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The Board of Taxation
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Review of the Legal Framework for the Administration of the Goods and Services Tax

The Australian Petroleum Production & Exploration Association (APPEA) is the peak national body representing the collective interests of companies engaged in petroleum exploration, development and production in Australia. The Association's membership comprises companies that account for an estimated 98 per cent of Australia's petroleum production and the vast majority of exploration.

The upstream petroleum industry is an important contributor to the Australian economy in many ways:

- petroleum (oil and gas) is the source of over 50 per cent of Australia's primary energy needs;
- the value of oil and gas production exceeds $25 billion per annum;
- exploration expenditure of around $3 billion per annum;
- nearly $20 billion in revenue is generated through the export of petroleum and petroleum products;
- taxation payments of more than $6 billion per annum is paid by the industry; and
- individual investments in large scale gas projects exceed many billions of dollars.

APPEA would like to make the following comments in relation to the operation of the goods and services tax (GST) regime.

General Comments

While the introduction of the GST provided a number of policy and implementation challenges, the willingness on the part of the Government to engage in a open and collaborative consultation process in the lead up to the formal commencement of the regime in 2000 allowed a range of matters to be addressed at an early stage. APPEA, the Minerals Council of Australia and the Australian Taxation Office (ATO) were members of the Mining and Energy GST Partnership Group which provided a forum for issues to be canvassed and discussed in the detail. This Group was important in ensuring that resource sector stakeholder consultations took place in an efficient manner.

A key industry focus during the implementation phase was ensuring that the normal commercial structures within which companies in the petroleum industry operate were not distorted or changed as a result of needing to comply with the operative provisions of the GST legislation. Key issues of focus during the early phase of discussions were the operation of the joint venture provisions, the treatment of exports, issues arising from underlifts/overlifts and industry transactions. While the outcome of the discussions were in the most part positive, difficulties were encountered at the time in relation to reconciling the detailed provisions of the GST legislation with some aspects of normal business practice.

One of the major difficulties remains the need to track and report various types of transactions for GST purposes differently from accounting requirements. While the accruals method of reporting GST liabilities and credits is broadly based on accruals accounting concepts, GST rules do not go far enough in terms of alignment with accounting standards to simplify reporting of specific transactions. Examples where simplification can be achieved while maintaining the integrity of the GST regime are parts exchange programs and business to business barter/ contra transactions.

Amendments to the GST legislation and/or administrative policies should be considered to allow the reporting of GST to be aligned with accounting principles for business to business domestic transactions where there is no revenue loss to the Government.

A number of specific operational concerns have also been encountered that taxpayers have needed to consider.

An Example of Reconciling the Policy Intent of the Regime with Business Practice – The GST Treatment of Exports

In the context of the comments above, APPEA considers it important that the GST law reflects both the broad policy intent of the regime and to the maximum extent possible, the way that business undertakes its day to day operations. It needs to be remembered that the industry must operate in a competitive environment.

An example of where there can be a tension between the legislation and the commercial dealings of taxpayers arises in the area of exports. Exports are essential to the industry and while the general principle underlying the legislation is that they should be GST-free, the complex nature of some contracts and the nature of physical product movements can see such transactions being either inadvertently captured in the GST system or requiring potentially complex interpretations to ensure that the underlying policy intent is maintained. The possible tension between the policy intent and the nature of the provisions can provide challenges for both taxpayers and administrators.

GST Joint Venture Provisions – Administrative Complexity

A key area of administrative complexity arises in relation to the operation of the joint venture provisions. Division 51 of the GST Act allows for entities engaged in a joint venture to have it approved as a GST joint venture. This provision reflects the special role played by joint ventures in the resources sector, with section 51-5(a) specifically referring to the exploration or exploitation of resources. APPEA strongly supports the current recognition of joint ventures under the GST law, including the ability of GST joint venture operators to consolidate GST returns.

APPEA members have advised of a number of complexities connected with the registration and tracking of GST joint ventures. This is particularly the case where a party is involved in more than one GST joint venture.

Impact on Australian Contractors – An Example of Potential Distortionary Outcomes

In 2002-03, an issue arose in relation to the operation of the GST law. Specifically, an Australian company (the development company) was planning to engage an overseas prime contractor (with no business presence in Australia) to supply equipment and plant for the construction of a project in Australia. Following the awarding of a contract, a sub-contractor (an Australian resident company) was to planning to enter into a contract with the prime contractor to supply a portion of the equipment direct to the development company in return for the payment of a fee by the prime contractor to the sub-contractor. At the same time, the development company was to enter for home consumption the remainder of equipment for the construction project sourced from the prime contractor and would have been entitled to an input tax credit under the GST deferral scheme. An issue arose in relation to the nature of the transaction between the prime contractor and the sub-contractor and in particular, whether that transaction was GST free. The overseas prime contractor indicated a desire not to register in Australia for tax purposes.

The competitive and commercial environment surrounding the project was such that no Australian contractor was able to undertake the overall project and very tight margins were associated with the investment. A concern was identified that in the circumstances outlined above, the Australian sub-contractor may not have been able to compete on price if GST of 10 per cent had to be included in their tenders for the project. The inability of Australian suppliers to compete for an important part of the project was seen as being inconsistent with the objective of encouraging Australian companies to participate in development projects.

It is noted that current GST related concessions for non-residents such as the reverse charge mechanism and agency arrangements are often not commercially possible for legal / other reasons. For example, the reverse charge concession requires the Australian customer to take on the liabilities under GST legislation which otherwise belong to the third party foreign supplier. There is clearly a disparity between GST concessions and other trade related concessions. The reason for the disparity is because temporary importation concessions which were put in place to ensure competitive

neutrality for the import of equipment do not extend to related services. GST remains payable by the non-resident supplier on services performed in Australia during the time the equipment is temporarily located in Australia.

APPEA is unaware as to whether this issue has been satisfactorily resolved, however we consider it highlights a concern whereby the operation of the tax regime potentially created an outcome that disadvantaged two parties – namely the sub-contractor that wished to bid for a part of the larger project and the development company that both wished to access local suppliers and ultimately may have needed to pay a higher contract cost to the prime-contractor. This issue was raised in the Australian Financial Review on 13 March 2003 (page 6) – a copy of the article is attached.

Technical and Operational Issues

In additional to the issues raised above, there a range of operational, compliance and technical maters that have been identified by APPEA member companies.

- Treatment of Foreign Entities

Registration obligations can be cumbersome and compliance requirements can still require complex processes. A pragmatic approach that provides transparency and simplifies compliance for the taxpayer should be the key objective.

- Invoicing, Recipient Created Tax Invoice and Adjustment Provisions

With respect to RCTI's, consideration should be given to removing the obligation for written agreements to exist. The parties should simply agree to the use of such an arrangement, and this process should be as flexible as possible. Parties should be able to agree to what is in and out of the scope of the arrangement.

- Reporting Periods, Refunds and Balances

There are significant compliance issues and refund delays where entities have multiple GST branches and GST joint venture registrations. The ATO system of liability and refund balances can see amounts offset against other taxpayer obligations leading to potentially inequitable outcomes and delays. This is particularly an issue for joint venture balances and where a party lodges excise or fuel tax credit returns.

- Attribution Rules

The attribution rules should be more closely aligned to the generally accepted accounting treatments where there is no risk to the integrity of the GST regime for business to business transactions as this does not impact directly on the GST borne by the end consumer.

- Characterisation of Supplies – Parts Exchange

Commercially and practically, many businesses involved in parts exchange programs consider that they have engaged the repairer to provide repair services. Indeed, typically accounting systems have been set up to record merely the 'net' figure, being merely the cost of the repair service. This is a practice that pre-dates the introduction of GST by many years and is required under current accounting standards.

Characterisation of the various transactions involved in a parts exchange program as a supply of repair services by the repairer to APPEA members would result in no loss of revenue to the ATO and would allow tracking and reporting of transactions under GST rules to be aligned with accounting requirements, significantly reducing compliance costs for all involved parties.

- Financial Acquisitions Threshold

For many entities, the compliance requirements to monitor the financial acquisition threshold can simply result in decisions to deny costs for relevant costs purely on the assumption that thresholds are breached, even though that may often not be the case. A test based on the higher of a threshold amount or a percentage of ITC's claimed by a taxpayer would perhaps be a more appropriate test.

- Adjustment Tracking/Correcting Mistakes

Tracking of five years for adjustment purposes is simply too long. The correction thresholds are also too low for large corporate entities.

- Interest Charges

Consideration should be given to SIC applying instead of GIC in circumstances where inadvertent mistakes have been made.

APPEA would be pleased to expand on the issues raised above. Contact officer is Noel Mullen (nmullen@appea.com.au).

Yours sincerely

Belinda Robinson
CHIEF EXECUTIVE

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Businesses hit by GST anomaly

Allesandra Fabro

Australian businesses face missing lucrative contracts on major projects because of a long-running GST anomaly, costing hundreds of millions of dollars and causing job losses around the country.

The problem arises when overseas firms sub-contracting to local businesses refuse to meet the local operators' GST liability.

"This is a real issue as of right now," said West Australian Chamber of Commerce and Industry director Bill Sashegyi. "Undoubtedly, many hundreds of Australian jobs are at risk."

Sub-contracts at risk include those relating to major projects such as gas, infrastructure, defence and heavy metals processing, with small and medium enterprises bearing the brunt of the problem.

The issue starts when an Australian business is contracted by an overseas company to provide services to another Australian entity.

Generally, supplies to an overseas entity are GST-free, but because the supply in this case is being made to another business in Australia, the fee is subject to GST regardless of the fact that it has been ordered – and paid for – by the overseas company.

Technically, the problem could be avoided by getting the overseas company to register for GST but in practice tax experts report that many overseas companies are refusing to register and refusing to pay the additional 10 per cent in taxes.

This leaves Australian businesses – which are still required to remit the GST component to the Taxation Office – to either fund the GST out of their own profit margin or risk pricing themselves out of the fiercely competitive sub-contracting market.

Horwath NSW indirect tax partner Jason Crawford said the uncertainty was costing business time and money. "This is another example of how the legislation and ATO rulings aren't necessarily mature enough to deal with what are practical business transactions," he said.

"The lack of definitive guidance and continued uncertainty means Australian businesses are being disadvantaged."

Mr Sashegyi said the problem was undermining recent government efforts to build up local involvement in major projects. "We are aware that there are specific examples where companies are going to miss out on work they otherwise should have been able to win.

"This GST issue runs counter to the efforts of Australian companies and the intent of the Australian government to enhance industry participation. There have been various approaches made to government on the matter but the wheels of government are grinding too slowly."

Labor manufacturing spokesman George Campbell said the issue had to be resolved. "The government is making it near impossible for Australian companies to compete on their home turf," he said.

Attachment