
Adapting to the rise of digital products and services

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In brief

Australia has joined a growing list of countries that have introduced, or will introduce, measures to tax the supply of digital products and services from overseas suppliers to resident consumers. The new measures will apply to supplies made on or after 1 July 2017.

The changes have been incorporated into the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) through measures enacted by *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016* on 5 May 2016.

In detail

Currently, digital products and services that Australian consumers purchase from non-resident suppliers are generally not subject to Goods and Services Tax (GST) as they do not have the relevant connection with Australia. However, Australia has new legislative measures to tax the supply of these products and services with effect from 1 July 2017.

These changes mirror measures already implemented (or about to be implemented) by other countries and replicate the Organisation for Economic Co-operation and Development's (OECD) recommendations in relation to taxing the digital economy. Specifically, non-resident suppliers will be required to register and remit GST on the supply of digital products and services they provide to Australian consumers. The GST law extends the meaning of 'connected with Australia' to include supplies of services and digital products (e.g. software, e-books, music, apps, movie streaming) made to 'Australian consumers'.

Who is an Australian consumer?

The key issue in the application of the new law is determining whether supplies are made to an 'Australian consumer'. An 'Australian consumer' is defined to be an Australian resident who is not registered for GST. Broadly speaking, this involves two elements: a location element (i.e. is the customer Australian?) and a consumer element. In relation to the latter, the new measures will only apply to 'business to consumer' (B2C) transactions, not 'business to business' (B2B) (except that the measures treat a business that is not registered for GST as a consumer).

'Location' element

Where a supplier reasonably believes that the recipient is not an Australian consumer and has satisfied the relevant evidentiary requirements in respect of this, the supplier can treat the supply to this customer as being made to an entity that is not an Australian consumer.

In some cases, a supplier's usual business systems approach in interacting with a customer, for example during an online check-out process, may be sufficient to form a reasonable belief as to whether a customer is Australian. All evidence acquired during this process must be considered by the supplier in their assessment. On balance, it must support the decision made by the supplier as to the consumer's location.

Types of information that will support a conclusion as to the location of a customer may include the recipient's billing address, mailing address, bank details (including the location of the bank) and credit card details (including the location of the credit card issuer).

We understand that the Australian Taxation Office (ATO) will take a similar approach to that used by the European Union and New Zealand where a supplier has a fully automated system and provide a 'safe harbour' for determining the customer's location. That is, a supplier can treat the customer as not Australian, providing they hold at least two forms of non-contradictory information to support this position. However, early views from the ATO indicate that the following approach will also be taken:

Number of pieces of evidence to indicate location	Effect/treatment
Equal pieces of evidence supporting both Australian and not Australian	Supplier can rely on credit card issue details (i.e. location) to determine if they are not Australian
More than two pieces of evidence indicating Australian	Supplier must treat the customer as Australian

This indicates that a supplier will be required to assess all information held, which appears to be particularly onerous.

In addition to using the usual business systems and processes to determine the residency of a consumer, suppliers can also take reasonable steps to collect relevant information. This will depend on the relationship and interaction that a supplier has with their customers.

'Consumer' element

Suppliers may not be subject to the new rules if they reasonably believe that their customer does not fall under the definition of a consumer based on the customer being registered for Australian GST. If the supplier is taking the position that the customer is registered for GST, belief that the customer is not an Australian consumer will only be reasonable if the supplier has obtained the Australian Business Number (ABN) of the customer and a declaration that it is registered for GST. Collection of an ABN alone is not acceptable proof of GST registration. Most suppliers will need to make systems changes to be able to collect this information from customers.

Suppliers that mainly make B2B supplies need to determine whether their supplies are always made to GST registered customers. If yes, then perhaps there is no need to register for GST. The difficulty will be if the supplier is then required to monitor this position going forward. Non-resident suppliers may prefer to implement the necessary changes now.

Electronic distribution platforms

An operator of an electronic distribution platform (EDP) may also be considered as a supplier of digital goods and services. As such, they would be responsible for the GST liability that exists under the new measures. This will occur when the operator controls any of the key elements of the supply such as delivery, charging or terms and conditions.

An EDP and a supplier can agree in writing that the supplier will be responsible for any payment of GST on digital supplies. In this case, a document should be issued to the recipient clearly stating that the supply is being made by the supplier and not the EDP.

It will be necessary for suppliers and EDPs to assess transactions and relationships to understand who is liable and to amend any commercial or legal terms to deal with the GST consequences. Further, EDPs may need to consider how they price any commission fees they charge for providing market place services. For instance, they may need to determine whether commissions should be calculated on a GST-inclusive or exclusive sales basis.

Requirement to register for GST

Non-resident suppliers of digital products and services may now be required to register and remit GST. There is a GST registration threshold of AUD75,000. Suppliers who must register have the choice to apply for full or limited GST registration.

The option of limited registration will be available from 1 April 2017. The following are specific characteristics of the limited registration system:

- only minimal proof of identity documents will be required to register
- registrants will not be required to obtain an ABN
- registrants will not have an entitlement to GST credits, and
- registrants will be required to lodge and pay GST quarterly.

Due to the difficulties noted above in distinguishing B2C and B2B supplies, some suppliers may make the decision to charge all customers GST on the basis that any GST registered business customers will be able to claim the GST input tax credit. However, business customers are only able to claim input tax credits when they hold a valid tax invoice (unless the supply is less than AUD82.50 including GST). Non-residents who have elected to use a limited registration will not be able to issue a valid tax invoice. In this situation, if a business customer disputed a GST charge, a limited registration entity would need to refund the amount of the GST to the customer and then seek a refund of the overpaid GST from the ATO. Given this issue, there may be merit in a full GST registration which will enable tax invoices to be issued. GST registered customers can claim an input tax credit of the GST.

Local business recipients incorrectly treated as Australian consumers will need to determine the approach that they will take in these circumstances. For example, do they request a refund or simply claim the GST?

The takeaway

Non-resident suppliers of digital goods and services may face a significant burden, as they must undertake an analysis of whether their customers are Australian consumers. Affected non-resident suppliers will need to ensure compliance with registration requirements and consider whether to apply for full or limited registration. Suppliers should promptly update their automated business systems if necessary to ensure they are ready for the implementation of the new rules from 1 July 2017. Where an EDP is involved, it is necessary to consider which entity is liable for the GST and ensure all commercial terms appropriately address GST.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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