

Chapter 2

Extending GST to digital products and other services imported by consumers

2.1 The Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016 (the bill) intends to increase the scope of the Goods and Services Tax (GST) to capture cross-border supplies of digital goods and services to Australian consumers.

Background

The Goods and Services Tax in Australia

2.2 A *New Tax System (Goods and Services Tax) Act 1999* (GST Act) was passed in 1999 to establish a GST, a broad-based tax of 10 per cent on most goods, services and other items sold or consumed in Australia.

2.3 At the time of the introduction of the GST, cross-border supplies of services or other intangibles were relatively unusual for consumers. Intangible goods have a value but do not have a physical presence. A hardcover copy of a book would be a tangible asset, whereas an e-book can be considered an intangible asset. As the supply of intangible goods by non-resident entities was rare when the GST was established, it was not considered necessary to make provisions in the GST Act for the collection of GST on these transactions. At the time, there was only a very limited range of services available to consumers that were not performed in Australia or through an enterprise carried on in Australia.¹ University of Sydney Professor of Law, Rebecca Millar, has pointed to a second consideration in deciding not to tax these goods when the GST was introduced:

The problem was that in 1998 it was unclear whether GST on services imported by consumers could effectively be collected. Collecting GST from suppliers with no presence in Australia would be difficult. Asking consumers to pay GST on their own purchases was impractical and unlikely to meet with high levels of compliance.²

2.4 Whereas physical goods can be stopped at the border and have the relevant customs and duties levied, the nature of digital importation means they are unable to be captured by the model historically used for imported goods, as they cannot be physically held at the border.

2.5 Presently, for the purposes of calculating GST, supplies of digital services are only subject to GST if they are made through an enterprise operating in Australia. Over time, growth in the digital goods and services sector has brought to light the

1 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 11.

2 Professor Millar, 'The "Netflix tax" — coming to a country near you', *The Conversation*, 22 April 2015.

significant tax integrity risks associated with the digital economy. As a matter of tax principle, cross-border supplies of digital goods and services should be captured by the GST in the same way they would be if provided by an Australian business. Due to the current wording of the legislation, transactions on the same goods and services are taxed differently depending on whether the provider is or is not in Australia.³

2.6 The growth and adoption of e-commerce platforms within the Australian community means that it is now just as easy for a consumer to order many types of services and items of intangible property from a foreign supplier as from a local supplier. Because GST does not apply to these purchases, local suppliers are at a tax disadvantage and the GST-revenue base is progressively eroded.

International efforts to address the challenges of the digital economy

2.7 In an increasingly interconnected world, national tax laws have not maintained pace with advances in technology and corporate strategy. New technologies and consumer tastes that are not being adequately captured by current taxation regimes have the potential to erode national tax bases and distort markets. Many consumers now purchase the majority of their entertainment in digital formats which, depending on whether the seller has a physical presence in Australia, may be GST-free.

2.8 Many countries have already acted to tax offshore supplies to their consumers, including Norway, Japan, Switzerland, Iceland, South Korea, South Africa and the member states of the European Union (EU).⁴ Non-EU businesses have been required to collect Value-Added Tax (VAT) on supplies of electronic services to EU consumers since 2003, and since 1 January 2015 all cross-border supplies of electronic service to EU consumers must be taxed in the Member State of residence, even when supplied from other EU countries.⁵

2.9 Reflecting the shift in global awareness of the erosion of national tax bases by emerging technologies and management techniques, the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project has been working to bring together the international community to address global taxation challenges. In July 2013, the Group of Twenty (G20) identified 15 key areas to be considered, including *Addressing the Tax Challenges of the Digital Economy*.⁶ The principle at the heart of the BEPS project is to 'ensure that profits are

3 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 48.

4 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 11.

5 Professor Millar, 'The "Netflix tax" — coming to a country near you', *The Conversation*, 22 April 2015.

6 Organisation for Economic Co-operation and Development, *About Base Erosion and Profit Shifting*, <http://www.oecd.org/ctp/beps-about.htm> (accessed: 1 March 2016).

taxed where economic activities generating the profits are performed and where value is created'.⁷

2.10 In October 2015 the OECD's report, *Addressing the Tax Challenges of the Digital Economy—Action 1—2015 Final Report*, was released. The report highlighted the impacts of the evolution of technology. It noted that technology has dramatically increased the ability of private consumers to shop online and the ability of businesses to sell to consumers around the world, without the need to be present physically or otherwise in the consumers' country.⁸ In particular, the report noted:

The digital economy also creates challenges for value added tax collection, particularly where goods, services and intangibles are acquired by private consumers from suppliers abroad.⁹

2.11 Using the work of the BEPS Project, the OECD has published guidelines (GST Guidelines) for the taxation of cross-border supplies of services and intangibles. The GST Guidelines concerning the place of taxation rules and collection mechanisms for business-to-consumer supplies were endorsed by the OECD Council on 1 October 2015, delivered to G20 Finance Ministers on 8 October 2015 and endorsed by the third meeting of the OECD Global Forum on VAT on 6 November 2015. The OECD Global Forum posited that:

These Guidelines recommend that foreign sellers register and remit tax on sales of e-books, apps, music, videos and other digital goods in the jurisdiction where the final consumer is located. The Guidelines also include a recommended mechanism to ensure the effective collection of VAT by tax authorities from foreign sellers, thus helping governments to protect VAT revenues and levelling the playing field between domestic and foreign suppliers.¹⁰

2.12 The work of the OECD BEPS Project and the release of the GST Guidelines point towards a growing international appetite to prevent further erosion of national tax bases caused by emerging technologies. The Australian Government has expressed an intention to implement 'the balance' of the OECD recommendations, including addressing the tax challenges of the digital economy.¹¹

7 Organisation for Economic Co-operation and Development, *Addressing the Tax Challenges of the Digital Economy*, OECD Publishing, Paris, 2014, p. 3.

8 Organisation for Economic Co-operation and Development, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD Publishing, Paris, 2015, p. 13.

9 Organisation for Economic Co-operation and Development, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD Publishing, Paris, 2015, p. 13.

10 OECD Global Forum on VAT, *OECD delivers international standard for collection of VAT on cross-border sales*, media release, 6 November 2015.

11 The Hon Scott Morrison MP, Treasurer, 'OECD report supports Australian Government action on multinational tax avoidance', media release, 6 October 2015.

2015/16 Budget measures

2.13 In the 2015/16 budget the Australian Government announced measures to address this gap in the current legislation, stating:

The Government will also apply the GST to cross-border supplies of digital products and services imported by consumers from 1 July 2017. This will help correct an anomaly in the current system and level the playing field between domestic and international businesses.¹²

2.14 The budget papers referred to this as 'closing the digital tax loophole', and referred to the purchase by consumers of cross-border digital products and services. These include: consultancy, accountancy and legal services; financial and insurance services; telecommunication and broadcasting services; online supplies of software and software maintenance; online supplies of digital content (movies, TV shows, music, e-books, apps and games), digital data storage; and online gaming.¹³

2.15 The government's proposed changes are supported by the OECD's GST Guidelines, which argue:

For supplies of services and intangibles whose consumption bears no necessary relationship to the location in which the supply is performed and in which the person performing the supply is located, a rule based on the customer's usual residence is the most appropriate approach for determining the place of taxation in a business-to-consumer context.¹⁴

2.16 Generally, there is support for extending the GST to cover digital goods and services. Professor Millar, writing in *The Conversation* observed that:

...we should be taxing the consumption of digital products by Australian consumers, regardless of origin. It is part of Australia's consumption tax base and for the most part it is not one of the 'social goods' that routinely give rise to exemptions from consumption taxes.¹⁵

2.17 On 12 May 2015, Treasury released an exposure draft of the bill and explanatory memorandum and conducted eight weeks of consultation ending on 7 June 2015. A further exposure draft and accompanying explanatory material was released on 7 October 2015 for a two week consultation period. Treasury reports that 26 formal submissions were received across both rounds of consultation with submissions received from resident and non-resident businesses, accounting firms,

12 Australian Government, Budget Paper No. 1 2015-16, p. 1-14.

13 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 49; Australian Government, *Closing the digital tax loophole*, <http://www.budget.gov.au/2015-16/content/glossy/tax/html/tax-03.htm> (accessed: 10 March 2016).

14 Organisation for Economic Co-operation and Development, *International VAT/GST Guidelines*, 2015, p. 46.

15 Professor Millar, 'The "Netflix tax" – coming to a country near you', *The Conversation*, 22 April 2015.

academics and peak bodies associated with accounting and business.¹⁶ Treasury has yet to release the details of these consultations, but has indicated that both consultation rounds resulted in changes to the proposed legislation.¹⁷

Key provisions

2.18 Schedule 1 of the bill makes proposed amendments to the GST Act to ensure that digital products and other imported services supplied to Australian consumers by foreign entities are subject to GST.

2.19 A non-exhaustive list of digital products and other intangible property includes the streaming or downloading of movies, music, apps, games and e-books as well as other services such as consultancy and professional services.¹⁸

Registration requirements on non-resident entities

2.20 The collection of GST on digital products and services will use a vendor registration model. Overseas online vendors will be required to collect GST from the Australian consumer at the point of sale. The overseas vendor will then remit the collected GST to the Australian Taxation Office (ATO) on a periodic basis.

2.21 Vendors with an Australian turnover greater than \$75,000 will be required to register. Vendors with a lower Australian turnover may register, but this is not compulsory.¹⁹ It is estimated in the Regulation Impact Statement that somewhere in the order of 100 non-resident entities will register for and remit GST as a result of this measure.²⁰ Vendor collection and remission models such as that proposed by the bill are in line with OECD recommendations that companies should collect revenue from end consumers.

2.22 Non-resident businesses will have two choices of GST registration: a limited registration which will facilitate the remission of payments to the ATO but will not enable the claiming of Input Tax Credits (ITCs) on supplies purchased in Australia; and a full registration that will be very similar to the current registration process undertaken by Australian businesses. The latter, full registration option will require a business to apply for an Australian Business Number (ABN) and will enable the business to claim ITCs.²¹

16 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 61.

17 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 12.

18 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 12.

19 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 52.

20 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 5.

21 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 54.

2.23 Registering for GST in Australia requires the provision of considerable amounts of information to verify the identity of the entity and its entitlement to be registered, which can pose particular challenges for non-residents. Many of these requirements stem from the necessity to ensure that there are no unauthorised ITC or GST refund claims. As non-resident suppliers only making inbound intangible consumer supplies have no need to claim a GST refund or ITCs, the bill includes a simplified registration process has been established to minimise compliance costs.²²

2.24 Many non-resident vendors are reported to already have the software systems in place to collect GST, as many larger online retailers operate in jurisdictions where the collection of GST is already a requirement.²³ In an effort to reduce compliance costs, the bill does not oblige providers to issue a tax invoice or adjustment note at the request of the consumer.²⁴

Electronic distribution platforms

2.25 Where a digital good or service is being provided through an electronic marketplace (electronic distribution platform), the operators of that marketplace will be responsible for any Australian GST on supplies to Australian consumers made through that platform. For example, the GST owing on a computer game purchased through an app store will be collected by the app store, not the game developer. Many Australian consumers would be familiar with these platforms from using Apple's iTunes store or Google Play to purchase digital goods.

2.26 The rationale for placing the burden of tax collection on electronic distribution platforms (EDPs) is that they will often be larger and better resourced than most of the individual vendors making supplies through the platform. These EDPs also have more information about the recipients of supplies to assist in determining if the consumer is an Australian resident for tax purposes.²⁵ Typically the operator of an EDP will also have significant influence over the terms of sales and payments made via the platform. Treasury is of the view that 'compliance and administration would be simplified if liability for GST rested on the platform operator rather than the vendor'.²⁶

22 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, pp. 41–44.

23 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, pp. 56, 62.

24 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 41.

25 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 30.

26 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 53.

2.27 For the purposes of the bill, advertisers, internet service providers, payment systems and processing services are not typically considered as EDPs as such services are not involved in making the supply available to a consumer.²⁷

Identifying Australian residents

2.28 Broadly, individuals are Australian residents if they usually reside in Australia. As identified by the OECD, for remote supplies of digital goods and services, it is often the place of usual residence of the consumer that is the best proxy for where the supply is consumed.

2.29 Determining the residency status of a consumer is not an easy undertaking, and the bill only requires that a non-resident supplier takes reasonable steps to obtain information concerning whether a recipient of supply is an Australian consumer. Having taken these steps, if the supplier reasonably believes that a recipient is not an Australian consumer they will not be required to collect GST.²⁸

2.30 As most online transactions will be completed automatically, without any human intervention, a consumer will be identified as an Australian resident based on the information collected by the company. Determination of a customer as an Australian resident will rely on appropriate systems and processes being put in place by suppliers. The EM provides an explanation of this policy decision:

The requirements placed on non-resident suppliers acknowledge the practical limits of what they can reasonably do in determining the residence of their consumers in other countries that may acquire services from them by largely automated processes.²⁹

2.31 Existing penalties for consumers that make false declarations of their place of residence to defeat the purpose of taxation law are only imposed for the most serious and deliberate breaches. To provide an alternative remedy to misrepresentation of residency status, the bill includes amendments to broaden the existing administrative penalties for making false and misleading statements. Australian consumers that make false or misleading statements in regard to their tax residency status are potentially liable to administrative penalties of up to:

- 60 penalty units (currently \$10,800) if the statement was false or misleading as a result of the intentional disregard of a taxation law;
- 40 penalty units (currently \$7,200) if the statement was false or misleading because of recklessness; and

27 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 32.

28 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 21.

29 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 25.

- 20 penalty units (currently \$3,600) if the false or misleading statement resulted from a failure to take reasonable care.³⁰

2.32 Australian residents that are also registered for GST, but misrepresent their status as Australian consumers in respect to a purchase made solely for personal purposes, may be liable for GST in relation to that purchase under an extension of the reverse charge rule.³¹

Enforcing compliance

2.33 The proposed changes will be administered and enforced by the ATO. The EM notes that '[i]nternational experience indicates that larger entities will voluntarily comply'.³²

2.34 The ATO will be provided with \$1.7 million over the forward estimates for administering the measures and marketing the above mentioned law changes to affected parties.

Commencement and ongoing review

2.35 In accordance with the announcements in the 2015–16 Budget, the new laws will come into effect on 1 July 2017. This will provide sufficient time for non-resident businesses to understand their obligations, register for GST and update their software systems where necessary.³³

2.36 Post-implementation, the ATO will monitor collections of digital supplies from non-resident suppliers, and inform the Australian Government in the event the legislation is not working as intended.³⁴

Issues

2.37 The committee did not receive any submissions relating specifically to this schedule of the bill.

Committee view

2.38 The proposed changes in the bill address one the emerging challenges raised by the growth of the digital economy. The changes proposed in the bill ensure that Australia's businesses are not at a tax disadvantage compared with their international competitors. The committee considers that it is prudent to put in place legislation to

30 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 26.

31 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 14.

32 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 54.

33 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 65.

34 Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*, p. 65.

ensure the GST base does not progressively erode over time as more services become digitised.

