

# **GST Distribution Review**

Options for GST taxation of  
imported goods and services

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## Executive summary<sup>1</sup>

I have been commissioned by the Department of the Treasury to prepare this preliminary report (the Report) for the GST Distribution Review Panel to examine the scope of practical methods to bring imported goods and services within the scope of Australia's goods and services tax (GST).

On 30 March 2011, the Treasurer announced the Government's appointment of a panel to conduct a review of the distribution of revenue from the GST to the States and Territories (the Review).

Treasury has sought this preliminary report for the Review Panel to explore whether the GST revenues available for distribution to the States and Territories might be increased by collecting GST currently forgone on the importation of goods below the "low value threshold" (LVT) of \$1,000 and services.

## Productivity Commission Report

On 9 December 2011, the Government released the report of the Productivity Commission Inquiry into the Economic Structure and Performance of the Australian Retail Industry (the PC Report) and its response to the PC Report.

The Media Release containing the Government's response stated:

"The Commission's report makes clear the low value threshold for GST and duty on imported goods is not the main factor affecting the international competitiveness of Australian retailers. The Commission found there are in-principle grounds to reduce the low value threshold, but that it is currently not cost-effective to do so.

It calculated that lowering the threshold to \$100, for example, could collect around \$500 million in revenue, but at a cost of \$1.2 billion in administration and compliance costs.

However, if significant improvements were made to the cost of processing international parcels, the Government would be in a position to reassess the threshold.

The Government will establish a Taskforce to investigate options to improve the efficiency of processing low value imported parcels. The Taskforce ... will provide an interim report in three months and a final report to the Government no later than July 2012."

The PC Report also contains an estimate of the revenue loss arising from the exemption from GST on imported intangibles.

"The Commission notes that any move to lower the level of the LVT would have no impact on the taxation of the importation of services and intangibles — for example, downloads of software, music and games. Treasury estimates that such imports currently give rise to around \$1 billion of GST revenue foregone."

This Report does not deal with the possible manner of increasing the efficiency of processing low value imports of goods. Rather, it canvasses the relative practicalities of **other options** for

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<sup>1</sup> Footnotes that are contained in the Chapters 1 – 4 of this Report have been omitted from the Executive Summary.  
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taxation of imported goods and services, including but not limited to those being used in other jurisdictions.

It contains:

- In Chapter 2 - The theory and practice of consumption taxation.
- In Chapter 3 - Australia's consideration to date of GST taxation of offshore supplies.
- In Chapter 4 - Options, other than collection of GST at the point of importation, for the taxation of goods and services imported from outside but consumed in Australia and the conclusion of the evident practicality of the options.

## **The theory and practice of consumption taxation**

A consideration of the taxation of imported goods and services under Australia's GST should commence with the objectives and purpose of the tax system, its scope and the purpose at which its design features are directed.

In respect of the design features of the GST, the PC Report commented on the balancing of neutrality and deadweight costs of administration and compliance:

“Notwithstanding the potential for inefficiency from non-neutral taxation of substitutable transactions, the costs of collecting taxes which are borne by government, business and consumers entail efficiency losses and are part of the deadweight loss for the community. Therefore, from the viewpoint of maximising the welfare of all Australians, the question is whether there are likely to be bigger losses in welfare from trying to provide equal treatment by collecting taxes on all imports, than from the distortions created by differential rates of tax and duty for overseas and domestic retailers.”

The particular feature of Australia's GST that gives rise to the non-neutral application of GST to some imported goods and services is the so-called “**destination principle**” of consumption taxation – that is, the design feature of a value-added tax that collects taxation in the jurisdiction in which consumption takes place and **not** in the jurisdiction from which the goods and services originate.

## **Taxation of household final consumption expenditure**

Australia's GST is an indirect tax on household final consumption expenditure (HFCE).

If the purpose of a taxation system is to raise revenue for Government programs, a tax should be both adequate and efficient. The choice of HFCE as the tax base is preferred because the tax base is:

- robust and reliable; and
- able to be collected with neutrality and efficiency - the tax can be levied to maximise the production of goods and services with minimal economic costs to the economy.

In practice, the design features of consumption taxes sometimes sacrifice the destination based neutrality for the sake of efficiency, practicality and integrity of collection.

## **Design features of consumption taxation**

Australia's GST is a value-added tax on HFCE. It is **an indirect tax** because it is collected from business as a proportion of the price paid by consumers for goods and services supplied by the business.

Australia's GST is **also** payable by a person who imports goods, whether or not it has been the subject of a supply by a business.

One of the factors that simplifies the collection of an indirect tax (such as GST) rather than a direct tax, is that the tax is collected by a significantly lower number of taxpayers – there are approximately 2 million GST registrants compared to a possible population of over 20 million consumers.

The underlying design features of a value-added tax that gives rise to the issues that are the subject matter of this Report are:

- Under the destination principle, VAT should be collected by the revenue authority in the jurisdiction in which the consumption takes place;
- Generally, being an indirect tax, it is the “supplier” that is liable for VAT on supplies it makes; and
- GST is a “self-assessed tax” and depends on voluntary compliance. A self-assessed tax is one where taxpayers comply with their obligations without the intervention of the tax authorities.

Consequently, there are practical difficulties in enforcing GST obligations on suppliers that do not have a presence in the jurisdiction in which consumption takes place (on whom the relevant revenue authority might impose and enforce those obligations).

For importation of goods, this tension has traditionally been managed through physical border controls whereby tax is collected from the importer before the goods are released from customs control.

A full assessment model for low value goods in the modern era is not an “efficient” administration and compliance system.

## **Consumption taxation mechanisms for imported goods and services**

The taxation of goods and services generally involves the imposition and collection of the tax from a party other than the consumer of the goods and services.

In Australia's GST, the entity upon who the compliance obligations and GST liability are imposed is, generally, the supplier of the goods and services. This poses difficulties if the supplier is not within the jurisdictional enforcement of the revenue authority.

Consequently, value-added and sales tax regimes adopt alternative mechanisms for enforcement of tax obligations where the supplier is outside of the jurisdictional reach. For example:

- Tax is imposed on importation
- Tax is collected from the recipient / customer
- Jurisdiction is enforced over non-residents

- Tax is collected from third parties, intermediaries or agents
- Tax is collected at origin

## Australia's consideration of GST taxation of offshore supplies

### The GST legislative scheme

It is significant to appreciate that Australia's GST law imposes GST on **both** supplies of goods and services and importation of goods. Further, there can be GST payable on a supply of goods from offshore **as well as** the importation of those goods.

The legislative mechanisms are:

- For **supplies** of goods or services.  
**The supplier is liable to pay GST** on the supply it makes if the supply is "connected with Australia".
  - Supplies of real property are connected with Australia if the land is in Australia;
  - Supplies of goods are connected with Australia if the goods are:
    - Delivered or made available in Australia;
    - Removed from Australia; or
    - Brought to Australia and the supplier imports or installs the goods;
  - Things other than goods are connected with Australia if "the thing is done in Australia" or the supply is made through a permanent establishment of the supplier in Australia;
  - Telecommunication services are connected with Australia if the recipient of the supply will effectively use or enjoy the supply in Australia. This rule is subject to the significant proviso that, if the supplier makes the supply through an establishment outside of Australia, the Commissioner may determine that it would not be administratively feasible to collect the GST. A determination has been made under this Division if the telecommunication provider is not registered for GST.
- For the **acquisition of intangibles** from offshore.  
**The recipient is liable to pay GST** on an acquisition it makes if the supply is **not** connected with Australia and the recipient would not otherwise be entitled to a full input tax credit. The provision only applies to services and recipients that are registered or are required to be registered for GST.
- For importations of goods  
**The person that enters the goods for home consumption** is liable to pay GST at the time of importation. However, goods imported into Australia with a value under \$1,000 are not subject to GST on importation.

## **Board of Taxation Review**

On 11 June 2008, the Board of Taxation (the Board) was asked to review the legal framework for the administration of the GST and identify ways to reduce compliance costs, streamline and improve the operation of the GST and remove any anomalies.

The Board expressed the view that:

“ ... it is not administratively feasible to try to bring non-resident supplies of low value goods and services into the GST system at this time.”

In reaching this conclusion, the Board noted in relation to the LVT for importation of goods:

- The administrative costs of bringing more goods into the customs system would be likely to outweigh the revenue gained;
- If the additional costs were passed on to the consumer, the charges could be disproportionately high compared to the value of the goods; and
- The threshold of \$1,000 has not been changed since 2005 so that “the value of goods able to be imported without GST has, and will continue, to fall over time. This will reduce over time any potential bias in favour of imported goods over local goods of the same quality and value.”

## **Productivity Commission**

The Productivity Commission (the Commission) made its report to the Assistant Treasurer on 4 November 2011. The PC Report was released together with the Government’s response on 9 December 2011.

The Commission considered the operation of the \$1,000 LVT and concluded:

“There are strong in-principle grounds for the low value threshold (LVT) exemption for GST and duty on imported goods to be lowered significantly, to promote tax neutrality with domestic sales. However, the Government should not proceed to lower the LVT unless it can be demonstrated that it is cost-effective to do so. The cost of raising the additional revenue should be at least broadly comparable to the cost of raising other taxes, and ideally the efficiency gains from reducing the non-neutrality should outweigh the additional costs of revenue collection. ...

The Commission notes that any move to lower the level of the LVT would have no impact on the taxation of the importation of services and intangibles — for example, downloads of software, music and games. Treasury estimates that such imports currently give rise to around \$1 billion of GST revenue foregone.”

### *Findings of relevance in considering options to tax*

The PC Report contained the following analysis that is significant in considering the practicalities of expanding the scope of GST to encompass imported goods and services by consumers:

- The vast majority of goods enter Australia through the international mail stream. In 2010-11, 10 million parcels entered through the express courier stream and the Commission estimates that over 47 million parcels entered through the international mail stream. Between 70 and 75% of these parcels have a value of less than \$100.
- The estimate of additional revenue if the threshold were abolished may be around \$480 million in GST. Reducing the LVT to \$100 would generate an estimated \$385 million in additional revenue from GST.
- Treasury has estimated that the loss in revenue from importation of intangibles in 2010-11 was \$1 billion, which is approximately twice the amount of revenue of the LVT on goods.
- “Data show that Australians spend more per capita on online shopping than the United States but lag the online shopping spend of people in the United Kingdom. For example, Access Economics reported some comparisons of per capita e-commerce purchases which showed the United Kingdom leading at US\$1266 per capita in 2009, followed by Australia (A\$534 per capita in 2009 and A\$1068 per capita in 2010) and the United States (at US\$420 per capita in 2008-09) (Access Economics 2010). Note that these estimates relate to e-commerce and may include purchases such as travel and entertainment as well as retail goods.”
- Around 2% of total retail sales are sourced from overseas online retailers.

## **Options for the collection of GST on goods and services supplied from outside Australia**

### **When GST is payable for offshore acquisitions under the existing law?**

At the outset it should be appreciated that, under the current law, and in addition to the taxation of imported goods with a value of greater than \$1,000, the GST law imposes a liability on offshore supplies of goods and services in the following circumstances:

- GST is payable by the non-resident supplier for **supplies of goods** that are delivered to an Australian customer if the supplier imports or installs the goods in Australia. The tax is payable as GST **on a supply** even though the importation may be exempt under the LVT.
- GST is payable by the non-resident supplier for **supplies of intangibles** if the service is performed in Australia **by the supplier** or by way of subcontract.
- GST is payable by the Australian customer **on the acquisition of intangibles** from an offshore supplier, if the customer:
  - Is registered for GST purposes;

- The acquisition is for the purposes of its enterprise; and
- The acquisition would not otherwise be solely for a creditable purpose.

This GST liability arises for the Australian registered customer under **the reverse charge rules** in Division 84 of the GST law.

It is not clear whether there is satisfactory voluntary compliance with these provisions and whether the Australian Taxation Office (ATO) has sought to enforce them.

Accepting the existing law as a basis for examining options, this Report examines and considers four Options.

### **Option 1 – Collection of GST from Australian customer**

Option 1 involves the collection of GST from Australian customers of imported goods and services. The tax would be collected under a voluntary compliance, self-assessment approach provided that the GST would not, otherwise, be fully creditable.

Option 1 proposes a different self-assessment model for:

- GST registered taxpayers; and
- Consumers who are not registered.

#### ***Acquisitions by entities that are registered for GST***

From a legislative point of view, the existing reverse charge provisions could be extended to include:

- Acquisitions that were not acquired for the purposes of the customer's enterprise; and
- Goods that were not subject to GST on importation,

The current process of lodgement of BAS and payment of GST for a period would be extended to the acquisition of all goods and services by registered GST entities that are not currently taxable.

As this extension of the GST base applies only to acquisitions made by registered entities, the scope should be extended to unregistered entities, if for no reason other than the collection of GST on currently untaxed household expenditure.

#### ***Self-assessment of GST by persons not registered for GST***

Option 1 envisages that GST would be payable by entities that are not registered for GST on acquisitions from offshore of:

- Goods that were not subject to GST on importation, and
- Intangibles.

Because the entities acquiring the goods and services in these circumstances do not, otherwise, have GST compliance obligations, an approach needs to be designed whereby the tax liability is reported and paid.

The experience in Canada and New Zealand would seem to indicate that levels of compliance with a self-assessment regime by individuals are very low.

This Report proposes that compliance be achieved through collecting the tax as part of the consumer's income tax return.

There is some experience of this approach in the United States where many states impose a "use" tax on the acquisition of goods and services from outside of the state that has not been subject to tax in the state of "use".

A 2010 study into the collections of use tax on state income tax returns indicated that greater compliance was obtained where taxpayers were required to answer a specific question and complete a line on the return dealing with the obligation to self-assess their liability.

The study notes that the average percentage of taxpayers declaring "use tax" obligations was:

- Across all states – 1.6%
- For states without "lookup tables" – 0.5%
- For states with "lookup tables" – 3.1%

"Lookup tables provide estimates of use tax liability by taxpayer income. The tables typically consist of two columns. Taxpayers find their income in the left column and read across to the right column to find their estimated use tax liability. Use tax liability is assumed to represent a percentage of income. The percentage is intended to represent average use tax liability of taxpayers."

Most states limit the use of the lookup table to purchases of less than USD1,000 – the percentage of "Adjusted" State or Federal income ranges between 0.04% and 0.09%.

The inclusion of information in "TaxPack" and a dedicated field for mandatory completion would, it seem, promote voluntary compliance in an Australia environment.

In addition to requiring completion of an item on an individual's income tax return, "voluntary compliance" could be encouraged through:

- A "lookup table" safe harbour; and
- Data matching with credit and debit card issuers.

Even if the data from the card issuers was not absolutely "matching" with the GST liabilities for taxpayers, it would produce a starting point for a review of compliance.

The data and communication of its availability and proposed use should encourage voluntary compliance.

### *Limitations*

Some commentators have opined that reliance on buyers to remit tax creates an unrealistic **tax on honesty**, as well as being complicated.

### Compliance costs

The requirement that taxpayers self-assess their GST liability on their income tax return involves substantial complexity and costs (if just in the form of time lost):

- Distinguishing between imports of GST-free and input-taxed goods, and imports of taxable goods would require significant information and knowledge on what was purchased and its GST classification.

While details of the company from which the purchase was made may be able to be ascertained from bank statements, the classification of taxable status of the purchase is not without difficulty. This is particularly the case if intangibles are included in the GST self assessment system.

- Difficulties would arise in ascertain whether the acquisition as made from:
  - An Australian entity that is not registered for GST (not taxable); or
  - An offshore entity that is registered for Australian GST and has accounted for GST.

Full data is likely to be available only from the offshore acquiring bank or merchant concerned.

Recognition of these difficulties could lead to the adoption of a safe harbour or “lookup” table as described above. In practice, this would lead to a de facto “cap” on liabilities and an under taxation of offshore acquisitions of goods and services.

### The number of taxpayers

The PC Report gives an indication of the widespread nature of the transactions that are to be taxed under the proposed “self-assessment” option.

Given that, just for low value goods, there are 57 million parcels one should contemplate some limitations on the practicality (and deadweight loss) of the process of data collection and matching – particularly when weighed against the revenue otherwise forgone.

Without voluntary compliance, given the likely number of taxpayers, it would seem that administration (and compliance) costs would be much higher than the average GST collection costs under the current regime of approximately 1.4% of revenue.

### Non-lodgers

The proposal to increase the Australian income tax free threshold from \$6,000 to \$18,200 from 1 July 2012, and to \$19,400 from 1 July 2015, will mean that over 1 million individuals will not be required to lodge a tax return.

Self assessment of GST on importations would substantially increase the number of people who would need to submit a tax return, many of whom would have only a small amount of tax due. This would increase the compliance and administrative cost such that the revenue would not justify the costs.

Alternatively, non-lodgers could be exempt from the GST liability.

### Collection and recovery

If the income tax return results in a liability to pay tax (rather than a refund of excess PAYG instalments), the costs of collection and recovery of small amounts may outweigh the additional revenue gained from the expansion of the scope of GST.

## **Option 2 – GST payable by offshore supplier and GST registered recipients**

Option 2 involves the collection of GST:

- from the non-resident supplier for supplies made to unregistered customers in Australia under the same mechanisms as currently applies for other GST taxpayers; and
- under a reverse charge for Australian recipients of goods and services that are registered for GST.

### ***GST on supplies made by non-residents – two approaches***

*Supplies made by non-residents to entities that are not registered for GST in Australia*

**Under Option 2** it is proposed that the non-resident supplier be made liable for GST on supplies it makes in the course of its enterprise of:

- goods that are brought into Australia and are not otherwise taxable as supplies or importations; and
- intangibles delivered to Australia that are not otherwise “connected with Australia”. The scope of services is proposed to be limited to minimise the taxpayer base and the administration and compliance complexity – see below.

*Acquisitions by entities that are registered for GST*

**Under Option 2** it is proposed that the reverse charge liability be extended to private acquisitions by GST registered entities (as in Option 1) – in which case GST is payable by the recipient.

### ***Voluntary compliance***

In the United States there has been a long history of individual states seeking to claim nexus over out-of-state suppliers. The difficulty in the US is the constitutional limitations of states to legally exercise extra-jurisdictional jurisdiction.

Amazon.com has resisted moves by the states in the US to extend sales tax laws to sales it makes through out-of-state establishments or companies. Some commentators contend that Amazon’s position stems from a desire to preserve the competitive advantage it gains over its rivals when they must add sales tax to their prices.

Other commentators suggest that the difficulties of enforcing out-of-state compliance is not caused by the desire of suppliers to avoid tax but on the complexity arising from the myriad of different tax rates and scope of taxation in the state and local governments that seek to collect them.

Amazon complies with many VAT and US taxation requirement, so why does it comply with some indirect tax laws and not others?

“The answer, quite simply, is that those countries’ tax laws say it has to; there are no foreign [laws preventing the exercise of extra-territorial power] to immunize the company from VAT-collection obligations. Amazon complies with applicable tax law when its legal obligations are clear.”

This Report concludes that the situation in the US is a constitutional one. If the tax impost is illegal, there is no legal requirement placed upon companies – in fact, a customer could resist the VAT/GST amount charged to it if the tax was not legally imposed.

In the case of Australia, if an obligation can legally be placed on an offshore supplier it may not be enforceable in foreign courts. It is a very different matter to seek to avoid tax on grounds non-enforceability than illegality.

### *EU*

The EU has different place of supply rules for goods, services and telecommunication between different EU Member States.

For telecommunication services and radio and television broadcasting services, the the Place of Supply Directive authorises collection of VAT from non-EU suppliers where the use and enjoyment of the service occurs within a Member State.

Supplies made from outside the EU to unregistered customers in a Member State, are taxable under a special scheme for offshore suppliers of television and broadcasting services.

The scheme allows any business that:

- is not established in the EU; and
- supplies telecommunications, broadcasting or electronic services to a customer that is not registered for VAT in the EU,

to register for VAT in **one** of the Member States and pay VAT on its EU supplies (made to unregistered customers in the EU) in that Member State.

The Board of Taxation’s discussion paper on cross-border transactions confirms that:

“For electronically supplied services, telecommunication and broadcasting services flowing directly to a consumer within the European Union (business to consumer supply) the European Union makes the non-resident supplier liable for the VAT. The non-resident supplier is required to register for VAT **in one of the member states** and account for VAT made to the consumer.” (emphasis added).

The important aspect of this arrangement is that the EU extended its reach to non-resident suppliers of telecommunication services.

Rather than ignore the proposed extra-territorial reach, the major providers have selected the lowest VAT jurisdiction in the EU (Luxembourg) to register and pay VAT.

“VAT in Luxembourg is charged at 15% - the lowest rate permitted in the EU - and the current rules have led dozens of major e-commerce firms such as eBay, Skype and iTunes to set up in the jurisdiction.”

In all likelihood these “voluntary” registrations for VAT account for a significant proportion of the value of telecommunication services imported to the EU.

### *Encouraging voluntary compliance*

The clear theme, in my view, is that the offshore suppliers, whilst preferring not to incur the compliance costs of registration and reporting, will respond to gentle persuasion and simple compliance regimes.

This view is supported by the submissions made to the Government at the time of the 2005 amendments to the GST law to extend the scope of GST to foreign tourist operators.

The submissions argued that companies that came within Sarbanes-Oxley (SOX) or similar governance regulations require assurance that suitable control mechanisms are in place to ensure compliance with the various regulatory regimes (including indirect tax) to which the companies are subject.

The Report of the Senate Economics Legislation Committee Inquiry into Tax Laws Amendment (2005 Measures No. 1) Bill 2005, agreed with the submissions and proposed an amendment to the proposals so that, in effect, the requirement to register was not mandatory but voluntary.

Accordingly, while it might be possible (as a matter of extra-jurisdictional enforcement) to ignore Australian GST obligations, in my view, the SOX and similar governance requirements mean that controls would be put in place to ensure compliance with the Australia law.

This is, of course, subject to materiality.

Many of the arguments in respect of extra-territorial reach and voluntary compliance are discussed in the Report of the Senate Economics Legislation Committee.

The main issues that would run counter to voluntary compliance are complexity of the registration and return lodgement process and difficulty in compliance with the law itself.

Accordingly, Option 2, to achieve voluntary compliance, requires:

- Simple registration, lodgement and compliance processes; and
- Certainty and clarity in the taxation treatment of the transactions at issue.

The Senate Economics Committee Report shows the danger of “overreaching” in the legislation and failing to limit its scope to the mischief at hand.

In this regard, I recommend that the scope of supplies at which the proposal is directed should be limited to:

- goods under the \$1,000 LVT; and
- “on-line” purchase and delivery of intangibles.

The Place of Supply Directive has definitions of these services for the purposes of its special scheme.

A registration threshold should also operate to minimise the “reach” of the proposals to a manageable number of taxpayers.

In addition, consideration should be given to:

- The option or requirement for the appointment of a “GST Agent” or “fiscal representative” in Australia to attend to the compliance obligations of a non-resident without a physical presence in Australia;
- A residual liability to be imposed on a customer for GST not paid by an offshore supplier to facilitate the collection of liabilities from amounts due to card issuers.

### *Summary*

In my view, Option 2 is more:

- likely to be successful; and
- efficient because the number of taxpayers would be far less, than a self-assessment of customers as in Option 1.

Under this approach, a non-resident supplier has two approaches to the supplies it makes to customers in Australia:

- No GST obligations arise if the Australian customer is registered for GST; and
- GST is payable for supplies made to Australia customers who are not GST-registered.

This approach is consistent with both:

- the proposed changes to the treatment of cross-border transactions recommended by the Board of Taxation review; and
- the approach adopted in the EU.

Option 2 involves the collection of GST from:

- The non-resident supplier under the same mechanisms as currently applies for other GST registered taxpayers; and
- Australian recipients of goods and services that are registered for GST.

### **Option 3 - Tax collected from third parties, intermediaries or agents**

Option 3 is, from the perspective of the legislative scheme and administration, two different options:

- The first approach of collection from third parties is proposed to be a recovery or withholding tax.
- The second approach is to impose a liability on third party facilitators of the supply rather than the supplier itself.

### ***Recovery of GST payable by a supplier – a “recovery” approach***

This option envisages the imposition of GST on the supplier or recipient in the same way as Options 1 or 2 but the recovery of the liability is from a third party.

The Australian taxation law has examples of situations where an intermediary that holds money for a taxpayer is required to pay tax due by the taxpayer.

Under Option 3, the collection of GST from, and enforcement of obligations on, a third party would first require a legitimate liability and obligation of the supplier to be established.

The alternative is to establish a primary liability on the facilitator – this is dealt with in the second part of Option 3.

### ***Imposition of GST on third party***

This option proposes that a new and separate GST liability be imposed on transactions entered into by intermediaries such as card issuers that obtain fees through facilitation of the offshore purchase of goods or services.

The PC Report, in considering this approach, stated:

“Another alternative may be to collect GST on overseas purchases made using credit or debit cards by requiring card issuers to collect the GST as part of the transaction.

The Commission sought information from financial intermediaries on the feasibility of this option. In response Visa advised that:

Visa is of the view that we could not perform this function. It is noteworthy that Visa does not perform this role for any other jurisdiction globally.

The core reason for our inability to perform such a function is that no technical data solution exists to deliver the suggested collection outcome. It is important to also note that no Visa-controlled steps exist that would change this situation. ...

The Commission understands that the current system for processing payments does not allow the identification of the individual components of a transaction which would be needed to identify what taxes were applicable. The Commission is not aware of any government which is currently using this approach.”

One presumes that, if the law imposed a GST liability on the card issuer for the transactions its card holders entered into with offshore merchants, the credit card agreement would allow the issuer to recover that amount from the card holder.

This would constitute a credit risk for the card issuer that would require relief in the event that the GST was not fully recovered from the card holder.

It is not clear that the information held by the card issuer would allow any more granular examination of each transaction than that of Visa. The information from Visa notes that the data on the break-down of a purchase may be held by the merchant’s acquiring bank – which is likely to be based in the merchant’s own jurisdiction.

The number of transactions involved, when intangibles are combined with 57 million parcels would appear to involve heavy compliance costs that may require the co-operation of the non-resident supplier or acquiring bank.

Further, the amount due from the card holder to the card issuer is the credit risk of the issuer. The card issuer is liable to pay the face value of the sale to the card acquirer whether or not it recovers the sum from the card holder.

Two approaches might be adopted to overcome the limitations of the card issuers to pay GST on transactions for which it provides credit:

- Card issuers could be required to deduct GST from all transactions with offshore parties at their face value and customers could claim a tax-rebate on GST incorrectly charged.

This mechanism suffers from several limitations:

- It would require the identification of GST registered card holders vs unregistered so that the deduction was only suffered by those customers that are consumers. Alternatively, a tax invoice system would need to be instituted to allow GST credits to registered card holders and any reverse charge obligation ignored.

For over deduction, a mechanism for refund to the unregistered card holder would need to be found.

- Without more in the GST law or the agreement with the card holder, the card issuer would not be able to recover the GST component from the customer so that the GST costs would be borne by the card issuer.

Under the existing credit card systems, the offshore acquirer and merchant would not suffer the GST cost. Any reduction from the amount due to the merchant would be in breach of the card issuers' contractual obligations to the card company and interchange arrangements.

- The GST liability could be based on a fraction or multiplier of an aggregate of cash flows or revenue of the card issuer.

The fraction or multiplier would be applied to an aggregate of all amounts payable to a card issuer for offshore purchases for a period and be calculated to approximate the GST that would otherwise be payable by the offshore supplier. For example, if a card issuer was required to pay to the card acquirer in respect of offshore merchants sales totalling AUD1 billion in a year – each being less than AUD1,000 – a GST might be imposed on the card issuer for a total of AUD 90,909,090, being 1/11<sup>th</sup> of the price received from the customer.<sup>2</sup>

Where aggregate arrangements have been used in the past for liquor franchise fees and fire service levy, the result has been per unit fees charged to customers (by the proxy taxpayer) that appear as if they are transaction based.

Consideration should be given to the danger of such a tax being characterised as a tax on income or assets rather than a GST must be considered in the context of our international treaties.

A system of deduction of this nature should also be accompanied by a system of Government indemnities for the card issuer.

**I do not recommend** these approaches because of the likely complexity and administrative costs involved.

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<sup>2</sup> Assuming that this is indirectly recovered from the customer, the use of the 1/11<sup>th</sup> fraction produces a 10% tax on the GST exclusive cost to the customer.

The use of a collection through the card issuer is more suited to the recovery of liabilities established under Option 2.

Option 2 is preferable from an efficiency and compliance perspective. While card issuers may be the source of information to establish the extent of liabilities under Options 1 or 2, it is unlikely that an efficient system of collection could be mounted against these entities as a principal point of reference.

#### **Option 4 – Tax collected at origin**

There are, again, two approaches to this option:

- GST collected in the jurisdiction of origin and shared with or transferred to the place of destination. In some federal jurisdictions (such as the Canadian Harmonised Sales Tax (HST)) tax is collected in the jurisdiction in which the supplier is established and from which the supply is made with a mechanism to transfer the benefit of tax to the customer's jurisdiction. This Option is not viable at the present stage of international co-operation of VAT systems.
- GST is collected but retained in the jurisdiction of origin. This option, while efficient and practical does not increase the GST revenue in Australia.

### **Conclusion**

#### *Option 2*

Of the four options, I consider that the second is the most likely to be successful. I note that:

- It is likely that offshore suppliers have liabilities under the existing law of which they are unaware; and
- The option, while contrary to the aim of reducing the involvement of non-residents in the Australian system announced in the 2010-11 Budget, is consistent with the exiting GST system and the apparently successful approach of the EU.

The success of the initiative would depend upon:

- Simple registration, lodgement and compliance processes, including a registration threshold;
- Certainty and clarity in the taxation treatment of the transactions at issue;
- The identification of, and communication with, the major suppliers to Australian customers to ensure their voluntary compliance with an increased scope of the Australian GST net.

Information provided by debit and credit card issuers or intermediaries would be an extremely convincing voluntary compliance tool and it is considered that large companies would be more likely to comply than not.

An ability to enforce the collection of tax against intermediaries that are within the Australian jurisdiction, while unpopular, may encourage the compliance of non-residents.

*Option 1*

My alternative recommendation is Option 1. I take note of the apparent success of communication and compliance encouragement in the US income tax system. I would hope that similar approaches in Australia, when combined with data matching, would be successful in recovering the significant revenue lost from on-line retailing under the current regime.

Because of the high number of taxpayers, its complexity and the collection costs of unpaid GST amounts, further examination may reveal that the administrative and compliance costs outweigh the revenue gain.

# 1 Introduction

## 1.1 Overview

I have been commissioned<sup>3</sup> by the Department of the Treasury<sup>4</sup> to prepare this preliminary report (the Report) for the GST Distribution Review Panel to examine the scope of practical methods to bring imported goods and services within the scope of Australia's goods and services tax (GST).<sup>5</sup>

### 1.1.1 The Review

On 30 March 2011, the Treasurer announced the Government's appointment of a panel to conduct a review of the distribution of revenue from the GST to the States and Territories (the Review).

The terms of reference required that the Review Panel provide an interim report to the Treasurer by February 2012 and a final report by September 2012.

On 1 July 2011, the Review Panel released an Issues Paper and called for submissions from interested parties. Following the addition of two items to the Review's terms of reference on 17 November 2011,<sup>6</sup> a supplementary issues paper was issued in December 2011, seeking submissions by 9 March 2012.

As a part of the Review, Treasury has sought this preliminary report, for the Review Panel, to explore whether the GST revenues available for distribution to the States and Territories might be increased by collecting GST currently forgone on the importation of goods below the "low value threshold" (LVT) of \$1,000 and services.

### 1.1.2 Task Force

On 9 December 2011, the Government released the report of the Productivity Commission Inquiry into the Economic Structure and Performance of the Australian Retail Industry (the PC Report) and its response to the PC Report.

In a Joint Media Release issued by the Assistant Treasurer<sup>7</sup> on that same day, the Government announced the establishment of the Retail Council of Australia to advise the Government on the future of the sector.

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<sup>3</sup> Michael Evans is an academic, independent consultant and registered tax agent specialising in tax policy, strategy and design of value-added tax systems.

<sup>4</sup> Under a letter of engagement dated 28 November 2011 and consultancy contract dated 2 December 2011.

<sup>5</sup> The tax that is payable under the *A New Tax System (Goods and Services Tax) Act 1999* and its regulations (referred to in this Report as the GST law).

<sup>6</sup> Supplementary terms of reference ask the Panel to examine and make recommendations on possible changes to the form of equalisation to achieve the following objectives:

- ensure that HFE does not provide a disincentive to State tax reform
- utilise HFE to provide incentives and disincentives to promote future State policy decisions which improve the efficiency of State taxes and mineral royalties
- examine the incentives for States to reduce Minerals Resource Rent Tax (MRRT) or Petroleum Resource Rent Tax (PRRT) revenue through increasing State mineral royalties.

<sup>7</sup> Then, the Honourable Bill Shorten MP.

The Media Release also stated:

“The Commission's report makes clear the low value threshold for GST and duty on imported goods is not the main factor affecting the international competitiveness of Australian retailers. The Commission found there are in-principle grounds to reduce the low value threshold, but that it is currently not cost-effective to do so.

It calculated that lowering the threshold to \$100, for example, could collect around \$500 million in revenue, but at a cost of \$1.2 billion in administration and compliance costs.

However, if significant improvements were made to the cost of processing international parcels, the Government would be in a position to reassess the threshold.

The Government will establish of a Taskforce to investigate options to improve the efficiency of processing low value imported parcels. The Taskforce ... will provide an interim report in three months and a final report to the Government no later than July 2012.

The Taskforce will consult the views of expert stakeholders, including the Australian Customs and Border Protection Service, the Australian Quarantine and Inspection Service; Australia Post; the Conference of Asia Pacific Express Carriers; and other stakeholders, including consumers, small business and representatives groups such as the Fair Imports Alliance.

Terms of reference will be released in January 2012.”

The PC Report also contains<sup>8</sup> an estimate of the revenue loss arising from the exemption from GST on imported intangibles.

“The Commission notes that any move to lower the level of the LVT would have no impact on the taxation of the importation of services and intangibles — for example, downloads of software, music and games. Treasury estimates that such imports currently give rise to around \$1 billion of GST revenue foregone.”

## 1.2 Scope of this Report

This Report does not deal with the possible manner of increasing the efficiency of processing low value imports of goods. Rather, it canvasses the relative practicalities of **other options** for taxation of imported goods and services, including but not limited to those being used in other jurisdictions.

It contains:

- In Chapter 2 - The theory and design features of consumption taxation, the practical difficulties of administration and the mechanisms generally adopted to address these difficulties.
- In Chapter 3 - The legislative scheme of Australia's GST law as it applies to cross-border transactions and the reviews conducted in Australia to date for the GST taxation of goods and services imported into Australia.

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<sup>8</sup> Box 6, PC Report.

- In Chapter 4 - Options, other than collection of GST at the point of importation, for the taxation of goods and services, imported from outside, but consumed in Australia and the conclusion of the evident practicality of the options.

## 2 The theory and practice of consumption taxation

The appropriate level of taxation of imported goods and services under the GST depends upon the purpose and objectives of the GST system and the policy underlying its particular design features.

In respect of the design features of the GST, the PC Report commented on the balancing of neutrality and deadweight costs of administration and compliance:

“Notwithstanding the potential for inefficiency from non-neutral taxation of substitutable transactions, the costs of collecting taxes which are borne by government, business and consumers entail efficiency losses and are part of the deadweight loss for the community. Therefore, from the viewpoint of maximising the welfare of all Australians, the question is whether there are likely to be bigger losses in welfare from trying to provide equal treatment by collecting taxes on all imports, than from the distortions created by differential rates of tax and duty for overseas and domestic retailers.

As the recent Henry Tax Review noted:

Related to the issue of complexity are the costs of administering and complying with the tax and transfer system. These costs represent a net loss to the economy, because the resources engaged in these activities could otherwise be put to more highly valued uses. Recent research suggests there is an optimal level of system complexity and operating costs, one that balances administration and compliance costs with improved efficiency and distributional outcomes.” (*Australia’s future tax system. Report to the Treasurer. December 2009 (the Henry Review)*, p. 21)

Under the current GST law, the exclusion of a proportion of Australia’s consumption expenditure (for imported goods and services) from the scope of GST is a consequence of the “balance” of neutrality and efficiency referred to in the PC Report and the Henry Review.

The particular feature of Australia’s GST that gives rise to the non-neutral application of GST to some imported goods and services is the so-called “**destination principle**” of consumption taxation – that is the design feature that requires that taxation occurs in the jurisdiction in which consumption takes place and **not** in the jurisdiction from which the goods and services originate.<sup>9</sup>

### 2.1 Taxation of household final consumption expenditure

#### 2.1.1 What are the reasons for the adoption of a tax on “household final consumption expenditure”?<sup>10</sup>

Australia’s GST is an indirect tax on final private consumption in Australia.<sup>11</sup> The Australian Bureau of Statistics (ABS) data category is “Household Final Consumption Expenditure” (HFCE)<sup>12</sup>.

<sup>9</sup> Often the jurisdiction of origin is the place in which production occurs and contributes to the Gross Domestic Product (GDP) of that jurisdiction.

<sup>10</sup> The Treasury’s “Tax Expenditure Statement”, for the goods and services tax, adopts that benchmark of “the final consumption of goods and services by households”.

<sup>11</sup> “GST in a nutshell”. Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1999*.

If the purpose of a taxation system is to raise revenue for Government programs, a tax should be both adequate and efficient. The choice of HFCE as the tax base is preferred because:

- **The tax base is robust and reliable**

With a tax base of HFCE, tax revenues grow in line with household expenditure, regardless of the type of the goods and services consumed.

While HFCE is linked to national incomes, the taxation of household consumption is less affected by variations in economic conditions than a direct tax on income.

- **Neutrality and efficiency** - The tax can be levied to maximise the production of goods and services with minimal economic costs to the economy.

With a uniform rate of tax applied to the broadest range consumption expenditure, a consumption tax will not distort relative prices. Because the tax does not alter relative prices, households and firms are indifferent, from a tax perspective, between:

- Which goods and services to buy, produce or sell; and
- Whether to consume (or produce) in the present or defer consumption (or production) for the future by means of saving.

The preference for a tax on consumption is that it enables a secure and reliable revenue source without distorting the behaviour of firms and households. Under the destination principle, a GST is intended to be neutral in relation to decisions of consumers and producers about what they buy and where and how it is produced.

Once it is determined that a tax base of HFCE satisfies the test of adequacy, reliability, stability and neutrality, consideration needs to be given to the preferred design features - its imposition and collection.

In practice, the design features of consumption taxes sometimes sacrifice the destination based neutrality for the sake of efficiency, practicality and integrity of collection.

### 2.1.2 The current GST tax base

This Report examines the practicalities of the expansion of the GST base to include currently untaxed HFCE on imported goods and services. The purpose is to consider whether additional GST can be collected for the benefit of the States and Territories.

In this context it is worthy of note that Australia's GST tax base does not encompass all HFCE, taxing only 57% of consumption.<sup>13</sup> With a decrease in HFCE (and an increase in savings) since 2006, GST has fallen:

- As a percentage of HFCE, from a high of more than 5.5% to 5% at June 2011; and
- As a percentage of GDP, from 4% to 3.5% at June 2011.<sup>14</sup>

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<sup>12</sup> ABS, 5206.0 Australian National Accounts: National Income, Expenditure and Product. Table 8. Household Final Consumption Expenditure (HFCE).

<sup>13</sup> Part 2 D, Taxing Consumption of the Henry Review.

<sup>14</sup> ABS, Australian National Accounts, National Income Expenditure and Product and National Income, Expenditure and Product; Table 8. Household Final Consumption Expenditure, June 2011.

The effect on the GST revenue as a percentage of consumption is a consequence of a change in household consumption patterns from expenditures that are subject to standard rate GST to those that are not fully taxed. The shift in consumption patterns is illustrated by the following examples of the change in the proportion of household expenditure for the following items between June 2000 and June 2011:

- Recreation and culture<sup>15</sup>: decreased from 11.83% to 10.66%.
- Rent<sup>16</sup>: increased from 18.13% to 19.8%
- Education and health<sup>17</sup>: increased from 6.91% to 9.21%
- Clothing and furnishings<sup>18</sup>: decreased from 9.52% to 7.58%
- Insurance and finance<sup>19</sup>: increased from 8.7% to 11.32%.<sup>20</sup>

The increase in internet shopping when combined with the low value (LVT) exemption of imported goods also has the consequence of a decrease in the base of HFCE that is subject to GST. An increase in the proportion of household expenditure on offshore acquisitions of intangibles also represents a shift in HFCE patterns that diminish the GST tax base.

The PC Report estimated that the additional revenue that might be collected if the LVT were abolished, and imported intangibles were brought within the scope of GST, may be around \$1.480 billion in GST. This represents approximately 7.9% of HFCE and 3% of total GST revenue.

It is worthy of note that the International Monetary Fund (IMF)<sup>21</sup> have examined the narrowness of Australia's (and other countries') GST base. In their analysis the IMF concluded that Australian GST revenue could be increased by approximately 2.5% of GDP through the removal of existing concessions.

In addition, the Henry review observed the negative impact on GST revenue and efficiency arising from Australia's exemption of financial services which results in the under-taxation of consumption by \$3.9 billion (in 2011 terms).<sup>22</sup>

## 2.2 Design features of consumption taxation

The main purpose of taxation is to raise revenue through:

- 'Direct Taxation' which is assessed upon the property, person, business, income or expenditure of those who pay them;
- 'Indirect Taxation' which is levied on goods and services before they reach the consumer and are paid by those upon whom they ultimately fall as part of the market price of the goods or services purchased.<sup>23</sup>

<sup>15</sup> Taxed at the standard rate of 10%.

<sup>16</sup> Input taxed.

<sup>17</sup> GST-free.

<sup>18</sup> Taxed at the standard rate of 10%.

<sup>19</sup> Input taxed.

<sup>20</sup> ABS 5206008 Household Final Consumption Expenditure, Jun2011.

<sup>21</sup> *Fiscal Monitor, Fiscal Exit: From Strategy to Implementation, November 2010*, International Monetary Fund.

<sup>22</sup> As well as an over taxation of business of \$760 million in 2011 terms.

<sup>23</sup> J Bouvier, *Bouvier's Law Dictionary* (1897).

Australia's GST is an indirect tax on final private consumption in Australia.<sup>24</sup> It is **an indirect tax** because it is collected from business<sup>25</sup> as a proportion of the price paid by consumers<sup>26</sup> for goods and services supplied by the business.

Australia's GST is also payable by a person<sup>27</sup> who **imports goods**, whether or not the goods have been the subject of **a supply** by a business.

In theory, a tax on HFCE could be levied by a **direct** personal expenditure tax.

Personal expenditure taxes were implemented briefly in India and Sri Lanka in the 1960s and 1970s and were proposed in the United States in 1995.<sup>28</sup> Under a personal expenditure tax, individuals would be required to account for their personal expenditure annually and remit the tax to the revenue authority.<sup>29</sup>

The Henry review<sup>30</sup> notes that the significant practical difficulties in adopting a personal expenditure tax to household consumption include the loss of revenue integrity compared to an indirect tax collected by vendors of goods and services. Essentially, a self-assessment system of declaration of one's own spending is difficult to enforce, audit and administer and is high in compliance costs.

One of the factors that simplifies the collection of an indirect tax (such as GST) is that the tax is collected by a significantly lower number of taxpayers than would be the case for a direct tax – there are approximately 2 million GST registrants compared to a possible population of more than 20 million consumers.

While many countries established single stage sales taxes, from the 1970's the adoption of a multi-stage value-added tax, often to replace these narrowly based sales taxes, has been described as an "unparalleled tax phenomenon".<sup>31</sup>

VAT has been implemented by over 150 countries throughout the world. The OECD explains the reason for preferring this form of taxation as follows:

“The value-added tax system is based on tax collection in a staged process, with successive taxpayers entitled to deduct input tax on purchases and account for output tax on sales in such a way that the tax finally collected by tax authorities equals the VAT paid by the final consumer to the last vendor. These characteristics ensure the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain and the technical means used for its delivery. When the destination principle, which is the international norm, is applied, it allows the tax to retain its neutrality in cross-border trade. According to this principle, exports are exempt with refund of input taxes (“tax

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<sup>24</sup> “GST in a nutshell”. Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1999*.

<sup>25</sup> Referred to in the GST law as suppliers. These are “entities” that carry on an “enterprise” and are required to be registered for GST purposes.

<sup>26</sup> In general terms these are households. Because of the credit offset mechanism in the GST, business is relieved from GST on its business inputs.

<sup>27</sup> The credit offset mechanism in the GST also relieves business from GST on its business imports.

<sup>28</sup> Schenk, A. and Oldman, O., *Value Added Tax – A Comparative Approach*, 2007 (Schenk).

<sup>29</sup> See, for example, N Kaldor, *An Expenditure Tax*, George Allen & Unwin Ltd, 1955.

<sup>30</sup> *Australia's future tax system. Report to the Treasurer*. December 2009.

<sup>31</sup> Tait, A., *Value Added Tax, International Practice and Problems*, International Monetary Fund (IMF), 1998.

free”)<sup>32</sup> and imports are taxed on the same basis and at the same rates as local production.”<sup>33</sup>

In recent years, the international aspects of value-added taxation have come more into focus. The Committee on Fiscal Affairs of the OECD has published so-called “Neutrality Guidelines”<sup>34</sup> which are concerned with VAT neutrality in the international context.

The OECD Neutrality Guidelines note that the principle of VAT taxation of international goods and services ought to be based on the destination principle – that is, that VAT is collected in the country in which consumption occurs and not the place of origin (where, generally, value is added).

The significant VAT issue at which these guidelines are directed is the possibility of “no-taxation” or “double taxation” of the same item of expenditure where the transaction involves more than one VAT jurisdiction.

The underlying design features of a VAT that gives rise to these complexities are:

- Under the destination principle, VAT should be collected by the revenue authority in the jurisdiction in which the consumption takes place;
- Generally, being an indirect tax, it is the “supplier” that is liable for VAT on supplies it makes; and
- VAT is a “self-assessed tax” and depends on voluntary compliance.<sup>35</sup> A self-assessed tax is one where taxpayers comply with their obligations without the intervention of the tax authorities.

Consequently, there are practical difficulties in enforcing VAT obligations on suppliers that do not have a presence in the jurisdiction in which consumption takes place (on whom the relevant revenue authority might impose and enforce those obligations).

For importation of goods, this tension has traditionally been managed through physical border controls whereby tax is collected from the importer<sup>36</sup> before the goods are released from customs control. In this respect, the GST system departs from the “voluntary compliance” and self-assessment model. Taxation on importation is, essentially, a full assessment model.

While the traditional full assessment model may have been suitable to an era where there were formalities at borders, it is neither consistent nor practical in an era of economic integration and large volumes of international trade in goods.

“Taxes should be collected efficiently to minimise the ‘deadweight loss’ for the community. This deadweight loss arises from not only the administrative and compliance costs, but also any undue delays in delivery to businesses and consumers that may result from the processes of collection.”<sup>37</sup>

<sup>32</sup> Commonly refer to as “zero rate”.

<sup>33</sup> OECD (2011), *Consumption Tax Trends 2010: VAT/GST and Excise Rates, Trends and Administration Issues*, OECD Publishing.

<sup>34</sup> *OECD International VAT/GST Guidelines. Guidelines on Neutrality*, Approved by the Committee on Fiscal Affairs on 28 June 2011, OECD Working Party No. 9 on Consumption Taxes. (Neutrality Guidelines).

<sup>35</sup> Ebrill, Keen, Bodin and Summers, *The Modern VAT*, IMF, 2001 Chapter 13 (Ebrill 2001).

<sup>36</sup> In the Australia model, the person who enters the goods for home consumption.

<sup>37</sup> *Economic Structure and Performance of the Australian Retail Industry*. Productivity Commission Inquiry Report No 56 (the PC Report).

A full assessment model for low value goods in the modern era is not an “efficient” administration and compliance system.

The OECD Neutrality Guidelines observe that, for the international trade in goods, imposing VAT at the point of importation and zero-rating exports achieves neutrality.

The guidelines do not, however, address the effects of economic integration and the increase in the frequency and volume of relatively low value imported items. These factors bring pressure on the costs and efficiencies of formalities at border frontiers such that the tax at the border of low value goods is often expressly, or in practice, forgone.<sup>38</sup>

Relevantly for the present discussion, for intangibles, the OECD Neutrality Guidelines observe:

“7. Applying the destination principle to supplies of services and intangible products is more difficult. The nature of services and intangibles is such that there are no customs controls that can confirm their exportation and no customs controls to impose the VAT at importation.”

For intangibles, the manner of imposition and enforcement of VAT liabilities has been the subject of considerable concern and discussion. In 1998 the OECD Committee on Fiscal Affairs (CFA) presented a report to the Ministers at the OECD Ministerial Conference<sup>39</sup>. The Ministers endorsed the proposals contained in the report.

This framework contained in the report - referred to as the “Ottawa Framework Conditions” – endorses a principle that taxation of cross-border electronic commerce should result in taxation in the jurisdiction where the consumption takes place.

Following on from the Ottawa conference, in 2003, the OECD released a progress report<sup>40</sup> recommending ways to implement this principle<sup>41</sup> might be achieved.

For B2C transactions, the 2003 Report proposed that the VAT be collected **from the foreign supplier** and remitted to the jurisdiction of consumption through registration of that supplier in the jurisdiction of consumption.

The 2003 report also resolved to incorporate the work on e-commerce into the Committee’s ongoing program for cross-border trade in intangibles undertaken under the auspices of the CFA’s Working Party no 9 on Consumption Taxes and its Technical Advisory Group (TAG).

Coming out of this project, in February 2006 the OECD released the *OECD International VAT/GST Guidelines* (the VAT guidelines) to provide guidance for governments on applying VAT to cross-border trade.

The Chapter dealing with B2C cross-border trade in intangibles is being developed.

<sup>38</sup> Chapter 17, Ebrill, L et al, *The Modern VAT*, Washington, IMF, 2001 (Ebrill 2001).

<sup>39</sup> “Electronic Commerce: Taxation Framework Conditions”.

<sup>40</sup> “Taxation and Electronic Commerce – Implementing the Ottawa Taxation Framework Conditions. The 2003 Report” (the 2003 Report).

<sup>41</sup> The report observes that “for business-to-business (B2B) supplies the customer, being subject to audit by the tax administration in the country of consumption, should account under the reverse charge. This well-established mechanism generally relieves the non-resident supplier of liability towards the tax administration in the customer’s country. The situation for business-to-consumer supplies is less easy. Administrations do not often find it feasible to involve final consumers in the tax collection process given that the costs would outweigh the revenue involved.”

As a starting point, the VAT Guidelines contain two principles for charging VAT on internationally traded services and intangibles:

- For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption (the destination principle);
- The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation (the neutrality principle).

In the EU, examination of the cross-border issues has been the subject of refinements and interim solutions but no substantial examination has been performed since 1993.<sup>42</sup> On 8 December 2011, the Commission adopted a Communiqué entitled "The future of VAT – Towards a simpler, more robust and efficient VAT system". The Communiqué opens the way for "substantial efforts to devise alternative concepts for a properly functioning destination-based EU system of VAT".

It should be appreciated that much of the discussion in the EU surrounding B2C taxation of goods and services is concerned with inter-EU trade. The absence of frontiers in a common market creates similar collection issues (if a destination basis of taxation is to be adopted) as is Australia's case with the LVT and importation of intangibles.

For Federal jurisdictions such as the United States and the EU, mail order transactions have been the source of continuing difficulty.<sup>43</sup> In the US, the major difficulty is the lack of legal capacity of the state in which the goods are consumed, to levy tax on a company that has insufficient nexus with the state. The legal problem is one of the exercise of extra-territorial legislative power.

It is the practical issues of collection of Australia's GST on imported goods and services that is the subject matter of this Report.

## **2.3 Consumption taxation mechanisms for imported goods and services**

The taxation of goods and services generally involves the imposition and collection of the tax from a party other than the consumer of the goods and services.

In a value-added tax, such as Australia's GST, the entity upon which the compliance obligations and GST liability are imposed is, generally, the supplier of the goods and services. This presents difficulties if the supplier is not within the jurisdictional enforcement of the revenue authority.

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<sup>42</sup> Taxation at destination had not been pursued because of the original EU commitment to the origin principle – in this case "origin" implied collection at origin but remittance to the place of consumption through some form of central agency or clearing house.

<sup>43</sup> McLure, Charles E Jr, *Electronic Commerce and the State Retail Sales Tax: A Challenge to American Federalism*, *International Tax and Public Finance*, 1999 Vol 6, pp 193-224 (McLure 1999).

Consequently, value-added and sales tax regimes adopt alternative mechanisms for enforcement of tax obligations where the supplier is outside of the jurisdictional reach. For example:

- **Tax imposed on importation**

For goods that are imported into the jurisdiction, GST is collected from the importer prior to the goods being released from customs control. Under the Australian approach, low value goods and accompanied baggage are subject to exemptions.

The importation of services by Australian households is not subject to GST (unless the service is performed in Australia).

- **Tax collected from the recipient / customer**

The liability for the GST is “reverse charged” so that it is payable by the recipient of the supply and not the supplier.<sup>44</sup>

The Canadian provinces of British Columbia and Newfoundland and Labrador collect data, from out-of-province suppliers that solicit orders within the provinces, of the identity of purchasers within the province to match against self-assessed liabilities of the customers.

- **Jurisdiction enforced over non-residents**

In the United States and Canadian provinces, attempts are made to extend the jurisdictional reach over suppliers with some tenable nexus to the state or province. For example, in the Canadian provincial sales taxes, some provinces have sought to require registration of out-of-province suppliers if they market goods through local television channels.

Under Australia’s GST law, non-resident suppliers of rights to acquire goods or services, the ultimate supply of which would be connected with Australia, are liable to GST on the supply of the right.<sup>45</sup> These provisions were directed at offshore tour operators selling rights to accommodation and sightseeing in Australia. Prior to the amendment of the GST law to address the issue, it was claimed that the supply of the tourist package was not a supply that was connected with Australia – being a supply of rights granted **outside Australia** and not a supply of accommodation and services **in Australia**.

- **Tax collected from third parties, intermediaries or agents**

For goods or services supplied through a resident agent, the obligations of the non-resident supplier are enforced upon the agent.<sup>46</sup> In the Australian GST model, this is only applicable for supplies made through the agent but, in the income tax approach, the term “agent” includes any person who has the control, receipt or disposal of money in Australia belonging to a person outside Australia.<sup>47</sup>

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<sup>44</sup> Under Division 84 of the Australian GST law, this is limited to intangibles (or can be voluntarily undertaken with the agreement of both parties under Division 83 for goods or services). In both cases the recipient must be registered for GST. Under the Canadian and New Zealand reverse charge rules, subject to certain thresholds, both private individuals and registered GST taxpayers may be liable for GST under the relevant reverse charge rules. In the EU, the basic rule for intra EU supplies between registered persons is that the VAT liability is reverse charged.

<sup>45</sup> Paragraph 9-25(5)(c). This provision is weakened by removing these supplies from the registration turnover so that the offshore supplier is not required to register merely as a result of the offshore supply of rights – See Division 188.

<sup>46</sup> Division 57 of the GST law.

<sup>47</sup> Sections 255, 256 and 257 of the *Income Tax Assessment Act 1936*.

For GST purposes, joint and several liability is imposed on members of GST groups or GST joint ventures.

The income tax law involves comprehensive “withholding” regimes whereby payers of income to non-residents must withhold amounts to be applied against income tax liabilities imposed on the non-resident.<sup>48</sup>

The PC Report mooted the possibility of collection of GST from the credit or debit card issuers, but concluded that this was “problematic”.<sup>49</sup>

- **Tax collected at origin**

*Sharing*

In some federal jurisdictions (such as the Canadian Harmonised Sales Tax (HST)), value-added tax is collected (by the federal authority) from a supplier located in the province in which the supplier is established.

In the Canadian HST, the revenue is distributed between the HST Provinces according to proportion of consumption in each Province.

This was the original plan for the EU but has not been implemented.<sup>50</sup> The common market arrangement was to contain a mechanism to redistribute the VAT revenue to the member states based on the levels of consumption in each member state.

A number of proposals have been put forward for common markets and federal jurisdictions such as the EU and Canada to collect VAT at origin but pay them across to the place of destination – a clearing house, compensating VAT (CVAT), Viable Integrated VAT (VIVAT) and Prepaid VAT (PVAT).<sup>51</sup>

Having considered the various proposals, the authors of the Modern VAT<sup>52</sup> conclude:

“Implementing the destination principle is likely to become increasingly difficult as economic integration proceeds, not least because of the increasing importance of e-commerce. ... thorny problems remain: including, not least those from the provision of intangible services by those with no physical presence in the jurisdiction of consumption.”

*Retention at origin*

The general rule within the EU is that the supply of services to consumers is taxed in the place where the supplier has established their business. This results in tax on the value of the consumption being retained in the jurisdiction of origin.

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<sup>48</sup> This is most commonly seen in employee PAYG withholding and interest, dividend and royalty withholding taxes but is also common for non-resident insurers.

<sup>49</sup> PC Report at page 210.

<sup>50</sup> European Commission Communiqué, “The future of VAT – Towards a simpler, more robust and efficient VAT system”, 8 Dec 2011.

<sup>51</sup> For discussion, refer to Ebrill 2001 pages 189 to 193 and Schenk Chapter 12.

<sup>52</sup> Ebrill 2001.

## 3 Australia's GST taxation of offshore supplies

### 3.1 The GST legislative scheme

It is significant to appreciate that Australia's GST law imposes GST on **both** supplies of goods and services<sup>53</sup> and importation of goods. Further, there can be GST payable on a supply of goods from offshore **as well as** the importation of those goods.

The legislative mechanisms are:

- For **supplies** of goods or services.

**The supplier is liable to pay GST** on the supply it makes if the supply is “connected with Australia”.<sup>54</sup>

- Supplies of real property are connected with Australia if the land is in Australia;
- Supplies of goods are connected with Australia if the goods are:
  - Delivered or made available in Australia;
  - Removed from Australia;<sup>55</sup> or
  - Brought to Australia and the supplier imports<sup>56</sup> or installs the goods;
- Things other than goods are connected with Australia if “the thing is done in Australia” or the supply is made through a permanent establishment of the supplier in Australia;<sup>57</sup>
- Telecommunication services are connected with Australia if the recipient of the supply will effectively use or enjoy the supply in Australia.<sup>58</sup> This rule is subject to the significant proviso that, if the supplier makes the supply through an establishment outside of Australia, the Commissioner may determine that it would not be administratively feasible to collect the GST. A determination has been made under this Division if the telecommunication provider is not registered for GST.<sup>59</sup>

To deal with situations where the supplier is not resident in Australia, the obligations for supplies that are connected with Australia are imposed on an agent that makes the supply on behalf of the supplier.<sup>60</sup>

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<sup>53</sup> The liability of a supplier for GST also depends upon the registration and nexus between the supply and an enterprise – see section 9-5.

<sup>54</sup> This term is defined in section 9-25 of the GST law. GST is not payable, however, on a supply that is connected with Australia but is GST-free (for example because it is an export) or input taxed (for example, a financial service).

<sup>55</sup> But an export of goods may be GST-free.

<sup>56</sup> In the case of low value importation of goods, the customer must be the importer, otherwise the supply may be covered by the Australian GST Act.

<sup>57</sup> Another rule applies for rights to acquire supplies that would be connected with Australia – paragraph 9-25(5)(c) – see 2.3 above.

<sup>58</sup> Division 85.

<sup>59</sup> *A New Tax System (Goods and Services Tax) Act 1999 Telecommunication Supplies Determination (No. 1) 2000.*

<sup>60</sup> Under Division 57 of the GST law. In the 2010-11 Budget, the Government announced a proposal to broaden Division 57 so that it would apply even if a common law agency did not exist – provided that the supplier and recipient agreed for Division 57 to apply. Implementation of this proposal was deferred in the 2011-12 Budget.

It is evident that this formulation is directed at identifying transactions that have sufficient nexus with Australia for the law to impose and enforce obligations on the supplier.

- For the **acquisition of intangibles** from offshore.

**The recipient is liable to pay GST** on an acquisition it makes if the supply is **not** connected with Australia and the recipient would not otherwise be entitled to a full input tax credit.<sup>61</sup> The provision only applies to services and recipients that are registered or are required to be registered for GST.

- For **importations of goods**

**The person that enters the goods for home consumption** is liable to pay GST at the time of importation.<sup>62</sup> However, goods imported into Australia with a value under \$1,000 are not subject to GST on importation.

Having reviewed the structure of the GST law, a discussion paper of the Board of Taxation in July 2009 concluded:

“While the GST Act aims to tax the consumption of goods and services in Australia, including things that are imported, there are instances where supplies or importations of these things are not subject to GST because of practical and administrative difficulties, for example:

- goods imported through the post that are valued at less than \$1,000; or
- the supply by an offshore supplier of intangibles, such as software and music files, and services over the internet made to a private consumer.”<sup>63</sup>

### 3.2 Board of Taxation Review

On 11 June 2008, the Board of Taxation (the Board) was asked to review the legal framework for the administration of the GST and identify ways to reduce compliance costs, streamline and improve the operation of the GST and remove any anomalies.

In its report to the Assistant Treasurer, noting the number of submissions received on the topic, the Board recommended that the Government consider reviewing the application of the GST to cross-border transactions.<sup>64</sup>

The Government accepted most of the recommendations of the Board and, in relation to recommendations 26 - 29 of the Board’s report,<sup>65</sup> asked the Board to undertake a review of the application of the GST to cross-border transactions.

<sup>61</sup> Division 84 of the GST law – referred to as a mandatory reverse charge.

<sup>62</sup> Subject to a deferral mechanism for approved importers.

<sup>63</sup> In this category also includes the acquisition of telecommunication services from offshore.

<sup>64</sup> Recommendation 26, *Review of the Legal Framework for the Administration of the Goods and Services Tax. A Report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs*. Board of Taxation, December 2008.

<sup>65</sup> Recommendations 27-29:

- the Commissioner should consider further streamlining the proof of identity and proof of enterprise requirements for non-residents in the circumstances where the risk to revenue is low (recommendation 27).
- a resident entity which acts for a non-resident but falls short of being an agent under the current provisions should be able to apply the features of the GST non-resident agency provisions. This may include a

The Board's report to the Assistant Treasurer<sup>66</sup> commented, mainly in the context of the possibility of competitive non-neutrality, on the exemption afforded to importations of goods with a value of less than \$1,000. The Report also considered the exemption of imported services by households from the GST.

The Board expressed the view that:

“... it is not administratively feasible to try to bring non-resident supplies of low value goods and services into the GST system at this time.”

In reaching this conclusion, the Board noted in relation to the LVT for importation of goods:

- The administrative costs of bringing more goods into the customs system would be likely to outweigh the revenue gained;
- If the additional costs were passed on to the consumer, the charges could be disproportionately high compared to the value of the goods; and
- The threshold of \$1,000 has not been changed since 2005 so that “the value of goods able to be imported without GST has, and will continue, to fall over time. This will reduce over time any potential bias in favour of imported goods over local goods of the same quality and value.”

Significantly, the Board's consideration focused on the \$1,000 LVT exemption from GST for importation and not alternative methods by which GST might be collected in relation to the household expenditure on goods purchased from offshore.<sup>67</sup>

In relation to the importation of services, the Board concluded that:

“In relation to the importation of services by consumers, the Board's view is that, based on the difficulty associated with seeking non-resident compliance with Australia's GST and the extensiveness of online retail activity, it does not seem administratively feasible to try to bring non-resident supplies of services into the GST system at this time.”

It is significant to note that the Board's recommendation was based on the conclusion that alternatives were not administrative feasible.

On Budget night 11 May 2010, the then Assistant Treasurer<sup>68</sup> announced that the Government had accepted the Board's recommendations on the GST treatment of cross-border transactions.

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commission agent or a sub-contractor who does things on behalf of the non-resident. The non-resident and the resident entity would both have to agree (recommendation 28).

- non-residents that do not account for their taxable supplies or importations and their creditable acquisitions or importations because of the current or expanded agency provisions, should no longer have to register for GST (recommendation 29).

<sup>66</sup> “*Review of the application of GST to cross border transactions. Report to the Assistant Treasurer*”. Board of Taxation. February 2010

<sup>67</sup> In comparison, the Board's discussion paper of July 2009 reviewed some international practices of collection of GST through registration of non-resident suppliers and reverse charge – including reverse charge of consumers.

<sup>68</sup> The Honourable Senator Nick Sherry.

### 3.3 Treasury discussion paper on cross-border transactions

On 15 February 2011, the then Assistant Treasurer<sup>69</sup> released a discussion paper on the implementation of the Board's recommendations in relation to the GST treatment of cross-border transactions.<sup>70</sup>

The paper did not expand upon, nor consider, the recommendations of the Board in relation to low value importations and imported services.

Relevantly for this Report, the discussion paper gave consideration to the broadening of circumstances in which a non-resident might appoint another entity to account for its GST obligations under the agency provisions contained in Division 57. The proposal in this regard is as follows:

“An Australian resident agent acting for a non-resident but who cannot conclude contracts for the non-resident, should be treated the same as a common law agent for GST purposes. For the purposes of this proposal the:

- non-resident entity must not have a GST PE in Australia;
- resident agent and the non resident must agree in writing to be treated as being in a 'principal and agent relationship' for the purposes of Division 57; and
- resident agent will have the same common law protection that is available to an agent in similar circumstances.

It seems that this proposal does not go so far as to allow the appointment of a representative that is “unconcerned” with the transaction as a “GST agent” for the non-resident.

In contrast, the E-commerce OECD report of February 2005<sup>71</sup> canvasses the practicality of the appointment of an intermediary (or agent) to take on the obligations imposed on a non-resident supplier.

“The option of an intermediary collecting and accounting for tax on behalf of a non-resident is not new. Most countries already have legislative provisions for such intermediaries. In the context of e-commerce (and possibly other transactions), can intermediaries add value to the process of cross-border collection? If countries increasingly implement a requirement to collect tax on these transactions, intermediaries might be well placed to provide an efficient service to suppliers who have to collect in a significant number of countries. The intermediaries' understanding of local language and application of rules can provide benefits to both suppliers and tax administrations.”

### 3.4 Productivity Commission

On 28 December 2010, the then Assistant Treasurer<sup>72</sup> announced the terms of reference for a Productivity Commission inquiry on the implications of globalisation on the Australian retail sector.<sup>73</sup>

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<sup>69</sup> The Honourable Bill Shorten MP.

<sup>70</sup> “Implementation of the recommendations of the Board of Taxation's review of the GST cross-border transactions. Discussion paper.” Assistant Treasurer and Minister for Financial Services and Superannuation The Hon Bill Shorten MP. 15 February 2011.

<sup>71</sup> Electronic Commerce. Facilitating Collection of Consumption Taxes on Business-to-Consumer Cross-Border E-Commerce Transactions. OECD 2 February 2005 (the 2005 OECD e-commerce report).

The Commission was requested to examine:

1. The current structure, performance and efficiency of the retail sector and impediments to its contribution to the Australian economy;
2. The drivers of structural change in the retail industry, including globalisation, increasing household and business access to the digital economy, cost structures of the domestic retail industry, employment structure, the exchange rate and structural change driven by the resources boom;
3. The broader issues which are contributing to an increase in online purchasing by Australian consumers and the role of online purchasing in providing consumers with greater choice, access and convenience;
4. The sustainability and appropriateness of the current indirect tax arrangements in this environment, including the impact on Commonwealth and State and Territory budgets, and the extent to which technology could reduce the administrative costs of collecting indirect taxes and duty on imported goods; and
5. Any other regulatory or policy issues which impact on structural change in the sector.

The Productivity Commission (the Commission) made its report to the Assistant Treasurer on 4 November 2011.<sup>74</sup> The PC Report was released together with the Government's response on 9 December 2011.

The Commission considered the operation of the \$1,000 low value importation threshold and concluded:

“There are strong in-principle grounds for the low value threshold (LVT) exemption for GST and duty on imported goods to be lowered significantly, to promote tax neutrality with domestic sales. However, the Government should not proceed to lower the LVT unless it can be demonstrated that it is cost-effective to do so. The cost of raising the additional revenue should be at least broadly comparable to the cost of raising other taxes, and ideally the efficiency gains from reducing the non-neutrality should outweigh the additional costs of revenue collection.”<sup>75</sup>

The Commission considered:

- the competitive neutrality implications of the LVT; and
- the feasibility of lowering the customs duty exemption for goods with an import value of less than \$1,000.

This Report is not directly concerned with these issues but, rather, the manner in which the taxation system might be altered to collect the GST forgone as a result of the LVT for imported goods and the non-taxation of household expenditure on imported services. This Report is concerned with the GST revenue which is available for distribution between the States and Territories.

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<sup>72</sup> The Honourable Bill Shorten MP.

<sup>73</sup> Shorten, B. (Assistant Treasurer), Conroy, S. (Minister for Broadband, Communications and the Digital Economy), O'Connor, B. (Minister for Home Affairs and Justice) and Sherry, N. (Minister for Small Business) 2010, *The Future of Australian Retail*, Joint Media Release no. 028, 18 December.

<sup>74</sup> *Economic Structure and Performance of the Australian Retail Industry*. Productivity Commission Inquiry Report No 56 (the PC Report).

<sup>75</sup> Recommendation 4.1.

In a Joint Media Release issued by the Assistant Treasurer on 9 December, the Government announced the establishment of the Retail Council of Australia to advise the Government on the future of the sector.

The Media Release also stated:

“The Commission's report makes clear the low value threshold for GST and duty on imported goods is not the main factor affecting the international competitiveness of Australian retailers. The Commission found there are in-principle grounds to reduce the low value threshold, but that it is currently not cost-effective to do so.

It calculated that lowering the threshold to \$100, for example, could collect around \$500 million in revenue, but at a cost of \$1.2 billion in administration and compliance costs.

However, if significant improvements were made to the cost of processing international parcels, the Government would be in a position to reassess the threshold.

The Government will establish of a Taskforce to investigate options to improve the efficiency of processing low value imported parcels. The Taskforce will be chaired by Dr Bruce Cohen, supported by Mr Jim Marshall and Professor Caroline Chan, and will provide an interim report in three months and a final report to the Government no later than July 2012.

The Taskforce will consult the views of expert stakeholders, including the Australian Customs and Border Protection Service, the Australian Quarantine and Inspection Service; Australia Post; the Conference of Asia Pacific Express Carriers; and other stakeholders, including consumers, small business and representatives groups such as the Fair Imports Alliance.

Terms of reference will be released in January 2012.”

This Report does not deal with the possible manner of increasing the efficiency of processing low value imports of goods. Rather, it canvasses the relative practicalities of other options to counter the under-taxation of imported goods and services.

### **3.4.1 Findings of relevance in considering options to tax**

The PC Report contained the following analysis that is significant in considering the practicalities of expanding the scope of GST to encompass imported goods and services by consumers:

- The vast majority of goods enter Australia through the international mail stream. In 2010-11, 10 million parcels entered through the express courier stream and the Commission estimates that over 47 million parcels entered through the international mail stream. Between 70 and 75% of these parcels have a value of less than \$100.
- The estimate of additional revenue if the threshold were abolished may be around \$480 million in GST. Reducing the LVT to \$100 would generate an estimated \$385 million in additional revenue from GST.
- Treasury has estimated that the loss in revenue from importation of intangibles in 2010-11 was \$1 billion, which is approximately twice the amount of revenue of the LVT on goods.

- “Data show that Australians spend more per capita on online shopping than the United States but lag the online shopping spend of people in the United Kingdom. For example, Access Economics reported some comparisons of per capita e-commerce purchases which showed the United Kingdom leading at US\$1266 per capita in 2009, followed by Australia (A\$534 per capita in 2009 and A\$1068 per capita in 2010) and the United States (at US\$420 per capita in 2008-09) (Access Economics 2010). Note that these estimates relate to e-commerce and may include purchases such as travel and entertainment as well as retail goods.”
- Around 2% of total retail sales are sourced from overseas online retailers.

## 4 Options for the collection of GST on goods and services supplied from outside Australia

Chapter 3 of this Report discussed the practical limitations that arise where a supplier of goods and services is outside of the apparent jurisdictional reach of Australian taxation and briefly discussed the following four approaches to taxation as alternatives to the taxation of goods on importation:

- GST collected from the recipient / customer
- GST collected from non-resident supplier
- GST collected from intermediary or agent
- GST collected at origin

### 4.1 When GST is payable for offshore acquisitions under the existing law

At the outset it should be appreciated that, under the current law, and in addition to the taxation of imported goods with a value of greater than \$1,000, the GST law imposes a liability on offshore supplies of goods and services in the following circumstances:

- GST is payable by the non-resident supplier<sup>76</sup> for **supplies of goods** that are delivered to an Australian customer if the supplier imports or installs the goods in Australia. This will generally be the case if the Incoterms<sup>77</sup> are DDP.<sup>78</sup> The tax is payable<sup>79</sup> as **GST on a supply** even though the importation may be exempt under the LVT.<sup>80</sup>
- GST is payable by the non-resident supplier for **supplies of intangibles** if the service is performed in Australia **by the supplier** or by way of subcontract.<sup>81</sup>
- GST is payable by the Australian customer **on the acquisition of intangibles** from an offshore supplier, if the customer:
  - Is registered for GST purposes;
  - The acquisition is for the purposes of its enterprise; and
  - The acquisition would not otherwise be solely for a creditable purpose.

<sup>76</sup> Provided other conditions for GST registration are satisfied.

<sup>77</sup> The most commonly used rules for the interpretation of trading terms in international trade are those defined by the International Chamber of Commerce (ICC). They are internationally recognised and are known as Incoterms. Incoterms signify to the buyer what is, and more importantly what is not, included in the selling price.

<sup>78</sup> Delivered Duty Paid - The seller's obligation is fulfilled when the goods have been made available at a specified point in the buyer's country. In this case the seller is also responsible for payment of duties, taxes and other customs clearance charges.

<sup>79</sup> Under the normal process of lodgement of a BAS and payment of the net amount for the tax period.

<sup>80</sup> If the Incoterms are such that it is the buyer's responsibility to clear the goods through Customs in Australia, the supplier will not be responsible for GST on the supply of the goods nor on importation. I understand that non-resident suppliers will generally obtain authorisation from the customer to appoint a freight forwarder or other person to transport the goods and clear them through Customs on behalf of the buyer. This aspect is confirmed on the Amazon.co.uk website – see discussion under 4.1.1.1.

<sup>81</sup> Subsection 9-25(5) brings these transactions within the scope of taxable supplies for which the supplier must register for Australian GST.

This GST liability arises for the Australian registered customer under the reverse charge rules in Division 84 of the GST law.

#### 4.1.1 Compliance with current law

It is not clear whether there is satisfactory voluntary compliance with these provisions and whether the Australian Taxation Office (ATO) has sought to enforce them.

##### 4.1.1.1 Goods

If the offshore provider of goods “imports” the goods to Australia, the offshore supplier is liable for **GST on the supply**. This **GST applies** whether or not:

- The act of clearing the goods through customs is performed by the offshore supplier; or
- The LVT exempts the goods from **GST on importation**.

For example, the Amazon.co.uk website states that while VAT is not charged for customers outside the EU, if VAT is payable **by the customer** on importation into their home jurisdiction “Amazon.co.uk will estimate and collect an import-fees deposit during checkout. These funds will be used to pay the import fees on your behalf to the appropriate authorities, when your package reaches the destination country”.

It should be appreciated from this description that Amazon avoids being the “importer” of the goods to Australia. The importer is a person who causes the goods to be brought into the destination **and** clears the goods through customs.<sup>82</sup>

By establishing an “agency” on behalf of the customer for carriage and importation, Amazon’s approach seeks to avoid a GST liability for Amazon **on the supply** it makes to the customer.

The effectiveness of these arrangements is a matter for interpretation.

Where the recipient of goods is not the person who has arranged their purchase (e.g., the goods are a gift), it is possible that the non-resident supplier is the “importer”. In this case, the **supply may subject to GST** and is not excluded from tax because of the LVT exemption for goods.

##### 4.1.1.2 Intangibles

For intangibles, a supply is made “in Australia” if it is “done in Australia” whether by the supplier or through an agent or subcontractor.

Again, the question of whether a supply of intangibles is “done in Australia” is a matter for interpretation.

Material that is delivered electronically will often require an internet service provider located in Australia. If the delivery of the content is “done” through a contractor in Australia, it might be

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<sup>82</sup> GSTR 2003/15 takes the view that a “supplier imports goods where the supplier causes the goods to be brought to Australia to apply them to its own purposes and completes the customs formalities. ... This is the case where a supplier causes the goods to be brought to Australia and enters the goods for home consumption, or for warehousing or transshipment ... . However, a supplier does not import goods where the customs formalities for the importation of the goods are completed by the entity that acquires the goods from the supplier.”

considered to be connected with Australia – as is the case with physical services. In this case, the supply would be “connected with Australia” and the supplier would be subject to GST.

The discussion below concerns acquisitions of goods and services where the existing law does **not** seek to impose GST.

## **4.2 Option 1 – Collection of GST from Australian customer**

Option 1 involves the collection of GST from Australian customers of imported goods and services. The tax would be collected under a voluntary compliance, self-assessment approach provided that the GST would not, otherwise, be fully creditable.

Option 1 proposes a different self-assessment model depending on whether the recipients are:

- GST registered taxpayers; or
- Consumers that are not registered.

The expansion of the GST system to include imported goods and services would not be extended to customs duty.

### **4.2.1 Acquisitions by entities that are registered for GST**

The existing provisions<sup>83</sup> whereby GST liabilities are “reversed” to the recipient of a supply are limited to acquisitions of intangibles acquired for the purpose of an enterprise of the GST registered recipient.<sup>84</sup> The provisions do not extend to acquisitions of goods or private acquisitions of intangibles.

The existing reverse charge provisions could be extended to include:

- Acquisitions that were not acquired for the purposes of the customer’s enterprise; and
- Goods that were not subject to GST on importation.

Under Option 1, the current process of lodgement of BAS and payment of GST for a tax period would be extended to the acquisition of all goods and services by registered GST entities that are not currently taxable.

As indicated above, the GST system operates on a self-assessment and voluntary compliance basis. The coverage of the ATO risk based audit program (including data matching) could be extended to ensure that there is an incentive for registered GST taxpayers to comply with the expanded reverse charge rules.

This approach is part of the New Zealand GST law, but only insofar as intangibles are concerned.

As this extension of the GST base applies only to acquisitions made by registered entities, the scope should be extended to unregistered entities, if for no reason other than the collection of GST on currently untaxed household expenditure.

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<sup>83</sup> Contained in Division 84.

<sup>84</sup> While the reverse charge does not apply to acquisitions that would otherwise be fully creditable, I do not deal with this issue in this Report because such acquisitions are not household consumption that are part of the GST tax base.

## 4.2.2 Self-assessment of GST by persons not registered for GST

Option 1 envisages that GST would be payable by **entities that are not registered for GST** on acquisitions, from offshore of:

- Goods that were not subject to GST on importation, and
- Intangibles, the supply of which is not connected with Australia.

From a design perspective, this is a direct personal expenditure tax.

Because the entities acquiring the goods and services in these circumstances do not, otherwise, have GST compliance obligations, an approach needs to be designed whereby the tax liability is reported and paid.

A “direct” consumption tax is imposed in New Zealand, Canada (at the Federal level) and in some States of the United States.

### 4.2.2.1 *New Zealand*

Individuals who do **not** carry on a taxable activity but who import intangibles are required to register for GST if the registration threshold in a 12 month period is exceeded taking into account those imported services.

The GST registration threshold is NZD 60,000.

Once registered, the obligations to lodge GST returns and pay GST arise under the normal GST rules.

### 4.2.2.2 *Canada*

Under the Canadian GST system, the importation of intangibles by both registered and unregistered entities is subject to GST (payable by the recipient). For registered persons the tax is accounted for in their normal GST return (unless the tax would be fully creditable).

Individuals are required to self-assess the liability in a return for the month in which the acquisition was made.

For goods that are imported, Canada has a LVT exemption (for Federal GST) of CAD 20.

### 4.2.2.3 *United States*

In the United States, many states impose a “use” tax on the acquisition of goods and services from outside of the state that has not been subject to tax in the state of “use”.

Of the 45 states with sales and use taxes, 38 also have an individual income tax. Of these 38 states, 23 provide for taxpayers to report use tax obligations on the individual income tax return, and another seven provide information about the use tax in the individual income tax booklets.<sup>85</sup>

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<sup>85</sup> Manzi, Nina *Use Tax Collection On Income Tax Returns In Other States*, St. Paul, Minnesota: Policy Brief, Research Department, Minnesota House of Representatives, June 2010. (Manzi 2010).

A 2010 study into the collections of use tax on state income tax returns indicated that greater compliance was obtained where taxpayers were required to answer a specific question and complete a line on the return dealing with the obligation to self-assess their liability.<sup>86</sup>

An extract from instructions included on Minnesota tax returns appears at Appendix A.

### **4.2.3 Effectiveness, voluntary compliance and enforcement**

#### **4.2.3.1 Overseas experience**

The experience in Canada and United States would seem to indicate that levels of compliance with a self-assessment regime by individuals is very low.<sup>87</sup>

However, the analysis of Nina Manzi referred to above found as follows:

“Some states that placed a use tax line on the income tax return reported significant increases in collections. Collections in Louisiana, Massachusetts, and Michigan all increased substantially in the year following implementation of use tax reporting on the income tax return; Louisiana and Michigan had previously included information on the use tax in their income tax booklets, while Massachusetts did not.

Michigan collections increased from \$240,000 in 1998 to \$2.9 million in 1999 and have increased since then, reaching \$4.1 million in 2007. Louisiana’s collections via individual filings increased from about \$20,000 per year prior to 2000 to over \$500,000 reported on the income tax form in 2000, and nearly \$640,000 for tax year 2004, but dropped off to just over \$300,000 in 2008.

In Massachusetts, addition of a use tax line to the income tax return resulted in a sharp increase in the number of individuals reporting use tax, from 200 in 2001 to over 11,000 in 2002, the first year of reporting, and further increased to almost 40,000 in 2005. Revenues have increased sharply since the reporting line was first added, from about \$1 million in 2001 to over \$3 million in 2005, and about \$4.5 million in 2007.”

The inclusion of information in “TaxPack” and a dedicated field for mandatory completion would, it seem, promote voluntary compliance in an Australia environment.

It should be noted that, while the information in Manzi 2010 is encouraging, the data on participation rates achieved is not able to be measured against the possible population that ought to report liabilities.

Manzi 2010 notes that the average percentage of taxpayers declaring use tax obligations was:

- Across all states – 1.6%
- For states without “lookup tables” – 0.5%
- For states with “lookup tables” – 3.1%

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<sup>86</sup> Manzi, Nina Use Tax Collection On Income Tax Returns In Other States. Policy Brief, Research Department, Minnesota House of Representatives, June 2010 (Manzi 2010).

<sup>87</sup> United States Accounting Government Office, “Sales Taxes Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain” June 2000 (the GAO Report,2000); McLure 1999.

In viewing these rates from the US it should be borne in mind that:

- The self-assessed use tax is largely a sales tax on goods;
- The self-assessed tax does not apply to on-line purchases from the taxpayer's home state;
- Purchases of over USD 1000 are excluded.

Manzi 2010 explains the use of lookup tables as follows:

“Lookup tables provide estimates of use tax liability by taxpayer income. The tables typically consist of two columns. Taxpayers find their income in the left column and read across to the right column to find their estimated use tax liability. Use tax liability is assumed to represent a percentage of income. The percentage is intended to represent average use tax liability of taxpayers.”

Most states limit the use of the lookup table to purchases of less than USD1,000 – the percentage of “Adjusted” State or Federal income ranges between 0.04% and 0.09%.

By way of comparison, the PC Report reported Australia's per capita e-commerce purchases at AUD 1068 in 2010. The Commissions estimate was that 2/3rds of Australia's online shopping was in Australia.

Taking 1/3<sup>rd</sup> of the AUD 1068 per capita spending and average weekly earnings of approximately AUD 980 per week in May 2010<sup>88</sup> would result in a “lookup” rate of 0.6%. However, this includes:

- travel and entertainment as well as retail goods; and
- purchases of more than \$1,000.

#### **4.2.3.2 Encouraging voluntary compliance in Australia**

In addition to requiring completion of an item on an individual's income tax return, “voluntary compliance” could be encouraged through:

- A “lookup table” safe harbour; and
- Data matching with credit and debit card companies.

The Productivity Commission report of 9 December 2011 indicates that some information in relation to the use of cards in offshore purchases is able to be extracted from banking records held by the bank that is the “card issuer” in Australia<sup>89</sup>. An investigation should be carried out as to the practicalities of ascertaining the main suppliers of goods and services through internet

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<sup>88</sup> ABS 6302.0 Average Weekly Earnings, Australia, May 2010.

<sup>89</sup> The terms “issuer” are “acquirer” and their relevance in the operation of a “payments system” are explained in *Commissioner of Taxation v American Express Wholesale Currency Services Pty Limited* [2010] FCAFC 122. A diagrammatic explanation (extracted from GSTR 2004/1) appears at Appendix B. In the case of online purchasers from offshore merchants, it is likely that the “card acquirer” is an overseas bank that is contractually obliged to pay the merchant, the face value of purchases made, from the merchant, using a credit card (issued to the holder by the “issuer”) to the merchant. The issuer is obliged, under the credit card system's contractual arrangements to pay the amount to the acquirer. The card holder must pay the amount of the purchase to the card issuer.

purchases which could assist in filtering this data to purchases made from Australia (rather than travelling overseas).<sup>90</sup>

Enquiries should be made of credit and debit card issuers (the banks in Australia) to ascertain whether it is possible to extract details of transactions of card holders based on this filtering process and use aggregates to match with self-assessed liabilities.

Even if the data from the card companies was not absolutely “matching” with the GST liabilities for taxpayers, it would produce a starting point for a review of compliance.

The data and communication of its availability and proposed use should encourage voluntary compliance.

### *Limitations*

McLure 1999<sup>91</sup> opines that reliance on buyers to remit tax creates an unrealistic **tax on honesty**, as well as being complicated.

### Compliance costs

The requirement that taxpayers self-assess their GST liability on their income tax return involves substantial complexity and costs (if just in time lost<sup>92</sup>):

- Distinguishing between imports of GST-free and input-taxed goods, and imports of taxable goods would require significant information and knowledge on what was purchased and its GST classification.

While details of the company from which the purchase was made may be able to be ascertained from credit card statements, the classification of taxable status of the purchase is not without difficulty. This is particularly the case if intangibles are included in the GST self-assessment system.

For example, the following would be GST-free, input taxed or consumed overseas:

- International travel, accommodation, meals, taxis and other costs;
- International transaction costs imposed by card issuers for foreign exchange transactions;
- Purchases in relation to “rights for use” outside Australia;<sup>93</sup>
- GST-free health and education;
- Card user charges that are input taxed;

<sup>90</sup> The Commission report indicated that an assumption was made that purchases made while a card was not presented were purchases made from Australia.

<sup>91</sup> McLure 1999.

<sup>92</sup> “... every extra hour spent by households and business grappling with the myriad of tax rules and obligations (including the different regimes across the States) is an hour not used to produce goods and services (including utilising leisure time), that are of higher value to Australians. Likewise, every dollar needed to fund the administration of the tax-transfer system is a dollar that needs to be raised through taxation. Given the regressive nature of complexity, a complex and inefficient system is also likely to fall short of expectations for a fair distribution of opportunities and risk throughout the community.” *Architecture of Australia’s Tax and Transfer System, August 2008*.

<sup>93</sup> These are GST-free under item 4 of subsection 38-190(1). An example may be brokerage of an offshore acquisition of securities.

- Global roaming charges and GST-free international calls;
- Amounts for which reimbursement is made under Division 111.
- Difficulties would arise in ascertain whether GST is payable under the self-assessed arrangements. For example, it would be difficult to ascertain, **at the end of the financial year**, whether the acquisition as made from:
  - An Australian entity that is not registered for GST (not taxable); or
  - An offshore entity that is registered for Australian GST and has accounted for GST.

This is particularly so where the purchase is made through e-Bay or similar on-line websites.

- Taxpayers would also have to calculate their GST liabilities and some may make errors in doing so.

Recognition of these difficulties could lead to the adoption of a safe harbour or “lookup” table as described by Manzi 2010. In practice, this would lead to a de facto “cap” on liabilities and an under taxation of offshore acquisitions of goods and services.

In addition, taxpayers would incur significant costs of compliance to ascertain whether or not their particular circumstances fell within the cap.

### The number of taxpayers

The PC Report gives an indication of the widespread nature of the transactions that are to be taxed under the proposed “self-assessment” option.

Given that, just for low value goods,<sup>94</sup> there are 57 million parcels one should contemplate some limitations on the practicality (and deadweight loss) of the process of data collection and matching – particularly when weighed against the revenue otherwise forgone.

Without voluntary compliance, given the likely number of taxpayers, it would seem that administration (and compliance) costs would be much higher than the average GST collection costs under the current regime of approximately 1.4% of revenue.<sup>95</sup>

### Non-lodgers

The proposal to increase the Australian income tax free threshold from \$6,000 to \$18,200 from 1 July 2012, and to \$19,400 from 1 July 2015, will mean that over 1 million individuals will not be required to lodge a tax return.<sup>96</sup>

Self assessment of GST on importations would substantially increase the number of people who would need to submit a tax return, many of whom would have only a small amount of tax due. This would increase the compliance and administrative cost such that the revenue would not justify the costs.

<sup>94</sup> Not including, therefore, the frequent downloading of software and other intangibles from offshore web sites, estimated to contribute to a loss of revenue of \$1 billion.

<sup>95</sup> 2010-11 Budget, Budget Paper No 3,

<sup>96</sup> The Treasurer, Joint Media Release No 81 with the Prime Minister. Combining Tax Cuts with Significant Tax Reform.

Alternatively, self-assessment could be limited to those taxpayers who would otherwise be required to file an income tax return.

One might hypothesise that these individuals who fall beneath the tax threshold are not major users of offshore purchases such that the revenue costs of limiting the GST liability to those that are required to file income tax returns may not be a significant disadvantage.<sup>97</sup>

However, if the use of on-line purchases is more prevalent in the younger members of society, this hypothesis may not hold true.

### Valuation

If the existing law were not changed, the GST payable by the customer for goods imported to Australia is 10 % of the sum of:

- the customs value of the goods imported;
- the amount paid or payable for:
  - the international transport of the goods to their place of consignment in Australia;<sup>98</sup> and
  - to insure the goods for that transport,  
(including any loading or handling of goods or other services that facilitates the international transport);
- any customs duty payable in respect of the importation of the goods; and
- Wine Equalisation Tax (WET).

The duty and WET elements of the above calculation are not likely to be relevant under the proposal for self-assessment (because duty is not payable for LVT and all alcohol is subject to tax on importation).

It would be common for the total transport and purchase price to be included in the amount paid to the offshore supplier, so self-assessment of the GST payable should not present a difficulty.<sup>99</sup>

### Gifts

Australian recipients of gifts of imported goods (or services) would, under current rules, be liable for GST if they entered the goods for home consumption.

Absent special rules for importation of goods, the donor would pay a tax inclusive price for the gift. This is the HFCE that is, in theory, subject to tax. The burden of the tax should fall on the person that pays for the gift, not the person that enjoys it.

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<sup>97</sup> McLure 1999 opines that the affluent are much more likely than the poor to be engaged in electronic commerce, and thus to benefit from any failure to tax electronic commerce.

<sup>98</sup> The place of consignment generally includes the Australian domestic leg of delivery that is GST-free under item 5A of s 38-355.

<sup>99</sup> The separate supply of transport of goods to be imported into Australia is a GST-free supply. Accordingly, some consideration needs to be given to the taxation of imported services as supplies that are reverse charged as opposed to the taxation of goods that are imported. For neutrality and simplicity, it would seem that a self-assessment of goods that are transported to Australia at the customer's cost ought **not** include in the value the separate transportation charge borne by the customer.

Accordingly, the self-assessed GST liability on imported goods or services should fall on the person that incurs the expenditure and not the donee. Some alteration of the GST law may be necessary to reflect this difference.

Gifts from offshore donors would, on this basis, be difficult to bring within the GST net and an Australian purchaser of a gift for a non-resident should be excluded because the place of consumption is outside of Australia.

### Collection and recovery

If the system of recovery and collection of the GST under this option is through the lodgement and declaration of an income tax return, the costs of collection of amounts owing by individual taxpayers may outweigh the additional revenue gained from the expansion of the scope of GST.

This is particularly so if the income tax return results in a liability to pay tax (rather than a refund of overpaid PAYG instalments), where the costs of collection and recovery of small amounts are likely to be prohibitively high compared to the revenue involved.

## **4.3 Option 2 - Tax collected from non-resident suppliers and GST registered recipients**

Option 2 involves the collection of GST:

- from the non-resident supplier for supplies made to unregistered customers in Australia under the same mechanisms as currently applies for other GST taxpayers; and
- under a reverse charge for Australian recipients of goods and services that are registered for GST.

### **4.3.1 GST on supplies made by non-residents – two approaches**

#### ***4.3.1.1 Supplies made by non-residents to entities that are not registered for GST in Australia***

Under the existing law an offshore **supplier is liable to account for GST** on supplies made into Australia if:

- In the case of goods, the supplier imports or installs the goods in Australia; or
- In the case of intangibles, the supplier makes the supply in Australia. In this case, the strict scope of the application of the GST law is not clear. The ATO has ruled (in GSTR 2000/31) that, for example:
  - a supply by way of contract is done in Australia if the contract is signed here; or
  - the contract is performed in Australia by an agent or subcontractor.

**Under Option 2** it is proposed that the non-resident supplier **also** be made liable for GST on supplies it makes in the course of its enterprise of:

- goods that are brought into Australia and are not otherwise taxable as supplies or importations; and

- intangibles delivered to Australia that are not otherwise “connected with Australia”.

#### **4.3.1.2 Acquisitions by entities that are registered for GST**

Under the existing law, an **Australian GST registered entity is liable** to reverse charge an acquisition it makes if the acquisition is made:

- for the purposes of its enterprise; and
- otherwise than solely for a creditable purpose.

**Under Option 2** it is proposed that the reverse charge liability be extended to private acquisitions by GST registered entities (as in Option 1) – in which case GST is payable by the recipient.

#### **4.3.2 Voluntary compliance**

Through these two mechanisms, the general approach to GST is preserved. The number of taxpayers that should account for GST on cross-border transactions are significantly less in number than under Option 1.

The question is how to encourage non-residents to comply with their GST obligations for supplies they make.

##### **4.3.2.1 Overseas experience**

#### **United States**

There has been a long history of individual states seeking to claim nexus over out-of-state suppliers. The difficulty in the US is the constitutional limitations of states to legally exercise extra-territorial jurisdiction.<sup>100</sup>

Amazon.com has resisted moves by the states in the US to extend sales tax laws to sales it makes through out-of-state establishments or companies. Some commentators contend that Amazon’s position stems from a desire to preserve the competitive advantage it gains over its rivals when they must add sales tax to their prices.<sup>101</sup>

The Government Accounting Office Report<sup>102</sup> suggests that, in the absence of the moratorium on taxation of internet sales, the level of voluntary compliance by suppliers was **not** insignificant. The main problem area was the variation in taxation rates and scope between states. In this regard, the aim of the Streamlined Sales Tax Project (SSTP) in the US was to

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<sup>100</sup> McLure 1999 states that “The Supreme Court ruled in 1967 (in *National Belas Hess*, 386 U.S. 753), and again in 1992 (in *Quill*, 504 U.S. 298), that it would violate the U.S. Constitution for states to compel out-of-state vendors to collect use tax on tangible products, unless the vendor has taxable “nexus” in the taxing state, as indicated by a physical presence in the state.

<sup>101</sup> Michael Mazerov, Amazon’s Arguments Against Collecting Sales Taxes Do Not Withstand Scrutiny, Centre of Budget and Policy Priorities, November 2009 (Mazerov 2009).

<sup>102</sup> United States Government Accounting Office, “Sales Taxes Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain”, June 2000 (the GAO report 2000).

simplify and modernize sales and use tax collection and administration in an effort to try to minimize the many differences between the sales tax policies and practices of states.

McLure 1999 also concludes that the difficulties of enforcing out-of-state compliance is not caused by the desire of suppliers to avoid tax but on the complexity arising from the myriad of different tax rates and scope of taxation in the state and local governments that seek to collect them.

It is significant to note that Amazon charges EU VAT on sales:

- Within the European Union (EU);<sup>103</sup> and
- Of items sold on behalf of any of Amazon's third-party sellers.<sup>104</sup> In addition, US sales tax is collected and paid on behalf of these third parties that sell goods on Amazon's websites.<sup>105</sup>

The Amazon.co.uk website also indicates that, while Amazon is not liable for VAT or GST on sales made to customers outside the EU, it will collect the import VAT, GST and duties as part of its on-line sales process and pay it to the authorities in the place of delivery on the customer's behalf.

“For dispatch to countries outside of the EU, VAT will not be charged. These packages may be assessed for import or customs fees, depending on the laws of the country concerned.

Customs or import duties are levied once the package reaches the destination country. For certain destination countries, Amazon.co.uk will estimate and collect an import-fees deposit during checkout. These funds will be used to pay import fees on your behalf to the appropriate authorities, when your package reaches the destination country.”

These factors cause Mazerov 2009 to question why Amazon complies with some indirect tax laws and not others. He opines:

“The answer, quite simply, is that those countries' tax laws say it has to; there are no foreign analogs of the Quill decision to immunize the company from VAT-collection obligations. Amazon complies with applicable tax law when its legal obligations are clear, as indicated by the fact that it chose to comply with New York's affiliate nexus law rather than flout it.”

The question that is of immediate interest is whether a large company like Amazon would comply with an extension of Australian GST liabilities over its offshore establishment or seek to resist this encroachment as has been the case in the US.

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<sup>103</sup> The Amazon.co.uk website states: “In accordance with the laws governing members of the EU, Amazon.co.uk is obliged to charge VAT on all orders delivered to destinations in member countries of the EU. In general, VAT is charged in accordance with the local legislation in each member state”.

<sup>104</sup> The Amazon.co.uk website states: “While each of these sellers has different VAT collection obligations, their prices are displayed inclusive of any applicable VAT for UK ... Amazon.co.uk is required by law to collect VAT on orders for goods (including e-Books) dispatched to most countries within the EU. For customers with an EU delivery address, VAT is charged in accordance with local legislation. VAT charges for your order will be itemised on the last page of your order, in the e-mail confirmation of your order and on the invoice dispatched with your order”.

<sup>105</sup> Mazerov 2009 states that “Amazon already shoulders most of those burdens for thousands of companies that sell on its website. For example, it calculates and collects sales taxes in every state except one for the Target department store chain, which has outlets in those states and therefore acknowledges an obligation to charge tax on its Internet sales made on Amazon's site”.

In my view, the situation in the US is a constitutional one. The tax impost is illegal, so there is no legal requirement placed upon Amazon and similar companies – in fact, a customer could resist the VAT/GST amount charged to it, if the tax was not legally imposed.

In the case of Australia, if an obligation can legally be placed on an offshore supplier it may not be enforceable in foreign courts. In the case of Australia, if an obligation can legally be placed on an offshore supplier it may not be enforceable in foreign courts. It is a very different matter to seek to avoid tax on grounds non-enforceability than illegality.<sup>106</sup>

Sales tax and GST/VAT are indirect taxes that are charged to the customer. Apart from costs of compliance, a legally imposed GST is collected from the customer.

The PC Report notes that the GST is not the reason leading to advantageous business competitiveness.

#### 4.3.2.2 *Canada*

At the provincial level, similar difficulties exist to that of the US for out-of-province suppliers of goods.

Several provincial sales tax statutes require registration of suppliers who sell goods in the ordinary course of business **in the province**.

“In *Fairline Boats Ltd. v. Leger*, a case dealing with a provincial personal property security statute, the Ontario Supreme Court enumerated the criteria to be considered in determining whether a sale is made in the ordinary course of business. In that case the court held that the circumstances of the sale determine whether or not the sale is made in the ordinary course of business, including

- the usual or regular type of transaction in which people in the vendor's business generally engage;
- where the agreement is made;
- the parties to the sale.
- the quantity of goods sold; and
- the price charged for the goods.

Some provinces have introduced legislation requiring registration by out-of-province based persons marketing goods through local television or cable television channels. For example, Nova Scotia requires that television operators carrying such advertising obtain a copy of the registration certificate issued to an out-of-province seller.

British Columbia and Newfoundland and Labrador require unregistered persons who solicit orders within the province to furnish the respective provincial sales tax branches with information concerning purchasers of their products. This presumably facilitates verification of the purchasers' self-remittances of tax by provincial sales tax authorities [see 4.2.2.2 above]. However, the constitutional validity of this type of provision is questionable.”

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<sup>106</sup> Below we comment on the importance of corporate governance obligations to tax compliance.

### 4.3.2.3 EU

The EU has different place of supply rules for goods, services and telecommunication between different EU Member States.

It is important to appreciate that these rules are largely concerned with which Member State benefits from the VAT revenue. The power of Member States to levy VAT is governed by the European Directive governing the VAT in the EU.<sup>107</sup>

For telecommunication services and radio and television broadcasting services, the Place of Supply Directive authorises collection of VAT from non-EU suppliers where the use and enjoyment of the service occurs within a Member State.<sup>108</sup>

### *Goods*

#### Sales to registered recipients within the EU

A business-to-business (B2B) sale of goods within the EU (generally the passing of property in goods) is taxable in the State in which the goods are delivered.

The recipient will generally be required to reverse charge the acquisition.

The conditions for the supplier to claim a zero-rate over the supply are:

- the customer is registered for VAT in that other EU Member State,
- the customer's VAT registration number is obtained and retained in the supplier's records,
- this number, together with the supplier's VAT registration number, is quoted on the sales invoice, and
- the goods are dispatched or transported to that other EU Member State.

#### Sales to unregistered recipients within the EU

Business-consumer (B2C) sales of goods by a supplier in one EU Member State to a person in another Member State who is not registered for VAT is referred to as a distance sale if the supplier is responsible for the delivery of the goods.<sup>109</sup>

Under these distance selling arrangements, **the supplier** is liable to VAT in his own Member State unless the threshold appropriate to the Member State of the customer is **not** breached. Under the EU VAT arrangements, Member States were required to adopt a distance sales threshold of either €35,000 or €100,000.

If the threshold is exceeded, **the supplier must register** and account for VAT in that Member State.

For present purposes, this arrangement has the effect of extending the VAT obligations of a supplier in circumstances similar to that **proposed in Option 2**.

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<sup>107</sup> Council Directive 2006/112/EC – 28 November 2006 (the Revised 6<sup>th</sup> Directive).

<sup>108</sup> Article 59b, Council Directive 2008/8/EC of 12 February 2008 (the Place of Supply Directive).

<sup>109</sup> Including mail order sales, phone or tele-sales or physical goods ordered over the internet.

### Sales from outside the EU

Goods arriving in the EU from outside the EU are taxable as imports.

### *Services*<sup>110</sup>

#### B2C supplies – supplier established in the EU

The general rule where services are supplied to a customer that **is not registered for VAT** in the EU is that the tax is payable in the Member State **where the supplier is established** – i.e., at origin.

#### B2B supplies – supplier established in the EU

The general rule where services are supplied to a customer that **is registered** for VAT in the EU is that the tax is payable in the Member State **where the customer is established** – i.e., at destination.

The VAT registered recipient of the services is required to self-assess (or **reverse charge**), the VAT on the acquisition and account for the VAT in the recipient's Member State.

For present purposes, this arrangement **for B2B supplies** has the effect of extending the VAT obligations of a supplier in circumstances similar to that **proposed in Option 2**.

For B2C supplies the VAT is collected at origin.

#### Supplies of services by suppliers outside the EU

Generally, supplies of services from outside the EU are only taxable in the EU if the recipient is registered. In these cases the reverse charge applies.

This is similar to the existing Australia law.

### *Telecommunication and broadcasting services*

#### Suppliers established within the EU

On B2B supplies, VAT is payable under the reverse charge mechanism.

For B2C supplies, VAT is payable in the State in which the supplier is established.

#### Suppliers **not** established within the EU

Supplies made from outside the EU to unregistered customers established (or who have their permanent address or usually reside) in a Member State, are taxable under a special scheme for offshore suppliers of television and broadcasting services.

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<sup>110</sup> Preamble (3) – (5), Council Directive 2008/8/EC of 12 February 2008 (the Place of Supply Directive).

The scheme<sup>111</sup> allows any business that:

- is not established in the EU; and
- supplies telecommunications, broadcasting or electronic services to a customer that is not registered for VAT in the EU,<sup>112</sup>

to register for VAT in one of the Member States and pay VAT on its EU supplies (to unregistered customers in the EU) in that Member State.

The proposal is destined to change in 2015 when the non-EU supplier must register and pay tax in the State in which the recipient usually resides or uses the service.

The Board of Taxation's discussion paper on cross-border transactions confirms that:

“For electronically supplied services, telecommunication and broadcasting services flowing directly to a consumer within the European Union (business to consumer supply) the European Union makes the non-resident supplier liable for the VAT. The non-resident supplier is required to register for VAT *in one of the member states* and account for VAT made to the consumer.” (emphasis added).

The important aspect of this arrangement is that the EU extended its reach to non-resident suppliers of telecommunication services.

Rather than ignore the proposed extra-territorial reach, the major providers have selected the lowest VAT jurisdiction in the EU (Luxembourg) to register and pay VAT.

The website for “LOWTAX Global Tax & Business Portal” records the development as follows:

In November 2007 Luxembourg continued to hold up an agreement between European Union finance ministers on reforms to the charging of VAT on certain services traded within the EU.

At issue was a proposed change in the VAT charging rules that would mean consumers who buy items from e-commerce firms would pay VAT at the rate of the country in which they are resident, instead of the rate charged in the jurisdiction where the vendor is registered.

VAT in Luxembourg is charged at 15% - the lowest rate permitted in the EU - and the current rules have led dozens of major e-commerce firms such as eBay, Skype and iTunes to set up in the jurisdiction. But if the new VAT system were to be put in place, the Luxembourg government would stand to lose an estimated EUR220 million (US\$320 million) annually in tax revenues.

The European Council of Finance Ministers (Ecofin) reached a landmark political agreement in December 2007 on two draft directives and a draft regulation aimed at changing the rules on value-added taxation intended to ensure that VAT on services accrues to the country where consumption occurs, and to prevent distortions of competition between member states operating different VAT rates.

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<sup>111</sup> TITLE XII, Chapter 6, section 2 *Article 359*

<sup>112</sup> And is established in a Member State or has his permanent address or usually resides in a Member State.

The agreement ended a five-year deadlock on the sweeping changes to the community's VAT laws, but the reverse charging of VAT on the purchases of goods and services electronically will not begin until 2015, with a revenue sharing agreement phased in over the subsequent three years. This has appeased Luxembourg, which used its veto to block the proposed reforms.

In all likelihood these “voluntary” registrations for VAT account for a significant proportion of the value of telecommunication services imported to the EU.<sup>113</sup>

### 4.3.3 Encouraging voluntary compliance in Australia

#### 4.3.3.1 *Voluntary compliance*

McLure (1999), Manzi (2010) and the GAO Report 2000 also found that “voluntary compliance” was more likely where the possibility of identification was high.

The EU experience with, at least, the major on-line distributors, appear to have been successful, particularly as the cost of compliance (25 different VAT systems) have been avoided.

The clear theme, in my view, is that the offshore suppliers, whilst preferring not to incur the compliance costs of registration and reporting, will respond to gentle persuasion and simple compliance regimes.<sup>114</sup>

This view is supported by the submissions made to the Government<sup>115</sup> at the time of the amendments to extend the GST law to capture foreign tour operators.<sup>116</sup>

This view is supported by the submissions made to the Government at the time of the 2005 amendments to the GST law to extend the scope of GST to foreign tourist operators.

The submissions argued that companies that came within Sarbanes-Oxley (SOX) or similar governance regulations require assurance that suitable control mechanisms are in place to ensure compliance with the various regulatory regimes (including indirect tax) to which the companies are subject.

The submissions pointed out that, while the extra-territorial reach proposed by the amendments was not intended to be enforced against companies that had not chosen to register under the GST law at the time, the internal governance requirements of listed companies that were subject to SOX and similar regimes had the effect that compliance would be assured under their internal control rules.

The Senate Economics Legislation Committee agreed with the submissions and proposed an amendment to the proposals so that the requirement to register was not mandatory but voluntary<sup>117</sup>.

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<sup>113</sup> The authors of the Modern VAT suggest that, as a rule of thumb, 90% of the value of supplies in a VAT are made by 10% of registrants.

<sup>114</sup> Much of the dissatisfaction expressed in the submissions made to the Board of Taxation review of the legislative scheme of GST were concerned with the administrative difficulties of the “proof of identity” requirements for registration. The issue was the subject of ongoing discussions though the NTLG GST Subcommittee – see Issue 4.5 NTLG GST Subcommittee 3 December 2008.

<sup>115</sup> The Report of the Senate Economics Legislation Committee Inquiry into *Tax Laws Amendment (2005 Measures No. 1) Bill 2005*, June 2005 (the Senate Economics Legislation Committee Report).

<sup>116</sup> The amendments were directed at inbound tourist operators – see example in paragraph 9-25(5)(c).

Accordingly, while it might be possible (as a matter of extra-jurisdictional enforcement) to ignore Australian GST obligations, in my view, the SOX and similar governance requirements mean that controls would be put in place to ensure compliance with the Australia law.

This is, of course, subject to materiality.

While it might be possible (as a matter of extra-jurisdictional enforcement) to ignore Australian GST obligations, in my view, the SOX and similar governance requirements mean that controls would be put in place to ensure compliance with the Australia law.

Clearly these governance requirement do not legally enforce compliance with Australian law, but they operate to ensure that good governance and controls apply that should result in substantial voluntary compliance.

In this respect it must be appreciated that compliance with VAT regimes is voluntary and self-assessed. It is not possible, efficiently, to enforce compliance on a case by case basis.

Many of the arguments in respect of extra-territorial reach and voluntary compliance are discussed in the Report of the Senate Economics & Legislation Committee.<sup>118</sup>

The main issues that would run counter to voluntary compliance are complexity of the registration and return lodgement process and difficulty in compliance with the law itself.

Accordingly, Option 2, to achieve voluntary compliance, requires carefully crafted legislation to direct its impact at the transactions concerned and simple registration and compliance processes.

#### ***4.3.3.2 Use of credit and debit card information***

The PC report of 9 December 2011 indicates that some information in relation to the use of cards in offshore purchases is able to be extracted from banking records. This would indicate that it is possible to ascertain the main suppliers of goods and services through internet purchases which could assist to identify major suppliers and seek their voluntary compliance.

It is likely that 90% of the value of supplies of imported goods and services that are presently untaxed is made by 10% of the total suppliers. It is likely that a well structured and communicated campaign would inform the largest companies of the new requirements. Provided some transition for systems changes and simple registration and compliance were put in place a significant proportion of the major online suppliers could be encouraged to comply with a broader scope of taxation.

#### ***Enforcement***

It should be appreciated that the on-line business model relies on trouble free delivery and immediate payment. The buying experience of the customer is the essence of repeat business.

By credit card payments, the credit risk of customers is minimised.

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<sup>117</sup> Refer to the amendments to the definition of annual turnover in Division 188 which exclude supplies of the rights referred to in subsection 9-25(5)(c).

<sup>118</sup> [http://www.aph.gov.au/senate/committee/economics\\_ctte/completed\\_inquiries/2004-07/tlab\\_1/report/report.pdf](http://www.aph.gov.au/senate/committee/economics_ctte/completed_inquiries/2004-07/tlab_1/report/report.pdf)

In the event that major suppliers are recalcitrant in meeting their obligations, the recovery provisions of Taxation Administration law<sup>119</sup> should be expanded so that the ATO can make claims against:

- Goods delivered to Australian customers by suppliers that have outstanding GST obligations; and
- Payments due to card issuers for purchases made from suppliers that have outstanding GST obligations,

so that compliance with the GST law is not only part of the good governance of the companies but GST liabilities can also be secured against assets in Australia.<sup>120</sup>

Significantly, recovery of unpaid GST amounts by non-residents is, I understand, unlikely to be able to be exercised through foreign courts.

To assist in both these enforcement issues, a tax liability could be placed on the Australian customer to the extent that the offshore supplier is in default of its liability.<sup>121</sup> Once a liability is established, the action against goods and payments referred to above might be exercised to enforce the GST obligation of the customer.

#### **4.3.3.3 Limitation on scope of proposals**

I highlight in the discussion below that voluntary compliance of suppliers requires:

- Simple registration, lodgement and compliance processes;
- Certainty and clarity in the taxation treatment of the transactions at issue;
- A method of recovery of debts in the event of default.<sup>122</sup>

The Senate Economics Legislation Committee Report shows the danger, from a complexity and compliance perspective, of “overreaching” in the legislation and failing to limit its scope to the mischief at hand.

In this regard, I recommend that the scope of supplies at which the proposal is directed should be limited to:

- goods under the \$1,000 LVT and “on-line” purchase; and
- delivery of intangibles.

A registration threshold would also operate to minimise the “reach” of the proposals to a manageable number of taxpayers.

The Place of Supply Directive has some definitions of these services for the purposes of its special scheme.

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<sup>119</sup> Contained in the *Taxation Administration Act 1953*.

<sup>120</sup> These measures would be particularly unique because it would involve the ATO claiming an interest in assets of Australian entities that relate to the third party’s default in its taxation obligations.

<sup>121</sup> Similar to the joint and several liability of partners and joint venturers under the existing law.

<sup>122</sup> These views are consistent with the opinions expressed by the authors of the Modern VAT and the 2005 OECD e-commerce report.

In addition, consideration should be given the option or requirement for the appointment of a “GST Agent” or “fiscal representative” in Australia to attend to the compliance obligations of a non-resident without a physical presence in Australia.<sup>123</sup>

#### **4.3.3.4 Summary**

In my view, Option 2 is more:

- likely to be successful; and
- efficient because the number of taxpayers would be far less, than a self-assessment of customers as in Option 1.

Under this approach, a non-resident supplier has two approaches to the supplies it makes to customers in Australia:

- No GST obligations arise if the Australian customer is registered for GST; and
- GST is payable for supplies made to Australia customers who are not GST-registered.

This approach is consistent with both:

- the proposed changes to the treatment of cross-border transactions recommended by the Board of Taxation review; and
- the approach adopted in the EU.

## **4.4 Option 3 - GST collected from third parties, intermediaries or agents**

Option 3 is, from the perspective of the legislative scheme and administration, two different options:

- The first approach of collection from third parties is proposed to be a recovery or withholding tax.
- The second approach is to impose a liability on third party facilitators of the supply rather than the supplier itself.

### **4.4.1 Recovery of GST payable by a supplier – “recovery” approach**

This option envisages the imposition of GST on the supplier or recipient in the same way as Options 1 or 2 but the recovery of the liability is from a third party.

The Australian taxation law has examples of situations where an intermediary that holds money for a taxpayer is required to pay tax due by the taxpayer.

The law will generally require that a liability is established against the primary party at first instance and the amount due collected from the intermediary.

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<sup>123</sup> This is the recommendation of the 2005 OECD e-commerce report.

There are a number of alternative models in this regard:

- This is the existing situation under the GST law for non-residents that trade in Australia through resident agents.<sup>124</sup>
- The proposal to allow the nomination of an entity other than a common law agent to deal with GST obligations of a non-resident is discussed in 3.3 above. The 2005 OECD e-commerce report discusses a framework around which an “intermediary” may be appointed to deal with the GST obligations on behalf of a non-resident.

Such an arrangement may be advantageous for non-residents that do not wish to establish a fiscal presence in Australia.

In a similar way, partners and joint ventures are made jointly and severally liable for indirect tax debts of their partnership and joint venture.

Under Option 3, the collection of GST from, and enforcement of obligations on, a third party,<sup>125</sup> would first require a legitimate liability and obligation of the supplier to be established.

The alternative is to establish a primary liability on the facilitator – this is dealt with in the second part of Option 3.

Essentially, the recovery approach presupposes Option 1 or 2 because, as a recovery of tax liability of another person, the law must first impose that liability. Under the current law the importation of goods under the LVT and the supply of services from offshore are not subject to GST as a matter of law.

As is discussed in Option 2, the ability to enforce obligations and attach goods or moneys may be a necessary element of the enforcement of Option 2.

However, it would seem that the information held by credit and debit card issuers, while suitable for data matching and audit, would not be of sufficient detail, without considerable processing and data accumulation from the offshore acquirer and/or merchant, to impose a withholding requirement for a liability of the merchant, as a matter of course.

While the identity of the offshore supplier (or payee) might be available, it is unlikely that the details of the purchase (goods vs services, and location of the card holder) would be readily available.

In this regard, we note that Visa explained the limitation on their data in its submission to the Productivity Commission. It would seem that the limitations of Visa’s data reflects the type of compliance difficulty discussed in relation to customers self-assessment of their own liability.

Significantly, the monies received from the customer by the card issuer are not due to the offshore supplier. By the time the issuer has required payment from the customer, the offshore merchant will have claimed and received the sales proceeds from its acquiring bank and the acquirer will have received payment from the issuer.

Consequently, some difficulty might arise in requiring a “withholding” type mechanism against the cardholders debt to the card issuer – unless, as discussed above, there is a residual liability for the customer in the event of default by the offshore merchant.

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<sup>124</sup> Division 57.

<sup>125</sup> Such as the customer as discussed in Option 2 above or, (say) a freight forwarder, bank or internet provider.

#### 4.4.2 Imposition of GST on third party

This option proposes that a new and separate GST liability be imposed on transactions entered into by intermediaries, such as card issuers, that obtain fees through facilitation of the offshore purchase of goods or services.

The PC Report, in considering this approach stated:

“Another alternative may be to collect GST on overseas purchases made using credit or debit cards by requiring card issuers to collect the GST as part of the transaction.

The Commission sought information from financial intermediaries on the feasibility of this option. In response Visa advised that:

Visa is of the view that we could not perform this function. It is noteworthy that Visa does not perform this role for any other jurisdiction globally.

The core reason for our inability to perform such a function is that no technical data solution exists to deliver the suggested collection outcome. It is important to also note that no Visa-controlled steps exist that would change this situation. ...

The Commission understands that the current system for processing payments does not allow the identification of the individual components of a transaction which would be needed to identify what taxes were applicable. The Commission is not aware of any government which is currently using this approach.”

One presumes that, if the law imposed a GST liability on the card issuer for the transactions its card holders entered into with offshore merchants, the credit card agreement would allow the issuer to recover that amount from the card holder.

This would constitute a credit risk for the card issuer that would require relief in the event that the GST was not recovered.<sup>126</sup>

It is not clear that the information held by the card issuer would allow any more granular examination of each transaction than that of Visa. The information from Visa notes that the data on the break-down of a purchase may be held by the merchant’s acquiring bank – which is likely to be based in the merchant’s own jurisdiction.

The number of transactions involved, when intangibles are combined with 57 million parcels would appear to involve heavy compliance costs that may require the co-operation of the non-resident supplier or acquiring bank.

Further, the amount due from the card holder to the card issuer is the credit risk of the issuer. The card issuer is liable to pay the face value of the sale to the card acquirer whether or not it recovers the sum from the card holder.

Two approaches might be adopted to overcome the limitations of the card issuers to pay GST on transactions for which it provides credit:

- Card issuers could be required to deduct GST from all transactions with offshore parties at their face value and customers could claim a tax-rebate on GST incorrectly charged.

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<sup>126</sup> Under the general law, a refund of GST paid on a supply is available to the supplier if the amount owing by the recipient is a “bad debt”.

This mechanism suffers from several limitations:

- It would require the identification of GST registered card holders vs unregistered so that the deduction was only suffered by those customers that are consumers. Alternatively, a tax invoice system would need to be instituted to allow GST credits to registered card holders and any reverse charge obligation ignored.

For over deduction, a mechanism for refund to the unregistered card holder would need to be found.

- Without more in the GST law or the agreement with the card holder, the card issuer would not be able to recover the GST component from the customer so that the GST costs would be borne by the card issuer.

Under the existing credit card systems, the offshore acquirer and merchant would not suffer the GST cost. Any reduction from the amount due to the merchant would be in breach of the card issuers' contractual obligations to the card company and interchange arrangements.

- The GST liability could be based on a fraction or multiplier of an aggregate of cash flows or revenue of the card issuer.

The fraction or multiplier would be applied to an aggregate of all amounts payable to a card issuer for offshore purchases for a period and be calculated to approximate the GST that would otherwise be payable by the offshore supplier. For example, if a card issuer was required to pay to the card acquirer in respect of offshore merchants sales totalling AUD1 billion in a year – each being less than AUD1,000 – a GST might be imposed on the card issuer for a total of AUD 90,909,090, being 1/11<sup>th</sup> of the price received from the customer.<sup>127</sup>

Where aggregate arrangements have been used in the past for liquor franchise fees and fire service levy, the result has been per unit fees charged to customers (by the proxy taxpayer) that appear as if they are transaction based.

Consideration should be given to the danger of such a tax being characterised as a tax on income or assets rather than a GST must be considered in the context of our international treaties.

A system of deduction of this nature should also be accompanied by a system of Government indemnities for the card issuer.

**I do not recommend** these approaches because of the likely complexity and administrative costs involved.

The use of a collection though the card issuer is more suited to the recovery of liabilities established under Option 2.

Option 2 is preferable from an efficiency and compliance perspective. While card issuers may be the source of information to establish the extent of liabilities under Options 1 or 2, it is unlikely that an efficient system of collection could be mounted against these entities as a principal point of reference.

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<sup>127</sup> Assuming that this is indirectly recovered from the customer, the use of the 1/11<sup>th</sup> fraction produces a 10% tax on the GST exclusive cost to the customer.

## 4.5 Option 4 – GST collected at origin

There are again, two approaches to this option:

- GST collected in the jurisdiction of origin and shared with or transferred to the place of destination; and
- GST is collected but retained in the jurisdiction of origin.

### 4.5.1 Sharing

In some federal jurisdictions (such as the Canadian Harmonised Sales Tax (HST)) value-added tax is collected in the jurisdiction in which the supplier is established, and from which the supply is made, with a mechanism to transfer the benefit of tax to the customer's jurisdiction.

In federal jurisdictions or common markets, once taxation of the supply is imposed, the question is how the revenue collected is shared amongst the member states.

In the Canadian HST, the revenue is distributed between the HST Provinces according to proportion of consumption in each Province.

A number of proposals have been put forward for federal jurisdictions to collect VAT at origin but pay them across to the place of destination – a clearing house, compensating VAT (CVAT), Viable Integrated VAT (VIVAT) and Prepaid VAT (PVAT).<sup>128</sup>

Having considered the various proposals, the authors of the Modern VAT<sup>129</sup> conclude:

“Implementing the destination principle is likely to become increasingly difficult as economic integration proceeds, not least because of the increasing importance of e-commerce. ... thorny problems remain: including, not least those from the provision of intangible services by those with no physical presence in the jurisdiction of consumption.”

The examples of this approach (whereby tax is collected at origin by the authority in the suppliers' home jurisdiction) arise in federal jurisdictions where a system of transfers of funds can be agreed between the Member States or provinces.

This Option is not viable at the present stage of international co-operation of VAT systems.

### 4.5.2 Retention at origin

The general rule within the EU is that the supply of services to consumers is taxed in the place where the supplier has established their business. This results in tax on the value of the consumption being retained in the jurisdiction of origin.

This option does not increase the GST revenue in Australia.

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<sup>128</sup> For discussion, refer to Ebrill 2001 pages 189 to 193 and Schenk Chapter 12.

<sup>129</sup> Ebrill 2001.

## 4.6 Conclusion

### 4.6.1 Option 2

Of the four options, I consider that the second is the most likely to be successful. I note that:

- It is likely that offshore suppliers have liabilities under the existing law of which they are unaware; and
- The option, while contrary to the aim of reducing the involvement of non-residents in the Australian system announced in the 2010-11 Budget to give effect to the Board of Taxation review of cross-border transactions, is consistent with the exiting GST system.

The success of the initiative would depend upon:

- Simple registration, lodgement and compliance processes, including a registration threshold;
- Certainty and clarity in the taxation treatment of the transactions at issue;
- The identification of and communication with the major suppliers to Australian customers to ensure their voluntary compliance with an increased scope of the Australian GST net.

Information provided by debit and credit card issuers or intermediaries would be an extremely convincing voluntary compliance tool and it is considered that large companies would be more likely to comply than not.

An ability to enforce the collection of tax against intermediaries that are within the Australian jurisdiction, while unpopular, may encourage the compliance of non-residents.

#### **4.6.2 Option 1**

My alternative recommendation is Option 1. I take note of the apparent success of communication and compliance encouragement in the US income tax system. I would hope that similar approaches in Australia, when combined with data matching, would be successful in recovering the significant revenue lost from on-line retailing under the current regime.

Because of the high number of taxpayers, its complexity and the collection costs of unpaid GST amounts, further examination may reveal that the administrative and compliance costs outweigh the revenue gain.

## **A. An excerpt from Form M-1 instructions for Minnesota income tax filers**

If you purchased items for your own use without paying sales tax, you probably owe use tax. Here are some cases when use tax is due:

- You buy taxable items over the internet, by mail order, from a shopping channel, etc., and the seller doesn't collect Minnesota sales tax from you.
- A seller in another state or country does not collect any sales tax from you on a sale of an item that is taxed by Minnesota.
- An out-of-state seller properly collects another state's sales tax at a rate lower than Minnesota's. In this case, you owe the difference between the two rates.

If your total purchases subject to use tax are less than \$770 in a calendar year, you are not required to file a use tax return. This exemption applies only to items for personal use, not to items for business use.

If your total purchases subject to use tax are \$770 or more, you owe use tax on all taxable items purchased during the year. File for free online at [www.taxes.state.mn.us](http://www.taxes.state.mn.us). Click on "Login to e-File Minnesota" on the right side of the screen. Enter your Social Security number and click on "Individual use tax," or you may file a paper Form UT1, *Individual Use Tax Return*. Form UT1 and Fact Sheet 156, Use Tax for Individuals, are available at [www.taxes.state.mn.us](http://www.taxes.state.mn.us), or by calling 651-296-6181 or 1-800-657-3777.

Source: Form M-1 Instructions, Minnesota Department of Revenue, Tax Year 2009

## B. Extract from GSTR 2004/1 – how a payment system works

