GST and Cross-Border B2B Supplies

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On 10 February 2016, the Turnbull Government introduced the *Tax and Superannuation Laws Amendment (2016 Measures No.1) Bill 2016* ("**Bill**"). The Bill was passed by the House of Representatives on 3 March 2016. The Bill was subsequently introduced into the Senate on 16 March 2016, but lapsed on 17 April 2016.

If the Bill is reintroduced and ultimately passed in its current form, it will make a number of amendments to the *A New Tax System (Goods and Services Tax) Act 1999* ("**GST Act**") which are aimed at reducing the need for non-residents to register for GST in Australia as a result of business-to-business transactions which, for the most part, are ultimately revenue neutral. This paper summarises those amendments and discusses some of the practical implications.

1. Why does the Government want to keep more non-residents outside the Australian GST net?

There are a number of reasons why it is beneficial to keep non-residents outside the Australian GST net, particularly if their involvement with the GST system is limited and predominantly revenue neutral. These benefits include:

- **Reduced compliance costs for non-resident suppliers**. Which may potentially translate into cost reductions for Australian recipients.

- **Reduced costs for the Australian Tax Office.** The proof of identity requirements to register non-resident entities are complex and time consuming for all concerned, including the Australian Tax Office.

- **Reduced revenue risks from credit claims / cash refunds.** Non-resident entities which are GST registered are entitled to input tax credits, which can ultimately give rise to an entitlement to cash refunds. While the ATO promptly processes refunds (subject to verification reviews), the ATO's collection and enforcement powers are limited in a practical sense if the same non-resident entity later fails to remit GST on its taxable supplies.

Of course, there will also be circumstances where the Government is keen to bring non-resident suppliers into the GST net to raise additional revenue. The reforms relating to inbound supplies of intangibles made to Australian consumers – often cited in the media as the Netflix Tax – is an example of this.

1. Supplies by non-residents that are not connected with the indirect tax zone

One of the simplest ways to keep non-resident suppliers outside of the Australian GST net is to reduce the circumstances in which their supplies are taken to be "connected with the indirect tax zone".

This is precisely the approach adopted in proposed section 9-26, which is extracted in full below.

9-26 Supplies by non-residents that are not connected with the indirect tax zone

*(1) A supply is not **connected with the indirect tax zone** if:*

*(a) the supplier is a *non-resident; and*

(b) the supplier does not make the supply through an *enterprise that the supplier *carries on in the indirect tax zone; and

(c) the supply is covered by an item in this table:

Offshore supplies that are not connected with the indirect tax zone		
Item	***Topic***	***These supplies are not connected with the indirect tax zone …***
1	Inbound intangible supply	a supply of anything other than goods or *real property if: (a) the thing is done in the indirect tax zone; and (b) the *recipient is an *Australian-based business recipient of the supply.
2	Intangible supply between non-residents	a supply of anything other than goods or *real property if: (a) the thing is done in the indirect tax zone; and (b) the *recipient is a *non-resident that acquires the thing supplied solely for the purpose of an *enterprise that the recipient *carries on outside the indirect tax zone.
3	Supply between non-residents of leased goods	a supply by way of transfer of ownership of leased goods if: (a) the *recipient is a *non-resident that does not acquire the thing supplied solely or partly for the purpose of an *enterprise that the recipient *carries on in the indirect tax zone; and (b) the lessee: (i) made a *taxable importation of the goods before the supply was made; and (ii) continues to lease the goods on substantially similar terms and conditions after the supply is made.
4	Supply by way of continued lease of goods from item 3	a supply made by way of lease if: (a) the *recipient is the lessee referred to in paragraph (b) of item 3 of this table; and (b) the lease is the lease referred to in subparagraph (ii) of that paragraph.

(2) An entity is an ***Australian-based business recipient*** of a supply made to the entity if:

(a) the entity is *registered; and

(b) an *enterprise of the entity is *carried on in the indirect tax zone; and

(c) the entity's acquisition of the thing supplied is not solely of a private or domestic nature.

Note: If a supply is not connected with the indirect tax zone, the Australian-based business recipient may be subject to a reverse charge: see Subdivision 84-A.

(3) This section applies despite sections 9-25 (which is about when supplies are connected with the indirect tax zone) and 85-5 (which is about telecommunication supplies).

The preconditions at the beginning of the section make it clear that the section is limited too supplies that are made by a non-resident, and which are also not made through an enterprise that is carried on in Australia.

Item 1 – in bound intangible supplies

Under the first item, inbound intangible supplies (i.e. supplies of anything other than goods or real property) are not connected with the indirect zone, notwithstanding the supply may be "done" in the indirect tax zone, if the recipient is an "Australian-based business recipient".

For example, assume that a non-resident supplier is supplying intellectual property to an Australian business under a license. Presently, if the license agreement is last executed in Australia, the supply of the intellectual property would be connected with the indirect tax zone and hence may be taxable and subject to GST.

If the Bill is enacted, then under Item 1 such a supply should not be connected with the indirect tax zone, albeit the license agreement may be last executed in Australia, provided the recipient is an Australian-based business recipient as defined in proposed s9-26(2) extracted above.

Item 2 – Intangible supplies between non-residents

The second item is similar to the first, except that rather than the recipient being an Australian-based business, the recipient must be a non-resident that acquires the thing supplied soley to carry on an enterprise outside of Australia.

Item 3 – Supply between non-residents of leased goods

The third item is directed at transfers of ownership of leased assets between non-residents.

For example, assume that an non-resident entity has leased an aircraft to an Australian airline operator. The Airline had been responsible for importing the aircraft into Australia.

Presently, the transfer of ownership of the aircraft would be connected with Australia and a taxable supply if title is transferred while the aircraft is located in Australia.

Under the reform proposal, such transfers would not be subject to GST. This reflects that the transfer in ownership of leased assets is ultimately revenue neutral (i.e. the purchaser is entitled to a full input tax credit for any GST paid). The impact of the reform proposal is that the purchaser does not need to register for GST merely to claim an input tax credit for the purchase of the leased asset.

Item 4 – Continued lease of goods covered by item 3

Under item 4, the continued lease of the asset referred to in Item 3 to the Australian recipient will also not be connected with Australia.

This reflects that as the lessee had imported the asset, the original supply by way of lease was unlikely to have been connected with Australia. This reform obviates the need for the purchaser to register for GST merely to account for GST on the lease of the asset, recognising that the Australian recipient would either be entitled to a full input tax credit or, alternatively, bore a GST cost on the original taxable importation of the asset.

2. What is an Australian-based business?

Section 9-26(2) (extracted above) sets out the requirements for a business to be considered "Australian-based".

It is not necessary for the entity to be resident in Australia. However, it is also not sufficient for the entity to merely GST registered in Australia. The entity must carry on an enterprise in the indirect

tax zone, and the acquisition of the thing supplied must not be solely for a private and domestic purpose.

3. When is an enterprise carried on in the indirect tax zone?

The definition of an Australian-based business inevitably leads on to a question as to when an enterprise is carried on in Australia. This is addressed in section 9-27 of the GST Act which is extracted below.

9-27 When enterprises are carried on in the indirect tax zone

*(1) An *enterprise of an entity is **carried on in the indirect tax zone** if:*

*(a) the enterprise is *carried on by one or more individuals covered by subsection (3) who are in the indirect tax zone; and*

(b) any of the following applies:

(i) the enterprise is carried on through a fixed place in the indirect tax zone;

(ii) the enterprise has been carried on through one or more places in the indirect tax zone for more than 183 days in a 12 month period;

(iii) the entity intends to carry on the enterprise through one or more places in the indirect tax zone for more than 183 days in a 12 month period.

(2) It does not matter whether:

(a) the entity has exclusive use of a place; or

(b) the entity owns, leases or has any other claim or interest in relation to a place.

(3) This subsection covers the following individuals:

(a) if the entity is an individual—that individual;

*(b) an employee or *officer of the entity;*

(c) an individual who is, or is employed by, an agent of the entity that:

(i) has, and habitually exercises, authority to conclude contracts on behalf of the entity; and

(ii) is not a broker, general commission agent or other agent of independent status that is acting in the ordinary course of the agent's business as such an agent.

This new section essentially incorporates tests that are similar to those used to determine whether an entity has a permanent establishment in Australia for corporate tax purposes.

In the author's view, this is a useful new concept and test in the context of determining whether a supplier has ***itself*** made a supply that is connected with Australia. As outlined above, one of the two preconditions for section 9-26(1) to apply is that the supply must not have been made through an enterprise that the supplier carries on in Australia.

However, in the author's view, it is unfortunate that this concept has also been used in the definition of "Australian-based business". The effect is that supplier's will need to form their own view on whether the ***recipient*** carries on an enterprise in Australia, which is a fact dependent issue. It would be preferable if the supplier's enquiry instead ended once it was determined that the recipient is a GST registered entity in Australia (which can usually, but not always, be readily determined through a search of the Australian Business Register if the recipient has provided its ABN).

As a practical matter, suppliers may need to ensure that they obtain statements (and ideally warranties and indemnities) from recipients of supplies that they intend to treat as being out-of-scope under Item 1.

4. Installation and maintenance services

When goods are imported into Australia, the non-resident supplier may need to provide some initial installation or assembly services to enable the goods to be used by the recipient.

If the relevant goods have been imported by the recipient, the non-resident supplier of the goods will not make a taxable supply in relation to the goods themselves.

However, presently, the supply of installation or assembly services would be connected with the indirect tax zone if those services are performed in Australia. Depending on the value of the services supplied, this may cause the recipient to need to register for GST in Australia to account for GST on those services.

Proposed section 9-25(6) seeks to address this issue by breaking out the supply of services from the supply of the goods. The separate supply of services may then potentially be out-of-scope of Australian GST if Item 1 in s9-26(1) applies in respect of those services.

Section 9-25(6) is extracted below.

> *Supplies of goods involving installation or assembly services*
>
> *(6) If a supply of goods (other than a *luxury car) (the **actual supply**) involves the goods being brought to the indirect tax zone and the installation or assembly of the goods in the indirect tax zone, then the actual supply is to be treated as if it were 2 separate supplies in the following way:*
>
> *(a) the part of the actual supply that involves the installation or assembly of the goods in the indirect tax zone is to be treated as if it were a separate supply of a thing done in the indirect tax zone;*
>
> *(b) the remainder of the actual supply is to be treated as if it were a separate supply of goods involving the goods being brought to the indirect tax zone but not involving the installation or assembly of the goods.*
>
> *Note 1: The paragraph (a) supply is connected with the indirect tax zone (see paragraph (5)(a)), unless item 1 or 2 of the table in section 9-26 applies.*
>
> *Note 2: The paragraph (b) supply may be a taxable supply (see subsection (3)), or there may be a taxable importation of the goods: see Division 13.*
>
> *Note 3: For the **price** of the separate supplies, see subsection 9-75(4).*

Further to Note 3, the Bill also contains a proposed section 9-75(4) which will assist in determining the price for the supply of the services. This will be relevant if the supply is not out-of-scope under Item 1 in s9-26(1) and it becomes necessary to determine whether the GST registration threshold has been exceeded and to calculate any applicable GST.

Section 9-75(4) is extracted below.

> *(4) Despite subsection (1), if a supply of goods (the **actual supply**) is to be treated as separate supplies because of subsection 9-25(6), then the **price** of each such separate supply is so much of the price of the actual supply, worked out under subsection (1), as reasonably represents the price of the separate supply.*

5. Reverse Charging for supplies between associates

If additional supplies are out-of-scope of Australian GST as a result of the provisions in proposed section 9-26(1), there will be new and additional circumstances in which recipients will need to consider whether the compulsory reverse charge provisions in Division 84 of the GST Act may apply to their acquisitions.

To address concerns that Division 84 did not apply adequately to supplies between associated entities for nil or inadequate consideration, a number of amendments have been proposed to both Division 72 and Division 84 of the GST Act. These are extracted below.

Subsection 72-5(2)

Repeal the subsection, substitute:

(2) This section has effect despite paragraphs 9-5(a) and 84-5(1)(d) (which would otherwise require a taxable supply to be for consideration).

At the end of section 72-10

Add:

*(3) This section does not apply to a supply that is a *taxable supply because of section 84-5 (which is about offshore supplies other than goods or real property).*

At the end of section 72-70

Add:

*(4) This section does not apply to a supply that is a *taxable supply because of section 84-5 (which is about offshore supplies other than goods or real property).*

Paragraph 84-5(1)(c)

Repeal the paragraph, substitute:

*(c) the *recipient of the supply acquires the thing supplied solely or partly for the purpose of an *enterprise that the recipient *carries on in the indirect tax zone; and*

*(ca) the recipient of the supply does not acquire the thing supplied solely for a *creditable purpose; and*

Subsection 84-13(1) (definition of extent of consideration)

Repeal the definition, substitute:

***extent of consideration** is:*

*(a) if the *recipient is the supplier's *associate and the supply is without *consideration—100%; or*

(b) in any other case—the extent to which you provide, or are liable to provide, the consideration for the acquisition, expressed as a percentage of the total consideration for the acquisition.

Subsection 84-13(2)

Repeal the subsection, substitute:

(2) This section has effect despite:

(a) sections 11-25 and 11-30 (which are about the amount of input tax credits for creditable acquisitions); and

(b) section 72-45 (which is about the amount of input tax credits on an acquisition from an associate without consideration).

After section 84-15

Insert:

84-20 The price of taxable supplies of offshore intangibles without, or for inadequate, consideration

(1) The **price** of a supply that is a *taxable supply because of section 84-5 is the *GST inclusive market value of the supply, if:

(a) the supply is from the *recipient's *associate; and

(b) the supply is:

(i) without *consideration; or

(ii) for consideration that is less than the GST inclusive market value.

Note: A supply to an associate without consideration may be a taxable supply, see section 72-5.

(2) This section has effect despite section 9-75 (which is about the price of taxable supplies).

84-25 Tax periods for supplies from associates that are not connected with the indirect tax zone

(1) This section applies if a supply that is a *taxable supply because of section 84-5 is:

(a) a supply from the *recipient's *associate without *consideration; and

(b) not *connected with the indirect tax zone.

Note: If the supply is connected with the indirect tax zone, see sections 72-15 and 72-50 for the tax periods.

(2) The tax period to which the GST on the supply, and the input tax credit on the acquisition, is attributable is the tax period in which the thing supplied starts to be done.

(3) This section has effect despite:

(a) sections 29-5 and 72-15 (about attributing GST to tax periods); and

(b) sections 29-10 and 72-50 (about attributing input tax credits to tax periods).

84-30 Adjustments for acquisitions made solely for a creditable purpose

(1) This section applies to an acquisition that relates to a supply if the supply would be a *taxable supply under section 84-5 if paragraph 84-5(1)(ca) were disregarded.

(2) For the purpose of working out whether there is an *adjustment for the acquisition, and the amount of that adjustment, disregard paragraph 84-5(1)(ca).

Note: As a result, the adjustment (including the full input tax credit referred to in sections 129-70 and 129-75) is worked out assuming the supply is taxable and the acquisition fully creditable.

At the end of subsection 85-5(3)

Add ", but is subject to section 9-26 (which is about when supplies are not connected with the indirect tax zone)".

5. Expanded scope of GST-free supplies

As noted in section 1 of this paper above, one way to keep non-residents outside the Australian GST net is to increase the range of supplies that are made by non-residents which are connected with the indirect tax zone.

A second way to keep non-residents outside of the GST net is to increase the range of supplies that are made to non-residents by Australian based suppliers which are GST-free. As the supplies are GST-free, it obviates the need for non-residents to register for GST in Australia for the purpose of claiming input tax credits.

Warranty services and related goods

One of the circumstances in which non-residents are presently required to register for GST in Australia to claim input tax credits is where the non-resident is the recipient of repair services performed on goods located in Australia to satisfy a warranty claim. The supply of the warranty itself may not be connected with the indirect tax zone, and consequently the non-resident supplier may not be required to register for GST in relation to the supply of the warranty.

For example, assume that a non-resident car manufacturer has provided a warranty to purchasers of its new vehicles in Australia. Under the warranty, the manufacturer may be required to pay for repair services that are performed at auto garages in Australia. Such services may presently be taxable supplies and it would be necessary for the non-resident supplier to register for GST in order to claim input tax credits (note that the services would not be GST-free under item 2 in s38-190(1) of the GST Act, as the services relate to work performed on goods in Australia).

To address this, proposed section 38-191 will provide that certain repair services supplied to non-residents will be GST-free. The section also provides that the supply of goods used in the repair and maintenance services are also GST-free. The proposed section is extracted below.

38-191 Supplies relating to the repair etc. of goods under warranty

*(1) A supply of anything other than goods or *real property is **GST-free** if:*

- *(a) the *recipient is a *non-resident who:*
  - *(i) is not in the indirect tax zone when the thing supplied is done; and*
  - *(ii) acquires the thing in *carrying on the recipient's *enterprise, but is not *registered or *required to be registered; and*
- *(b) the supply is constituted by the repair, renovation, modification or treatment of goods; and*
- *(c) the repair, renovation, modification or treatment is done in order to meet the recipient's obligations under a warranty relating to the goods; and*
- *(d) either:*
  - *(i) *consideration for the warranty was included in the consideration for the supply of the goods; or*
  - *(ii) the supply of the warranty was a separate *taxable supply to the supply of the goods.*

*(2) A supply of goods is **GST-free** if:*

- *(a) it is made in the course of a supply that is GST-free under subsection (1), and to the same *recipient; and*
- *(b) either:*

(i) the goods are attached to, or become part of, the goods to which the warranty relates; or

(ii) the goods become unusable or worthless as a direct result of being used to repair, renovate, modify or treat the goods to which the warranty relates.

Other exported services

Other exported intangible supplies may be GST-free presently under the items listed in the table in s38-190(1) of the GST Act.

One of the principal exemption items used is Item 2. Under that item, supplies of things other than goods or real property will be GST-free if:

- The supply is made to a non-resident.
- The non-resident is not present in Australia in respect of the supply.
- The supply is not directly related to real property in Australia, or work performed on goods in Australia.
- OR – if the supply is related to real property or goods in Australia, the non-resident is not GST registered, or required to be GST registered.

However, this GST-free exemption is lost under the provisions in section 38-190(3) of the GST Act if the non-resident directs that the intangible supplies be provided to another entity (such as a customer, agent or subsidiary) that is present in Australia.

If the Bill is enacted, section 38-190(3) will be further limited, so that it does not apply where the entity to which the relevant intangible supply is provided in Australia is an Australian based business (or certain qualifying individuals). The proposed provisions are extracted below.

At the end of subsection 38-190(3)

Add:

*; and (c) for a supply other than an *input taxed supply—none of the following applies:*

*(i) the other entity would be an *Australian-based business recipient of the supply, if the supply had been made to it;*

*(ii) the other entity is an individual who is provided with the supply as an employee or *officer of an entity that would be an Australian-based business recipient of the supply, if the supply had been made to it; or*

*(iii) the other entity is an individual who is provided with the supply as an employee or officer of the *recipient, and the recipient's acquisition of the thing is solely for a *creditable purpose and is not a *non-deductible expense.*

It is clear from the EM that accompanies the Bill that there is an assumption that the non-resident entity which makes the GST-free acquisition will make a supply of the same thing to the entity in Australia to whom the supply has been provided. This is addressed in paragraph 2.159 of the EM which provides as follows:

"2.159 The provision of the thing that is supplied to another entity ***results in a separate supply between the non-resident (the recipient of the original supply) and the other entity (the recipient of the separate supply)****. A separate supply of this kind can be reverse charged to the recipient because of the exceptions to the connected with the ITZ rules outlined above…."* (Emphasis added)

Interestingly, the Bill does not contain any provisions which deem the non-resident to make the separate supply referred to in the paragraph above. While there will be many instances where there is clearly a separate supply, in the author's view, this will not necessarily be the case in all circumstances, meaning that the reverse charge provisions in Division 84 of the GST Act do not necessarily apply where the Australian-based business has been provided with something in Australia which it will use for a non-creditable purpose.