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7 July 2015

General Manager
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The Treasury
Langton Crescent
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By email
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Dear Sir:

Tax Laws Amendment (Tax Integrity: GST and Digital Products) Bill 2015

We thank you for the opportunity to make submissions on the exposure draft legislation and draft explanatory material for the proposed Tax Laws Amendment (Tax Integrity: GST and Digital Products) Bill 2015 (**Exposure Draft**).

We write to you on behalf of the Digital Economy Group (the **DEG**), an informal coalition of leading U.S. and non-U.S. software, information/content, social networking, and e-commerce companies that provide goods or services through digital and non-digital means.

Members of the DEG have extensive experience complying with extraterritorial GST and VAT obligations in other jurisdictions, such as the EU. Thus, members of the DEG are well-positioned to provide comments based on experience regarding value added taxes and e-commerce.

We comment as follows on some of the key issues.

Extraterritoriality

Extraterritorial obligations remain unusual and exceptional in trans-national law and impose unusual operational and legal burdens on enterprises not actually operating in the state imposing such obligations. As such, extraterritorial obligations should be imposed only under conditions which lead to high rates of voluntary compliance. Otherwise, extraterritorial impositions place compliant enterprises at a competitive disadvantage to non-compliant ones.

To this end, extraterritorial tax collection obligations should have a clear focus on simplicity and predictability in order to increase voluntary compliance. Our recommendations in this letter aim to improve the proposed regime's (**Regime**) simplicity and predictability, with a view to facilitating the administration of the Regime for both taxpayers and the Australian government.

Taxing nexus

The Exposure Draft sets out a new taxing nexus for GST, namely the recipient of a supply of a digital product or any service, including a non-digital service, being an "Australian consumer" (Schedule 1, Part 1, item 1). An "Australian consumer" in turn is defined to mean an "Australian resident" where the recipient is either (i) a natural person or (ii) an entity that (a) is not registered for GST or required to be registered for GST, or (b) if registered or required to be registered, does not acquire the thing supplied solely or partly for the purpose of an enterprise that the entity carries on.

Notably, the operation of the taxing nexus is not limited to consumption in Australia but may apply to an "Australian resident" consuming supplies outside of Australia. As the range of services to which the Regime potentially applies is extremely wide, this nexus rule has the effect of extending the Regime's scope to cover services that a nonresident supplies to an Australian consumer anywhere in the world, regardless of whether or not the service is supplied remotely with respect to Australia. As compared to extraterritorial indirect tax regimes in other jurisdictions, such as the EU, such a scope is overbroad, since it embraces services other than those that nonresidents supply in cross-border transactions to Australian consumers who are located in Australia. As noted below, the overbroad scope of the Regime raises significant compliance challenges for nonresidents that seek provide to services to Australian consumers.

Specifically, it is submitted that the extension of the taxing net to consumption outside Australia creates significant difficulties for business in requiring a business to identify the place of residence of a consumer where the supply is made outside of Australia. The following examples may illustrate this point:

- purchase of a personal service (such as medical treatment) by an Australian resident outside of Australia;
- purchase of services generally rendered outside of Australia such as financial advice.

While some such services may be treated as being GST free by reason of sec 38-190(1), Item 3 on the basis that the relevant services are enjoyed outside Australia, it is not clear how the exemption will operate in practice, for example, where the benefits of personal services such as medical treatment received overseas inure to benefit the consumer after his/her return to Australia, and where advice received overseas is applied by Australian residents to their domestic affairs on returning home.

We respectfully recommend that limiting the taxing nexus to cases where actual consumption occurs in Australia will be more easily complied with and administered. The supplier should be able to rely on the place of delivery identified for example by means of the customer's address as declared by it or relevant IP address (see below) to determine the place of consumption, as the place of actual consumption may be impossible to ascertain in most cases.

Identification of the recipient

The proposed rules set out in the Exposure Draft allow suppliers who take reasonable steps to obtain information about whether or not the consumer is an Australian consumer to escape the application of the GST rules if they satisfy the requirements of the proposed new sec 84-100. We respectfully submit that a supplier should be required to take reasonable steps to obtain such information, as specified in the Explanatory Materials, and not all reasonable steps, because the concept of all reasonable steps is too broad and unclear to be administrable. Subject to the submission above, we endorse this qualification to the imposition of liability, as a service provider located overseas may have a limited ability to ascertain with certainty whether its customer is an Australian resident or not. Some overseas suppliers may not be large businesses and may have a limited capability to source the information that a more well resourced business may have. Indeed, the Explanatory Materials accept that in "many of the cases where supplies are made to Australian consumers by foreign suppliers, the transaction will be largely automated and the foreign supplier may have only a limited capacity to investigate the residency and GST registration status of the recipient".

In determining customer location for non-tax purposes, businesses typically rely on certain indicators. These indicators include:

(a) the customer's self-declared residence or domicile;

(b) the customer's billing address as declared by the customer;

(c) the customer's IP address;

(d) the location of the bank from which the customer payment originates; and

(e) the customer's address as given to the supplier of its credit card (if different from (b) above).

These criteria generally fall within the information that the EU's Electronically Supplied Services regime allows taxpayers to use as evidence of customer location.

(a) We respectfully recommend that the Regime and/or the implementing regulations provide examples of a nonresident supplier that takes reasonable steps to determine whether a service recipient is an Australian consumer, and, after taking these steps, reasonably believes that the recipient is not an Australian consumer. In one example, a consumer that purchases an e-book from a nonresident supplier could provide the supplier with a mailing and billing address in England (which may result in UK VAT being payable). The supplier concludes that the recipient is not an Australian consumer. The example could state that the supplier has taken reasonable steps to determine whether the service recipient is an Australian consumer and reasonably believes that the recipient is not an Australian consumer, as none of the information that the supplier obtains from the recipient or in the ordinary course of its business indicates that the recipient is an Australian consumer. In another example, a nonresident supplier could provide streaming

entertainment services to a recipient, which the supplier identifies as an Australian consumer based solely on the IP address of the device through which the service is consumed. In this example, the supplier's systems look solely to service recipient IP addresses in determining the location of the supplier's users / customers for its business purposes. The example could state that the supplier has taken reasonable steps to determine whether the service recipient is an Australian consumer and reasonably believes that the recipient is an Australian consumer, as the supplier determines user / customer location based solely on IP address for its business purposes.

(b) Reliance on the customer's self declared billing or residence address or their IP address it is submitted provides the most practical solution to satisfying the requirements of sec 84-100.

Liability of platform companies and other intermediaries

The proposed new rules in certain cases shift the liability for GST on to the "electronic distribution service" that is: the platform company through which a supply is made (proposed subdivision 84-B included in the Exposure Draft). We understand that this provision is intended to apply to the operator of a website through which digital content is sold by the creator of the content.

The term, "electronic distribution service", can apply to many different business models, under which companies may provide very different types of services or levels of service. In some cases, platform companies have robust indirect tax compliance functions because of the size of their business and can more easily comply with the Regime's requirements. We would expect that these companies can satisfy the GST obligations that would otherwise be borne by micromultinationals and small and medium size enterprises that transact with Australian customers because these companies have a greater functional capacity to comply with an extraterritorial indirect tax regime than the small and/or emerging companies that transact through the companies' platforms.

In other cases, however, platform companies have adopted business models in which they provide a smaller scope of services to providers that sell through their platforms. In those cases, it would be entirely appropriate not to expect those platform companies to undertake responsibility for GST, as the actual suppliers would not expect such companies to provide GST collection services. Moreover, requiring such companies to undertake GST collection obligations on behalf of the actual suppliers would be unduly burdensome.

Accordingly, we respectfully recommend that this requirement be removed or that platform companies be allowed to elect whether or not to undertake GST collection and remittance obligations on behalf of suppliers. In the latter cases, the actual non-resident suppliers of the service purchased by the Australian user would remain liable for complying with the Regime.

Alternatively, it is submitted that the platform company should be relieved of any liability under the legislation if it has in its contract with the actual supplier, shifted to the supplier the responsibility for discharging liability for GST. This is preferable to

an election regime which requires an affirmative election, in the interests of administrability especially for smaller enterprises.

Availability of input credits

There is a possibility that in order to ensure compliance in all cases, sellers of content from offshore into Australia, may, for the avoidance of doubt, charge GST on all sales into Australia and remit what they collect regardless of whether the recipient is an Australian consumer (in which case the GST would be correctly paid) and also where the recipient is registered for GST and makes the acquisition in the course or furtherance of its enterprise (in which case the GST will be incorrectly charged and paid). Technically, any input tax credit will also be incorrectly claimed. In these circumstances, as there is no net loss to the revenue, the recipient should not be penalized for incorrectly claiming an input tax credit, especially as the recipient may not know that GST has been wrongly charged.

We respectfully recommend that relevant legislation or ruling should make provision for these circumstances to excuse all parties from liability that may otherwise arise.

Registration

The current registration turnover threshold is A$ 75,000. That is, a supplier carrying on an enterprise who has a turnover that meets this turnover threshold must register for GST. A higher registration threshold for foreign suppliers brought within the taxation net appears reasonable as suppliers may include small enterprises with limited capability to undertake responsibility for administering an extraterritorial tax imposed by a foreign jurisdiction.

A registration threshold of A$ 150,000 would, it is submitted, be appropriate. This threshold would apply both to suppliers and to platform companies / intermediaries. As applied to platform companies and other intermediaries, once a platform company / intermediary crosses this threshold, the company would be required to charge, collect, and remit GST for any supplier for which the company elects to, or contractually commits to, assume the collection and remittance obligation. This approach would minimize the compliance burden on such companies by not requiring the companies to track the Australian revenues of each individual supplier.

Under the Japanese Consumption Tax regime, an enterprise generally must earn JPY 10,000,000 (approximately A$ 107,000) in annual gross revenues subject to consumption tax from Japanese customers in the fiscal year two years prior to the relevant year before the enterprise is required to collect and remit consumption tax.[1] Under the Bahamian VAT regime, an enterprise must make B$ 100,000 (approximately A$ 132,000) in taxable supplies before the enterprise is required to register for, collect, and remit VAT.[2] Similarly, the EU is considering limiting the obligations of its Electronically Supplied Services regime to enterprises that cross a EUR 100,000 (approximately A$ 146,000) threshold. The EU is considering

[1] Japanese Consumption Tax Law, Arts. 9(1), 9-2(1).
[2] Bahamas, Value Added Tax Act, Art. 21 (2014); Bahamas Ministry of Finance, Value Added Tax Department, The Bahamas VAT Guide to Registration (Oct. 8, 2014).

establishing such a threshold out of a concern that the challenges of complying with the Electronically Supplied Services regime, which currently has no registration threshold, may be deterring small and emerging digital businesses from providing cross-border services because they lack the ability to manage indirect tax compliance outside their home jurisdictions.[3]

In light of similar examples in the EU, Japan, and the Bahamas, a registration threshold of A$ 150,000 is reasonable using the EU benchmark. A reasonable threshold is justified because foreign service providers face disproportionate compliance costs as compared to resident enterprises relative to the revenue that is derived from the market, due simply to the fact that they are not actually operating in the Australian market.

A reasonable registration threshold also helps to ensure that the Regime excludes from its scope both nonresident small businesses, which are less able to manage the compliance burdens of an extraterritorial regime, and foreign service providers that are not actively targeting the Australian market, for which occasional Australian supplies should not trigger indirect tax registration obligations.

Low registration thresholds create inevitable noncompliance, as smaller enterprises remote from the Australian market cannot be expected to comply when their volume of sales to Australian customers is low. We respectfully submit that the Regime should be designed without punitive consequences for inadvertent noncompliance, as technical noncompliance can create significant legal and financial exposures for entities that are entirely disproportionate to the amount of tax involved. As a common example, the discovery of technical noncompliance with an extraterritorial regime shortly before a company's IPO or other corporate transaction can create significant difficulties for the company which cannot be resolved quickly.

We would welcome the opportunity to meet with The Treasury to discuss our recommendations and are prepared to provide additional input as needed.

Please contact the writer for clarification or any further information.

Yours sincerely

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[3] http://www.vatlive.com/european-news/eu-propose-e100000-vat-threshold-digital-services-moss/.