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CPA Australia Ltd
ABN 64 008 392 452
Level 20, 28 Freshwater Place
Southbank VIC 3006
Australia
GPO Box 2820
Melbourne VIC 3001
Australia
Phone 1300 737 373
Outside Aust +613 9606 9677
Website cpaaustralia.com.au

General Manager
Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600

By email: taxlawdesign@treasury.gov.au

Dear Sir or Madam

SUBJECT: SUBMISSION ON EXPOSURE DRAFT LEGISLATION CONCERNING TAX LAWS AMENDMENT (TAX INTEGRITY: GST AND DIGITAL PRODUCTS) BILL 2015

CPA Australia represents the diverse interests of more than 150,000 members in 120 countries, including more than 25,000 members working in senior leadership positions. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background, we provide this submission in relation to the Exposure Draft Legislation 'Tax Laws Amendment (Tax Integrity: GST and Digital Products) Bill 2015' and the accompanying Explanatory Materials (EM) which were issued by Treasury on 12 May 2015.

GENERAL COMMENTS

CPA Australia has long advocated the need for Australia to develop a robust and comprehensive suite of direct and indirect tax laws to address the burgeoning challenges of the digital economy including the ability to efficiently and equitably tax supplies of intangibles by overseas entities which are consumed in Australia.

Such reforms are critical as Australian entities providing intangible supplies should not be placed at a competitive disadvantage to offshore providers supplying equivalent intangible supplies who are currently outside the Australian tax net.

However, we also recognise that care needs to be taken in designing such tax laws to ensure that they are workable and are capable of being enforced against all offshore suppliers.

We have concerns whether the proposed exposure draft legislation will achieve those outcomes especially as the proposed changes are in some respects inconsistent with the design features of the GST, appear to trigger an array of anomalous outcomes and may be unenforceable in many cases.

Whilst it may encourage certain larger offshore suppliers such as Netflix to voluntarily change their behaviour and subject their supplies to Australian GST, it may prove difficult to mandatorily apply such a tax to all offshore suppliers which we believe is a fundamental aspect to any taxing regime to ensure the consistent and equitable treatment of all offshore intangible supplies.

Accordingly, we believe that there could be significant merit in the Government using forums such as the Organisation for Economic Co-operation and Development (OECD) to explore the merits of obtaining a multilateral solution where all international supplies of intangibles are subject to an 'intellectual property transfer levy'.

Essentially, such a levy would be imposed on any cross border supply of intellectual property (such as downloads of digital content) by an entity regardless of their country of residency for tax purposes which would be payable to the jurisdiction in which the supply was consumed.

As a corollary it would be necessary to set up an international clearing house to pool the collected levies and then re-allocate them on some internationally agreed methodology.

Whilst we recognise that this is a daunting task, we note that there has been long standing international consensus that the revenue generated from international postage of mail is allocated to a clearing house and then allocated to the member country which has collected such revenue pursuant to an internationally agreed formula administered by the Universal Postage Union.

Such an approach is also broadly consistent with the taxing regime adopted by the European Union where the value added tax imposed on intangible supplies is payable in the member jurisdiction in which the supply is consumed rather than the country of residence of the offshore supplier.

It is also equitable in that it will ensure that both Australian entities providing intangible supplies offshore and foreign suppliers providing intangible supplies into Australia are treated in a common way which would lead to greater international consensus as certain foreign jurisdictions may view the proposed Netflix tax as protecting the Australian revenue but not deterring Australian suppliers from eroding the tax base of their jurisdictions through the making of equivalent supplies.

Finally such an approach would avoid any assertion that Australia is essentially setting up a trade barrier to the international supply of intangibles by way of a tax which in some respects appears to have some of the hallmarks of a customs duty albeit on the supply of intangibles and not tangible goods.

SPECIFIC COMMENTS

We also make the following specific comments in respect of the exposure draft legislation:

1. Australian consumer

Proposed section 9-25(5)(d) of A New Tax System (Goods and Services Tax) Act 1999 (the GST Act) provides that a supply of anything other than real property will be connected with Australia if the recipient of the supply is an 'Australian consumer'.

The term 'Australian consumer' is in turn effectively defined under proposed section 9-25(7) of the GST Act to be an Australian resident (other than an entity resident in an external territory) which is either not registered or required to be registered for GST purposes, or is registered for GST but did not acquire the thing supplied to any extent in carrying on an enterprise in Australia other than in the external territories.

It is also envisaged under proposed section 84-100 of the GST Act that an offshore supplier will not be liable for GST on the supply of an intangible where the supplier reasonably believes that the consumer of the supply is not an Australian consumer after taking all reasonable steps to obtain information about whether or not the consumer is an Australian consumer.

Paragraph 40 of the EM states that it is expected that the Australian Taxation Office (ATO) will work with affected suppliers to develop an agreed understanding of what would constitute what reasonable steps would need to be applied by the offshore supplier in satisfying proposed section 84-100.

We believe that such an approach is inconsistent with the design features of the GST and could lead to a diverse range of anomalous outcomes.

First, the GST is fundamentally a tax which is imposed on suppliers where the supply has the necessary connection with Australia and potentially applies to all purchasers in Australia regardless of their residency status for tax purposes.

It appears counter-intuitive that an Australian resident downloading an electronic book on Kindle in the United Kingdom which they bring back to Australia would be potentially subject to the tax under proposed section 9-25(5)(d) whereas a tourist consuming an equivalent product in Australia will not based on the premise that he or she is a non-resident for Australian tax purposes.

Secondly, we believe that it will be challenging for the ATO and offshore suppliers to develop a mutually agreed criteria which will enable offshore suppliers to be assured that they have taken reasonable steps to identify the tax residency of a consumer such that reliance can be placed on the exempting provisions of proposed section 84-100.

Paragraph 31 of the EM notes, amongst other things, that the residency of an individual takes its ordinary meaning. However, in the past year cases such as Re Dempsey and FCT[2014] AATA 335, Re The Engineering Manager and FCT [2014] AATA 969 and Re Shord and FCT [2015] AATA 355 have all illustrated the complexities of applying the definition of the residency status of an individual especially in the context of

individuals who regularly work outside Australia which is becoming increasingly common as the workforce becomes more internationally mobile.

Similar problems can also arise in determining the residency of a company where it is not incorporated in Australia, and it is necessary to determine the location of its central management and control or where its voting power is controlled. This problem is exacerbated in an increasingly global economy where effective ownership or control may be held by a mixture of resident and non-resident entities.

We believe that similar issues will arise in determining the residency status of other types of entities which is essentially recognised under paragraph 31 of the EM.

Thirdly, it will often be practically difficult for the offshore supplier or electronic distribution service provider to ensure that the entity being supplied the intangible is a consumer who is not partly or wholly carrying on an enterprise in Australia.

Conceivably some recipients of a supply may be acquiring an intangible partly or wholly for a creditable purpose which will not always be readily apparent to the entity responsible for remitting tax such as an electronic service provider.

It would also be particularly unfair where the recipient did acquire the supply in carrying on a business that it is ultimately denied an input tax credit for the GST borne on the intangible acquired. Moreover, the need to identify such transactions would add to the compliance burden of many businesses.

2. Enforceability

Whilst certain suppliers such as Netflix may voluntarily comply with the proposed regime for reputational reasons we believe that consistent enforcement of the GST under the proposed amendments to all offshore supplies of intangibles will be difficult to realise.

We concur with the view that it is not appropriate to extend the reverse charge rules under current Division 84 of the GST Act to Australian consumers under the proposed legislation given the offshore supply of intangibles by-passes physical border controls and thus is extremely hard to characterise and police.

Accordingly, we note that the proposed legislation principally imposes the GST liability arising under the proposed changes on electronic distribution service providers, and that such a liability will only be imposed on the offshore supplier where the electronic distribution service provider has no substantive involvement in making the supply and an invoice is issued identifying the overseas supplier as the supplier of the intangible supply.

As set out in proposed section 84-50 where the provider does not authorise the payment or delivery of the supply or set the terms and conditions for making the supply, it will not be treated as being a supply made by an electronic service provider in which case the GST liability will default back to the overseas supplier.

Whilst we believe that imposing the liability on the operator of the electronic distribution service is the most viable option in collecting the tax it is not readily apparent how this tax can be collected or enforced where such an operator contracts with the supplier so that the exempting conditions under proposed section 84-50 are met and the liability reverts back to the offshore supplier.

From a practical perspective we believe that it will be extremely difficult to enforce any liability on such offshore suppliers other than for particularly large corporate taxpayers such as Netflix, which may voluntarily subject themselves to GST.

For example, if an internet supplier in Liberia makes the supply of an intangible which is supplied to an Australian consumer it is not clear how the ATO could seek to identity such a supplier or enforce payment of any related GST liability.

3. Simplified registration regime

Proposed section 84-105 provides that a foreign resident entity making an inbound intangible consumer supply may elect to have a limited registration apply for the year in which such a supply is made under which the supplier would not be entitled to any input tax credits for GST paid on things acquired in making such a supply.

We question whether foreign entities subject to the proposed regime are likely to typically avail themselves of this election as we believe such taxpayers like any other entities subject to GST will be keen in practice to identify any input tax credits which would potentially reduce their GST liability.

If you have any questions regarding the above, please contact Gavan Ord, Manager Business and Investment Policy, on (03) 9606 9695 or via email at gavan.ord@cpaaustralia.com.au.

Yours faithfully

Paul Drum FCPA
Head of Policy