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Review of the Application of GST to Cross-Border Transactions
The Board of Taxation
c/- The Treasury
Langton Crescent
PARKES ACT 2600

Our ref 8937705_1

Contact Lachlan Wolfers 02 9335 7515

9 September 2009

Dear Sir / Madam

Submission on behalf of professional services firms

We welcome the opportunity to provide this submission in response to the Board of Taxation's Review of the application of GST to cross-border transactions. We confirm that the Board has granted a short extension of time for the lodgement of this submission.

This submission has been prepared by KPMG on behalf of Allens Arthur Robinson, Arnold Bloch Leibler, Clayton Utz, Gadens Lawyers, Greenwoods & Freehills Pty Ltd, Mallesons Stephen Jaques, Minter Ellison and KPMG. These firms represent many of the largest professional services firms in Australia operating in the legal and accounting professions. This submission solely focuses upon the GST issues affecting these professional services firms in their capacity as taxpayers, rather than upon the issues affecting their clients.

Without wishing to be too prescriptive, each of the professional services firms which are signatories to this submission would:

- regularly be engaged by non-resident clients, pursuant to an engagement letter with the non-resident;
- ordinarily provide their services within Australia; and
- provide their services to non-resident recipients who, except for providers of financial supplies, would be eligible for a full input tax credit (if they were registered or required to be registered for GST).

The primary GST compliance issue which this submission seeks to draw to the Board's attention is the potential application of subsection 38-190(3) of the GST Act to the supply of professional services. In particular, as a matter of process, most professional services firms will determine the GST-free status (or otherwise) of the nature of the intended services at the time an engagement letter is issued to the client. Generally speaking, the client's details will be flagged

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in a firm's billing system as being either 'GST-free' or 'taxable' when the engagement is set up. The determination of the status of the intended services as 'GST-free' or 'taxable' is typically made based on factors such as:

- the identity of the client (i.e. whether the client is or is not a resident of Australia);
- the likely extent of any interaction between the professional services firm and any of the client's representatives in Australia (e.g. if the client is a foreign multinational, the extent of interaction with the local Australian office);
- the nature of the professional services being provided (e.g. whether there is any supply which will be directly connected with real property in Australia); and
- the GST registration status of the non-resident.

On-going review of the GST status of the services being supplied after the engagement process is established is time consuming and difficult.

The complexity in this area is demonstrated by the significant number of examples in GST Ruling 2005/6 which relate to the supply of either legal or accounting services.

The problem

Where professional services firms encounter difficulties is with the potential application of subsection 38-190(3) of the GST Act. That is, when an engagement is entered into with a non-resident client, and the services are physically provided to another entity in Australia. Some common examples where this can arise are:

- An engagement is entered into with a non-resident fund manager which requires the professional services firm to assist in establishing an Australian resident fund;
- An engagement is entered into with a foreign company to provide legal services in relation to the sale of its Australian subsidiary. Where the engagement involves a high level of interaction with the Australian subsidiary, subsection 38-190(3) may apply;
- An engagement with a foreign multinational to register trade marks held by its Australian subsidiary in Australia. While in Example 4 in GST Ruling 2005/6 the ATO concludes that the supply is both 'made' and 'provided' to the non-resident, this conclusion rests upon the lack of involvement or interaction with the Australian subsidiary, which may not be reflected in practice.

There are at least three common responses when these issues arise.

First, the non-resident client can register for GST purposes so as to claim an input tax credit. This is a time consuming and costly process. Not only are the proof of identity procedures for non-resident directors cumbersome, but the non-resident may also need to set up an Australian bank account to obtain a refund, and there will invariably be verification checks undertaken by the ATO before any refund is paid. Furthermore, many non-residents without a permanent establishment in Australia are loath to register for GST purposes.

Second, the professional services firm may be asked by the non-resident client to put in place new engagement letters and tax invoices so as to endeavour to enable the Australian resident entity to be the 'recipient' of the supply. This is intended to facilitate the Australian resident entity claiming an input tax credit. It can put the professional services firms in a difficult position.

Third, the professional services firm may levy GST on the supply of its services to the non-resident client, and a leakage of GST occurs. Commercially, this makes GST a real cost to business, which is inconsistent with one of the fundamental design features of Australia's GST regime.

The solution

The professional services firms favour the option put forward by the Board which limits section 38-190(3) of the GST Act to B2C transactions. That is effectively along the lines of the New Zealand model referred to in the Board's paper.

If a supply of services is GST-free where the services are made to a non-resident, but provided to an Australian resident which is registered or required to be registered for GST purposes, then this should overcome many of the difficult GST compliance issues referred to earlier in this submission.

The Board's paper raises the question as to how the Australian supplier will be able to identify situations where it provides a supply to a registered Australian business. In that regard, we make the following brief comments:

1 While there will no doubt be some situations where uncertainty arises, the question the Board asks is no less complex than the position which currently prevails under the law in any event. That is, under item 2 of subsection 38-190(1) the Australian supplier must know whether the non-resident client is "in Australia", whether they are acquiring the services in carrying on their enterprise, whether they are registered or required to be registered for GST purposes, and for the purposes of subsection (3), whether the services are provided to another entity in Australia. To limit subsection (3) in the way proposed imposes a less onerous test, whilst also overcoming the subsequent compliance difficulties which arise if the services are not GST-free.

2 The professional services firms favour the New Zealand “reasonably foreseeable” test. That is, the firms determine whether it is “reasonably foreseeable” that the services will be provided to an entity “which is, or is likely to be, registered or required to be registered” for GST. The significance of this slightly reformulated test is that it is quite common for professional services firms to be engaged by a non-resident entity for the provision of their services, and part-way through the transaction, or even upon conclusion of the transaction, they will be asked to “provide” their services to a resident. Furthermore, the resident may be a newly established entity which is not registered for GST purposes at the commencement of the engagement, but is registered later. The use of the term “is likely to be” is consistent with the approach to forecasting future events in other parts of the GST Act – for example, in the projected GST turnover test in section 188-20.

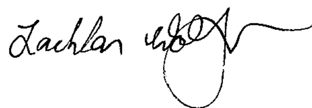
We acknowledge that if this change is enacted, subsection 38-190(3) will still apply to engagements with non-residents to provide services to Australian resident private consumers. This clearly raises different policy considerations, and in any event, is not likely to represent a significant part of the client base of the professional services firms represented in this submission.

We also note that if the professional services firms truly encounter difficulties in ascertaining the status of their supplies, it would be open to them to enter into an agreement with the client to apply the “option to tax” approach referred to in Chapter 2.3 of Treasury’s Discussion Paper on the legal framework for the administration of the GST.

For the sake of completeness, the professional services firms also support measures to allow non-residents to use a “tax representative” in Australia (to claim any input tax credits), or a direct refund scheme for non-residents. However, any such measures will only be effective in practise if the ease with which non-residents can lodge such refund claims and have them paid into bank accounts (whether Australian or foreign), is significantly improved.

The professional services firms represented in this submission would be prepared to meet with members of the Board to discuss any aspect of this submission or the Board’s report more generally. If you would like to discuss this further, please do not hesitate to contact the writer.

Yours sincerely



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