

SUBMISSION TO THE CONSULTATION ON THE GST TREATMENT OF CROSS-BORDER TRANSACTIONS

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Comments Prepared By:

Dr. Benjamin Hayward

Deakin Law School

Deakin University

221 Burwood Highway

Burwood VIC 3125

Australia

benhay@deakin.edu.au

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I. INTRODUCTION

In its 2015 Federal Budget,¹ the Australian Government announced its intention to apply Australia's consumption tax – the goods and services tax² (the 'GST') – to imported digital products, with effect from 1 July 2017.³

Under existing law, GST is already payable on digital products sold within Australia. Against this context, this proposed measure (the 'Budget measure') has two stated purposes:⁴

- To close the currently existing revenue gap, whereby imported digital products are not subject to the GST; and
- To remove tax discrimination between digital products sold within Australia and imported digital products, thereby improving fairness, by ensuring that both receive the same GST treatment.

On 12 May 2015, Treasury published an exposure draft bill addressing this matter – the Tax Laws Amendment (Tax Integrity: GST and Digital Products) Bill 2015 (Cth) (the 'First Exposure Draft').⁵ The First Exposure Draft was accompanied by a set of explanatory materials. Comment was invited on the First Exposure Draft, and this initial period of consultation concluded on 7 July 2015.

¹ See generally Australian Government, *Budget 2015* (2015) <<http://www.budget.gov.au/>>.

² See generally *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

³ Australian Government, *Budget Measures 2015 – 2016* (Commonwealth of Australia, 2015) 20 – 21.

⁴ Australian Government, *Budget Measures 2015 – 2016* (Commonwealth of Australia, 2015) 20.

⁵ See generally Treasury, *Tax Integrity: Extending GST to Digital Products and Other Services Imported by Consumers* (12 May 2015) Australian Government

<<http://treasury.gov.au/ConsultationsandReviews/Consultations/2015/Tax-integrity-Extending-GST-to-digital-products>>.

On 7 October 2015, Treasury published a further exposure draft bill – titled the Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015 (Cth) (the ‘Second Exposure Draft’).⁶ The Second Exposure Draft was also accompanied by a set of explanatory materials (the ‘Second Explanatory Materials’). The Second Exposure Draft, unlike the First Exposure Draft, incorporated provisions related to the GST treatment of cross-border transactions between businesses. Comment has been invited on the Second Exposure Draft, with this second period of consultation running through to 21 October 2015.

This submission has been prepared for the purposes of this second period of consultation, and has been submitted to Treasury for its consideration on 21 October 2015.

II. THE GST AND DIGITAL PRODUCTS – CURRENT LAW, AND THE PROPOSED AMENDMENTS

On the current state of the law, digital products sold within Australia are subject to the GST, whereas imported digital products are not.

Pursuant to the *A New Tax System (Goods and Services Tax) Act 1999* (Cth), GST is payable on taxable supplies.⁷ A taxable supply occurs if it is made for consideration, if it is made in the course or furtherance of an enterprise, if it is connected with the indirect tax zone, and if the supplier is registered or is required to be registered for GST.⁸

The concept of supplies being connected with the indirect tax zone is defined in the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25. It is this element of the definition of a taxable supply which differentiates digital products supplied within Australia from digital products which are imported, for GST purposes.

The *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ss 9-25(1) – (3) address when supplies of goods will be treated as connected to the indirect tax zone. The *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25(4) addresses the supply of real property, which is not relevant to the issues raised in this submission. Then, the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25(5) addresses when a supply of anything other than goods or real property will be connected with the indirect tax zone.

Goods are defined in the dictionary contained in the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 195-1. According to this definition, goods ‘means any form of tangible personal property’. This definition, using the term ‘means’, is an exhaustive (rather than an inclusive) definition. Thus for the purposes of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth), goods must be tangible. Digital products are thereby excluded, with the result that they constitute things other than goods or real property, and are dealt with under the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25(5) for the purposes of assessing whether their supply is connected with the indirect tax zone.

⁶ See generally Treasury, *GST Treatment of Cross-Border Transactions* (7 October 2015) Australian Government <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/GST-treatment-of-Cross-Border-Transactions>>.

⁷ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 7-1(1).

⁸ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-5.

Pursuant to that provision:

A supply of anything other than goods or real property is connected with the indirect tax zone if:

- (a) the thing is done in the indirect tax zone; or
- (b) the supplier makes the supply through an enterprise that the supplier carries on in the indirect tax zone; or
- (c) all of the following apply:
 - (i) neither paragraph (a) nor (b) applies in respect of the thing;
 - (ii) the thing is a right or option to acquire another thing;
 - (iii) the supply of the other thing would be connected with the indirect tax zone.

Where digital products are supplied within Australia, they are liable to be treated as connected to the indirect tax zone by virtue of either the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ss 9-25(5)(a) or (b). Where digital products are imported, they do not presently fall within any of the limbs of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25(5) and are thereby not subject to GST.⁹

Pursuant to the Second Exposure Draft, imported digital products will become subject to the GST. The Second Exposure Draft proposes to achieve this result by adding a further limb to the definition of when a supply of anything other than goods or real property is connected with the indirect tax zone, contained in the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25(5). Pursuant to a proposed new paragraph (d), a supply of anything other than goods or real property will be connected with the indirect tax zone if ‘the recipient of the supply is an Australian consumer’.¹⁰ This proposed new paragraph will ensure that a supply of digital products to an Australian consumer will be subject to the GST even where those digital products are imported,¹¹ as under this proposal it is the location of the consumer (rather than the location of the supply or the supplier) that is important.

As noted in the Second Explanatory Materials, the importation of digital products is not treated as a taxable importation under the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) because taxable importations must be of goods.¹² As also noted in the Second Explanatory Materials, Division 84 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) contains special rules for the supply of things other than goods and real property between businesses where those supplies are not otherwise taxable supplies, and where they are acquired for the purposes of carrying on a local enterprise – such GST being ‘reverse charged’ to the recipient of the supply.¹³

⁹ Explanatory Materials, Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015 (Cth) [1.10].

¹⁰ Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015 (Cth) Schedule 1, cl 1.

¹¹ Explanatory Materials, Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015 (Cth) [1.21] – [1.22].

¹² Explanatory Materials, Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015 (Cth) [1.9].

¹³ Explanatory Materials, Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015 (Cth) [1.11].

This is said to ‘create[...] symmetry with taxable importations where the GST is imposed on the importer who may not be the supplier’.¹⁴ It also explains why the proposed new paragraph (d), referred to above, refers to the recipient of a supply being ‘an Australian consumer’.¹⁵

III. BROADER STRUCTURAL ISSUES IN THE REGULATION OF DIGITAL PRODUCTS IN AUSTRALIA

Taxation law is not the only area of Australian law which has struggled to properly regulate and accommodate digital products. The deficiency of Australia’s current GST law in dealing with digital products sits amongst broader structural issues in the regulation of digital products. It is submitted that when considering the Second Exposure Draft, the Australian Government should also take the opportunity to consider addressing other problematic aspects of the regulation of digital products. It is desirable for the Australian Government to take a broad approach to its consideration of the regulation of digital products at this time given that a unique opportunity exists to secure coherent solutions across different areas of the law. This is particularly so given that difficulties currently exist in the regulation of digital products under State and Territory law. The States and Territories are stakeholders in the on-going reform of the GST pursuant to the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*,¹⁶ and can properly be involved to secure broader law reform around existing problems in the regulation of digital products.

One long-standing structural issue in the regulation of digital products, which has been the subject of judicial analysis now for over 30 years, is the treatment of software as goods (or otherwise) for the purposes of the State and Territory sale of goods Acts.¹⁷ This issue is an important issue with important consequences. Where software is treated as goods, its sale attracts the application of the statutory implied terms under the State and Territory sale of goods Acts – including that the goods (software) conform with description,¹⁸ that they be of merchantable quality,¹⁹ and that they conform to the requirements of a buyer’s particular purpose, where the buyer has made that purpose known to the seller and has relied upon the seller’s skill and judgment.²⁰ Where software is not treated as goods, terms of this nature are only implied into contracts of sale where such implication is permitted by the common law. Where the State and Territory sale of goods Acts do not apply, the implication of these kinds of terms is not automatic. On this basis, the way in which the law approaches this issue stands to significantly affect the rights and obligations of parties entering into transactions involving software.

¹⁴ Explanatory Materials, Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015 (Cth) [1.11].

¹⁵ Tax Laws Amendment (GST Treatment of Cross-Border Transactions) Bill 2015 (Cth) Schedule 1, cl 1.

¹⁶ *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (25 June 1999) <<https://www.coag.gov.au/node/75>> cl 3.

¹⁷ See generally *Sale of Goods Act 1954 (ACT)*; *Sale of Goods Act 1923 (NSW)*; *Sale of Goods Act (NT)*; *Sale of Goods Act 1896 (Qld)*; *Sale of Goods Act 1895 (SA)*; *Sale of Goods Act 1896 (Tas)*; *Goods Act 1958 (Vic)*; *Sale of Goods Act 1895 (WA)*.

¹⁸ See, eg, *Goods Act 1958 (Vic)* s 18.

¹⁹ See, eg, *Goods Act 1958 (Vic)* s 19(b).

²⁰ See, eg, *Goods Act 1958 (Vic)* s 19(a).

Australia's State and Territory sales Acts are modelled on the *Sale of Goods Act 1893* (UK), which has since been consolidated in the United Kingdom through the *Sale of Goods Act 1979* (UK). At the time that this legislation was originally passed, it was necessarily the case that digital products were not within the contemplation of its drafters. Between 1983 and the present time, a series of Australian and English decisions have considered the treatment of software under the *Sale of Goods Act 1979* (UK) and the State and Territory sale of goods Acts in Australia. By way of summary:

- In *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd*,²¹ it was held by the New South Wales Supreme Court that an overall package comprising of both hardware and software did constitute goods for the purposes of the *Sale of Goods Act 1923* (NSW);
- In *St Albans City and District Council v International Computers Ltd*,²² it was suggested in *obiter dicta* by Sir Iain Gildewell of the English Court of Appeal that where software is embodied in a physical medium (such as on a disk) it will be treated as goods, but it will not be treated as goods where the software is not embodied in a physical medium;
- In *Watford Electronics Ltd v Sanderson CFL Ltd*,²³ the distinction drawn in *St Albans City and District Council* was critiqued in *obiter dicta* by Thornton J of the English High Court, though it was decided on the facts of that case that the *Sale of Goods Act 1979* (UK) did not apply for other reasons;
- In *Re Amlink Technologies Pty Ltd and Australian Trade Commission*,²⁴ the Administrative Appeals Tribunal determined (for the purposes of the *Export Market Development Grants Act 1997* (Cth), but drawing upon sale of goods jurisprudence) that there is a difference between software commissioned and written or modified to specifications (constituting know-how or intellectual property) and software sold as a tangible commodity after being copied or mass-produced (constituting goods); and
- In *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd*,²⁵ the New South Wales Supreme Court decided that software in and of itself (that is, software which is not embodied in a physical medium) is not goods for the purposes of the *Sale of Goods Act 1923* (NSW).

From these decisions can be distilled the general principle that software will only constitute goods for the purposes of the State and Territory sale of goods Acts where it is embodied in a physical medium – either in hardware (as in *Toby Constructions*), or in other media such as a disk, CD, DVD, USB stick, or memory card (as in *Re Amlink Technologies*). Where software is not sold by means of a physical medium – such as where it is directly downloaded via the internet (as in *Gammasonics Institute for Medical Research*) or where the physical medium is not itself transferred to the purchaser (as in *St Albans City and District Council*) – it does not constitute goods for the purposes of Australian sales law. The only exception to this principle under Australian law arises in the specific context of the *Australian Consumer Law*, which expressly includes software in its statutory definition of goods for the purposes of the *Australian Consumer Law* only.²⁶

²¹ *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd* [1983] 2 NSWLR 48.

²² *St Albans City and District Council v International Computers Ltd* [1996] 4 All ER 481.

²³ *Watford Electronics Ltd v Sanderson CFL Ltd* [2000] 2 All ER (Comm) 984.

²⁴ *Re Amlink Technologies Pty Ltd and Australian Trade Commission* (2005) 86 ALD 370.

²⁵ *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd* (2010) 77 NSWLR 479.

²⁶ *Australian Consumer Law* s 2(1).

This position is a paradigm example of form triumphing over substance. There is no reason in principle why the rights and obligations of parties to a transaction involving the sale of software should differ just because of the medium through which that software is delivered. The rationale for this distinction is rooted in the view that goods are exclusively tangible property, a view prevailing at the time that the *Sale of Goods Act 1893* (UK) was drafted, but which (it is submitted) is no longer appropriate to modern conditions.

Despite the potential for this distinction to create unfairness, the courts have refrained from developing the law via judicial decision and have instead insisted that any remedy to this unfairness must lie with Parliament. According to Fullerton J in *Gammasonics Institute for Medical Research*:²⁷

It is no doubt desirable that the *Sale of Goods Act* affords protection to consumers purchasing software delivered online equally as it affords protection to software delivered by other means ...

In this case, the plaintiff submitted that it is productive of injustice if consumers purchasing software in the form of CDs or DVDs, either sold in retail shops or via the internet, are protected by the statutory warranties in the *Sale of Goods Act*, whereas consumers who download the same software directly from the internet or from a supplier (as was the case here), would not. Accepting that to be the case, rectifying that injustice or perceived injustice in this case, is a matter deserving of a legislative review of the operation of the *Sale of Goods Act* rather than judicial intervention.

Maintaining this distinction between software embodied in a physical medium and software which is not so embodied is now clearly inconsistent with modern technological and economic conditions. It is also inconsistent with the position taken under international sales law – the *United Nations Convention on Contracts for the International Sale of Goods*,²⁸ to which Australia is a Contracting State²⁹ – which accepts that software is goods for the purposes of that *Convention* and the international sales contracts which it governs irrespective of the mode in which it is delivered.³⁰

In addition to this existing difficulty involving the treatment of software for the purposes of the State and Territory sale of goods Acts, and even though the *Australian Consumer Law* includes software in its statutory definition of goods,³¹ it can also be observed that (today) software is only one kind of commonly traded digital product. While the focus of debate across the 1980's, 1990's and beyond 2000 has been on the classification of software as goods (or otherwise), it would be inappropriate to exclude (by implication) other digital products such as digital music and electronic books from the scope of this analysis.

²⁷ *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd* (2010) 77 NSWLR 479, 488.

²⁸ *United Nations Convention on Contracts for the International Sale of Goods*, opened for signature 11 April 1980, 1489 UNTS 3 (entered into force 1 January 1988).

²⁹ United Nations, *United Nations Convention on Contracts for the International Sale of Goods – Vienna, 11 April 1980* (2014) United Nations Treaty Collection – Chapter X – International Trade and Development <https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-10&chapter=10&lang=en>.

³⁰ Ingeborg Schwenzer and Pascal Hachem, 'Article 1' in Ingeborg Schwenzer (ed), *Schlechtriem & Schwenzer – Commentary on the UN Convention on the International Sale of Goods (CISG)* (Oxford University Press, 3rd ed, 2010) 28, 35 – 36 [18].

³¹ *Australian Consumer Law* s 2(1).

The unfairness arising from the treatment of digital music and electronic books as other-than-goods is essentially the same as that arising from the sale of software, and is particularly patent given their clearly identifiable tangible (and traditional) equivalents.

It is opportune to consider legislative reform to the State and Territory sale of goods Acts, and the *Australian Consumer Law*, at the same time as the Second Exposure Draft, as all implicate fundamental issues as to the characterisation of digital products under Australian law. Considering these broader structural issues in the regulation of digital products at the same time as the GST implications of digital sales provides the opportunity to secure solutions to both problems that are both appropriate to modern conditions, and that are coherent with each other.

IV. A COUNTER-PROPOSAL – DIFFERENT, AND BROADER, LAW REFORM

It is submitted that the Second Exposure Draft secures the right result from a GST policy perspective, but goes about achieving that result in the wrong way. This is because the Second Exposure Draft will result in digital products being subject to GST – the goods and services tax – precisely because the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) treats digital products as *not* constituting goods. This submission proposes that instead, the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) should be amended to ensure that digital products are subject to GST on the basis that they *are* goods. At the same time, amendments should be made to the State and Territory sale of goods Acts to ensure that digital products are also treated as goods for the purposes of those regimes. Amendments should also be made to the *Australian Consumer Law* to ensure that the broader category of digital products as a whole (and not just software) are treated as goods for the purposes of Australia’s consumer protection law.

This different, and broader, law reform would:

- ensure that the Budget measure’s purposes are achieved;
- remedy a problematic issue arising under Australian sales law that has been the subject of judicial analysis, and that has been without legislative redress, for over 30 years;
- bring Australian sales law (and the *Australian Consumer Law*) into line with modern technological and economic conditions by encompassing digital products as a whole (not just software) within their statutory definitions of goods; and
- ensure coherence between the *A New Tax System (Goods and Services Tax) Act 1999* (Cth), the State and Territory sale of goods Acts, and the *Australian Consumer Law*, as to their statutory definitions of goods.

It is submitted that this different, and broader, law reform should consist of the following three actions.

First, the GST should apply (as is the result of the Second Exposure Draft) to digital products that are domestically sourced and also those that are imported. However, the application of the GST to digital products should be secured on a different basis. Digital products should be subject to the GST because they *are* goods, rather than being subject to the GST because they are *not* goods.

This proposal can be effected through several amendments to the *A New Tax System (Goods and Services Tax) Act 1999* (Cth). The definition of goods in the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 195-1 should be amended to read:

‘goods’ means any form of tangible personal property, and digital products of all kinds including, but not limited to, computer software.

Defining goods so as to include digital products allows digital products to be subject to the GST on the basis that they are goods, pursuant to the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ss 9-25(1) – (3), rather than on the basis that they are not goods, pursuant to the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25(5). The proposed new *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25(5)(d) should be abandoned. Instead, a new paragraph (c) should be inserted into the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-25(3) (dealing with supplies of goods to the indirect tax zone) which reads:

supplies digital products to a recipient of the supply who is an Australian consumer.

Finally, the importation of digital products should be defined as a non-taxable importation, in a new section in Part 3-2 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth). A new *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 42-15 should be inserted so as to read:

An importation of goods is a non-taxable importation if it is an importation of digital products only.

This new provision would ensure that the importation of digital products is not treated as a taxable importation in addition to being a taxable supply. The use of the word ‘only’ would ensure that the importation of digital products which comprise part of a larger supply of otherwise tangible goods (eg. software installed within hardware) may still constitute a taxable importation.

Secondly, the State and Territory sale of goods Acts should be amended to include digital products within the scope of their inclusive statutory definitions of the term goods.³² These provisions define goods as including all chattels personal other than things in action and money, and then go on in a second sentence to specifically mention several types of goods that are included (such as emblements).³³ A third sentence should be added to this definition in the following terms:

Notwithstanding that goods does not include things in action, goods does include digital products of all kinds including, but not limited to, computer software.

³² See generally *Sale of Goods Act 1954* (ACT) s 2 & [dictionary]; *Sale of Goods Act 1923* (NSW) s 5(1); *Sale of Goods Act* (NT) s 5(1); *Sale of Goods Act 1896* (Qld) s 3(1); *Sale of Goods Act 1895* (SA) s A2(1); *Sale of Goods Act 1896* (Tas) s 3(1); *Goods Act 1958* (Vic) s 3(1); *Sale of Goods Act 1895* (WA) s 60(1).

³³ In the ACT and Queensland legislation, both elements of the existing definition run across a single sentence.

Thirdly, the *Australian Consumer Law* should be amended to include digital products within the scope of its inclusive statutory definition of the term goods.³⁴ This provision currently includes computer software within its definition of goods, but not digital products as an overall class of goods. Paragraph (e) of the definition of goods in the *Australian Consumer Law* s 2(1), currently reading ‘computer software; and’, should be amended in the following terms:

digital products of all kinds including, but not limited to, computer software; and

V. CONCLUSION

In conclusion, this Treasury consultation on the Second Exposure Draft affords a unique opportunity for the Australian Government to consider not only the GST treatment of digital products, but also the way in which digital products are regulated in other areas of the law. Difficulties arise in the regulation of digital products not only under the GST, but also in other areas of the law, including under the State and Territory sale of goods Acts. The current consultation is an opportune time to examine the regulation of digital products more broadly, given that the States and Territories are stakeholders in the on-going reform of the GST pursuant to the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*.³⁵

In summary, it is submitted that:

- The Second Exposure Draft secures the right result, but does so in the wrong way, and digital products should be subject to the GST because they *are* goods, rather than because they are *not* goods;
- The State and Territory sale of goods Acts should be amended to ensure that digital products are considered goods for the purposes of those regimes; and
- The *Australian Consumer Law* should also be amended to ensure that the category of digital products as a whole (and not just software) is treated as goods for the purposes of that regime.

³⁴ See generally *Australian Consumer Law* s 2(1).

³⁵ *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (25 June 1999) <<https://www.coag.gov.au/node/75>> cl 3.