
TAX LAWS AMENDMENT (GST TREATMENT OF CROSS-BORDER
TRANSACTIONS) BILL 2015

EXPOSURE DRAFT EXPLANATORY MATERIAL

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

| <i>Abbreviation</i> | <i>Definition</i> |
|----------------------------|---|
| ABN | Australian Business Number |
| ADI | Authorised Deposit-taking Institution |
| ATO | Australian Taxation Office |
| Board | Board of Taxation |
| Commissioner | Commissioner of Taxation |
| GST | goods and services tax |
| GST Act | <i>A New Tax System (Goods and Services Tax) Act 1999</i> |
| Intangibles | things other than goods or real property |
| ISP | internet service providers |
| ITC | input tax credit |
| OECD | Organisation for Economic Co-operation and Development |
| TAA 1953 | <i>Taxation Administration Act 1953</i> |

General outline

GST Treatment of Cross-Border Transactions

Australia's Goods and Services Tax (GST) System has been in place for 15 years. Over the time it has been in operation, there have been a number of significant changes in Australia and the world.

One of the most significant of these changes has been the significant growth in cross-border supplies of services and other intangibles. When the GST was introduced in 2000, such transactions were relatively unusual, especially for consumers. However, cross-border supplies now form a large and growing part of Australian consumption.

The growing importance of these types of transactions has highlighted the fact that the GST system was designed with a focus on Australian-based, rather than cross-border supplies.

In the context of cross-border supplies where consumption is of a private or domestic nature, the GST often does not apply to supplies made by non-residents to consumers in Australia. Given the increase in cross-border transactions and the growth of the digital economy, this treatment has led to a growing area of consumption being out of scope of the GST. This harms the integrity of the GST tax base and can disadvantage local suppliers.

At the same time, the GST system is also often not well adapted to the circumstances of non-resident suppliers in respect of their dealings with Australian-based businesses. In many cases supplies between such entities result in little or no final GST being payable. As a result, the current GST settings can impose unnecessary obligations and compliance costs on non-resident suppliers.

This exposure draft legislation contains two measures that modernise the GST to address these challenges.

- The first measure, described in Chapter 1, updates the GST law to ensure that GST applies consistently to all supplies of services and other intangibles to Australian consumers.
- The second measure, described in Chapter 2, makes a number of updates to the GST law to minimise compliance costs for non-resident suppliers while maintaining the integrity of the GST base.

Chapter 1

Tax integrity: extending GST to digital products and other services imported by consumers

Outline of chapter

1.1 Schedule 1 to this exposure draft Bill amends the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) to ensure that digital products and other imported services supplied to Australian consumers by foreign entities (offshore intangible supplies to Australian consumers) are subject to goods and services tax (GST) in a similar way to equivalent supplies made by Australian entities.

1.2 All legislative references in this Chapter are to the GST Act, unless otherwise stated.

Context of amendments

Existing GST framework

1.3 GST is payable on taxable supplies and taxable importations.

1.4 Generally, for a supply to be a taxable supply, it must, among other things, be connected with the indirect tax zone (broadly, Australia, excluding those geographic areas where the GST does not apply, such as the external Territories).¹ The supply must also not be GST free or input taxed (see section 9-5).

1 For simplicity, elsewhere in this document, references to Australia (including Australian resident) should be read as a reference to the indirect tax zone, unless the context indicates otherwise.

1.5 Whether a supply is connected with the indirect tax zone 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 the indirect tax zone include where:

- the thing is done in the indirect tax zone (paragraph 9-25(5)(a));
- the supply is made through an enterprise that is carried on in the indirect tax zone (paragraph 9-25(5)(b)); 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 the indirect tax zone (paragraph 9-25(5)(c)).

1.6 The connected with the indirect tax zone rules, in conjunction with the rules for GST free exports and other provisions of the GST law, are generally intended to exclude supplies from GST where the supply is not consumed in Australia.

1.7 An importation is a taxable importation if it is an importation of goods that are entered for home consumption, provided the importation is not specified to be a non-taxable importation.

1.8 Frequently, when an Australian resident obtains services or intangible property from a non-resident entity there will be neither a taxable supply nor a taxable importation.

1.9 The importation of services or intangible property will never be a taxable importation as importations must be of goods, which the GST Act defines as 'any form of tangible property'.

1.10 They will also generally not be a taxable supply. For many such supplies of intangibles the location where the supply is performed can often be arbitrary. If the location of performance is not in Australia, a supply by a non-resident will generally not be connected with the indirect tax zone.

1.11 Special rules exist for supplies of things other than goods and real property in the context of supplies between businesses that are not taxable supplies under the general GST rules. Division 84 of the GST Act broadly provides that these supplies will be taxable supplies if they are acquired for the purposes of an enterprise carried on by an entity in the indirect tax zone that is registered or required to be registered for GST and not solely for a creditable purpose. However, any GST payable on such a

supply is ‘reverse charged’; that is, it is payable by the recipient of the supply and not the supplier. This creates symmetry with taxable importations where the GST is imposed on the importer who may not be the supplier.

Intangible supplies to consumers

1.12 The effect of Division 84 is generally to ensure that entities that are registered or required to be registered for GST are in the same net GST position in respect of things acquired for their Australian activities from overseas as they are for those things acquired locally.

1.13 However, this rule does not apply to supplies acquired by entities that are not registered or required to be registered for GST, or supplies that are not acquired for the purpose of carrying on an enterprise. As a result, such services and intangibles obtained by consumers from foreign residents are not generally subject to GST.

1.14 At the time of the introduction of the GST it was not considered necessary to address this gap as there was only a very limited range of services available to consumers from foreign suppliers that were not performed in Australia.

1.15 This is now clearly not the case. With the growth in the use of the internet and e-commerce more generally, it is often no more difficult for Australian residents to obtain many types of services and items of intangible property from a foreign resident than from a local supplier.

1.16 As a result, because GST does not apply to these supplies it creates both a significant integrity risk and places Australian suppliers at a tax disadvantage relative to foreign suppliers. This measure will ensure the GST revenue base does not steadily erode over time through increasing use by Australian consumers of foreign suppliers to provide services and other intangible supplies.

1.17 The Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting Project on Addressing the Tax Challenges of the Digital Economy noted that the evolution of technology has dramatically increased the ability of private consumers to shop online and the ability of businesses to sell to consumers around the world without the need to be present physically or otherwise in the consumer’s country. It further noted that this often results in no GST being levied at all on these flows, with adverse effects on countries’ GST revenues and on the level playing field between resident and non-resident vendors.

1.18 The OECD is in the process of developing guidelines for the taxation of cross border supplies of services and intangibles. Guidelines concerning the place of taxation rules and collection mechanisms for business to consumer supplies are expected to be finalised by the end of 2015.

1.19 However, many countries have already acted to tax offshore supplies to their consumers, including Norway, Japan, Switzerland, Iceland, South Korea, South Africa and the member states of the European Union.

Other reforms to the GST treatment of cross border transactions

1.20 These amendments are proceeding at the same time as other amendments to the GST system to address the greater involvement of non-resident suppliers as well as other issues relating to cross-border transactions. Chapter 2 contains a detailed discussion of these amendments.

Summary of new law

1.21 Schedule 1 to this Bill amends the GST law to make all supplies of things other than goods or real property connected with the indirect tax zone where they are made to an Australian consumer. An Australian consumer is broadly an Australian resident other than a business.

1.22 This change will result in supplies of digital products, such as streaming or downloading of movies, music, apps, games, e-books as well as other services such as consultancy and professional services, receiving similar GST treatment whether they are supplied by a local or foreign supplier.

1.23 In some circumstances, responsibility for GST liability that arises under the amendments may be shifted from the supplier to the operator of an electronic distribution platform.

1.24 This will occur where the supply is made through such a platform, and the operator controls any of the key elements of the supply such as price, terms and conditions or delivery arrangements.

1.25 Shifting responsibility for GST liability to operators of electronic distribution platforms minimises compliance costs as operators are generally better placed to comply. In addition, it ensures that digital goods and services sourced in a similar manner are taxed in a similar way.

These amendments are broadly modelled on similar rules currently in operation in the European Union and Norway.

1.26 Finally, Schedule 1 also amends the GST law to make a number of changes to the administrative framework for supplies affected by these amendments. These changes include allowing entities making supplies that are only connected with the indirect tax zone as a result of this measure to elect to become limited registration entities. Such entities cease to be entitled to input tax credits which will allow the Commissioner of Taxation (Commissioner) to potentially simplify their registration and reporting arrangements.

Comparison of key features of new law and current law

| <i>New law</i> | <i>Current law</i> |
|---|---|
| Supplies of services and intangibles to Australian consumers | |
| <p>In addition to the operation of the current law, supplies of things other than goods or real property are also connected with the indirect tax zone and therefore potentially subject to GST if the recipient of the supply:</p> <ul style="list-style-type: none"> • is an Australian resident (but not solely because they are a resident of one of Australia’s external territories); • is not registered for GST; and • if registered for GST, the recipient does not make the acquisition to any extent in the course of an enterprise: <p>Accordingly, supplies of digital products, such as streaming or downloading of movies, music, apps, games, e-books as well as other services such as consultancy and professional services will receive similar GST treatment whether they are supplied by a local or foreign supplier.</p> | <p>Supplies of things other than goods or real property are only connected with the indirect tax zone and therefore potentially subject to GST if:</p> <ul style="list-style-type: none"> • done in Australia; • made through an enterprise carried on in Australia; or • the thing supplied is a right or option to acquire something that is connected with the indirect tax zone. |

| <i>New law</i> | <i>Current law</i> |
|---|--------------------|
| GST obligation imposed on electronic distribution platforms | |
| <p>In some circumstances, responsibility for GST liability that arises under the amendments may be shifted to the operator of an electronic distribution platform rather than the supplier.</p> <p>This will occur if inbound intangible consumer supplies are made through an electronic distribution platform.</p> <p>A supply will be an inbound intangible consumer supply if a supply is of something other than goods or real property that is not wholly made in Australia or through an Australian permanent establishment.</p> <p>However, this shift in responsibility for GST liability will only apply if the electronic distribution platform controls at least one of the key elements of the supply. These include any of the following:</p> <ul style="list-style-type: none"> • authorising billing; • authorising delivery of the supply; or • setting the terms and conditions under which the supply is made. <p>Broadly, the amendments impose GST liability on the operator (rather than the actual supplier) if the specified criteria are met.</p> | Not applicable. |
| Modified GST administrative arrangements | |
| <p>Suppliers that make at least one inbound intangible consumer supply may opt to be a limited registration entity.</p> <p>These suppliers will not be entitled to input tax credits or receive an ABN and must have quarterly tax periods. However, the Commissioner is expected to significantly simplify the process of registration and reporting for these entities.</p> <p>An entity that has elected to be a limited registration entity may apply</p> | Not applicable. |

| <i>New law</i> | <i>Current law</i> |
|---|--|
| <p>to the Commissioner in the approved form to revoke this election and become a ‘full’ registration entity.</p> <p>This revocation is backdated until the later of:</p> <ul style="list-style-type: none"> • the day the entity first became a limited registration entity; and • the start of the financial year before the financial year in which the revocation had effect; <p>allowing the entity to claim input tax credits over the period.</p> | |
| Financial supplies | |
| <p>Certain financial supplies by non-resident banks authorised to engage in banking business by another jurisdiction and foreign superannuation funds are input taxed financial supplies.</p> <p>Further, the Treasurer may determine by legislative instrument that supplies by a non-resident are GST free or input taxed if the Foreign Minister advises in writing that this is required for Australia to be consistent with its international trade law obligations.</p> | <p>The same GST rules apply to financial supplies made by residents and non-residents.</p> |

Detailed explanation of new law

Offshore supplies of services and intangibles to Australian consumers

1.27 The amendments extend the scope of the GST to supplies of services and intangibles made by non-residents to an Australian consumer. *[Schedule 1, item 1, paragraph 9-25(5)(d) of the GST Act]*

1.28 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 receive similar GST treatment whether they are supplied by a local or foreign supplier.

1.29 An entity that is a recipient of a supply will be an Australian consumer if:

- the entity is an Australian resident (but not an Australian resident solely because they are a resident of the external territories where GST does not apply); and
- either the entity:
 - is not registered for GST; or
 - does not acquire the supply to any extent for the purpose of an enterprise they carry on.

[Schedule 1, item 3, subsection 9-25(7)]

1.30 Under the existing GST law, supplies of things other than goods or real property will be connected with the indirect tax zone (ie. the supply involves some action undertaken in or through the area of Australia in which GST applies) and therefore potentially subject to GST if:

- the things supplied are done in the indirect tax zone;
- the supplies are made through an enterprise carried on by the supplier in the indirect tax zone; or
- the supplies are of rights or options to acquire another thing that would be connected with the indirect tax zone.

1.31 The amendments broaden the scope of the GST connected with the indirect tax zone rules consistent with reforms in a number of countries to extend the scope of their value added taxes to the growing volume of offshore intangible supplies made to consumers of those countries.

1.32 The scope of the supplies that become subject to GST as a result of these amendments is significantly affected by rules for GST free exports and other supplies for consumption outside the indirect tax zone in Subdivision 38-E. This includes, in particular, section 38-190, which deals with supplies of things other than goods or real property. Among other things, this section provides for supplies connected with property that is outside the indirect tax zone and supplies for which the effective use or enjoyment occurs outside the indirect tax zone to be GST free.

1.33 These provisions ensure that while some supplies that are not consumed in Australia are connected with the indirect tax zone as a result of these amendments, these supplies will not be subject to GST as they will be GST free. The Commissioner has provided detailed guidance on the operation of section 38-190 in several rulings.

Australian consumer – residence

1.34 There are two key questions in determining if a supply is made to an Australian consumer and therefore connected with the indirect tax zone as a result of these amendments. The first is whether the recipient is an ‘Australian resident’. [*Schedule 1, item 3, paragraph 9-25(7)(a)*]

1.35 Australian resident is currently defined in the GST law by reference to the definition in the *Income Tax Assessment Act 1936*. Broadly, individuals will be considered Australian residents if they usually reside in Australia, subject to some specific statutory extensions. Similarly, a company will generally be an Australian resident if the company is incorporated in Australia or if it is effectively owned or controlled by Australian residents. Determining the residency status of other types of entities within the meaning of the GST law is more complex. The Commissioner has also published guidance on how to determine the residency status of various types of entities, both in the context of the GST law and more generally.

1.36 However, for the purposes of these amendments, the normal scope of Australian resident is restricted. The amendments do not apply to extend GST to supplies to Australian residents that are Australian residents only because they reside in the external Territories of Australia where the GST does not apply. Given GST does not apply to supplies made in these Territories, it would be inappropriate for supplies made to residents of these areas to be subject to GST.

1.37 Supplies to entities that are not Australian residents will not be supplies to Australian consumers and hence will not be subject to GST as these supplies are not connected with the indirect tax zone as a result of this measure. As identified by the OECD, for supplies of intangibles, it is often the place of residence of the consumer that best reflects where the supply is consumed. In contrast, absent any other connection with Australia, supplies to non-residents have no link to Australia and should not be subject to GST.

Australian consumer – being a consumer

1.38 The second key question in determining if an entity is an Australian consumer is whether the entity is a ‘consumer’. [*Schedule 1, item 3, paragraph 9-25(7)(b)*]

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

1.40 Where a supply is made to an entity that is not a consumer in respect of that supply – ie. the entity acquires the supply in whole or part in the course of an enterprise and the entity is registered for GST – the supply will not be connected with the indirect tax zone as a result of these amendments.

1.41 Supplies to entities entitled to input tax credits may well be consumed in Australia. However, the use of supplies in the course of the operations of a registered enterprise is not final consumption and the net GST revenue impact from taxing such supplies is effectively nil.

1.42 In most cases, an entity that acquires a supply in the course of a enterprise that is registered for GST will be entitled to an input tax credit equal to the amount of the GST on the supply. In those cases where the recipient would not be entitled to a full input tax credit for a supply, the reverse charge rules in Division 84 broadly ensure that the recipient must pay GST on the portion of the acquisition for which an input tax credit would not be available.

1.43 Some amendments to the reverse charge rules are being made in Schedule 2 to this Bill – see Chapter 2 of this explanatory memorandum.

Example 1.1: Offshore supply of streaming of video on demand

Global Movies, a non-resident carrying on an enterprise, supplies Fellini with video on demand services. The supply is not performed in Australia and Global Movies does not carry on an enterprise in Australia. Fellini is a resident of Australia and lives in Perth. Fellini does not carry on an enterprise and is not registered for GST purposes.

The supply made by Global Movies is connected with the indirect tax zone as a result of the amendments. This reflects that:

- the supply is not otherwise connected with the indirect tax zone under paragraphs 9-25(5)(a) to (c);
- the supply is made to Fellini who is a resident of Australia (not being resident in an external territory); and
- Fellini is not registered for GST.

Example 1.2: Supplies to non-residents in Australia

Ruby, a non-resident individual, visits Australia for a short holiday in March 2018.

During her time in Australia, Ruby subscribes to Global Music, a non-resident that supplies access to music over the internet on a subscription basis and downloads a number of songs.

The supply made by Global Music to Ruby is not connected with the indirect tax zone as a result of these amendments. Ruby is not an Australian resident and therefore cannot be an Australian consumer. It does not matter that Ruby was in Australia when she may have obtained some or all of the supply.

Example 1.3: Supplies made to entities that are registered

John, an individual resident in Australia, carries on business as a financial adviser in Australia as a sole trader and is registered for GST.

John purchases accounting software from Numbers Inc, a non-resident. John intends to use this software both to assist in his business but also partly for his own private and domestic purposes.

The supply of the software to John by Numbers Inc. is not connected with the indirect tax zone as a result of these amendments. Even though John has acquired the software for a partly private purpose, because he is registered for GST and has acquired it at least partly for a creditable purpose, he is not an Australian consumer in relation to the supply.

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

Suppliers and reasonable belief

1.44 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. Even in cases where supplies involve more dealings with the customer, generally the foreign supplier will need to rely upon information provided by the customer.

1.45 Recognising this, the amendments provide a safeguard for suppliers. If the entity that would be liable for GST in relation to supplies of services and intangibles:

- takes reasonable steps to obtain information concerning whether the recipient of the supply is an Australian consumer; and
- based on this information, 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. *[Schedule 1, item 6, subsection 84-100(1) of the GST Act]*

1.46 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.

1.47 However, in some circumstances, the process for making a supply will be largely automated and occur without human involvement. In initial consultation some concerns was expressed about whether gathering this information through these ordinary business systems and processes would constitute taking reasonable steps.

1.48 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. *[Schedule 1, item 6, subsection 84-100(2) of the GST Act]*

1.49 Finally, the amendments modify these safeguards to the extent they relate to treating an entity as being registered for GST, to provide clarity for suppliers about the minimum information that is necessary to treat an entity as being registered for GST in the Australian context.

1.50 For the safeguard to apply in these circumstances, the recipient's Australian Business Number (ABN) or similar identifier prescribed by the Commissioner by legislative instrument must have been disclosed to the supplier and the recipient must have made a declaration or provided information indicating they are registered for GST. *[Schedule 1, item 6, subsections 84-100(3) and (4) of the GST Act]*

1.51 It is not necessary to hold an ABN to treat an entity as not being an Australian consumer on the basis they are both not a resident of the indirect tax zone but are registered for GST.

1.52 The Commissioner's power to prescribe acceptable alternative identifiers allows for other appropriate identification to be established for the small number of entities that are registered for GST but not entitled to an ABN. The scope for the use of this power is expected to be very limited and apply in the circumstances in which an entity is entitled to

register for GST but not entitled to an ABN. This is largely confined to non-resident entities.

Example 1.4: Safeguards for suppliers

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

On 22 October 2017, Nightingale Co supplies Peter, an Australian resident who is not registered for GST, with their latest game.

Peter is an Australian consumer and so this supply is connected with the indirect tax zone as a result of these amendments.

However, Peter is a dual citizen of Australia and the United Kingdom, who is visiting family in London 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.

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

As a result, Nightingale Games may treat Peter as not being an Australian consumer when determining if its supply to him is connected with the indirect tax zone.

Penalties for misrepresentations by customers

1.53 These protections for suppliers acknowledge the practical limits of what they can reasonably do in determining the residence of their customers in other countries that may acquire services by largely automated processes. In contrast, Australian resident customers will generally be aware of their place of residence and GST registration status, but may have some incentives to misrepresent this to avoid GST on acquisitions.

1.54 The tax law already contains penalties for Australian consumers that engage in conduct such as making false declarations of their place of residence to defeat the purposes of a taxation law. This is an offence under section 8U of the *Taxation Administration Act 1953* (TAA 1953). Likewise, section 23 of the *A New Tax System (Australian Business Number) Act 1999* creates criminal offences that apply to entities that make improper use of an ABN.

1.55 However, these offences would only be imposed for the most serious and deliberate breaches concerning statements about residence and the use of an ABN respectively.

1.56 To provide an alternative remedy for the Commissioner to address misrepresentations about an entity's status as an Australian consumer, the amendments will broaden the existing administrative penalties for making false or misleading statements (see subsection 284-75(4) of Schedule 1 to the TAA 1953). This will apply to statements made in relation to the entity's status as an Australian consumer. *[Schedule 1, item 31, paragraph 284-75(4)(b) in Schedule 1 to the TAA 1953]*

1.57 Australian consumers that make such false or misleading statements will be potentially liable to an administrative penalty of up to:

- 60 penalty units (currently \$10,800) if the statement was intentionally false or misleading;
- 40 penalty units (currently \$7,200) if the statement was found to be reckless; and
- 20 penalty units (currently \$3,600) if the false or misleading statement resulted from a lack of reasonable care (see section 284-90 of Schedule 1 to the TAA 1953).

Registration requirements

1.58 These amendments do not alter the general GST rules for registration for entities making supplies that are connected with the indirect tax zone as a result of this measure. Consistent with all other entities, they will be required to register for GST if the total of their GST turnover for a financial year meets or exceeds the GST turnover threshold of \$75,000 (\$150,000 for non-profit entities).

1.59 However, the amendments make two changes to the rules for determining an enterprise's GST turnover.

1.60 First, an entity's GST turnover includes, among other things, the value of the GST free supplies the entity makes that are connected with the indirect tax zone.

1.61 While this is generally appropriate, as a result of these amendments there will be a significant number of supplies made by foreign suppliers to Australian residents that are connected with the indirect tax zone that are used or enjoyed outside the indirect tax zone and therefore GST free. This would include, for example hairdressing services that an Australian resident might obtain whilst travelling overseas. The suppliers may have no involvement with the Australian GST system and in some situations will not be aware they are making a supply to an Australian resident.

1.62 Requiring such foreign suppliers to register where the only supplies they make that have a connection with Australia are provided to Australian residents when they are not in Australia and hence the supplies are GST free is unnecessary. Further, it would impose undue compliance costs on any business dealing with an Australian where the supply is fully performed outside Australia.

1.63 There are also wider issues with the inclusion of GST free supplies by non-residents in their GST registration turnover threshold. For more discussion of these issues, see Chapter 2.

1.64 To address the issues specific to these amendments, this Schedule will amend the GST law to exclude GST free supplies from GST turnover where they are only connected with the indirect tax zone because of these amendments. [*Schedule 1, items 8 and 9, paragraphs 188-15(3)(d) and 188-20(3)(ba)*]

1.65 In addition to its wider scope, this amendment will ensure that entities making supplies that are only connected with the indirect tax zone because of these amendments will not need to register because of their GST free supplies.

1.66 Secondly, the current rules for determining GST turnover also generally exclude supplies of a right or option to acquire another taxable supply.

1.67 This exclusion may give rise to inappropriate ambiguity in the context of intangible supplies to Australia consumers, as in some cases it might be arguable that the only supply made for consideration is the supply of a right, while the subsequent underlying supply is not made for consideration and is hence not subject to GST.

1.68 To ensure that this outcome cannot be argued to arise, the amendments modify the exclusion for supplies of rights so that a supply of a right or option to an Australian consumer will be included in the GST turnover of the entity with the GST liability if the underlying supply is not a supply of goods or real property and the supply is not GST free. [*Schedule 1, items 7 and 9, paragraphs 188-15(3)(b) and 188-20(3)(b)*]

Example 1.5: Determining if an offshore supplier is required to register

Frisor GmbH is a large German hairdressing company that operates from premises in Munich. It is close to a number of hostels which are very popular with Australian tourists.

Because of this location, Frisor supplies hairdressing services to a large number of Australian residents holidaying in Germany, with the total

value of the supplies made to Australian residents in the 2018-19 financial year exceeding \$80,000.

These supplies are not supplies of goods or real property and are not obtained by the Australian resident customers in the course of enterprises that are registered for GST.

Accordingly, these supplies are connected with the indirect tax zone as a result of these amendments. However, there is no practical impact for Frisor. This is because the supplies of hairdressing services in Germany are GST free, as they are made to recipients who are outside Australia at the time of the supply and the effective use or enjoyment of the supply is outside Australia (see item 3 in subsection 38-190(1)).

In addition, the amendments ensure that these GST free supplies do not count towards Frisor's GST registration threshold. Therefore Frisor will not need to register for GST as a result of these supplies.

GST obligation imposed on electronic distribution platforms

Electronic distribution platforms

1.69 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.

1.70 Generally, in such cases the platform operator – the entity supplying access to the platform– will have most of the information about the recipients of supplies. Additionally, the operators are generally much larger and better resourced entities than most of the entities making supplies through the platform. They will also generally have significant influence over the terms of sales made using their platforms and either manage or closely regulate the payment process.

1.71 Given this, where a supply is made through such an electronic distribution platform that is connected with the indirect tax zone as a result of these amendments, compliance and administration will be simplified if liability for GST rests on the platform operator rather than the supplier.

1.72 On this basis, this Schedule shifts responsibility for the GST liability from a supplier to the operator of an electronic distribution platform for supplies that are inbound intangible consumer supplies made through the electronic distribution platform they operate. [*Schedule 1, item 6, section 84-55*]

1.73 However, this will 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 documentation. *[Schedule 1, item 6, section 84-55]*

1.74 A platform operator will have no control of any of the key elements of the supply if they are not involved in authorising payment for or delivery of the supply, nor in setting the terms and conditions under which the supply is made. *[Schedule 1, item 6, paragraph 84-55(4)(c)]*

1.75 Clarifying the liability of the supplier will require 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. *[Schedule 1, item 6, paragraphs 84-55(4)(b) and (c)]*

1.76 The amendments do not apply to supplies that are not inbound intangible consumer supplies such as supplies of goods or real property, supplies to registered entities and supplies performed in Australia – even where such supplies are made through the electronic distribution platform.

Requirements to be an electronic distribution platform

1.77 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* (broadly the communication of information by means of electro-magnetic energy). 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 by mail. *[Schedule 1, item 6, paragraph 84-65(1)(a)]*

1.78 The platform must also allow entities to use the platform to offer supplies to potential customers. This requirement will not be satisfied by services that merely create awareness of possible supplies (such as advertising) or provide access to a communications medium (such as internet access). Such services are not sufficiently involved in making the supply available. Similarly, payment systems and processing services also do not satisfy this requirement on their own, as such services are again not involved in making the supply available. *[Schedule 1, item 6, paragraph 84-65(1)(b)]*

1.79 Finally, 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. *[Schedule 1, item 6, paragraph 84-65(1)(c)]*

1.80 During consultation stakeholders sought clarification about how these rules might apply to entities that make supplies that may be used by suppliers or recipients when making or arranging for supplies, such as internet service providers.

1.81 These types of services are not within the scope of electronic distribution platforms. However, for the avoidance of doubt, the amendments specifically identify several types of services that on their own will not be 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.

[Schedule 1, item 6, subsection 84-65(2)]

1.82 The amendments provide that the supply of these services will not be sufficient to be the operation of an electronic distribution platform on their own (or in conjunction with another excluded service). The fact that an entity operates a carriage service does not mean that it is not operating an electronic distribution platform in respect of other services it may supply. For example, an ISP would not be operating an electronic distribution platform when providing its ISP services, but could be operating an electronic distribution platform when operating an online platform through which its customers can download media content from vendors.

Requirements to be inbound intangible consumer supplies

1.83 A supply will be an inbound intangible consumer supply if it is a supply of anything other than goods or real property that is not done wholly in the indirect tax zone or made through an enterprise the supplier carries on in the indirect tax zone. *[Schedule 1, item 6, section 84-60]*

1.84 As a result, supplies made by Australian resident enterprises will rarely be inbound intangible consumer supplies as they will either be done in Australia or made through an enterprise carried on in Australia. Instead,

for these supplies, the Australian supplier will be liable to GST under the existing GST rules.

1.85 This ensures that these amendments do not affect existing arrangements where the GST already applies appropriately.

Consequences for supplies made through an electronic distribution platform

1.86 While the operator of an electronic distribution platform is treated as the supplier, the supply is also treated as having been made through the operator's enterprise and for the same consideration for which the supply was made by the actual supplier. This ensures that these special rules only change the entity that is liable for GST rather than changing the nature of what is supplied. *[Schedule 1, item 6, subsection 84-55(1)]*

1.87 The rules treating the operator as making the inbound intangible consumer supply do not apply when determining if the supply is made through an enterprise carried on in Australia for the purposes of working out if the supply is an inbound intangible consumer supply. This avoids circularity in the application of the provision. *[Schedule 1, item 6, subsection 84-60(2)]*

1.88 As a result of being treated as making the supply, the operator will be liable for the GST payable on the supply and the supply will be included in their GST turnover for all purposes, including whether they are required to register for GST. The operator will also be entitled to or liable for any adjustments that arise in relation to the supply.

1.89 The amendments do not modify the general GST registration rules for operators of electronic distribution services. Consistent with these rules, operators will be 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 (\$150,000 for non-profit entities).

1.90 These rules are broadly consistent with the models applied in the European Union and Norway. This is intended to limit any compliance cost impact on suppliers and operators as they will already need to comply with similar rules when making supplies to consumers in these countries.

1.91 Both Australian residents and non-residents can be the operator of an electronic distribution platform. If a non-resident entity is the operator of an electronic distribution platform for GST purposes this does not, by itself, have any impact on determining whether the entity has a permanent establishment in Australia for the purposes of the income tax law. This reflects that the permanent establishment definition in the income tax law

considers a number of criteria, none of which are linked to the entity being treated as making supplies to Australian consumers for the purposes of the GST law.

Example 1.6: Electronic distribution platform liable for supply by an app developer

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

Zoe Distribution Service as the operator of the electronic distribution platform distributes some of App Inspiration's apps to Australian consumers. As Zoe 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 Inspiration's apps to Australian consumers.

Supplies made through multiple electronic distribution platforms

1.92 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 would become liable for the GST on the supply.

1.93 Instead, the amendments provide that where there is more than one operator that is potentially liable in respect of the supply, only the first operator to authorise a charge or receive any of the consideration for the supply will be treated as making the supply. If none of the operators meet this requirement, it is the first operator to authorise the delivery of the supply that will be liable. The Commissioner may also, by legislative instrument, prescribe additional rules to override or supplement these general rules. This will ensure that appropriate arrangements can be put in place should industry and the ATO identify situations that are not resolved under the proposed rules. [*Schedule 1, item 4, paragraphs 84-55(2)(a) and (b)*]

1.94 However, the amendments also allow the default outcome provided for by these rules to be changed where this may better fit commercial arrangements between operators. If the operator that would be treated as being liable for the GST in respect of a supply and another entity that operates an electronic distribution platform through which the supply or class of supplies is made, have previously agreed in writing that the other operator will be liable, the other operator will become liable for the GST on the supply or class of supplies. [*Schedule 1, item 4, subsection 84-55(2)*]

1.95 An important qualification to these rules is that they only apply to determine which potentially liable operator is liable. If an operator is not potentially liable because they have met the requirements relating to documentation and have no substantive involvement in the making of the supply, as discussed in paragraphs 1.73 to 1.75, then they are not taken into account when determining which operator is liable for the purpose of these rules.

Changes to the GST law for inbound intangible consumer supplies

1.96 In consultation, a number of parties identified that the extended scope of GST would have implications for a number of concessions in the GST law.

1.97 A number of concessions operate by reference to the nature of the entity making a particular supply or supplies. Sometimes concessions of this sort define the entity by reference to Australian regulatory requirements or status.

1.98 The use of these requirements in GST concessions does not give rise to any issues for entities operating in Australia, as these entities are generally subject to the relevant regulation when making the supply. However, non-resident entities may not be subject to the relevant rules. While none of these requirements is tied to nationality or residence, in practice foreign residents will not seek to comply with the regulatory requirements of jurisdictions in which they do not operate.

1.99 For example, the supply of an interest in a bank account will only be an input taxed financial supply if, broadly, it is provided by an authorised deposit-taking institution (ADI). This limit is in place because the supply of a bank account in Australia by an entity other than an ADI or other entity authorised by State and Territory law is illegal. However, a foreign bank may supply a foreign bank account to an Australian resident without this being contrary to any law. A foreign bank may become an ADI, but in practice has little reason to do so if it does not intend to carry on a banking business in Australia.

1.100 Generally this policy outcome, under which GST may apply to certain imported services even where similar domestic supplies are generally GST free or receive some other concession, is considered acceptable. The various concessions provided under the GST law have intentionally been linked to the supplier meeting relevant standards – there is no reason to revisit the existing legislative and policy arrangements in relation to GST concessions in the context of these amendments.

1.101 There are, however, two areas where specific changes are proposed.

International trade law obligations

1.102 First, as outlined, it is not considered that any of the concessions in the GST law are currently linked to residence or nationality – instead they are defined consistently for all entities.

1.103 However, this measure potentially affects a range of supplies by non-residents to Australian consumers. Given this breadth of application, as a matter of prudence, the amendments include provisions to allow any international trade law issues to be resolved.

1.104 Specifically, the amendments include a power for the Treasurer to determine by way of legislative determination that a particular supply that is only a taxable supply as a result of these amendments or class of such supplies is GST free or input taxed. This power may only be exercised if the Treasurer is advised in writing by the Foreign Minister that the current treatment of the supply or class of supply is contrary to Australia's international trade law obligations and the Treasurer is satisfied that a supply made by a comparable Australian resident entity would receive the same treatment. *[Schedule 1, items 4 and 5, sections 38-610 and 40-180]*

1.105 There are strict conditions on when and how this legislative power delegated to the Treasurer can be exercised. The exercise of the power is tied to Australia's existing international legal obligation and the treatment received by similar supplies made by equivalent Australian residents. Further, any determination made is a disallowable legislative instrument that is subject to parliamentary disallowance.

Financial supplies

1.106 Secondly, unlike many other concessions in the GST law, the input taxed treatment of financial supplies is not a result of any policy decision to assist individuals consuming these supplies. Rather, financial supplies are input taxed because there are difficulties in working out the consideration for certain financial supplies in order to apply GST – specifically the value of the use of the capital held by the entity.

1.107 In the context of these amendments, this means that even though in theory it would be acceptable if certain supplies by foreign residents were to become taxable, the difficulty of determining the consideration make this impractical.

1.108 Most supplies in the current list of financial supplies are not defined by regulatory concepts. As a result, no practical issues will generally arise for suppliers operating outside Australia. However, there

are two type of financial supply that are defined by reference to Australian regulatory concepts:

- the supply of an interest in a bank account, which under the GST law must be supplied by an ADI or an entity licensed to conduct banking business under a State and Territory law; and
- the supply of an interest in a superannuation fund, which under the GST law only includes interests in regulated superannuation funds, approved deposit funds, pooled superannuation trusts and public sector superannuation schemes.

1.109 The proposed amendments to the *A New Tax System (Goods and Services Tax) Regulations 1999* extend the definition of financial supplies to include:

- the supply of an interest in a bank account by a non-resident in the context of its regulated banking business; and
- the supply of an interest in a superannuation fund by a foreign superannuation fund.

[Tax and Superannuation Laws Amendment (2015 Measures No. #) Regulation 2015]

1.110 As a result of the amendments, the supply of a bank account by a foreign entity carrying on banking business will be an input taxed financial supply even if the entity is not an Australian ADI. Similarly, the supply of an interest in a foreign superannuation fund will likewise be input taxed even if the fund has not met the requirements to be a regulated superannuation fund, approved deposit fund or pooled superannuation trust. This ensures there is no need for suppliers and the ATO to determine the value of the consideration for these supplies.

Modified administrative arrangements

1.111 Inbound intangible consumer supplies are linked to Australia in a different way to most supplies that are connected with the indirect tax zone under other provisions of the GST law. In some cases that would mean that the present GST administrative arrangements would not give rise to appropriate outcome. To address this, these amendments include a number of minor changes to administrative arrangements.

Tax invoices and input tax credits

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

1.113 Further, the types of entities making inbound intangible consumer supplies will often have only a limited connection with the Australian tax system.

1.114 This would give rise to two concerns. The first, raised in consultation by a number of stakeholders, is that entities making inbound intangible consumer supplies may face significant costs in setting up systems to issue tax invoices for inbound intangible consumer supplies. These costs would arise even though by definition the recipients of these supplies are consumers who do not need tax invoices. Subsection 29-70(2) makes issuing a tax invoice within 28 days of a request mandatory, whatever the nature of the recipient.

1.115 To avoid these unnecessary costs for suppliers, the amendments provide that the supplier will not be obliged to provide a tax invoice at the request of the recipient. *[Schedule 1, item 6, section 84-50]*

1.116 The second concern is that there are compliance risks associated with allowing entities access to input tax credits based on the payment of tax by non-resident entities whose only connection with Australia is making supplies with Australian residents. Access to input tax credits increases this risk and creates the potential for active fraud in addition to simple non-payment of taxes.

1.117 Consistent with international practice on this issue, the amendments seek to reduce these risks by preventing input tax credits from being available for the recipient of a supply that is wrongly treated as being an inbound intangible consumer supply. Instead, these entities will need to seek a refund from the supplier. *[Schedule 1, item 23, subsection 142-15(6)]*

1.118 This restriction removes much of the risk of the manipulation of the GST system to create fraudulent input tax credits. In doing so, it reduces the need for the ATO to undertake detailed examination of non-residents seeking to register for GST and entities claiming refunds.

1.119 It also ensures that entities that are registered for GST have appropriate incentives to make their status clear when receiving supplies. The recipient should be aware of their GST status and is best placed to make sure that this is appropriately reflected in the treatment of their own acquisitions.

Limited registration

1.120 Currently, the Commissioner requires most entities that are registered for GST to complete a monthly or quarter business activity statement, providing the Commissioner with information about the activities of the entity. Likewise, the Commissioner requires entities seeking to register for GST, to provide a considerable amount of information to verify their identity and their entitlement to be registered, especially in the case of non-resident entities.

1.121 A significant factor underlying current compliance arrangements for GST is the risk to the Commonwealth presented by unauthorised input tax credit and GST refund claims. The current administrative arrangements adopted by the Commissioner seek to address these risks, such as by, for example, requiring entities to include detailed information on their GST returns.

1.122 However, entities that are only required to be registered because they make inbound intangible consumer supplies are likely to have a more remote link with Australia than other entities that are required to be registered for GST. In many cases, while they may make supplies to Australian residents, they will otherwise have nothing to do with Australia and will have no input tax credits.

1.123 Given these entities will not undertake activities for which they need to claim GST refunds, in practice there is little need for them to provide the same level of information when registering and providing periodic GST returns.

1.124 To allow the Commissioner to provide simplified administrative arrangements for this class of entities, the amendments allow entities to opt to be a limited registration entity. *[Schedule 1, item 6, section 84-140]*

1.125 Limited registration entities will not be entitled to input tax credits. For simplicity, they will also not be entitled to have an ABN, must have a quarterly tax period and may not elect to pay GST by instalments. *[Schedule 1, items 6 and 25 to 27, sections 84-145 and 84-150, paragraphs 162-5(f) and 162-30(1)(d) and subsection 162-30(6)]*

1.126 As a result of these restrictions, the Commissioner will be able to require only minimal information from these entities when registering and remitting. While it is not expected that limited registration will be adopted by many entities that are currently registered for GST, it is likely to be more useful for entities that are only required to be registered because of this measure and which do not expect to have any input tax credit entitlements.

1.127 An entity may 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 in which the entity makes the election. *[Schedule 1, item 6, subsections 84-140(2) and (3)]*

1.128 This allows entities to adopt limited registration at or before the time when they register in order to benefit from any simplified processes that the Commissioner may develop.

1.129 Given limited registration is intended as a convenience for entities, it is also intended to be flexible and easy to exit should an entity's circumstances change. An entity that is a limited registration entity may, at any time, apply to the Commissioner in the approved form to cease to be a limited registration entity. *[Schedule 1, item 6, subsection 84-140(5)]*

1.130 Likewise, it is also not intended that an entity could be permanently disadvantaged by electing for limited registration if their circumstances change. The amendments provide that an entity that has ceased to be a limited registration entity is treated as not having been a limited registration entity effective back to the start of the preceding financial year and will be able to claim input tax credits over the full amount of this period in which they were registered for GST. This ensures that entities that become aware that being a limited registration entity will result in unanticipated costs can reverse this decision within a reasonable period and will suffer no disadvantage. *[Schedule 1, item 6, subsections 84-140(3) and (4)]*

Consequential amendments

1.131 Schedule 1 also makes a number of consequential amendments to the GST law, including guide material, to reflect the substantive amendments. *[Schedule 1, items 2, 6, 10 to 24 and 28 to 30, the note to subsection 9-25(2), note 2 to section 13-1, table items 1AB and 1AC in section 27-99, table item 4A in section 29-99, subparagraph 48-40(2)(a)(i), subsection 48-45(3), paragraphs 58-10(2)(b) and 83-5(2)(a), the headings to Subdivision 84-A and sections 84-1, 84-5 and 84-14, subsection 142-15(6), paragraph 162(1)(e) and section 195-1]*

Application and transitional provisions

Application rule

1.132 The amendments apply to supplies that are attributable to tax periods commencing on or after 1 July 2017 and to supplies which would be attributable to such tax periods were they a taxable supply. *[Schedule 1, item 22]*

1.133 As a result of this application rule, entities will only need to consider these amendments in respect of tax periods commencing from 1 July 2017. Subject to the transitional rules, entities will not need to identify when a supply is made, which is consistent with the general approach taken in the GST law.

Transitional provisions

1.134 The amendments also include special transitional rules for periodic or progressive supplies that are attributable to a tax period commencing before 1 July 2017, similar to those that applied when the GST was introduced. *[Schedule 1, item 33]*

1.135 Under these rules, supplies made over a period of time will be treated as being a separate supply in each tax period over the period of the supply, with the consideration for the supply being attributed uniformly across each tax period. As a result of this treatment, the proportion of such periodic or progressive supplies made after 1 July 2017 will be subject to the changes introduced by these amendments. *[Schedule 1, item 33]*

1.136 However, if a supply is made under an agreement entered into before 7.30 pm on 12 May 2015 (by legal time in the Australian Capital Territory), then the supply will not be affected by this transitional rule except to the extent it relates to tax periods either occurring on or after 1 July 2019 or on or after the day on which the review opportunity occurred in relation to the supply, within the meaning of the *A New Tax System (Goods and Services Tax Transition) Act 1999*. *[Schedule 1, item 34]*

1.137 This transitional rule will also not apply to:

- the supply of a warranty, if the value of the warranty was included in the price of the supply to which it relates;
- supplies of long term leases; and
- supplies to which the existing rules for progressive and periodic supplies under the GST law apply.

[Schedule 1, subitem 33(2)]

1.138 These rules ensure that there is no scope for entities to avoid GST on inbound intangible consumer supplies by entering into long-term supply arrangements before the amendments come into effect.

Chapter 2

GST treatment of cross-border transactions between businesses

Outline of chapter

2.1 This Schedule amends the *A New Tax System (Goods and Services) Tax Act 1999* (GST Act) to better target the way Australia's goods and services tax (GST) rules apply to cross-border supplies that are made by non-resident entities.

2.2 These changes will mean that certain supplies will no longer be connected with the indirect tax zone, or will become GST free.

2.3 The primary objective of these changes is to relieve non-resident suppliers of the obligation to account for GST for transactions that are either revenue neutral or a more suitable Australian based entity can be made liable for the GST. These changes are revenue neutral because the obligation to account for GST is shifted to a GST registered recipient of the supply where GST is payable on the supply. Where no GST is ultimately payable on the supply, the obligation on the non-resident supplier is simply removed. This is in contrast to law changes discussed under Chapter one where in those situations the supply by the non-residents being drawn into the GST system is made directly to final consumers.

2.4 The amendments also reduce compliance costs for GST registered importers in calculating the value of taxable importations.

2.5 All legislative references in this Chapter are to the GST Act, unless otherwise stated.

Context of amendments

Application of existing GST law to supplies by non-resident entities

2.6 Consistent with most value added tax systems in the world, Australia applies the destination principle in imposing GST on cross-border supplies. This principle states that GST on cross-border supplies should only be levied in Australia when consumption of the thing

supplied occurs in the indirect tax zone. The GST is a multistage tax under which input tax credits are generally available to businesses to prevent cascading of GST through each stage of production and ensure that the economic cost of GST is borne on private consumption in the indirect tax zone.

2.7 Under the current law, a non-resident supplier is generally liable for GST on any taxable supplies it makes that are ‘connected with the indirect tax zone’. The connected with the indirect tax zone rule ensures that the GST does not apply to supplies made by non-residents that have no connection with Australia.

2.8 Currently, for a non-resident supplier to be subject to Australian GST in respect of a supply, the following conditions under the GST Act must be satisfied:

- the supplier must be registered for GST or required to be registered;
- the supply must be connected with the indirect tax zone; and
- the supply must not be GST free (such as a supply that is consumed outside the indirect tax zone) or input taxed.

2.9 In certain circumstances, a supply that is not connected with the indirect tax zone can still be a taxable supply. An example of such a supply is one that involves a business recipient who is registered for GST, or required to be registered. In such cases, the supply can be ‘reverse charged’ (meaning that the recipient rather than the supplier is responsible for the GST on the supply) if it is acquired for the purposes of an enterprise the recipient carries on in the indirect tax zone, but is not acquired solely for a creditable purpose.

GST Registration

2.10 Under the current law, non-resident suppliers are required to register for GST if their projected or current turnover is greater than the registration turnover threshold. The value of supplies connected with the indirect tax zone count towards this threshold, even if those supplies are GST free. As such, non-resident suppliers that only make GST free supplies but that nevertheless have a turnover that is greater than the turnover threshold are required to register for GST, despite having no GST liability.

2.11 Conversely, non-resident suppliers with a turnover that is lower than the threshold may still have an incentive to register for GST in order

to claim input tax credits (ITCs) for GST that they have been charged on acquisitions related to carrying on their enterprise.

2.12 Registering for GST can be a costly and time consuming process for non-resident suppliers based overseas. These amendments reduce the incidences in which a non-resident supplier is unnecessarily drawn into the GST system.

Connected with the indirect tax zone

2.13 Section 9-25 sets out the circumstances in which a supply will be connected with the indirect tax zone.

2.14 Supplies of goods may be connected with the indirect tax zone in a number of ways, including where the goods are:

- delivered or made available in the indirect tax zone; or
- brought to the indirect tax zone and installed or assembled by the non-resident supplier (whether directly or through a sub-contractor).

2.15 Supplies of things other than goods or real property (intangibles) will be connected with the indirect tax zone if they are done in the indirect tax zone or are made through an enterprise carried on in the indirect tax zone.

2.16 The broad application of the connected with the indirect tax zone rules can result in non-resident entities being subject to GST in respect of their business-to-business transactions, even where those transactions do not result in a net gain to GST revenue.

The Board of Taxation review

2.17 On 11 May 2010, the Board of Taxation (Board) released its report on the application of Australia's GST to cross-border transactions. In its report, the Board noted that:

- Australia's GST system is overly inclusive of non-residents which can place unnecessary compliance costs on non-residents and can lead to embedded taxation for Australian businesses; and
- there are significant compliance costs faced by non-residents who seek to register in Australia's GST system.

2.18 The Board made a number of recommendations for addressing these issues. The former Government accepted the Board's recommendations as part of the 2010-11 Budget, and announced further changes to the Board's recommendations as part of the 2012-13 Budget. These changes included narrowing the meaning of 'carrying on an enterprise in the indirect tax zone' so that it only applies to entities with a significant presence in Australia.

2.19 In December 2013, the Government announced that it would proceed with the following recommendations (Recommendations 1 to 5, 6, 9 and 12), as amended in the 2012-13 Budget:

- limiting the application of the connected with the indirect tax zone provisions for certain supplies by a non-resident where the supply is made to an entity with a business presence in Australia that is registered for GST (Recommendations 1 and 2, although the scope of Recommendation 2 was narrowed in the 2012-13 Budget announcements);
- limiting the application of the connected with the indirect tax zone provisions for certain supplies of goods between non-residents that are not acquired for the purpose of an Australian enterprise (Recommendation 3);
- allowing supplies made to a non-resident but provided to a registered business in the indirect tax zone or employee or office holder to be GST free (Recommendation 5);
- allowing supplies of warranty services made to a non-resident but provided to an Australian warranty holder to be GST free (Recommendation 6);
- removing the requirement for non-residents to register if they only make GST free supplies (Recommendation 9); and
- introducing an alternative option for calculating transport and insurance costs included in the value of taxable importations (Recommendation 12).

2.20 These amendments implement the Government's December 2013 announcement.

Summary of new law

2.21 These changes improve the balance between ensuring Australia's GST system does not draw in non-residents unnecessarily whilst ensuring the existing GST base is maintained by:

- updating the test for when an enterprise is carried on in the indirect tax zone so that it is better aligned with key GST concepts;
- relieving non-resident suppliers of the obligation to account for GST on certain supplies by:
 - shifting the responsibility for identifying and paying a GST liability to the recipient, where they are registered for GST and carry on an enterprise in the indirect tax zone;
 - switching off the GST liability for certain supplies between non-residents;
 - extending the GST free rules to certain acquisitions made by non-residents; and
 - removing the GST registration requirements for non-residents that only make GST free supplies through an enterprise carried on outside of the indirect tax zone.

2.22 The amendments also reduce compliance costs for GST-registered importers in calculating the value of taxable importations.

Comparison of key features of new law and current law

| <i>New law</i> | <i>Current law</i> |
|--|--|
| Test for carrying on an enterprise in indirect tax zone | |
| <p>The test for when an enterprise is carried on in the indirect tax zone is more closely aligned with Australia's modern treaty practice in relation to permanent establishments.</p> <p>An enterprise will be carried on in the indirect tax zone where particular individuals (including an entity who is an individual) carry on the</p> | <p>The test for when an enterprise is carried on in the indirect tax zone utilises the income tax definition of permanent establishment. This definition focusses on the place at or through which a business is carried on by a person.</p> |

| <i>New law</i> | <i>Current law</i> |
|---|--|
| Test for carrying on an enterprise in indirect tax zone | |
| enterprise of the entity in the indirect tax zone through a fixed place, or through one or more places for more than 183 days in a 12 month period. | |
| Scope of connected with the indirect tax zone: business to business supplies | |
| <p>The connected with the indirect tax zone rules have more limited application in relation to supplies between businesses.</p> <p>The more limited application results in the compulsory reverse charge provisions applying to a greater range of supplies.</p> <p>GST-registered entities are responsible for any GST on supplies of things other than goods or real property that are done in the indirect tax zone that are made to them by non-resident suppliers.</p> | <p>The connected with the indirect tax zone rules have broad application, particularly for things that are done in the indirect tax zone.</p> <p>The compulsory reverse charge provisions have limited application due to the breadth of the connected with the indirect tax zone rules.</p> <p>Non-resident suppliers are generally responsible for any GST on supplies of things other than goods or real property that are done in the indirect tax zone.</p> |
| GST free treatment of supplies to non-resident recipients | |
| The GST free treatment of supplies made to non-resident entities will be restored to certain supplies made to non-resident recipients but provided to particular entities in the indirect tax zone. | Certain GST free supplies made to a non-resident may lose their GST free status if the supply is provided to another entity in the indirect tax zone. |
| Registration of non-resident suppliers only making GST free supplies | |
| Non-resident suppliers will no longer be required to register for GST if the only supplies they make that are connected with the indirect tax zone are GST free. | Non-resident suppliers generally will be required to register if they make supplies connected with the indirect tax zone even if all their supplies are GST free. |
| Value of taxable importations | |
| In calculating the value of taxable importations, an uplift factor may be applied to the customs value of goods as an alternative to calculating the actual transport, insurance and ancillary costs. | The actual transport, insurance and ancillary costs must be included in calculating the value of taxable importations. |

Detailed explanation of new law

When enterprises are carried on in the indirect tax zone

2.23 Under the current law, the test for when an enterprise is carried on in the indirect tax zone relies upon the income tax definition of ‘permanent establishment’ in subsection 6(1) of the *Income Tax Assessment Act 1936*.

2.24 These amendments update the current test for when an enterprise is carried on in the indirect tax zone so that it is framed in terms of concepts that are fundamental to the GST law. While the new test moves away from using the definition of permanent establishment to ascertain when an enterprise is carried on, it is still based on the factors that are relevant in determining when a permanent establishment exists.

2.25 Under the revised test, an enterprise of an entity is carried on in the indirect tax zone if:

- the enterprise of the entity is carried on by particular individuals who are in the indirect tax zone; and
- the enterprise is carried on through a fixed place in the indirect tax zone; or
- the enterprise of the entity is carried on, or is intended to be carried on, through one or more places in the indirect tax zone for more than 183 days in a 12 month period.

[Schedule 2, item 2, subsections 9-27(1) to (3)]

2.26 The terms ‘enterprise’ and ‘indirect tax zone’ are core concepts under the GST law, and are defined in section 9-20 and section 195-1, respectively.

2.27 The revised test can be distinguished from the approach under the previously used income tax definition of ‘permanent establishment’ which applies to a ‘business’ that is carried on through a ‘place’. In particular, the use of the term ‘enterprise’ better aligns the underlying components of the carrying on an enterprise test with the intended scope of the test.

Enterprise carried on by individuals in the indirect tax zone

2.28 For an enterprise of an entity to be carried on in the indirect zone, the enterprise must be carried on by an individual who is the entity,

or who is an employee, officer, or a dependent agent of the entity.
[Schedule 2, item 2, paragraph 9-27(1(a)) and subsection 9-27(4)]

2.29 This ensures that the location of any individuals who actually undertake the activities of an entity are the primary focus of the test. Where the entity is an individual (ie a sole trader), the activities of that individual are relevant in determining whether and where an enterprise is carried on. Irrespective of the type of entity, the activities of an individual who is an employee, officer or dependent agent of the entity are also taken into consideration.

2.30 The terms ‘employee’ and ‘agent’ are undefined in the GST law and take their ordinary meaning, whereas the term ‘officer’ is defined by reference to the definition in the *Corporations Act 2001*.

2.31 The scope of agents considered under the revised test is limited to those agents who have, or who habitually exercise authority to conclude contracts on behalf of the entity, and are not a broker, general commission or independent agent. [Schedule 2, item 2, paragraph 9-27(4)(c)]

2.32 Limiting the types of agents in this way is more consistent with the type of agents that are relevant in determining whether an entity has a permanent establishment under the current law, and under the permanent establishment articles in Australia’s tax treaties. However, for GST purposes the wording ‘substantially negotiates’ as used in recent Australian tax treaties in regards to the role of agents has not been used. As such, the analysis of whether an agent causes a non-resident to carry on an enterprise in the indirect tax zone focusses on the authority of an agent to conclude contracts on the non-resident’s behalf.

2.33 The use of the term ‘fixed place’ more closely aligns the enterprise test with the internationally accepted approach that has been adopted under the permanent establishment articles in Australia’s tax treaties. In this context, the term ‘fixed’ requires there to be a stable or continual connection between the enterprise of the entity and the place. In this respect, the term ‘fixed’ is not intended to require a connection between an enterprise and a place that is ‘everlasting or forever’. However, it does require a connection that is more than merely temporary or transitory in nature.

183 day test

2.34 In addition to the ‘fixed place’ component of the revised test, an enterprise of an entity will be treated as being carried on in the indirect tax zone if it is carried on, or is intended to be carried on, through one or more places in the indirect tax zone for more than 183 days in a 12 month period. [Schedule 2, item 2, subsection 9-27(2)]

2.35 The reference to ‘183 days in a 12 month period’ means that the days over which the enterprise is carried on do not need to be consecutive. Although the 183 day test will be satisfied where an enterprise is carried on through a single place continuously over a period of more than 6 months, it is also satisfied where an enterprise is carried on through different places on an intermittent basis throughout any 12 month period.

2.36 In practice, the 183 day test means that a substantive evaluation of whether a place is a ‘fixed place’ only needs to be done where an enterprise is carried on in the indirect tax zone for 6 months or less, because enterprises that are carried on for more than 6 months in the indirect tax zone will satisfy the 183 day test.

2.37 The combination of the ‘fixed place’ and ‘183 day’ tests more closely aligns the connected with the indirect tax zone rules with Australia’s current tax treaty approach in respect of permanent establishments. Under that approach, the concept of a ‘fixed place’ is used as the primary principle for determining when a permanent establishment exists. The 183 day test applies separately to deem an entity to have a permanent establishment where it undertakes business activities for more than 183 days.

Exclusive use not required

2.38 In determining whether an enterprise is carried on through a particular place, the place does not need to be exclusively used by the entity for carrying on the enterprise, nor does the entity need to own, lease or have any other claim or interest in relation to the place. [*Schedule 2, item 2, subsection 9-27(3)*]

2.39 This additional rule clarifies that the concept of a place being ‘fixed’ does not rely on things like ownership or formal rights. Instead, the focus of the test is the regularity with which a place is used, or an intention to utilise the place on an ongoing basis.

Example 2.1: Enterprise carried on in the indirect tax zone

Jo Co is a computer service provider and a resident of Japan. It successfully tenders to train the employees of Smith Corp, a company resident in Australia, in a new computer system. To undertake the training, Jo Co sends four of its employees to Australia for seven months. Smith Corp provides Jo Co’s employees with a room in one of its offices for that time. Because Jo Co has at its disposal a room in Smith Co’s offices for more than 183 days in a 12 month period and carries on its enterprise at or through that place, Jo Co has a place at or through which it carries on its enterprise in the indirect tax zone.

Example 2.2: Application of 183 day test

Following on from the example above, if Jo Co intended that the employees were to be based at the office of Smith Co for the purpose of carrying out activities of the enterprise for a period of seven months but the employees were called back after only two months, Jo Co will be liable for GST on any supplies made at or through that fixed place during the two months. The 183 day test is met as Jo Co intended that the enterprise be carried on through that place for more than 183 days. If the intention was always that the employees would only be based at the office of Smith Co for two months, the 183 day test would not be met and Jo Co would not be liable for supplies made during this period (provided the supplies are not otherwise connected with the indirect tax zone).

Smith Co should first consider the business agreement it has with Jo Co to determine if Jo Co is or intends to make the supply through an enterprise it carries on in the indirect tax zone. If so, Jo Co would be responsible for any GST liabilities on the supply made to Smith Co and Smith Co would not be responsible for those GST liabilities on their acquisition. In those circumstances Smith Co will need to seek a tax invoice from Jo Co to claim an ITC to the extent it is entitled to do so.

Certain cross-border supplies not connected with the indirect tax zone

Disconnected supplies

2.40 These amendments ensure that various supplies made by non-resident suppliers are not connected with the indirect tax zone where imposing GST on the non-resident suppliers does not result in a net gain to GST revenue.

2.41 To achieve this, the amendments apply as an exception to the connected with the indirect tax zone rules in section 9-25. For simplicity, a supply that is not connected with the indirect tax zone as a result of these changes is referred to as a supply that is ‘disconnected’.

2.42 For a supply to be disconnected as a result of these amendments:

- the supplier must be a non-resident; and
- the supply must *not* be made through an enterprise that the supplier carries on in the indirect tax zone.

[Schedule 2, item 2, paragraphs 9-26(1)(a) and (b)]

2.43 Although the conditions in relation to the supplier apply irrespective of the type of supply, the conditions for the recipient that must be satisfied vary according to the type of supply. For some supplies,

the recipient must be ‘potentially chargeable’, whereas for others the recipient must be a non-resident or a lessee of the goods supplied.

2.44 Where a supply is disconnected because it is made to a recipient that is potentially chargeable, the recipient will be responsible for determining whether they have a GST liability in relation to the supply under the reverse charge rules in Division 84.

Interaction with existing definitions and telecommunication supplies

2.45 The term ‘non-resident’ and the test for when an enterprise is carried on in the indirect tax zone are already defined under the GST Act.

2.46 The existing definition of ‘non-resident’ is unaffected by these amendments. However, the changes explained above concerning when an enterprise is carried on in the indirect tax zone are relevant for determining if non-residents carry on an enterprise in the indirect tax zone, and whether recipients are ‘potentially chargeable’. [*Schedule 2, items 2, table to subsection 9-26(1)*]

2.47 These changes take priority over the existing special rules about when a telecommunication supply is connected with the indirect tax zone. [*Schedule 2, items 2 and 8, subsections 9-26(4) and 85-5(3)*]

2.48 This priority ensures that telecommunication supplies that are disconnected as a result of these amendments can be subject to the compulsory reverse charge provisions in Division 84, and reverse charged to the recipient of the services where they are not acquired for a purpose that is solely creditable.

Non-resident supplier must not make the supply through an enterprise that they carry on in the indirect tax zone

2.49 For a supply to be disconnected as a result of these amendments, the supplier must be a non-resident, and the supply must not be made through an enterprise the supplier carries on in the indirect tax zone. [*Schedule 2, item 2, paragraphs 9-26(1)(a) and (b)*]

2.50 In addition to these conditions about the supplier, various requirements must be satisfied in relation to the supply and by the recipient. These conditions are explained further below.

2.51 The enterprise requirement relates to individual supplies. A supply can therefore satisfy the requirement even if the non-resident supplier carries on an enterprise in the indirect tax zone provided the enterprise was undertaken separately from the supply in question. This could occur where the non-resident supplier carried on separate

enterprises in the indirect tax zone and overseas but makes the supply through their overseas enterprise.

2.52 Where the non-resident supplier makes a supply through an enterprise they carry on in the indirect tax zone, the supplier has a sufficient presence in Australia in respect of that supply to account for their GST obligations in the same way as other entities that are based in Australia. In such circumstances, the exception to the connected with the indirect tax zone rules introduced by these amendments will not apply to the supply.

Potentially chargeable entities

2.53 For particular supplies to be disconnected as a result of these amendments, the recipient of the supply must be an entity that is 'potentially chargeable'. [*Schedule 2, item 2, items 1 and 3 in the table to subsection 9-26(1)*]

2.54 In the case of business-to-business supplies, the supplier is generally liable for GST on a taxable supply that is connected with the indirect tax zone and the recipient is usually entitled to input tax credits to the extent that the thing supplied is acquired for a creditable purpose. This multi-stage collection and credit mechanism ensures that businesses do not bear the economic cost of GST on supplies (other than input taxed supplies). However, in a number of situations the recipient of a business-to-business supply will not be entitled to full ITCs and, as a result, there will be GST that is not offset or refunded from the multi-stage collection and credit mechanism. In such cases, the recipient bears the economic cost of GST included in the price payable for the supply to the extent that the GST is not creditable.

2.55 In the absence of other rules, disconnecting the supply that is not fully creditable would mean that a liability to GST that was otherwise ultimately payable would be removed (because the supply would no longer be taxable). Requiring the recipient to be a potentially chargeable entity in relation to the supply ensures that the reverse charge rules in Division 84 can be applied to the supply, which will result in the recipient being responsible for any GST that is ultimately payable.

Operation of reverse charge rules in Division 84

2.56 In broad terms, Division 84 applies to supplies of anything other than goods and real property that are not connected with the indirect tax zone, that are acquired:

- by a recipient who is registered or required to be registered;

- solely or partly for the purpose of an enterprise carried on by the recipient in the indirect tax zone; and
- not solely for a creditable purpose.

2.57 Where Division 84 applies to such a supply, the supply becomes a taxable supply, and any GST on the supply is payable by the recipient.

2.58 Where a supply is disconnected as a result of these changes, the recipient will be responsible for determining if they have a GST liability in relation to the supply under the reverse charge rules in Division 84.

2.59 Although a particular supply that is excluded from the connected with the indirect tax zone rules as a result of these amendments may be subject to Division 84, it is not necessarily the case that Division 84 will apply to the supply. If the acquisition would have been fully creditable in the recipient's hands, Division 84 does not apply. This reflects that there is no need to collect GST through a reverse charge where the GST revenue from the reverse charge would be fully offset by an equivalent ITC claimed by the recipient. That is, the multi-staged collection feature of the GST is suspended in these circumstances.

2.60 To ensure that Division 84 is capable of being applied to a supply that is disconnected as a result of these amendments, the definition of 'potentially chargeable' reflects certain elements in Division 84 that must be satisfied in order for it to apply to a supply.

Meaning of potentially chargeable

2.61 In order for an entity to be 'potentially chargeable' in relation to a supply:

- the entity must be registered;
- an enterprise of the entity must be carried on in the indirect tax zone; and
- the entity's acquisition of the thing supplied or provided must not solely be of a private or domestic nature.

[Schedule 2, item 2, subsection 9-26(2)]

2.62 The non-resident supplier should consider their business agreement with the recipient to determine if they are dealing with a potentially chargeable entity. Recipients who do not disclose that they are a GST-registered enterprise that carry on an enterprise in the indirect tax zone are likely to be treated as acquiring services as an end consumer by a non-resident supplier.

Recipient registered

2.63 The requirement that the recipient be registered is more limited in scope than the ‘registered or required to be registered’ condition in Division 84.

2.64 However, the ‘required to be registered’ requirement is appropriate in the context of the Division 84 because that Division imposes a liability on supplies that would otherwise not be taxable. Where a recipient is required to be registered, but is not registered, the liability to GST imposed upon them by Division 84 will still be imposed upon the recipient.

2.65 Notwithstanding the interaction between the proposed changes and the reverse charge mechanism in Division 84, the proposed changes to the connected with the indirect tax zone rules are concessional from the perspective of the supplier. A more limited registration requirement (that is, that the recipient must actually be registered) is appropriate in this context, because it means that a supplier is only relieved of their GST obligations in relation to a supply with a recipient that is already compliant with their GST obligations. It also reflects that in practice a non-resident supplier will not be in a position generally to determine if a recipient is not registered for GST but otherwise satisfies the requirements and should be registered.

Enterprise in indirect tax zone

2.66 The requirement that the recipient carry on an enterprise in the indirect tax zone supports the registration requirement, and ensures that the recipient has a substantive presence in the indirect tax zone.

Acquisition not private or domestic

2.67 Finally, the restriction in the definition of potentially chargeable entity that supplies not be solely of a private or domestic nature aligns with the requirement in Division 84 that the thing supplied be acquired by the recipient ‘solely or partly’ for a purpose of an enterprise that the recipient carries on. The restriction ensures that suppliers continue to bear responsibility for supplies made to recipients that are solely private or domestic in nature as they do for supplies to final consumers discussed in Chapter 1.

2.68 Where an acquisition is solely of a private or domestic nature, the recipient of the supply would not be able to claim ITCs in relation to the supply if GST is payable by the supplier. Moreover, because the supply would not satisfy the purpose test in the reverse charge rules in Division 84, if it were disconnected as a result of the proposed

amendments it would be neither a taxable supply nor reverse charged to the recipient under those rules.

2.69 The requirement that the supply not be solely private or domestic in nature therefore ensures that the supply cannot be disconnected if ITCs would not be claimable because of the private nature of the acquisition resulting in the supply being outside of the scope of Division 84.

Supplies that disconnected from the indirect tax zone

2.70 Under the current law, a supply can be connected with the indirect tax zone if it is a supply of goods brought to or located in the indirect tax zone, or a supply of anything other than goods or real property that is 'done' in the indirect tax zone.

2.71 Supplies of things that are connected with the indirect tax zone count towards a non-resident supplier's registration threshold even where ITCs are claimed by the recipient in respect of all of the GST charged on the supply. As a consequence, non-resident suppliers may be required to register and account for GST even where there is no net gain to revenue from the GST on the supplies they make.

2.72 As a result of these amendments, particular supplies will be disconnected from the indirect tax zone. For each of these types of supplies, the conditions explained above in relation to the supplier must always be satisfied (that is, the supplier is a non-resident and the supply is not made through an enterprise that the supplier carries on in the indirect tax zone).

2.73 Specific conditions also apply to the different supplies covered by these amendments which can be divided into the following categories:

- supplies of anything other than goods or real property that are done in the indirect tax zone;
- supplies of goods that are made to a potentially chargeable entity; and
- supplies of leased goods.

[Schedule 2, item 2, table to subsection 9-26(1)]

2.74 The exceptions to the general 'connected' rules for these supplies ensure that a non-resident supplier is not unnecessarily drawn into the GST system where there is no GST ultimately payable on the

supply, or where the recipient is better placed to account for any such liability.

Supplies of intangibles that are done in the indirect tax zone

2.75 Supplies of things that are not goods or real property are generally referred to as supplies of ‘intangibles’, and include things such as services and digital products.

2.76 Ordinarily, a supply of an intangible that is ‘done’ in the indirect tax zone is connected with the indirect tax zone. These amendments are designed to relieve non-resident suppliers of the obligation to account for GST where no GST is ultimately payable on the supply, or where it is more appropriate for the recipient to identify and pay the GST liability.

2.77 To ensure this outcome applies, supplies of intangibles that are done in the indirect tax zone will be disconnected where the recipient of the supply is:

- a potentially chargeable entity; or
- a non-resident who acquires the supply solely for the purposes of an enterprise that is carried on outside of the indirect tax zone.

[Schedule 2, item 2, items 1 and 2 in the table to subsection 9-26(1)]

2.78 In addition to the requirements about the recipient, the requirements explained above in relation to the supplier must also be satisfied – that is, the supplier must be a non-resident that does not make the supply through an enterprise it carries on in the indirect tax zone.

[Schedule 2, item 2, paragraphs 9-26(1)(a) and (b)]

2.79 Disconnecting the supply in relation to a recipient that is potentially chargeable ensures that the recipient can be reverse charged for the supply where they would not have been entitled to full ITCs if the supplier had charged GST. Division 84 will not apply to a potentially chargeable recipient where the GST charged by the supplier would have been fully offset by ITCs.

2.80 Disconnecting the supply in relation to a non-resident recipient who acquires it solely for the purposes of an enterprise that is carried on outside the indirect tax zone means that such supplies will only be disconnected where ITCs would have been fully claimable by the recipient.

2.81 If a non-resident recipient's acquisition of the intangible was solely of a private or domestic nature, they would not be entitled to ITCs in relation to the GST charged on the supply.

2.82 Furthermore, restricting the exception for non-resident recipients carrying on an enterprise outside the indirect tax zone to supplies that would have been fully offset is appropriate because, unlike supplies to potentially chargeable entities, there is no reverse charge mechanism to collect the GST from the non-resident recipient for acquiring supplies made through an overseas enterprise. *[Schedule 2, item 2, item 1 in the table to subsection 9-26(1)]*

2.83 Conversely, a non-resident recipient who is also potentially chargeable would be covered by Division 84. Such recipients will still be able to apply the exception in relation to potentially chargeable entities.

2.84 For an intangible to be 'done' somewhere, it will usually need to involve the performance of some sort of service or action by the supplier. Because of the requirement that the thing supplied be 'done' in the indirect tax zone, the exceptions for intangibles are less likely to be able to be applied to intangibles that do not involve activities performed by the supplier.

2.85 The following examples explain the way supplies of intangibles will be treated as a result of being disconnected because of these amendments:

Diagram 2.1: Intangible supplies to a potentially chargeable recipient – item 1 in the table to subsection 9-26(1)

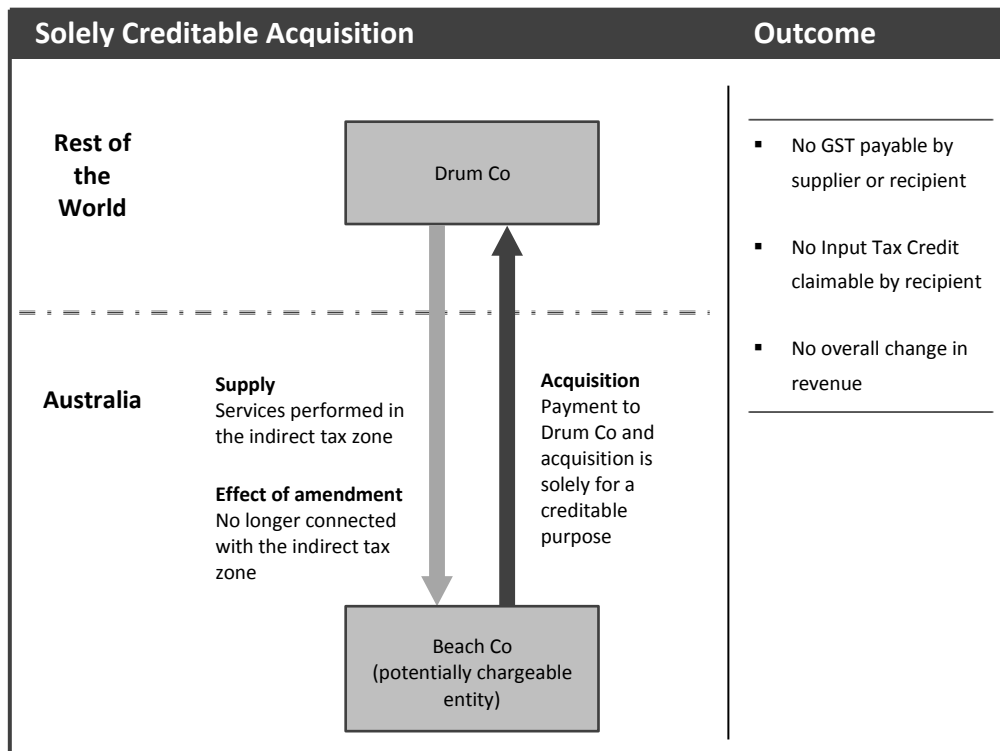
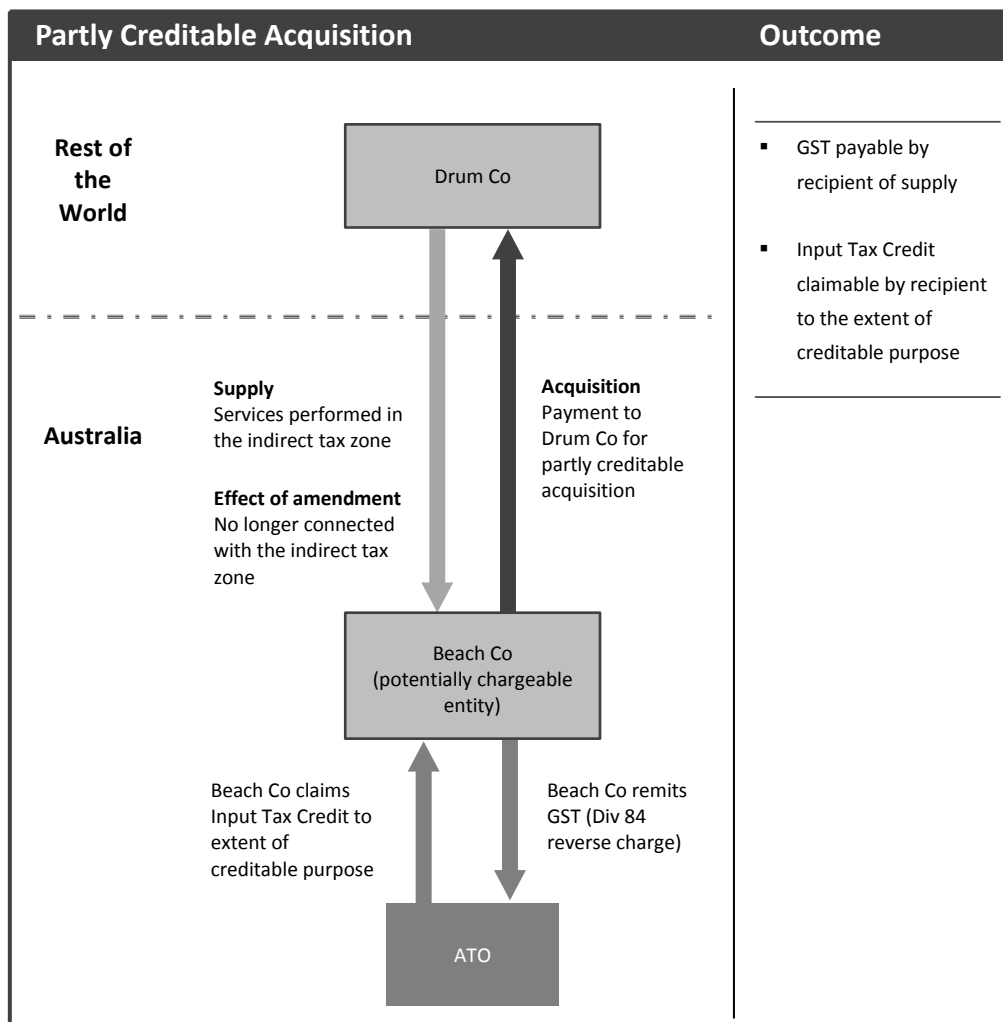


Diagram 2.2: Intangible supplies to a potentially chargeable recipient – item 1 in the table to subsection 9-26(1)



Example 2.3: Intangible supplies to a potentially chargeable recipient - item 1 in the table to subsection 9-26(1)

Drum Co (a non-resident) enters into an agreement with Beach Co (a potentially chargeable entity) to supply call centre services. These services provide support to Beach Co’s employees in relation to their use of a software package that Beach Co utilises in carrying on its enterprise in the indirect tax zone.

None of the supplies that Drum Co makes are through an enterprise Drum Co carries on in the indirect tax zone. While some of the call centre services supplied by Drum Co are performed by employees that

are based overseas, the majority of the services are performed in the indirect tax zone by a Bec Corp – an Australian based subcontractor that is engaged by Drum Co. Bec Corp is not an employee, officer or an agent of Drum Co, and as such the services undertaken by Bec Corp do not cause Drum Co to have an enterprise that is carried on in the indirect zone.

The projected annual turnover of the services performed in the indirect tax zone by Bec Corp is \$80,000.

Under the current law, the services that Drum Co supplies through Bec Corp would be connected with the indirect tax zone because they are done in the indirect tax zone. The projected value of the services exceeds Drum Co's GST registration threshold, and Drum Co is therefore required to be registered and to account for the GST that is payable. Beach Co must obtain a tax invoice from Drum Co in relation to the services it acquires to claim any ITCs to which it is entitled.

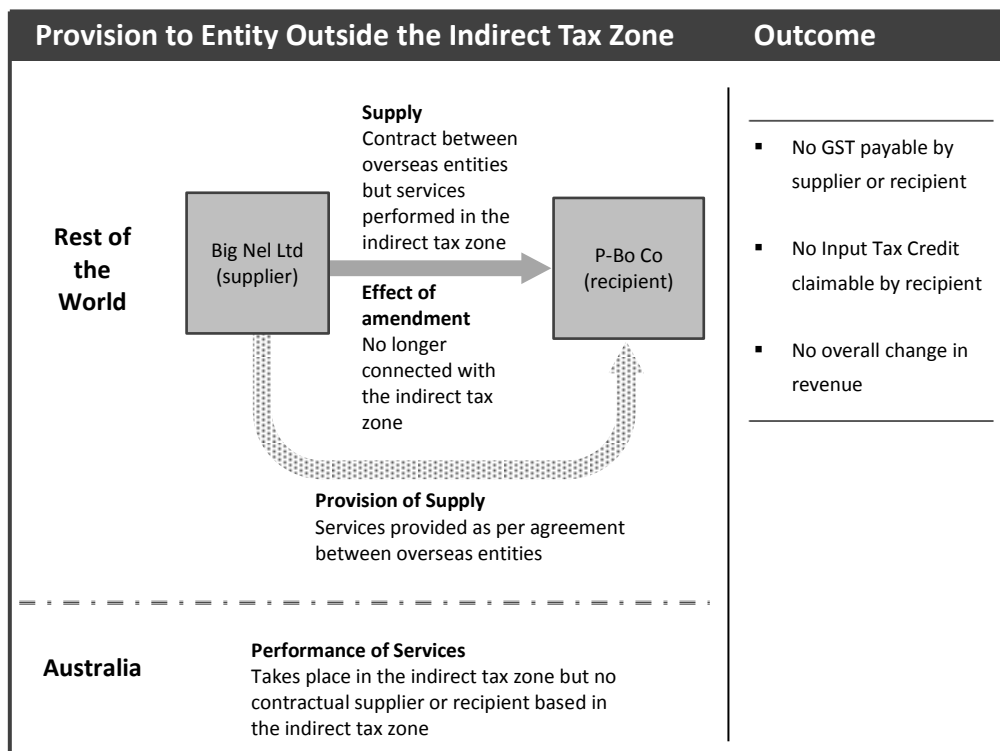
As a result of these amendments, the supplies that Drum Co makes through Bec Corp are no longer connected with the indirect tax zone. The supplies done by Bec Corp in the indirect tax zone satisfy the conditions for being disconnected because Drum Co is a non-resident, the supply is not made through an enterprise it carries on in the indirect tax zone, and Beach Co is a potentially chargeable entity.

Drum Co is not required to pay GST on the supplies, or include them in its GST registration threshold.

As Drum Co does not charge any GST on the supplies it makes, Beach Co is not entitled to any ITCs. If the services that Aussie Co acquires are solely obtained for a creditable purpose, the reverse charge provisions under Division 84 will not apply and no GST will be payable on the supply. This overall revenue neutral outcome is the same as would have been the case if Drum Co had been required to charge GST on the supply because Beach Co would have been entitled to ITCs equal to the GST charged.

In contrast, if the acquisition of the services by Beach Co is not solely for a creditable purpose, the supply will be a taxable supply under Division 84 and GST will be payable by Drum Co ('reverse charged'). This reverse charge is necessary because the GST that would have been payable if the supplies were connected with the indirect tax zone would not have been fully offset by ITCs. The same outcome is maintained by reverse charging the GST to Beach Co, which is then able to claim ITCs to the extent the supply was acquired for a creditable purpose.

Diagram 2.3: Intangible supplies to a non-resident recipient – item 2 in the table to subsection 9-26(1)



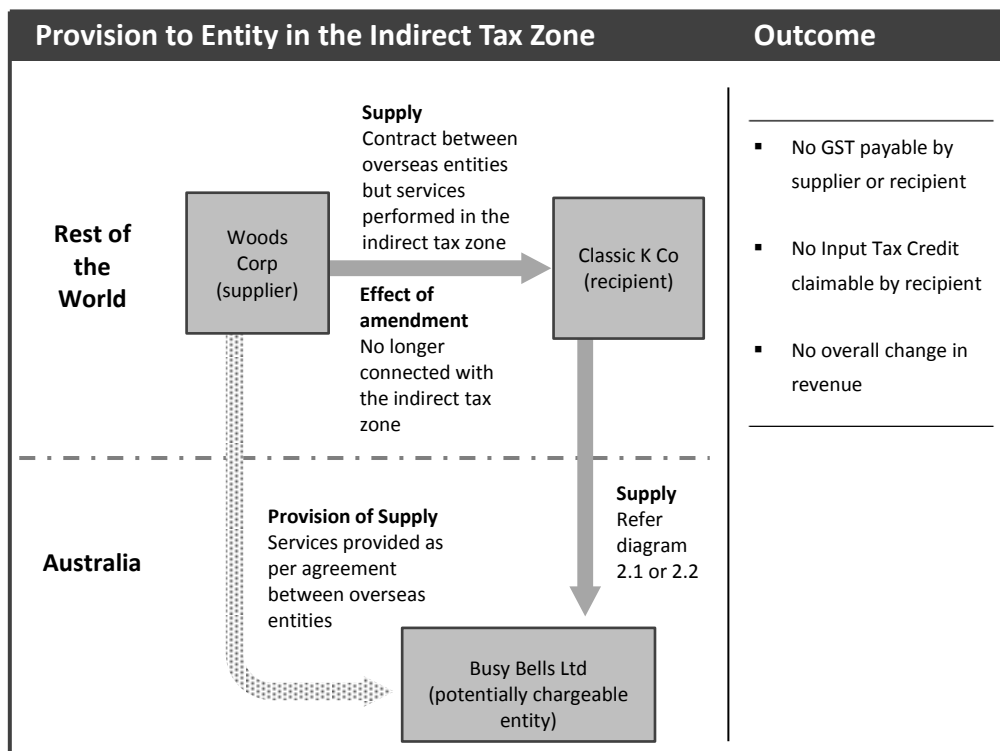
Example 2.4: Intangible supplies to a non-resident recipient – item 2 in the table to subsection 9-26(1)

P-Bo Corp enters into an agreement with Big Nel Ltd to acquire services. Big Nel Ltd supplies the services through an independent sub-contractor who performs the services in the indirect tax zone.

P-Bo Co and Big Nel Ltd are both non-residents. Neither P-Bo Co nor Big Nel Ltd supply or acquire the service through an enterprise that they carry on in the indirect tax zone.

The supply between P-Bo Co and Big Nel Ltd will not be connected with the indirect tax zone because it is supplied by a non-resident to another non-resident, neither of which carry on an enterprise in the indirect tax zone, and the non-resident recipient acquired the services solely for the purpose of an enterprise it carried on outside the indirect tax zone.

Diagram 2.4: Intangible supplies to a non-resident recipient that are provided to another entity



Example 2.5: Intangible supplies to a non-resident recipient that are provided to a potentially chargeable entity

Busy Bells Ltd enters into an agreement with its parent company Classic K Co to supply them with particular services. Classic K Co enters into an agreement with Woods Corp to acquire the services that Classic K Co agreed to supply to Busy Bells Ltd. Woods Corp provides the services via an independent sub-contractor who performs the services in Australia.

Classic K Co and Woods Corp are both non-residents. Neither Classic K Co or Woods Corp supply or acquire the service through an enterprise that they carry on in the indirect tax zone. Busy Bells Ltd is a potentially chargeable entity.

The original supply from Woods Corp to Classic K Co will not be connected to the indirect tax zone because it is supplied by a non-resident to another non-resident, neither of which carry on an enterprise in the indirect tax zone, and Classic K Co acquired the supply solely for the purpose of an enterprise it carried on outside the indirect tax zone.

The on-supply between Classic K Co and Busy Bells Ltd is not connected with the indirect tax zone and any GST that needs to be collected will be collected through Busy Bells Ltd under Division 84.

Supplies of goods installed and assembled in the indirect tax zone

2.86 Ordinarily, supplies of goods brought into the indirect tax zone will be connected with the indirect tax zone if the supplier either imports the goods, or installs or assembles the goods in the indirect tax zone. In such circumstances, the supplier of the goods (if registered or required to be registered) must pay GST on the supply, and the recipient is entitled to ITCs to the extent that the goods were acquired for a creditable purpose. In calculating the amount of GST that applies on a taxable supply of a good that is assembled or installed in the indirect tax zone, the value of the assembly or installation service can be embedded in the value of the good supplied.

2.87 An importer must also pay GST on a taxable importation. A taxable importation will occur where goods that are imported into the indirect tax zone are 'entered for home consumption' under customs law (which generally means that the goods have passed out of customs control). In contrast to a taxable supply, the amount of GST payable on a taxable importation is calculated by reference to the customs value of the goods. The customs value of imported goods does not include the value of any assembly or installation services.

2.88 The liability to GST on taxable importations applies separately to any liability imposed on the supplier as result of the goods being connected with the indirect tax zone. Where a supplier imports goods into the indirect tax zone, they will be required to account for both GST liabilities. To the extent that the goods are acquired by the recipient for a creditable purpose, the recipient of the goods is entitled to offsetting ITCs for acquiring the taxable supply and the supplier (importer) would be entitled to a full input taxed credit assuming the supply of the goods was not an input taxed supply.

2.89 Where imported goods are *not* imported by the supplier (for example, because they are imported by the recipient), but the supplier installs or assembles the goods in the indirect tax zone, the supplier is only liable to pay GST on the supply.

2.90 In many cases, supplies of imported goods to business recipients that involve assembly or installation services will be fully creditable. In such cases, the recipient is entitled to full ITCs for the GST on both the supply and importation.

Scope of amendments

2.91 These amendments reduce the number of non-resident suppliers required to account for GST by disconnecting particular supplies of goods.

2.92 As such, a supply of goods brought into the indirect tax zone will not be connected with the indirect tax zone if the supplier installs or assembles, but does not import, the goods in the indirect tax zone. As with the amendments in relation to intangible supplies, the recipient of the goods must be potentially chargeable, and the supplier must be a non-resident who satisfies the enterprise conditions referred to above. *[Schedule 2, item 2 and item 3 in the table to subsection 9-26(1)]*

2.93 The scope of the amendments is restricted to supplies of goods that are not imported by the supplier. This approach is due to the fact that the amendments are designed to remove suppliers from the GST system altogether. In circumstances where the supplier is the importer (and is therefore liable for the taxable importation), the supplier would normally want to claim for an offsetting input tax credit on a creditable importation and as such needs to register for GST.

2.94 Disconnecting the supply in the above circumstances will mean that to the extent goods are not acquired for a fully creditable purpose, the amount of GST that is ultimately payable is collected through the GST importation rules.

2.95 However because the customs value of imported goods will not generally include any installation or assembly services, these amendments include an additional rule to ensure that the recipient must account for any GST that would have ultimately been payable on the installation or assembly services undertaken by the supplier.

2.96 To facilitate this, the goods component and the installation or assembly component of a supply of goods that is disconnected as a result of these amendments are treated as two separate supplies. This rule applies where the installation or assembly component of the supply is embedded in the price of the supply of goods. In such circumstances, the installation or assembly component is treated as a separate supply of a thing done in the indirect tax zone. *[Schedule 2, item 2, subsection 9-26(3)]*

2.97 The price of the installation or assembly services is so much of the price of the actual supply as reasonably represents the price of the intangible supply. *[Schedule 2, items 5, 6 and 7, note 1 and 2 to section 84-12 and section 84-20]*

2.98 The treatment of the two components of supplies that are split in this way is explained below.

Goods component

2.99 A supply of goods that is brought into the indirect tax zone and installed or assembled, but not imported, by a non-resident supplier is not connected with the indirect tax zone. *[Schedule 2, item 2, item 3 in the table to subsection 9-26(1)]*

2.100 The supplier does not have to pay GST on the goods component of the supply or include it in determining if they are required to register for GST as this supply is no longer connected with the indirect tax zone.

2.101 The recipient of the goods is not required to consider whether their acquisition of the goods is subject to a reverse charge under Division 84 as that Division only applies to supplies of intangibles.

2.102 However, the value of the goods is still subject to GST as a taxable importation for the importing entity. The importer is entitled to input tax credits to the extent that the goods are imported for a creditable purpose.

Installation or assembly component

2.103 The installation or assembly component of the supply is not connected with the indirect tax zone because it relates to a supply of intangibles that are done in the indirect tax zone. This outcome is the result of the amendments in relation to intangible supplies made to potentially chargeable entities, as explained above. *[Schedule 2, item 2, item 1 in the table to subsection 9-26(1) and subsection 9-26(3)]*

2.104 The supplier does not have to pay GST on the installation or assembly component of the supply or determine if they are required to register for GST as this supply is no longer connected with the indirect tax zone.

2.105 Because the recipient of the goods must be a potentially chargeable entity for the supply of goods to be disconnected, the recipient must consider if their acquisition of the installation or assembly component of the supply is subject to a reverse charge under Division 84. Division 84 will only apply where the acquisition of the installation or assembly component of the original supply (which is deemed to be a separate supply) is not solely for a creditable purpose.

2.106 In such circumstances, although the goods component of the supply will no longer be subject to GST because of these amendments, GST will still have been payable on the importation of the goods and the

importer can claim an ITC to the extent that the importation was for a creditable purpose.

Supply of leased goods made available in the indirect tax zone

2.107 Ordinarily, a supply of goods that are delivered or made available in the indirect tax zone will be connected with the indirect tax zone. This is the case even where the supply is made between two non-residents, neither of which makes the supply or acquisition in the course of an enterprise they carry on in the indirect tax zone.

2.108 These amendments provide two exceptions to the connected rules for supplies that involve a transfer of ownership of goods that are subject to a lease.

Supply by transfer of ownership of leased goods

2.109 These amendments apply to a supply of goods subject to a lease involving a transfer of ownership from one non-resident lessor to a new non-resident lessor. A supply of this kind will be disconnected if:

- the non-resident recipient does not acquire the goods to any extent for the purpose of an enterprise they carry on in the indirect tax zone;
- the goods were leased to an entity that made a taxable importation of the goods before the transfer of ownership occurred; and
- after the supply is made, the goods continue to be leased to the entity that made the taxable importation on the same terms and conditions that operated under the lease before the transfer of ownership occurred.

[Schedule 2, item 2, item 4 in the table to subsection 9-26(1)]

2.110 The supply of goods would ordinarily be connected with the indirect tax zone if the goods are made available to the recipient (new lessor) in the indirect tax zone. However, as the goods continue to be leased under the same terms and conditions, there has been no substantive change in the arrangements that apply to the goods supplied. Provided the lessee paid GST on the goods when they were imported, it is appropriate to disregard the transfer of ownership between the two non-residents. The requirement that the goods were subject to a taxable importation by the lessee ensures that an appropriate amount of GST was collected when the goods were imported into the indirect tax zone.

2.111 To the extent that the acquisition of the goods by the non-resident recipient (new lessor) was done in the course of an enterprise carried on outside of the indirect tax zone (which would ordinarily be the case, given that the goods are leased to another entity), the recipient would be able to claim ITCs in relation to the supply. Accordingly, there is no net GST foregone as a result of disconnecting the supply.

2.112 As with the other supplies covered by these amendments, the requirements about the supplier must also be satisfied in order for these exceptions to apply – that is, the supplier must be a non-resident that does not make the supply through an enterprise it carries on in the indirect tax zone. [*Schedule 2, item 2, subsection 9-26(1)*]

2.113 Preventing a supply being disconnected if the non-resident supplier supplies the goods through an enterprise it carries on in the indirect tax zone is appropriate because in those circumstances the supplier has a sufficient presence in the indirect tax zone to justify maintaining their GST obligations in relation to the supply.

2.114 For similar reasons, the exception does not apply if the non-resident recipient acquires the goods to any extent through an enterprise carried on in the indirect tax zone. However, in those circumstances it is open to the non-resident supplier and registered recipient to utilise the voluntary reverse charge provisions in Division 83.

Example 2.6: Supply between non-residents of asset leased in the indirect tax zone

Singapore Co leases an aircraft to North Australia Travel Co for 10 years. Upon the lease being entered into, the aircraft was made available in Singapore to North Australia Travel Co and North Australia Travel Co imported the aircraft into the indirect tax zone.

Five years into the 10 year lease, Singapore Co decides to sell the aircraft, subject to the lease, to Indonesia Co. North Australia Travel Co continues to lease the aircraft from Indonesia Co on the same terms and conditions as were in their lease with Singapore Co.

Despite the aircraft being made available to Indonesian Co in the indirect tax zone, the supply between Singapore Co and Indonesian Co is not connected with the indirect tax zone.

Supply by way of new lease

2.115 Building on the circumstances explained above in relation to the transfer of ownership between the two non-residents of goods that are subject to a lease, the new lease arrangements that are entered into between the non-resident that acquired ownership of the goods and the

entity that continues to lease the goods constitutes a new supply by way of a lease.

2.116 These amendments disconnect such supplies where the lessee of the goods (that is also the recipient of the supply of the lease) satisfies the conditions in respect of the lessee that were required to disconnect the original supply between the two non-residents. As such, a supply of a goods by way of a lease between a non-resident and a lessee will be disconnected if:

- the goods were leased to an entity that made a taxable importation of the goods before the transfer of ownership occurred; and
- the goods continue to be leased to the entity that made the taxable importation on the same terms and conditions that operated under the lease before the transfer of ownership occurred.

[Schedule 2, item 2, item 5 in the table to subsection 9-26(1)]

2.117 In order for this exception to apply, the goods must have been leased before the transfer of ownership, and then remain subject to the same terms and conditions of the lease or a new lease after the transfer of ownership.

2.118 Disconnecting these supplies ensures that GST is not imposed again on the supply between the new owner of the goods and the lessee as a result of the change of ownership. This outcome is appropriate because the goods have already been subject to GST as a result of the lessee importing them into the indirect tax zone.

Adjustments under the compulsory reverse charge rules in Division 84

2.119 The GST law contains a number of rules that apply where an adjustment to previously declared GST or ITCs is required. Such adjustments may be necessary if supplies are cancelled after they have been subject to GST, goods are returned, there is a part-refund, or a change in GST status occurs. These adjustment events are taken into account in a later tax period, and have the effect of reducing or increasing an entity's GST liability.

2.120 These amendments modify the way that the adjustment rules will apply to certain supplies that are subject to the compulsory reverse charge rules in Division 84.

2.121 In broad terms, Division 84 applies to supplies of anything other than goods and real property that are not connected with the indirect tax zone, that are acquired:

- by a recipient who is registered or required to be registered;
- solely or partly for the purpose of an enterprise carried on by the recipient in the indirect tax zone; and
- that are not solely for a creditable purpose.

2.122 Where Division 84 applies to such a supply, the supply becomes a taxable supply, and any GST on the supply is payable by the recipient.

2.123 Under the current law, a supply that is acquired solely for a creditable purpose will not be a taxable supply that is subject to a reverse charge and this outcome is generally appropriate because the recipient would have been entitled to full ITCs for any GST payable by them on the acquisition.

2.124 However, if the relevant supply had been a taxable supply, there are certain circumstances in the GST Act that can give rise to an adjustment event. For example, a change in the recipient's creditable purpose under Division 129 would generally require an adjustment to an entity's ITC entitlement.

2.125 These amendments ensure that for the purpose of working out if there is an adjustment under any of the adjustment provisions in the GST Act, the supply is treated as a taxable supply under Division 84, despite the fact that the acquisition by the recipient was initially solely for a creditable purpose. [*Schedule 2, item 7, section 84-25*]

2.126 Under the existing law, the requirements in Division 84 about the recipient's enterprise and creditable purpose are contained in the same legislative provision. To ensure Division 84 can also apply to a recipient that initially acquired a thing solely for a creditable purpose, these amendments split the enterprise and creditable purpose requirements into two separate provisions so that they apply independently. The overall effect of these requirements is unchanged in the broader context of Division 84. [*Schedule 2, items 4, paragraphs 84-5(1)(c) and (ca)*]

Extensions to GST free rules

2.127 These amendments also extend the GST free rules to reduce embedded GST on supplies made to non-residents, and as a consequence reduce the need for non-residents to register for GST in order to claim ITCs.

2.128 As a result of these changes, fewer non-residents will be drawn into the GST system to claim ITCs to recover the GST on acquisitions in the indirect tax zone that are business inputs consumed in the indirect tax zone.

Supplies of intangibles for consumption outside the indirect tax zone

2.129 Under the current law, supplies of things, other than of goods or real property, that are made to a non-resident who is not in the indirect tax zone when the thing supplied is done (for example, when the service is performed), are generally GST free under item 2 in the table to subsection 38-190(1) (referred to subsequently as item 2).

2.130 However, item 2 does not apply to a supply to make it GST free if the supply is entered into, whether directly or indirectly, with a non-resident and the supply is provided, or required to be provided, to another entity in the indirect tax zone.

2.131 These amendments preserve the application of item 2 to make a supply GST free where the supplier is satisfied that the entity in the indirect tax zone to whom the supply has been provided is:

- registered for GST;
- an individual in their capacity as an employee or officer of a potentially chargeable entity; or
- an individual in their capacity as an employee or officer of the recipient, provided the recipient's acquisition of the thing supplied is solely for a creditable purpose and is not a non-deductible expense.

[Schedule 2, item 13, subsection 38-190(3A)]

2.132 The amendments do not apply to preserve GST free treatment under item 2 to a supply that would be an input taxed supply but for the operation of subsection 9-30(2). This is because the non-resident recipient is not acquiring a taxable supply, and therefore is not being drawn into the GST system to claim an input tax credit. Additionally, the supplier of an input taxed supply should not be entitled to greater access to ITCs. If these input taxed supplies were GST free, the supplier would be entitled to ITCs under Division 11 in making that supply.

2.133 In order to establish that a particular supply is covered by these changes, the supplier must obtain 'sufficient documentary evidence' to show that the recipient and providee satisfy the relevant requirements. Although this information will in many cases be included in the terms and

conditions of the supply (for example, in the agreement specifying that particular services be provided to an employee), the supplier may need to obtain additional documentation to evidence that the supply satisfies the relevant criteria.

Supply provided to a registered entity in the indirect tax zone

2.134 The amendments preserve the GST free treatment of supplies made to a non-resident recipient that are provided in the indirect tax zone to an entity that is registered for GST. [*Schedule 2, item 13, paragraph 38-190(3A)(a)*]

2.135 Where the supply is provided in the indirect tax zone to another entity that is registered for GST, that entity will generally use the acquisition in the course of an enterprise they carry on in the indirect tax zone.

2.136 It is unnecessary for non-residents to register for GST to claim ITCs on their acquisitions when the supply made to them is provided to another entity in the indirect tax zone that is registered for GST. The provision of the thing supplied to the providee will constitute a separate supply between the non-resident that originally acquires the thing and the providee. The appropriate amount of GST (if any) can be collected in respect of this on-supply.

2.137 As a result of this approach, the GST's multi-staged collection and credit mechanism is suspended and no GST is embedded in the price of the supply and the non-resident recipient is relieved of the need to claim ITCs.

Supply provided to employee or officer of a potentially chargeable entity in the indirect tax zone

2.138 The amendments also preserve the GST free treatment of supplies made to a non-resident that are provided in the indirect tax zone to an individual who is an employee or officer of a potentially chargeable entity. [*Schedule 2, item 13, paragraph 38-190(3A)(b)*]

2.139 As noted above, an entity is potentially chargeable for a supply if the entity carries on an enterprise in the indirect tax zone, is registered for GST, and the acquisition is solely for a private or domestic nature.

2.140 An employee or officer of a potentially chargeable entity will be provided with a supply in their capacity as an employee or officer if the supply was provided to them:

- in the performance of their duties; or

- as part of their remuneration.

2.141 However a supply that is acquired directly by an employee or officer of a potentially chargeable entity will not satisfy the conditions necessary for the carve-out to apply. In such circumstances, the supply will be outside the scope of item 2 because it was made to a recipient that was in the indirect tax zone. These amendments do not impact upon the basic requirements for item 2 to apply – they simply preserve the application of item 2 in particular circumstances.

2.142 To ensure that the application of item 2 is only preserved where there would be no net GST ultimately collected, this change takes into account that the non-resident recipient will normally have an underlying supply agreement (directly or indirectly) with the potentially chargeable employer who by definition must be a GST registered entity.

2.143 As such, the underlying supply between the employer and the employee will be subject to the compulsory reverse charge provisions in Division 84 where the supply of services is not acquired by the employer solely for a creditable purpose.

Supply provided to employee or officer of the non-resident recipient in the indirect tax zone

2.144 Under the existing law a supply that is provided to the non-resident's employee who is in the indirect tax zone is not a GST free supply as a result of item 2. An example would be the acquisition by the non-resident of training services if the employee is provided the training in the indirect tax zone. In these circumstances, the non-resident employer would need to register to recover the GST as an ITC if the acquisition was a creditable acquisition. Where the non-resident would not otherwise have to register for GST, this imposes an unnecessary compliance burden on what would essentially be a revenue neutral transaction.

2.145 The amendments preserve the GST free treatment of supplies to a non-resident recipient outside of the indirect tax zone where the non-resident recipient is not registered for GST, the providee is an employee or officer of the recipient, and the recipient's acquisition of the thing is both solely for a creditable purpose and is not a 'non-deductible expense'. [*Schedule 2, item 13, paragraph 38-190(3A)(c)*]

2.146 In order for the supply to be GST free, the supplier must be satisfied that:

- the employee or office holder is provided with the supply in their capacity as an employee or office holder of the unregistered non-resident enterprise;

- the supply would not have been input taxed; and
- the acquisition by the non-resident recipient would be a fully creditable acquisition.

2.147 As with the amendment in relation to supplies provided to an officer or employee of a potentially chargeable entity, these changes do not apply where an employee of a non-resident (rather than the non-resident employer) directly acquires something in the indirect tax zone.

2.148 In terms of the requirement that acquisitions be fully creditable, any supplies listed in Division 69 (about non-deductible expenses) will generally not be a creditable acquisition for a non-resident employer. Expenses listed in Division 69 include entertainment expenses that could be paid to employees of a non-resident as part of their remuneration package.

2.149 These changes to extend GST free treatment do not apply to supplies listed in Division 69 which are denied entitlement to input tax credits.

2.150 Small and large businesses making supplies to non-resident entities but providing their services to individuals in Australia can continue to charge GST when they are not satisfied that the recipient has given sufficient information showing the true character of the acquisition. This is particularly important for an ‘on-the-spot’ service such (for example, a massage) performed in Australia by a small business. Small businesses would rarely turn their mind to treating any such services as GST free unless the recipient provided sufficient information.

Supplies of repair or similar services for goods under warranty

Operation of current law

2.151 Under the current law, non-resident warrantors can be drawn into Australia’s GST system to recover GST on the cost of repairs under warranty. This imposes a significant compliance burden on these non-residents where they are not registered or required to be registered for GST.

2.152 An example of a supply of this kind is where a non-resident manufacturer is, under its warranty, required to repair a defect in goods that it has supplied to a recipient in the indirect tax zone. If the non-resident manufacturer has no presence in the indirect tax zone through which it can make the necessary repairs, the goods will need to be either sent offshore to be repaired, or be repaired in the indirect tax zone

on behalf of the manufacturer. If the non-resident manufacturer engages a GST registered entity in the indirect tax zone to undertake the repairs, then the repairer makes a taxable supply of repair services to the non-resident manufacturer.

2.153 Provided the non-resident manufacturer is not in the indirect tax zone when the repair services are done, and if the warrantor acquires the services in carrying on its enterprise, the supply of the repair services can be GST free under item 2 in the table to subsection 38-190(1). However, the limitation to item 2 referred to above will apply in these circumstances because the repair services are provided to the entity that purchased the goods from the manufacturer.

2.154 In these circumstances, the non-resident manufacturer will generally be entitled to ITCs for its acquisitions of the warranty services because those supplies are acquired in the course of carrying on its enterprise. However, to obtain these ITCs, the non-resident manufacturer will be required to register for GST and to lodge a business activity statement to claim the refund.

2.155 Additionally, any replacement parts, including a full replacement of the goods that are supplied in accordance with the provision of a warranty, are not GST free if the goods remain within the indirect tax zone.

Scope of amendments

2.156 To prevent non-residents in these circumstances from being drawn into Australia's GST system, these amendments ensure that a supply of a repair, renovation, modification or treatment of goods will be GST free if it is made to a non-resident that is not in the indirect tax.
[Schedule 2, item 14, subsection 38-191(1)]

2.157 In order for such supplies to be GST free:

- the non-resident recipient of the service must be neither registered nor required to be registered;
- the non-resident recipient must acquire the service supplied in carrying on its enterprise;
- the service must be done to meet the non-resident's obligations under a warranty relating to the goods; and
- the warranty must have either been sold as part of a package with the supply of goods (such that the consideration for the warranty was included in the consideration for the supply of

goods), or been a taxable supply separate from the supply of the goods.

[Schedule 2, item 14, subsection 38-191(1)]

2.158 The requirements that the non-resident recipient of the service be unregistered and not required to be registered and must acquire the service supplied in carrying on an enterprise are due to the broad requirement that the supply must be covered by paragraph (b) of item 2 of the table in subsection 38-190(1). *[Schedule 2, item 14, paragraph 38-191(1)(a)]*

2.159 These requirements ensure that the GST free treatment provided by these amendments only applies to entities that are not already engaged with Australia's GST system, but that would be entitled to ITCs for the services acquired if they were to register.

2.160 The requirements in relation to the warranty services ensure that the GST free treatment provided by these amendments is restricted to services that are acquired by a non-resident in fulfilling their warranty obligations.

2.161 These amendments also extend GST free treatment to goods that are part of warranty services that are made GST free under these amendments. In order for a supply of such goods to be GST free, the goods must form part of the goods being repaired, or be goods that become unusable or worthless as a result of being used as part of the repair services. *[Schedule 2, item 14, subsection 38-191(2)]*

Amendments to GST registration thresholds

2.162 Under the current law, non-resident suppliers are required to register for GST if their projected or current turnover is greater than the registration turnover threshold. The value of supplies connected with the indirect tax zone count towards this threshold, even if those supplies are GST free. As such, non-resident suppliers that only make GST free supplies but have a turnover that is greater than the turnover threshold are required to register for GST, despite having no GST liability.

2.163 These amendments change the calculation of the current and projected GST turnover tests for certain non-resident suppliers.

2.164 The amendments ensure that GST free supplies made by a non-resident supplier are not counted towards these turnover tests where the supply is not made through an enterprise the non-resident carries on in the indirect tax zone. *[Schedule 2, item 15, subsections 188-15(3) and 188-20(3)]*

2.165 The amendment reflects that GST free supplies by non-residents made through an enterprise carried on outside the indirect tax zone should not by themselves result in the suppliers being required to register for GST.

2.166 Where a non-resident supplier makes the supply through an enterprise it carries on in the indirect tax zone, the supplier has a sufficient presence in the indirect tax zone and should have its GST turnover calculated in the same way as any other GST-registered domestic entity.

Calculation of the value of the taxable importation

2.167 These amendments reduce compliance costs for GST-registered importers by providing an alternative option to calculate their transport, insurance and ancillary costs for importations.

2.168 These changes mean that GST-registered importers are no longer required to identify the exact amount paid or payable for the following costs, for the purpose of calculating the value of their taxable importations:

- international transport of the imported goods to their place of consignment in Australia;
- insurance costs for that transport;
- any costs for loading or handling during the international transport or service costs for facilitating that transport.

[Schedule 2, item 16, subsection 13-20(4) and paragraph 13-20(5)(a)]

2.169 Instead, the GST-registered importer may use a percentage of the customs value of the imported goods as a proxy for these costs when calculating the value of their taxable importation. This percentage is currently ten per cent but may be set at a different percentage if prescribed by regulation. *[Schedule 2, item 16, subsection 13-20(4) and paragraph 13-20(5)(a)]*

2.170 The amendments do not apply to taxable importations where the local entry of the goods is a taxable dealing in relation to wine, or the importation of the goods is a taxable importation of a luxury car. *[Schedule 2, item 16, paragraphs 13-20(5)(b) and (c)]*

2.171 These exceptions for importations of wine and luxury cars are required because the changes in calculation method are not intended to apply to importations of goods that are not covered by the general rules.

2.172 To facilitate these exceptions, these amendments remove the existing definition of “wine (within the meaning of the *Wine Tax Act)” and insert definitions of ‘taxable importation of a luxury car’ and ‘taxable dealing’ and ‘wine’ into the Dictionary. [*Schedule 2, items 17 and 18, subparagraph 38-185(3)(f)(ii), subparagraph 38-185(4)(f)(ii) and section 195-1*]

Example 2.7: Value of taxable importations

Butcher Importers, a GST-registered importer, imports equipment into Australia. The customs value of the equipment is \$125,000. At the time of the importation, Butcher Importers is uncertain of the total transport, insurance and ancillary costs as those invoices have not yet been received.

Butcher Importers chooses to use the percentage proxy option. Assuming that no percentage has been prescribed, the relevant uplift percentage is 10 percent. Therefore, Butcher Importers includes \$12,500 rather than the actual transport, insurance and any additional loading, handling and facilitation costs in calculating the value of the taxable importation.

Consequential amendments

Interactions between reverse charging provisions and associate provisions

2.173 These amendments clarify the interaction between the reverse charge provisions in Division 84 and the associate provisions in Division 72.

2.174 Section 72-5 is an anti-avoidance provision which ensures that a supply can still be a taxable supply under section 9-5 in the absence of consideration when the supply is between associates. This is achieved by removing the requirement in section 9-5 for consideration to be given. However it does not explicitly remove the need for consideration to be provided for the supply to be reverse charged under Division 84.

2.175 These amendments clarify that a supply between associates which meets the other requirements of Division 84 will still be a taxable supply in the absence of consideration. [*Schedule 2, item 19, subsection 72-5(2)*]

2.176 The amendments also ensure that the ITC entitlement for supplies between associates for no consideration is worked out based on a formula in the associate rules in Division 72. In working out the ‘full input tax credit’ for the purpose of that formula, it is necessary to assume that the acquisition had been made solely for a creditable purpose despite the

fact that Division 84 only applies to supplies where the corresponding acquisition is partly creditable. *[Schedule 2, item 22, subsections 72-45(1B) and (2)]*

2.177 Where there is inadequate consideration, the recipient uses a modified version of the partial ITC formula for reverse charged supplies in section 84-13. The ‘full input tax credit’ (a component of the formula) is worked out without grossing up what would have otherwise been the full input tax credit by 11/10 had the supply been a taxable supply under the basic rules in Division 9 rather than section 84-5. Given that the GST payable is worked out under section 84-12 by reference to price, and as a result of section 72-75 price is the GST exclusive market value, the full ITC payable is equal to the GST payable. It is therefore not appropriate to gross up the full input tax credit amount by the factor which usually applies to the formula in section 84-13. *[Schedule 2, item 24, section 72-80]*

2.178 The GST payable on supplies between associates that are reverse charged for no consideration is attributed to the tax period in which the supply starts to be done. Similarly, the ITC on the corresponding acquisition is attributed to the same period. *[Schedule 2, items 21 and 23, subsections 72-15(1A) and 72-50(1A)]*

2.179 Given the uncertainty regarding the interaction of the associate provisions and the reverse charge provisions under the current law, it is arguable that the law already applies in a way consistent with these clarifying amendments. These amendments accordingly ensure that despite the change in the wording of the law, this cannot be used as evidence that the application of the law prior to the amendments was not consistent with the amendments. *[Schedule 2, item 27]*

Interactions between reverse charging provisions and resident agent provisions

2.180 These amendments also make a technical change to the resident agent provisions to prevent a double GST liability arising.

2.181 Under the current GST law, where a non-resident made a supply through a resident agent, the resident agent is liable to collect and remit the GST. However, the resident agent rules do not interact appropriately with the existing ‘reverse charge’ provisions. Where the ‘reverse charge’ provisions operate, but a supply is made through a resident agent, both the resident agent and the resident purchaser are liable to collect and remit the GST.

2.182 These amendments ensure that the resident agent provisions only make the resident agents liable in cases where the non-resident

would otherwise also be liable. This avoids the application of double taxation.

2.183 For supplies that are not connected with the indirect tax zone, the non-resident is not liable for GST and the agency provisions will have no application. When the supply is a taxable supply because of section 84-5, the recipient remains liable for GST on the supply and the resident agent is not liable. *[Schedule 2, item 3, paragraph 57-5(3)(a)]*

2.184 Similarly, Division 57 will not apply to supplies that the non-resident supplier makes through an enterprise that they carry on in the indirect tax zone. *[Schedule 2, item 2, paragraph 57-5(3)(b)]*

Other amendments

2.185 Minor consequential changes are also made to the note at the end of the definition of connected with the indirect tax zone, and to the heading of Subdivision 38-E (about exports and other cross-border supplies) to reflect the scope of the amendments. *[Schedule 2, items 10 and 12]*

Application and transitional provisions

An application rule has not been included for Schedule 2 to the exposure draft.

Submissions are encouraged to provide feedback about whether the state date for Schedule 2 should be aligned with that for Schedule 1 (which applies in relation to supplies that are attributable to tax periods starting on or after 1 July 2017, and to supplies that would be attributable to such periods if they were taxable supplies), or be based on some other date.

