to invoice, capture and report any applicable GST liabilities.

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NOTES

[1] Note that the above labels of "Measure 1, Measure 2 and Measure 3" have been used in this article for convenience only. The labels have not been used by the government.

[2] http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/GST-treatment-of-Cross-Border-Transactions

[3] http://jbh.ministers.treasury.gov.au/transcript/175-2015/

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