KPMG

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Regular commentary from our experts on topical tax issues

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Australia is to put pressure on multi-nationals selling to Australians through tax havens, and will level the GST playing field on cross-border digital products and services.

Australian Government targets sales to Australia

Snapshot

Ahead of today's Federal Budget, the Australian Treasurer has announced two measures to *"strengthen Australia's tax system"*. The first will introduce a new anti-avoidance rule targeted at companies doing business in Australia but without a taxable presence. The second will apply Australian GST to digital services and products imported from offshore.

These proposals need to be considered in context. Australia is staring down the barrel of significant Government budget deficits, there is an ongoing Senate Committee inquiry into multi-national tax avoidance, and changes to GST are difficult politically because the Federal Government needs consensus from the Australian State Governments before any changes are made.

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What's the problem?

No GST on imported digital goods and service

The current Australian GST does not apply when a non-resident supplier provides digital products and services to Australian customers. This means the playing field is not level for Australian suppliers or consumers.

Avoiding an Australian "permanent establishment"

Under current Double Taxation Agreements ("DTAs"), a foreign company is taxable on business profits made from Australia, but only if the company has a taxable presence (technically speaking, a "permanent establishment") in Australia and the profits can be attributed to that permanent establishment. The concern is that companies have been able to make significant sales in Australia without creating a permanent establishment so no Australian income tax is payable. This is often the case even though related Australian companies provide pre and after sales support in relation to much of the Australian sales.

The OECD / G20 focus on Base Erosion and Profit Shifting

The types of operating structures that are being targeted have been the focus of the OECD (and G20's) Base Erosion and Profit Shifting ("BEPS") project. In some cases they result in little or no tax being paid anywhere.

It is important to note though that it is the advent of technology that often enables tax and economically efficient operating structures. The challenge for Governments and Revenue Authorities is that tax law, including DTAs, are based on old business models where selling goods or services into a particular country or region required a physical presence. Today's reality is that technology enables business to be done without borders and without a physical presence. A company has a choice on where to locate its physical presence. Countries are aggressively competing to attract this presence due to the employment, tax and other economic benefits it generates. They will continue to compete.

The OECD is also considering the issue of GST on cross-border supplies. Its BEPS recommendations are yet to be finalised, with the final recommendations due later this year.

What's proposed?

GST on digital imports

The Australian Government's media release provides little detail on the proposed measure. However, it is clear that a non-resident supplier of digital goods or services will be required to register for Australian GST, charge it to Australian customers, and pay it to the Australian Tax Office ("ATO").

Permanent establishment anti-avoidance rule

The key requirements of the proposed permanent establishment anti-avoidance rule are:

- The foreign company must have global group revenues of more than A$1 billion and sell goods or services to Australian customers;
- The revenue from its Australian sales must be booked offshore but with Australian customers dealing mainly with Australian-based employees;
- The Australian sales revenue must be booked in a tax haven (not defined); and
- The principal purpose of the scheme must be to avoid a taxable presence in Australia.

If this rule applies, Australian income tax will apply to the Australian profits and presumably withholding tax will apply to any royalties and interest paid if they are attributable to the deemed Australian permanent establishment. The foreign

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company will also be charged interest and be subject to penalties if the tax is not paid.

Who should take note?

The permanent establishment anti-avoidance proposal is unlikely to impact many in New Zealand. However, it is worthy of note as a further example of the global trend towards, and of potential problems with, a unilateral approach.

The New Zealand Government has signalled its support for the OECD BEPS project. It has yet to confirm which BEPS recommendations will be implemented. A similar legislative change may not be required if the BEPS project delivers a multi-lateral solution.

The GST proposal will affect New Zealand businesses supplying digital products and services to Australia. The New Zealand Government is also focused on the same issue, for the same reasons. We consider than an equivalent change is likely for New Zealand.

Our view

A multi-lateral response to permanent establishment structures is better

The United Kingdom introduced a Diverted Profits Tax to counter similar operating structures. It was introduced as a separate tax to ensure that the UK's existing DTAs did not apply to prevent the UK taxing the income. It appears that Australia has instead chosen to amend its anti-avoidance rule. It considers that its DTAs are subject to its anti-avoidance rule so that this new permanent establishment anti-avoidance rule does not offend its existing agreements.

Unilateral action like this risks creating double taxation. There is no guarantee that other countries will allow a credit for tax collected under the new Australian rule. The message to multi-nationals is clear – if double tax results from your current operating models, then change your model.

If the OECD produces a consensus on re-defining a permanent establishment, the double taxation problem is less likely to arise. This is KPMG's preferred approach to resolving what is a very complex international tax issue.

There is the potential for others to follow suit

The Australian Treasurer noted that Australia's permanent establishment avoidance solution was raised with the OECD and G20 countries. A number of G20 countries have expressed interest in the proposed rule.

Despite our support for a multi-lateral solution, a proliferation of similar anti-avoidance rules is unlikely to promote certainty. It is more likely to create double taxation as countries seek to apply their own avoidance rules to their own advantage. If successfully applied by other countries, it is also likely to reduce the home country's tax take as other countries tax the home country's multi-nationals. This may be a particular problem for Australia.

Taxable presence – a definitional problem

The proposed rule requires a principal purpose of avoiding a taxable presence in Australia. The countries most often used are regional management hubs. There are employees and other resources present in those jurisdictions. The likely response is that it is regional requirements which are the primary purpose of the structure. The application of the new anti-avoidance rule is unlikely to be straightforward.

The foreign company's position may be supported by the country hosting these functions due to the economic benefits it gains. The fact, however, that little or no tax is paid on the income in question is likely to mean such justifications, to Revenue Authorities, will fall on deaf ears.

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Will additional tax be collected?

The Australian Treasurer has not released any costings on the anti-avoidance proposal. As always, the devil will be in the detail.

GST

We have previously noted the global trend to applying GST to cross-border services. The Minister for Revenue has recently confirmed that Officials' findings are being considered. The New Zealand Government is likely to follow the Australian announcement with its own.

Conceptually, GST is a tax on consumption by the final consumer, not transactions. There are a number of problems to solve, including:

- Business-to-business supplies where GST is able to be claimed so there is no net GST collected. New Zealand does not generally treat such supplies differently from other supplies.
- The potential for double taxation if the supplier's home country does not, in our language, "zero-rate" the export to New Zealand. Not all GST/VAT regimes treat supplies to non-residents in the same way as New Zealand. If GST/VAT is charged in the supplier's country, there will be double taxation.
- While many foreign businesses will be willing to comply, it will be difficult to ensure compliance by the rest.

The Australian announcement leaves the Australian low-value imported goods threshold unchanged at A$1,000. This appears to be the subject of on-going discussions between the Federal Government and the Australian States.

For those supplying digital products and services to Australia, a major problem is likely to be the relative difficulty of registering for GST. We are used to quick and easy registration. Those who have registered for GST in Australia will know that the Australia registration process can be both protracted and painful. We hope that Australia will rationalise its GST registration process as a result of changing its rules.

Actions

If you would like to discuss how the Australian proposals will affect your business please contact your regular KPMG advisor.

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