

Goods and Services Tax

Inbound Intangibles and Digital Supplies

ATAX Conference

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May 2016

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Background

By way of background, the Government announced on Federal Budget night on 12 May 2015 that it would introduce measures that will require non-resident suppliers to register, collect and remit GST on digital products and services that are provided to Australian consumers.

The intention of the proposed measures is to ensure a level playing field for the suppliers of digital products and services in Australia in relation to GST. Specifically, the proposed amendments have been characterised as an integrity measure to stop erosion of the GST tax base.

The new measures are to apply to supplies made on or after 1 July 2017 and the revenue from this initiative is expected to be \$350m over the first 2 years following the implementation of the law.

Affected supplies include the streaming or downloading of movies, music, apps, games, e-books and other digital products as well as other services such as consultancy and professional services. As a result of the amendments, all of these supplies will be similarly treated for GST purposes, irrespective of whether they are supplied by a local or foreign supplier. Gambling supplies will also be captured by the new provisions and will be connected with the 'indirect tax zone' (hereon "Australia") if the recipient of the supply is an Australian resident.

With these new measures, Australia has joined a growing list of countries that have introduced, or will introduce, measures to tax the supply of digital products and services from overseas suppliers to resident consumers.

Following the initial announcement, there have been two exposure drafts subject to public consultation, culminating in the release of The Tax and Superannuation Laws Amendment (2016 Measures No.1) Bill 2016.

Contents

Background	i
1 The Current GST System	2
2 Proposed Legislation	3
2.1 Australian Consumer - Residence	3
2.2 Australian Consumer - Being a Consumer	3
2.3 Practical Issues in Determining Australian Consumer Status	4
2.4 Limit to the Scope of the Safeguards	5
2.5 GST Obligation Imposed on Electronic Distribution Platforms	6
2.6 Limited Registration	9
2.7 Tax invoices and ITCs	9

1 *The Current GST System*

One of the most notable recent economic changes has been the growth in cross-border supplies of services and other intangibles. The initial drafting of the GST law in the late 1990s did not anticipate such a massive growth in the supply of digital products from overseas such as movies, games and e-books. Accordingly, a large (and growing) gap has arisen in supplies and consumption not currently captured by the GST law.

Under the current law, for a supply to be a taxable supply (and therefore subject to GST), it must, among other things, be connected with Australia (excluding those geographic areas where the GST does not apply, such as the external Territories).

The supply must also not be GST-free or input taxed.

Whether a supply is connected with Australia depends on the nature of the supply and the circumstances in which the supply is made. The circumstances in which a supply of anything, other than goods or real property, is connected with Australia include where:

- the thing is done in Australia;
- the supply is made through an enterprise that is carried on in Australia; or
- neither of those situations apply and the supply is the supply of a right to acquire another thing and the supply of the other thing would be connected with Australia.

Therefore, the operation of the current legislation means that supplies of digital products from offshore suppliers generally do not fall within the 'connected with Australia' test (i.e. because the supply is not made through an enterprise carried on in Australia and is not done in Australia).

Accordingly, when an Australian resident obtains services or intangible property from an overseas entity ordinarily there will not be a taxable supply or a taxable importation.

In these circumstances, suppliers of digital products in Australia will be required to account for GST while off-shore suppliers do not, which results in an economic mismatch between suppliers and does not reconcile with the draft OECD recommendations.

(Note: The importation of services or intangible property will never be a taxable importation as importations must be of goods, which the *A New Tax System (Goods and Services Tax) Act 1999* (the "GST Act") defines as 'any form of tangible personal property'.)

2 Proposed Legislation

The intended effect of the proposed legislative changes is to include supplies of services and intangibles by non-resident suppliers to 'Australian consumers' within the scope of GST.

The proposed legislation involves extending the meaning of 'connected with Australia' to include supplies of things other than goods or real property made to 'Australian consumers'.

Under the proposed legislation, an Australian consumer is broadly defined as an Australian resident that is not registered for GST or acquires the supply for a purpose other than an enterprise that it carries on. The new measures will therefore not apply to 'business to business' transactions where the customer is registered for GST.

There are two key questions in determining if a supply is made to an Australian consumer and therefore connected with Australia as a result of these amendments:

- whether the recipient is an 'Australian resident'.
- whether the entity is a 'consumer'.

2.1 Australian Consumer - Residence

An Australian resident is currently defined in the GST Act by reference to the definition in the Income Tax Assessment Act 1936 . Broadly, individuals are Australian residents if they usually reside in Australia, subject to specific statutory extensions; or in the case of a company, if the company is incorporated in Australia or effectively owned or controlled by Australian residents.

2.2 Australian Consumer - Being a Consumer

Broadly, in the framework of the Australian GST, an entity is generally treated as a final consumer if the entity is not entitled to an input tax credit ("ITC") in respect of their acquisition of the relevant supply. To be entitled to an ITC, the entity must be registered for GST and the supply must be acquired for the purpose of an enterprise that the entity carries on and to some extent for a creditable purpose.

Example 1: Offshore supply of streaming of on-demand TV content

StreamTV Singapore, a non-resident carrying on an enterprise, supplies Matthew with online TV content. The supply is not performed in Australia and StreamTV Singapore does not carry on an enterprise in Australia. Matthew is a resident of Australia and lives in Sydney. Matthew does not carry on an enterprise and is not registered for GST.

The supply made by StreamTV Singapore is connected with Australia as a result of the new legislation on the basis that:

- *the supply is made to Matthew who is a resident of Australia (not being resident in an external territory); and*

- *Matthew is not registered for GST.*

Example 2: Supplies made to entities that are registered

Sam, an individual resident in Australia, carries on business as an accountant in Australia as a sole trader and is registered for GST.

Sam purchases accounting software from Calcul8er Inc, a non-resident entity that does not carry on an enterprise in Australia. Sam intends to use this software partly to assist in his business but also partly for his own private and domestic purposes.

The supply of the software to Sam by Calcul8er Inc. is not connected with Australia as a result of these amendments. Even though Sam has acquired the software for a partly private purpose, because he is registered for GST and has acquired it at least partly for the purpose of an enterprise he carries on, he is not an Australian consumer in relation to the supply.

However, if the supply is not otherwise connected with Australia, John will be subject to the reverse charge rules in Division 84.

2.3 Practical Issues in Determining Australian Consumer Status

Residency, especially residence of individuals, is a complex and flexible concept that can take into account a very wide range of factors and considerations. On this basis, making a quick and definitive judgment on whether a taxpayer is a resident of Australia would often not be realistic given the complexity of the law and associated rules.

Therefore, the proposed new legislation provides a safeguard for suppliers. If the entity that would be liable for GST in relation to a supply:

- takes reasonable steps to obtain information concerning whether the recipient of the supply is an Australian consumer; and
- having taken these steps, reasonably believes that the recipient is not an Australian consumer;

then the entity may treat the supply as if it had been made to an entity that was not an Australian consumer even if this is later found not to have been the case.

What steps are reasonable in gathering information and what information is sufficient to have a reasonable belief will depend on the context of the particular supply. However, given sometimes only incomplete information will be reasonably available to suppliers, a supplier's belief about residence may well be based on limited facts that it has been able to obtain, such as addresses, contact numbers and statements about location. The fact that a supplier may only have access to limited information in reaching a conclusion should not make their belief unreasonable.

For large suppliers, the process for making a supply may be largely automated. To make clear that such supplies can also be covered by this safeguard, the amendments provide that if an entity:

- has business systems and processes which provide a reasonable basis for identifying if the recipient of a supply is an Australian consumer; and

- reasonably believes that the recipient is not an Australian consumer;

then the entity may treat the supply as if it had been made to an entity that was not an Australian consumer. This applies even if this is later found not to have been the case.

In practice, these safeguards should ensure that the law only requires that suppliers need to account for GST based on information collected by their business systems that identify their customers as Australian consumers, provided the information gathered by these processes is sufficient to provide a basis for a reasonable belief.

Example 3: Safeguards for suppliers

OnlineGamer LLC, a non-resident that is registered for GST, develops and sells video games through its website.

On 14 November 2017, OnlineGamer LLC supplies Patrick, an Australian resident who is not registered for GST, with their latest game.

As an Australian resident who is not registered for GST, Patrick is an Australian consumer and so this supply is connected with Australia as a result of these amendments.

However, Patrick is a dual citizen of Australia and the United Kingdom. While he is not a resident of the UK, he is visiting family in London for a month at the time of making the purchase. He pays using a credit card from a UK bank and gives the address and phone number of his relatives as his contact information.

OnlineGamer LLC has developed business processes to determine the residence of customers. Given the information these processes gather in relation to Patrick, OnlineGamer LLC reasonably believes he is not an Australian resident.

As a result, OnlineGamer LLC may treat Patrick as not being an Australian consumer when determining if its supply to him is connected with Australia.

It is understood that the ATO is considering offering the same "safe harbour" used in the EU (i.e. two non-conflicting pieces of information). However, there has been much discussion around the ATO accepting what businesses are currently relying on to determine the residency of a customer for other purposes (which might only be a single piece of information).

2.4 Limit to the Scope of the Safeguards

For the safeguards to apply, the supplier must have a reasonable belief that the recipient of a supply is not an Australian consumer, based on all of the information in its possession.

These safeguards also do not extend to entities that pay more GST than they are required as a result of incorrectly treating an entity as an Australian consumer.

Likewise, the safeguards are not available in all circumstances. If a supplier believes that an entity is not an Australian consumer based on the entity being registered for GST, then this belief will not be reasonable for the purpose of the safeguard unless the supplier has both:

- obtained the recipient's Australian Business Number (ABN) or a similar identifier prescribed by the Commissioner by legislative instrument; and
- received from the other entity a declaration or other information indicating that the other entity is registered.

Unlike a belief about residence, which involves consideration of a broad concept, issues about registration and whether an acquisition is for the purpose of an enterprise the entity “carries on” are specific to the Australian GST system.

2.5 GST Obligation Imposed on Electronic Distribution Platforms

2.5.1 Electronic distribution platforms

One of the key features in the use of the internet by consumers to buy goods and services has been the emergence of a number of large electronic markets and stores. In many cases, the operators of these platforms allow other entities to make supplies through the store or market to consumers, in effect providing distribution services to these suppliers.

Generally, in such cases the platform operator (the entity supplying access to the platform) has most of the information about the recipients of supplies. In these circumstances, the proposed legislation shifts the responsibility for the GST liability that arises under the amendments from the supplier to the operator of an electronic distribution service. This will occur where the operator controls any of the key elements of the supply such as delivery, charging or terms and conditions. It is the view of Treasury that shifting responsibility for the GST liability to operators is intended to minimise compliance costs as operators are generally better placed to comply.

However, this additional collection responsibility may add significant compliance costs for the operator of an electronic distribution service. The electronic distribution service provisions appear to replicate the equivalent EU rules.

The operator of an electronic distribution service can also elect to be liable for supplies which are not caught by the inbound intangibles provisions. This could be relevant for the operators of electronic distribution services that deal with non-resident and also resident suppliers. This election is a simplification measure that allows electronic platform operators to treat all digital supplies (whether made by a non-resident or by an Australian resident) in the same way.

However, in both cases, the shift in liability does not occur if the platform operator does not control any of the key elements of the supply and the liability of the supplier is made clear in the related documents.

For the liability of the supplier to be clear, it is necessary that a document issued to the recipient identifies the supply as being made by the supplier and the supplier and platform operator have agreed in writing that the supplier is responsible for the payment of GST on supplies.

These amendments do not apply to supplies unless they are either inbound intangible consumer supplies or supplies for which the supplier and the operator of the electronic distribution platform have agreed in writing that the operator should be liable for GST.

2.5.2 Requirements to be an Electronic Distribution Platform

To be an electronic distribution platform, a platform must be operated by means of electronic communication within the meaning of the Electronic Transactions Act 1999. This means that it includes platforms operating over the internet and potentially by other forms of electronic communication such as telephone, but not a physical store or one operated via physical mail.

The platform must also allow entities to use the platform to make supplies available to customers. This requirement will not be satisfied where the platform is not sufficiently involved in making the supply available. For example, services that merely create awareness of possible supplies (such as advertising) or provide access to a communications medium (such as internet access) would not satisfy this requirement.

Further, to be an electronic distribution platform, the supplies made through the platform must be made by means of electronic communication. Electronic communication allows for supplies to be made in such a way that the nature of the supply is standardised and the information about the supply retained. Where supplies are made by other means, the nature of the supply is much more likely to vary and the availability of information to be more limited, making it appropriate for liability to remain with the supplier.

It should be noted that it is not necessary that a supply be delivered through the platform itself for the platform to be an electronic distribution platform. That is, the platform will still constitute an electronic distribution platform where all of the arrangements for a supply are settled through the platform, but part of the thing supplied is delivered through an email from the supplier to the recipient.

For completeness, the amendments specifically identify several types of services that on their own are not electronic distribution platforms. These excluded services include:

- carriage services, such as those provided by internet service providers (ISPs) and telecommunications companies;
- access to payment systems or payment processing services; and
- supplies of vouchers which are not taxable supplies as a result of section 100-5 of the GST Act.

The amendments provide that the supply of these services is not sufficient to be the operation of an electronic distribution platform on their own (or in conjunction with another excluded service). However, this does not limit such suppliers from operating an electronic distribution platform in respect of other services they may supply.

The ATO has indicated that it will publish a number of examples in its guidance to help taxpayers determine the application of the electronic distribution platform provisions - primarily determining which entity is liable when there are multiple platforms in the supply chain. We understand the ATO is intending to use the examples developed by the EU, potentially providing some additional examples which have come through the telecommunications industry in respect of services supplied through mobile devices.

2.5.3 Consequences for Supplies made through an Electronic Distribution Platform

For inbound intangible consumer supplies and other eligible supplies made through an electronic distribution platform:

- the operator of an electronic distribution platform is treated as the supplier;
- the supply is treated as having been made through an enterprise the operator carries on; and
- the supply is treated as having been made for the same consideration for which the supply was made by the actual supplier.

In the case of supplies for which an operator is liable that are not inbound intangible consumer supplies, the enterprise through which the supplies are taken to be made is also taken to be the enterprise in the course of which the operator provides access to the electronic distribution platform.

Consistent with these rules, operators are required to register if their GST turnover for a financial year (including both their own supplies and those supplies they are treated as having made) reaches or exceeds \$75,000 (or \$150,000 for non-profit entities).

Example 4: Electronic distribution platform liable for supply by an app developer

App-spirations, an app developer based in USA, contracts with Everyday Distribution Service, which is based in Ireland, for the worldwide distribution of its gaming app via Everyday Distribution Service's internet site. Under the terms of the contract, Everyday Distribution Service collects payment from consumers via its internet web site, arranges delivery of App-spirations' applications to consumers and requires App-spirations to include certain key terms and conditions when making its supplies.

Everyday Distribution Service as the operator of the electronic distribution platform distributes some of App-spirations' apps to Australian consumers. As Everyday Distribution Service has a GST turnover in excess of \$75,000 and is registered for GST, it is liable to GST on the distribution of App-spirations' apps to Australian consumers.

2.5.4 Supplies made through Multiple Electronic Distribution Platforms

In some cases, a supply may be made through multiple electronic distribution platforms. In this case it is not intended that all of the operators become liable for the GST on the supply.

Instead, where there is more than one operator that is potentially liable in respect of the supply, the operators may agree in writing which operator will be treated as making the supply and liable to pay GST.

If there is no agreement between the operators, the proposed legislation prescribes default rules. Generally, it will be the first operator to authorise a charge or receive any of the consideration for the supply that is treated as making the supply. If none of the operators meet this requirement, the first operator to authorise the delivery of the supply assumes the GST liability.

2.6 Limited Registration

Currently, the Commissioner requires most GST registered entities to complete either a monthly or quarterly business activity statement, providing the Commissioner with information about the activities of the entity. Relevantly, the Commissioner requires entities seeking to register for GST (particularly non-resident entities) to provide significant information and documentation to verify their identity and their entitlement to be registered.

However, non-resident entities that are only required to be registered because they make inbound intangible consumer supplies are likely to only have a remote link with Australia and may not undertake activities for which GST refunds would be available (i.e. these entities may make little or no acquisitions on which GST is incurred). On this basis, there is little practical need for these overseas entities to provide the same level of information when registering for GST.

For the purpose of allowing the Commissioner to provide simplified administrative arrangements for these types of entities, the legislative amendments allow entities to elect to be a limited registration entity for GST purposes.

Limited registration entities:

- are not entitled to ITCs;
- are not entitled to have an ABN;
- do not have their registration recorded on the Australian Business Register;
- must have a quarterly tax period; and
- may not elect to pay GST by instalments.

As a result of these restrictions on limited registration entities, the Commissioner will be able to require only minimal information from these entities when they register for GST and provide GST returns.

A non-resident entity may elect to become a limited registration entity by applying to the Commissioner in the approved form if they have made or expect to make at least one inbound intangible consumer supply, whether or not they are currently registered for GST. This election applies from the start of the tax period nominated in the election. It is expected that the Commissioner will combine the approved form for electing to be a limited registration entity with the approved form for applying to be registered for GST, allowing entities to adopt limited registration in a single simplified process.

2.7 Tax invoices and ITCs

Unlike most other types of taxable supplies, inbound intangible consumer supplies by definition cannot be made to an entity that is entitled to an ITC in relation to the acquisition of the supply.

Based on the above, the legislative amendments specifically preclude the requirement to issue a tax invoice (or adjustment note) in respect of a taxable supply that is an inbound intangible consumer supply. The rationale behind this decision is to reduce the cost of Australian GST compliance (e.g. setting up invoicing systems).

