

Business to consumer

Indirect taxes update

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Business to consumer – Indirect taxes update

Welcome to the PwC Business to Consumer (B2C) newsletter, which brings you the most up to date commentary on indirect taxes relevant to the B2C sector.

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Qantas Full Federal Court Decision - The meaning of 'supply' under GST law

In *Qantas Airways Limited v Commissioner of Taxation* [2011] FCAFC 113, the Full Federal Court unanimously held that GST was not payable by Qantas when a person booked and paid for domestic air travel but subsequently cancelled the booking, or did not turn up for the flight, and did not receive a refund.

The Commissioner had previously succeeded in the Administrative Appeals Tribunal (AAT) and Qantas appealed directly to the Full Court. The Commissioner contended that there was a taxable supply when payment of the fare was made, and that what the passenger received for payment of the fare was the reservation.

The Court disagreed, however, finding that what each customer pays for is carriage by air, describing this as 'the essence, and sole purpose of the transaction'. The actual travel

was the relevant supply, and if it did not occur, there was no taxable supply.

In making its decision, the Court also reasoned that the intended supply constituted by the making of the contract (i.e. air travel) should not be treated as being converted into another taxable supply upon cancellation of the contract, provided there was no specific provision in the statute mandating this.

The Tribunal had erred in looking for other 'acts' satisfying the definition of supply (such as the booking), because even if the identified 'acts' were capable of meeting the definition of supply, they were not 'acts' for which the consideration was provided and hence there was no taxable supply for GST purposes.

The Court's decision contradicts the Commissioner's current views expressed in Goods and Services Tax Ruling 2009/3 on Cancellation fees, which provides that most fees charged upon the cancellation of an intended supply will represent consideration for a taxable supply, either for the intended supply or for a different supply, being a supply of facilitation, cancellation or release.

The Commissioner has until the end of September to seek leave to appeal to the High Court.

Implications

This is a landmark decision on the meaning of 'supply' under GST law, and has implications for a wide range of taxpayers, particularly in the business to consumer sector.

On the basis of the decision, businesses should now review the GST treatment of all payments received by them for an intended purpose which does not take place or which fails.

This could include a wide range of payments received in respect of cancellations and forfeitures, together with prepayments including some deposits. In addition to the obvious application to travel bookings, other areas may include payments received in relation to bookings for hotel stays, events, entertainment and attractions. Security deposits that, generally speaking, do not exceed ten per cent and are non-refundable, will not be affected as these supplies are dealt with by a specific Division of the GST Act.

Businesses should determine any retrospective impact of this decision and, if they haven't already done so, consider protecting their position with respect to prior periods. In this case, section 105-65 in Schedule 1 to the Taxation Administration Act 1953 (TAA) will generally need to be considered and the payment of GST refunds will be subject to the discretion of the Commissioner.

Whilst the Commissioner will likely continue to restrict the payment of GST refunds by reference to section 105-65, we note that the ability for him to rely on this section is constantly evolving. In this regard, the Commissioner has been unsuccessful in a number of instances to date when defending his decisions in respect of this discretion in the Courts, as evidenced in the recent GST decisions including the present case in *Qantas, Luxottica Retail Australia Pty Ltd* [2010] AATA 22, *International All Sports* [2011] FCA 824 and *KAP Motors Pty Ltd* [2008] FCA 159.

Taxpayers should also review their strategy going forward in relation to relevant payments received and consider whether they should continue to pay GST on those amounts.

Indirect Tax implications of the Productivity Commission's report on the Retail Industry

On 4 August 2011, the Productivity Commission released a draft report on its findings and recommendations in relation to the implications of globalisation for the Australian retail industry, a key part of which focused on the appropriateness of the current indirect tax arrangements.

Key findings relating to indirect taxes

- Many of the submissions considered that the low value threshold (LVT) of \$1,000 for exemption from GST and duty on imports undermines the competitive position of Australian retailers in comparison to their overseas online counterparts.
- The Commission is of the view that the current LVT of \$1,000 is not the main factor affecting the international competitiveness of Australian retailers, and suggests that a number of other factors such as the difference in pricing of goods purchased online and the availability of a wider range of products available online, are of significance. Australian retailers also operate under several Australian regulatory regimes, including complex planning and zoning regulations (which are often exclusionary), trading hours regulations, and constraints on workplace flexibility.
- On the other hand, some protection is awarded by the cost of freight, the geographic location and the perceived security some consumers see in purchasing from an Australian supplier.
- The Commission recognises that there are strong in-principle grounds for lowering the LVT significantly to ensure tax neutrality, but recommends that the Government should not proceed with lowering the LVT

until the tax revenue collected exceeds the full cost of collecting it.

- The Commission also suggests that the current processes for collecting taxes and duties at the border are not efficient, as the costs of collection increase significantly upon the increased volume of parcels resulting from a lower LVT.
- On this basis, the Commission recommends that the Government sets up a task force to investigate new approaches to processing of low value imported parcels with a view to significant improvements and efficiencies in handling.

Options for reform

The Commission has proposed the following options for reforming the current system:

- The collection of customs duty is more burdensome than the collection of GST and yields a quarter of the revenue, as the assessment of customs duty requires a higher level of information to be collected. Accordingly, consideration should be given to setting a separate, higher threshold for customs duty than GST.
- Revision and simplification of the current Customs tariff classification for low value imports, e.g. setting a flat rate of duty for these.
- Implementation of a simplified electronic solution for the processing of imports to allow easier and more automated identification of the tariff classification and statistical code for goods.
- Implementation of an electronic system (being developed by the Universal Postal Union) to replace the current manual process for identifying the value of parcels and entering the information into the customs systems to

facilitate the collection of tax on low value imports and achieve improvements in efficiency.

- Shifting the collection of revenue from the carriers and Customs to Australia Post, with Australia Post being allowed to collect a fee to recover its costs.
- Efficiencies could be created by changing the point at which GST is collected, for example, to online retailers, which would involve the retailer identifying and informing the customer up front of the taxes applicable to their purchase and collecting these. Alternatively, the collection could be shifted to the credit and debit cards issuers, although the current payment processing system does not appear to facilitate this.

What should retailers do now?

The Productivity Commission's draft report makes it clear that no immediate changes can be expected in the processing of imports which would allow the LVT to be lowered or tax neutrality to be achieved in other ways. The increasing preference by consumers to use online channels for retail purchases, for reasons beyond any indirect taxes savings, presents an opportunity for retailers to capitalise on opportunities that online retailing may offer.

It is therefore important that retailers consider their options in light of the prevalent environment in order to stay competitive.

Retailers developing their strategy with respect to setting up or improving an existing an online channel should assess the potential impact of future reform. Retailers should aim to structure their supply chains and online presence to optimise their position in the future trading environment, to ensure that the structure and systems have sufficient flexibility to deal with the potential future changes outlined above.

In this regard, as part of developing and structuring an online

channel, retailers should take into account key considerations, including:

- supply chain
- payment systems and protocols, allowing flexibility for future changes
- dealing with returns
- terms and conditions of sale including incoterms
- marketing, and
- pricing.

As there is a broad range of issues to consider, we encourage retailers to treat their online strategy as a matter of priority in order to protect their competitive position in the changing commercial landscape.

Changes to the Fuel Tax Credit Scheme

Fuel tax credits to include alternative fuels

As reported in our April 2011 edition, various legislative changes will be implemented to bring alternative fuels into the fuel tax regime. The Alternative Fuels (Taxation of Alternative Fuels Legislation Amendment Act 2011) Act has been introduced into Parliament and is expected to come into effect on 1 December 2011. The Act brings LPG, biodiesel, ethanol and other alternative fuels fully into the excise regime. As a part of this amendment, Fuel Tax Credits will also be available on the use of these fuels, as with diesel and ULP insofar as they are used for eligible activities.

Carbon Pricing scheme and fuel tax credits

The legislation to give effect to the Government's carbon pricing mechanism was introduced into Parliament on 13

September 2011, and is expected to be enacted before the end of the calendar year.

As a result of these legislative amendments, from 1 July 2012, the fuel tax credits available to businesses will be reduced for liquid (i.e. diesel and petrol) and gaseous (LPG, LNG and CNG) transport fuels acquired after that date by the equivalent of the carbon price on the fuel.

Implications

We recommend that businesses review their fuel tax credit processes and entitlements in light of the new Alternative Fuels legislation and consider their energy strategy in light of these changes. Taxpayers should:

- consider whether the current processes and systems for calculating fuel tax credits capture the now wider field of eligible fuels under the new fuel tax credit regime
- review the existing fuel tax credit methodology to take into account any changes in the fuel tax credit rates and eligible activities
- ensure that decisions around capital expenditure properly factor in the fuel tax credit changes
- engage with sustainability stakeholders in the business to factor in the fuel tax credit changes, and
- undertake a review of supply contracts to assess the impact on the price due to the new changes.

The changes to the fuel tax credit regime and the introduction of the carbon pricing scheme should be major considerations for the business sector to ensure that sustainable business practices are maintained and an environmental strategy implemented that gives a tax efficient outcome.

Case update

International All Sports Limited v Commissioner of Taxation

In the case of *International All Sports Limited v Commissioner of Taxation* [2011] FCA 824 ("Sportsbet"), the Federal Court of Australia found for the taxpayer, holding that the appellant's GST 'net amount' should be re-assessed on the basis that the meaning of 'monetary prizes' contained in section 126-10 of the A New Tax System (Goods and Services Tax) Act 1999 ("the GST Act") includes those prizes given to non-residents of Australia.

This is despite the fact that related supplies to non-residents of Australia (i.e. amounts wagered by non-residents) are GST-free and do not fall within the definition of "gambling supplies" contained in section 126-35 of the GST Act.

Sportsbet carried on a bookmaking business, providing wagering opportunities to customers both domestically and overseas. It argued that, under the correct interpretation of the calculation provisions contained in Division 126, it was entitled to refunds of GST net amounts overpaid on its gambling and betting activities. This was on the basis that, on the literal interpretation of section 126-10, and specifically, of the definition of 'total monetary prizes', all prizes paid out which relate to the outcome of a 'gambling event' should be included in the calculation of the 'global GST amount' regardless of whether they relate to taxable wagers.

This resulted in all wagers, rather than just wagers from domestic customers, being included in the calculation of 'total monetary prizes', which subsequently reduced Sportsbet's net amount of GST by a significant amount.

Decision

The Federal Court found that, if Parliament had intended that only those monetary prizes related to taxable wagers be included in the formula for the calculation of a global GST amount, the definition of total monetary prizes would have been linked with the term 'gambling supply' (which is a taxable supply by definition) rather than a 'gambling event'.

The Court also considered whether section 105-65 in Schedule 1 to the TAA applied to prevent the Commissioner from being obliged to refund the GST overpaid to Sportsbet. The Court found that section 105-65 would not apply as the overpayments did not arise as a result of the 'supplies being treated as taxable supplies to any extent'. In the circumstances in question, the GST that was overpaid by Sportsbet did not arise from the supply having been treated as a taxable supply. Rather, the overpayment arose as a result of prizes being paid out to non-residents not being subtracted in the calculation of the global GST amount.

Implications

This decision has direct implications for any businesses involved in making supplies relating to gambling that use the global accounting system to calculate their GST. We recommend that impacted businesses review their calculation methodology under Division 126 of the GST Act, specifically with reference to the calculation of monetary prizes paid out which do not relate to taxable wagers.

The decision on the application of section 105-65 of the GST Act is encouraging for taxpayers seeking refunds in a business to consumer scenario and shows the importance of analysing the technical and legal basis of each GST refund claim on its own merits to determine whether this section will apply to give the Commissioner discretion not to pay out GST refunds in a B2C context.

Contacts

To have a deeper discussion about what the above means for your business, please contact your usual PwC contact or:

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