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The Board of Taxation
C/ - The Treasury
Langton Crescent
CANBERRA ACT 2600

8 September 2009

Dear Sir/Madam

Submission to Board of Taxation - Direct GST Refund to non-residents

We are writing this submission in response to the Board of Taxation's invitation to stakeholders to comment on the recent discussion paper regarding the 'Review of the Application of GST to Cross-Border Transactions' ("the Discussion Paper"). We write on behalf our client, VATit. In particular, through this letter we seek to provide feedback on the issue of whether non-residents that do not make taxable supplies in Australia should be given a direct refund of Goods and Services Tax ("GST") incurred in the course of their enterprise, rather than having to register for GST purposes and lodge Business Activity Statements ("BAS").[1]

Executive Summary

We support the introduction of a direct refund mechanism for non-resident businesses rather than the current model of requiring such businesses to register for GST purposes and lodge monthly or quarterly BAS in order to recover GST incurred in the course of their business on the following basis:

- A direct refund system is more efficient than the current approach and as a consequence, compliance costs for business and administration costs for government would be less;
- Such a system is clearly comparable to those operating in other GST or value added tax ("VAT") systems and, if introduced, should enable Australian businesses to recover VAT incurred in all European countries. Currently, Australian businesses cannot recover VAT in Germany, Italy, Spain and Switzerland as these countries do not accept that the Australian GST system provides refund entitlements to their VAT registered businesses.

[1] Issue 2: Direct Refund Mechanism – page 33 of Discussion Paper

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- Will enhance the neutrality of the Australian GST by making refunds more widely available to non-resident businesses that do not currently avail themselves of such refunds because of the associated compliance costs. This will reduce the incidence of double taxation in Australia.

Background

VATit is a multinational company that assists businesses to claim VAT and GST refunds, particularly in countries that allow non-resident businesses to recover GST or VAT incurred in the course of their business. Accordingly, VATit has a keen interest in the recommendations made by the Board of Taxation in relation to this matter.

In the context of VATit's operations, a number of ongoing issues have arisen in relation to refunds of VAT and GST to non-residents in a number of jurisdictions. In particular, a number of European countries do not allow Australian businesses refunds of VAT incurred in the course of their business (unless they are required to register and account for output VAT) on the basis that Australia does not provide reciprocal refund rights to businesses resident in their jurisdiction.

VATit has already made a submission to the Australian Treasury regarding the difficulties faced by Australian businesses seeking refunds in Germany. VATit makes this submission, partly as a consequence of the difficulties experienced in attempting to convince the German tax administration that the Australian GST system is reciprocal to the European VAT system insofar as it allows non-resident businesses refunds of Australian GST incurred in the course of their business.

Outline of Submission

In support of our submission, we set out the following:

(a) An outline of the scheme of the Australian GST law

(b) Outline of the treatment of direct refunds paid to non-resident entities in the European Union ("EU").

(c) Our response to the questions posed by the Discussion Paper in relation to direct refunds of GST.

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Submission

(a) The scheme of the Australian GST law

The key design feature of a VAT or GST which makes it the preferable form of indirect tax internationally is that it operates as a tax on domestic private final consumption expenditure, but relieves business from tax on its business inputs.

Australia's GST is intended to give effect to neutrality, efficiency and international competitiveness by ensuring that GST is only 1/11th of the price paid by the consumer for private consumption in Australia. This is achieved by a registered business applying GST to its taxable outputs and providing a credit for GST incurred on its inputs[2]. In this way, GST is only payable by a supplier on the value added at each stage of the production and distribution process. The credit offset mechanism ensures that GST is ultimately borne by the consumer.

In HP Mercantile Pty Limited v Commissioner of Taxation[3], Hill J referred to the system of input tax relief on business inputs as follows:

> "The genius of a system of value added taxation, of which the GST is an example, is that while tax is generally payable at each stage of commercial dealings ("supplies") with goods, services or other "things", there is allowed to an entity which acquires those goods, services or other "things" as a result of a taxable supply made to it, a credit for the tax borne by that entity by reference to the output tax payable as a result of the taxable supply. That credit, known as an input tax credit, will be available, generally speaking, so long as the acquirer and the supply to it ... satisfied certain conditions, the most important of which, for present purposes, is that the acquirer made the acquisition in the course of carrying on an enterprise and thus, not as a consumer. The system of input tax credits thus ensures that while GST is a multi-stage tax, there will ordinarily be no cascading of tax. It ensures also that the tax will be payable, by each supplier in a chain, only upon the value added by that supplier."

We submit that it is correct in principle that Australia allows non-resident businesses to claim refunds of Australian GST borne on inputs to their business activities. To deny non-residents a refund of GST

[2] With the exception of inputs acquired to make input taxed supplies or inputs acquired for a private or domestic purpose
[3] HP Mercantile Pty Limited v Commissioner of Taxation [2005] FCAFC 126, paras 13

in these circumstances would result in the Australian GST taxing business inputs rather than Australian private consumption.

Furthermore, to deny non-resident businesses a refund of GST incurred on its inputs, significantly increases the likelihood that Australian entities will be subject to double taxation (as that cost will often flow through to Australian consumers as part of the cost base of other taxable goods and services).

We note that the majority of OECD countries that have a GST, VAT or similar indirect tax system, provide non-resident businesses with a refund of GST/VAT incurred in the course of their business. We have detailed at Appendix A those countries that provide non-resident businesses with an entitlement to a refund of VAT or GST.

A refund entitlement for non-resident businesses is also consistent with OECD guidelines on VAT and GST systems. In particular, the OECD states in its document International VAT/GST Guidelines – February 2006 that:

> "It is not the intention of these principles to suggest that compliance costs should not be borne by business, but rather that, business should not incur irrecoverable value added tax."

We therefore submit that it is appropriate that the Australian GST system allows non-residents the right to recover GST incurred on its business inputs.

(b) Refunds of European VAT

Two features of the EU VAT system are very high rates compared to Australia (the general rate of VAT is between 15% and 25% in all EU countries) and a non-residents entitlement to a refund of EU VAT.

Pursuant to the 13th Council Directive 86/560/EEC of 17 November 1986[4] ("the 13th Directive"), European Union ("EU") Member States shall refund to any taxable person not established in the territory of the EU, any VAT charged to him:

(a) in the territory of a Member State by other taxable persons, in relation to the supply of services and movable property and

[4] 13th Council Directive 86/560/EEC of 17 November 1986 on the harmonisation of the laws of the Member States relating to turnover tax arrangements for the refund of value-added tax to taxable persons not established in Community territory

(b) in relation to the importation of goods into the territory of the Member State.

However, member States may make such refunds conditional upon an applicant's country providing "comparable advantages" in relation to VAT, GST and other turnover taxes.

Currently, Germany, Italy, Spain and Switzerland do not accept that the Australian GST system provides comparable advantages (i.e. reciprocity) their VAT system in relation to non-resident refunds. As more countries join the EU there is a risk that other EU countries may adopt the same view as Germany in relation to this matter.

The EU approach

The refund scheme operating in the EU generally relies on the GST or VAT registration system in a non- EU country to determine the eligibility of an entity to claim direct refunds of VAT.

Once a non-EU resident applicant has demonstrated that they are registered for GST purposes in their resident country, the EU scheme allows those businesses to reclaim VAT from the country in which the VAT was incurred (subject to certain restrictions) where the following general requirements are satisfied;

- The entity is not registered, liable or eligible to be registered for VAT in an EU country.
- The entity has no place of business or other residence in the EU; and
- The entity does not make any supplies in the relevant EU country.

Most EU countries do not enforce reciprocity in relation to non-resident refunds. Further, entities that are registered for VAT purposes in an EU country (but not the country in which they have incurred VAT) have a VAT refund entitlement under the 8th Directive.

We note that the 13th Directive refund scheme does not apply if the relevant business is registered in an EU country. To be registered in an EU country, the relevant business must be making "taxable transactions" in that country. This is in contrast to the Australian approach where registration is available to any business, whether or not they make supplies in Australia. Consequently, a large proportion of registrations in Australia comprise entities that incur GST on goods and services acquired in Australia, but do not make any taxable supplies in Australia.

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We submit the registration and compliance obligations associated with GST registration makes the Australian system inefficient and discourages many other non-residents from recovering Australian GST. Furthermore, the Australian approach is, in our view, more expensive to administer and arguably exposes the Australian GST system to a greater risk of fraud. This will be discussed in detail at Question 5.13.

(c) Response to the Discussion Paper

The following comments are our response to the specific questions raised by the Board of Taxation in relation to a direct refund mechanism.

Question 5.13 – Should the GST law provide a direct refund mechanism? If so, under what circumstances?

The Australian approach to non-resident refunds has the following implications:

- the international competitiveness of Australian business is reduced because some key EU trading partners do not accept that the Australian GST system reciprocates their own in relation to non-resident refunds. This is a direct and an unnecessary cost for Australian businesses seeking to trade internationally;
- in many instances, non-resident business do not register and recover Australian GST incurred on their business inputs because the compliance costs associated with registering for, and complying with, the Australian GST system is greater than the benefits of GST recovery. Consequently, many non-resident's business inputs are subject to Australian GST;
- compliance costs for non-resident businesses that do register for the sole purpose of recovering Australian GST are considerably higher than would be the case if Australian adopted a direct refund mechanism;
- administration costs for the Australian Taxation Office ("ATO") are also considerably higher than is necessary as that ATO must manage a system that does not take into account the VAT registration process in an applicants home country and unnecessarily requires all registrants to lodge regular returns; and

- Arguably the Australian approach creates a greater risk of fraud than a direct refund model.

We submit that the introduction of a direct refund mechanism, pursuant to which non-resident businesses that do not make taxable supplies in Australia (and are not registered for GST in Australia) will be entitled to a refund of Australian GST incurred in the course of their business, will enhance the international competitiveness of Australian businesses, significantly reduce compliance and administration costs and further promote the integrity of the Australian GST law.

A direct refund model can provide a refund of GST in the same circumstances as those available under the registration model currently in place. A critical element of a direct refund model is an improved identity process (in other words a "refund registration" process) that more appropriately addresses circumstances relevant to non-resident applicants.

The notable benefits of a direct refund system are outlined in our comments below.

International Competitiveness

In our view, the Australian GST system should, to the extent possible (and appropriate), be compatible with similar taxation systems operated by our major trading partners. The Australian GST system currently restricts the ability for many non-resident businesses to trade with and within Australia by unnecessarily and inappropriately increasing the cost of doing so. This, inadvertently perhaps, creates an environment for the inefficient international movements of goods and services and places Australia at a disadvantage in the global market. An example of this is demonstrated by the German Government's approach to the application of its non-resident businesses VAT refund scheme.

Currently, the Germany VAT law provides for a direct refund regime for non-resident entities incurring VAT on the acquisition of goods and services in Germany. However, the German Government does not extend the benefits of this regime to Australian businesses because, in their view, the Australian GST does not provide reciprocal entitlements to German businesses.

While we may not agree with the view adopted by the German Government in this regard, it is notable that 10 years after the introduction of GST in Australia, the German Government still does not recognise that both countries VAT and GST systems are reciprocal in relation to non-resident businesses refund rights.

The situation with Germany is not isolated. Spain, Italy and Switzerland share Germany's view. As the EU expands, there is a risk that more countries will align to the German view.

Cost to Australian Business of the current system

It is difficult to quantify the cost to Australian businesses of the German Government's decision, given that Australian businesses are not applying for VAT refunds in Germany. However, we estimate that the amount of unclaimed German VAT by Australian businesses could range from A$40 million to A$80 million per annum. We are happy to provide the basis of this estimate, if necessary.

We also note that if Germany changes its view and accepts that the Australian GST system provides reciprocal GST refund rights to German businesses, other European countries that currently share Germany's view in relation to this matter (i.e. Spain, Italy and Switzerland), may change their view as well. If this eventuates the potential European VAT refundable to Australian businesses would be considerably greater than the high level estimate of German VAT refunds.

Currently, the price of Australian goods and services supplied to consumers in Germany (and elsewhere) by Australian businesses that are not registered for VAT purposes in Germany (Spain, Switzerland and Italy) contains embedded and non-recoverable VAT. We submit that this outcome makes Australian businesses less internationally competitive. This is so only because of the non-resident refund regime currently adopted in Australia.

We submit a direct refund mechanism that relieves foreign businesses of the Australian GST impost on their business inputs should lead to all EU countries and Switzerland allowing Australian businesses similar refund rights. This will enhance the international competitiveness of Australian business.

Business compliance costs and neutrality

If a non-resident entity wishes to recover Australian GST incurred in the course of their business, they must register for GST purposes and comply with the same obligations incumbent upon a resident entity. That is, the non-resident must complete a lengthy registration application form that is inherently difficult, and in some cases, impossible for non-residents to complete. Once registered, the non-resident must lodge at least quarterly BAS, often through local agents (with associated costs) and be

subject to regular ATO compliance checks. This is inefficient and a considerable cost for non-residents to comply with our GST law.

Registration (identity) cost

The primary reason for a thorough registration process is to confirm the bona fides of the applicant. However, the current GST registration process is designed for Australian resident businesses. Australian businesses and key Directors are registered for a series of taxes with the ATO. GST registration is one of many and as such does not pose a burden on such entities. However, for a non-resident entity, GST registration is its only interaction with the Australian taxation system.

We submit that it is manifestly unfair to impose onerous (and, in some cases, potentially dangerous) identity requirements on Directors of non-resident companies, without having regard to the businesses VAT or sales and use tax registration status of the entity in their country of residence. Many of the requirements Australia imposes on non-resident businesses (and their Directors) have already been undertaken in their home country. We believe that Australia can apply an appropriate level of identity checks and balances without unnecessary compliance costs for non-resident applicants by having due regard to their interaction with their local tax authorities. This should particularly be the case where the home country of non-resident applicant is a close trading partner of Australia with modern tax system and administration, a fellow OECD member or have double tax or information sharing agreements with Australia.

Recurring costs

Once a non-resident is registered (and many do not progress through this process), they must lodge monthly or quarterly BAS. Many of these are "Nil BAS" or BAS lodged for relatively small refund claims. This is clearly inefficient for both the non-resident and the ATO who must process these BAS and administer the system that monitors the lodgement process.

These BAS are often prepared and lodged by local tax agents. Even for "Nil BAS" the tax agent costs can be prohibitive and should be unnecessary.

A direct refund model should not require any obligation to lodge further refund claims.

One off GST exposure

Non-residents often that incur a one off series of costs because, for example, they attend a conference or exhibit at an Australian trade show will often not register to recover their Australian GST cost because of the onerous registration requirements and their ongoing obligation to comply with the Australian GST law.

A direct refund model with streamlined identity tests will enable more non-resident businesses to recover Australian GST. This will enhance the integrity of the GST system by more thoroughly relieving GST on the business inputs of non-residents and ensuring Australian consumers are not subject to double taxation. An efficient non-resident refund system also makes Australia a more desirable destination for businesses to promote their products.

Administration costs

The current system is expensive to administer. Currently there are more than 2.6 million entities registered for GST purposes. A significant number of these are non-residents seeking refunds of Australian GST. The nature of the system is such that the ATO administers non-resident registration applications, BAS lodgement and BAS integrity checks, initially at least, as though these registrants are little or no different from resident applicants.

We have discussed the registration difficulties for non-resident businesses above, however, the ATO must administer this arrangement. This often requires considerable interaction with non-residents (often difficult given time differences and their understandable lack of knowledge of our tax system). This is time consuming, expensive and ultimately inefficient.

A direct refund mechanism that sits along side, but separate from, the day to day operation of the GST system should allow the ATO to more easily identify non-residents seeking refunds of Australian GST and to establish a compliance program specific to them. Such a system should minimise the risk of fraud as we would expect all claims would be reviewed and processed by a dedicated specialist area of the ATO. Monitoring refund trend, identifying fraud risks and tailored compliance programs should be considerably easier to implement.

Furthermore, a direct refund mechanism should mean fewer entities would be required to lodge BAS. This must reduce administration costs as the ATO will only be required to interact with non-residents when they make a refund claim rather than ensuring that they lodge a monthly or quarterly BAS (even if it is "Nil".

In our view, the EU model is an example of an efficient refund regime that does not expose the relevant tax authorities to a greater level of fraud than that experienced in Australia. In fact, we understand fraud in the EU is largely based around the VAT registration process and transactions taking place in the EU rather than 13th Directive refund claims.

Question 5.14 – Is a direct refund system necessary if the number of non-residents in the GST system is reduced under the options in this paper?

We submit that a direct refund system is still necessary even though the options expressed in the Discussion Paper may serve to reduce the number of non-residents incurring Australian GST in the course of their business. We note that the Option 3.1 in the discussion paper will only apply to supplies of services and intangibles. It will not apply to supplies of goods or real property. Furthermore, it is unlikely that GST-free status will extend to a supply of services or intangibles to a non-resident that is "in Australia in relation to the supply".

In our view, it is likely the following supplies to non-resident businesses will still be taxable, notwithstanding any law changes that may eventuate as a consequence of this review:

- Conferences;
- Trade show space;
- Ancillary trade show costs, including furniture, exhibition stand costs and other associated goods;
- Training services; and
- Accommodation, meals and car hire.

Even if the incidence of GST applying on transactions to non-residents reduces as a consequence of this review, GST is still likely to apply to the above supplies. We contend that a direct refund mechanism is still necessary for the reasons outlined in our response to question 5.13 above.

Question 5.15 – Should a direct refund system be based on reciprocal agreements with other countries as is the case in some European Countries?

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The Australian GST is designed to tax final private consumption in Australia. For the purposes expressed earlier in this submission[5], we consider that basing the system on a reciprocal agreement with other countries would be contrary to the nature of the scheme of a GST or VAT system.

We note that only a few countries (even in the EU) demand reciprocity as a requirement for a non-resident refund. By way of example, the United Kingdom ("UK") does not require reciprocity unless a country has a GST/VAT refund system and UK companies are specifically excluded from accessing refunds under that system. GST or VAT registered businesses in countries that do not have a non-resident refund system (such as New Zealand) are still entitled to a refund of UK VAT.

Furthermore, we submit that to base a direct refund system on reciprocal agreements with other countries would add an additional layer of complexity to the Australian system as the Treasury or ATO would need to determine which countries indirect tax systems are reciprocal to Australia's. This is not necessarily an easy task.

Question 5.16 – Should there be a more restrictive time limit for non-resident refund claims (as is the case in some foreign jurisdictions)? If so, how long should this period be?

We submit that time limits on refund claims of non-residents should remain in line with the current rules under the *Taxation Administration Act 1953* ("the TAA"). Most countries with non-resident refund provisions in their GST or VAT law generally treat resident and non-resident entities the same. Therefore, a refund time limit that applies to a resident equally applies to a non-resident.

In any case, however, we consider that if a restrictive time limit for non-resident refund claims is implemented, that the associated audit period available to the ATO should also be restricted.

Question 5.17 – Should it be restricted to certain supplies as in some foreign jurisdictions?

We consider that there is no rationale available to support restriction of refunds to certain supplies other than those that already apply to resident entities. In the EU, any restrictions that apply to resident entities also apply to non-residents (no more, no less).

The rationale for allowing non-resident businesses a refund of Australian GST is set out above. That is, the Australian GST is not a tax on business inputs, rather, it is a tax on final private consumption in

[5] Refer part (a) of the submission – the scheme of the GST law

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Australia. To give effect to this design principle, and to the extent businesses are denied refunds or credits of GST for certain types of expenditure, we submit that resident and non-resident businesses should be subject to the same restrictions. Furthermore, we consider that minimal disruption to the GST system will be created by ensuring consistency of refund or credit entitlements.

In doing so, the neutrality of the Australian GST system will also be protected as non-resident entities will not be disadvantaged by reason of the fact that they do not have a presence in Australia.

Conclusion

We submit that the Board of Taxation and the Australian Government look favourably on this submission. In our view there are compelling reasons to adopt a direct refund mechanism, including the improved international competitiveness of Australian businesses and a significant reduction in compliance costs for business and administration costs for the ATO.

We trust the above is of assistance in outlining VATit's position as a stakeholder in this matter. We are happy to discuss the content of this submission. Please do not hesitate to contact me if you so require on 8266 5229.

Yours sincerely

Denis McCarthy
Executive Director
Tax and Legal Services