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e-GST

Abstract
This article provides a comprehensive analysis of the application of e-commerce to GST. The first part identifies the general problems for GST that arise from the nature of e-commerce transactions in the context of national and international reports. The second part provides detailed analysis of the specific application of the GST law to e-commerce transactions through an extensive discussion of specific examples. The article concludes by highlighting the key issues affecting GST and the Internet.

Keywords
e-commerce, GST, tax, internet

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e-GST

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This article provides a comprehensive analysis of the application of e-commerce to GST. The first part identifies the general problems for GST that arise from the nature of e-commerce transactions in the context of national and international reports. The second part provides detailed analysis of the specific application of the GST law to e-commerce transactions through an extensive discussion of specific examples. The article concludes by highlighting the key issues affecting GST and the Internet.

INTRODUCTION[1]

The popular perception these days is that, in the years to come, e-commerce will be the norm with everybody doing business on the Internet. In an article last year, Alan Kohler referred to the World Economic Forum in Davos, Switzerland and commented:[2]

> Australian executives returning over the past few weeks have been full of two things about Davos: the fact that the internet business revolution was the only topic of conversation, and how good it was to meet and talk about that with so many other significant business figures from around the world.

Kohler further made reference to the Nasdaq share index that at the time was reaching new highs while the Dow was heading in the other direction. He commented:[3]

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1 This article draws substantially upon a previous version, Mann JG and Swinson JV, *GST and the Internet*, a paper presented at Business Forum 2000, 17 May 2000.

2 Kohler A, "Look who's talking to see holes in the net", *Australian Financial Review* (29 February 2000) at 21.

3 Ibid.

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> investors apparently believe that everyone in the world will soon never go outside their homes, with vans plying the suburbs to bring to them everything they need ordered on the net.

If this occurs, what is going to happen to taxation administration? The way that business is conducted interests taxation administrators because it has a direct impact upon taxation system design, taxation administration itself and upon the collection of taxes. Whilst the notion of taxing commerce conducted electronically is not new,[4] the use of the Internet as a trading tool is relatively new. Therefore a key question is how effectively the goods and services tax will operate in the ether environment of e-commerce?

e-COMMERCE AND THE INTERNET

What is e-commerce?

E-commerce is commerce conducted electronically. It is not new. EDI (electronic data interchange) is business-to-business ("B2B") e-commerce that has been carried out between businesses for decades. Over the past five years, e-commerce transactions have become more prevalent in our society, partly due to the growth of the Internet. When most people today think of e-commerce, they are thinking of commerce conducted using the Internet, a global network of interconnected computers communicating according to a common communications protocol.[5]

The Inland Revenue has acknowledged that there is no internationally accepted definition of e-commerce, the Department of Trade and Industry is reported as having proposed the following working definition to the OECD:[6]

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4 Fleming JC, "Electonic Commerce and the State and Federal Tax Bases", 2000 *Brigham Young University Law Review* 1; "At the federal level, the taxation of electronic commerce can be thought of as a case of Back to the Future because it begins almost sixty years ago with an early form of electronic commerce in *Piedras Negras Broadcasting Co v Commissioner* ...[that] involved a Mexican corporation operating a commercial radio station on the Mexican side of the Rio Grande River" where the company was essentially a foreign corporation earning $US that successfully avoided being inside the jurisdiction of the US government notwithstanding that 95% of its income came from the USA.

5 E-commerce probably does not include commerce conducted by fax or telephone.

6 Inland Revenue and HM Customs and Excise, *Electronic Commerce: the UK's Taxation Agenda*, (November 1999) at para 1.3.

> Using an electronic network to simplify and speed up all stages of the business process, from design and making to buying, selling and delivery, e-commerce is the exchange of information across the electronic networks, at any stage in the supply chain, whether within an organisation, between businesses, between business and consumers, or between the public and private sectors, whether paid or unpaid.

The report then stated:[7]

> E-commerce is most simply described as doing business electronically, whether communicating by PC, interactive television, console gaming machine or through high street kiosks. It includes Electronic Data Interchange (EDI), the exchange of documents in structured or coded form between business computers which began over a decade ago.

Will the incidence of e-commerce increase?

There appears to be significant optimism about the increased future use of the Internet for transactions:[8]

> E-commerce between businesses and consumers is less significant at present, with an estimated $7 billion world-wide in 1998 but expected to grow to perhaps $80 billion in 2002.

If this is a trend, then it appears that more transactions, (both in volume and dollar value), will be conducted electronically. Such transactions will need little or no human intervention by at least one party to the transaction. If this is the case then how will the parties to the transaction be identified?

Identification of the Internet supplier/recipient

In many cases, Internet users are anonymous. They can choose whether or not to provide information as to their identity. And often, it is impossible to determine if the information provided is correct.

When the user chooses to enter into a transaction on the Internet, as a practical matter the user will often provide accurate information as to identity. For example, the user may be required to provide an address for delivery and/or credit card information (that "proves" identity) for payment. But this is not always the case. Consider, for example:

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7 Ibid at para 1.4.

8 Ibid at para 1.6.

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- A user who orders a gift for another, and has it delivered to an address other than the user's address;
- An inmate in a jail who orders a "gift" for a friend in the jail using a stolen credit card; or
- A child using a parent's credit card details to play online computer games.

In the above examples, often the customer provides no information or incorrect information to the supplier about their identity. Moreover, it is often impossible for the supplier to determine other information about the customer, such as the physical location and age of the customer.

Similarly, it can be difficult to determine the true identity of the supplier of an Internet service; particularly where the service provided is delivered electronically. In many countries, there is no law requiring the supplier to provide their identity when entering into transactions. Particularly in relation to sex and gambling sites, the supplier will often provide no information as to their identity, or if the information is provided, it is misleading or incomplete. The physical location of the supplier may be difficult to identify and indeed the location of the supplier may change on a daily basis.

There are technical measures in place that can assist in proving identity. Consumers do not commonly use these measures. For most e-commerce transactions, the technical measures to prove identity are often an optional safe guard, and not compulsory. As would be expected, people who wish to hide their true identity avoid these technical measures. One example of a technical measure is the digital signature.[9]

Even if the identity of the parties may be determined, there are further difficulties in determining the value of the transaction.

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[9] An example of a technical measure to prove identity is a digital signature. A digital signature is not a digitised version of a handwritten signature. In simple terms, a digital signature is a cryptographic representation (or fingerprint) of a document that could have only been created by a specified individual. That individual is a person who is in possession of a private key (or code) used to create the fingerprint of the document. Using complex mathematics, and provided the individual keeps the private key secret, the digital signature can prove who created the document and that the document has not been altered. If properly issued and used this type of technology can be helpful in proving identity. To set up an infrastructure to issue digital signatures is complex and costly. The ATO is doing so as part of the process to issue Australian Business Numbers.

Valuation issues associated with dealing via the Internet

As the Internet is a new commercial medium, the best way to value Internet transactions is often uncertain. The NASDAQ provides an example of the wide variations in the valuations of pure Internet businesses that do not report profits or indeed have positive revenue streams. For the GST, there are unsolved issues relating to the valuation of the supply of goods and services.

Consider the following common Internet business transaction. The Yahoo site provides a "free" Internet e-mail account to users who register with Yahoo. In the registration process, the user is required to provide detailed demographic and other information. Assuming that the user does not cheat, this information is valuable, and can possibly be used by Yahoo for commercial benefit including the on-sale of the user's personal information to advertisers. Sometimes, information about one particular user is of little value to Yahoo, but aggregated or analysed data about a large number of users is potentially of great value. So what is the value of the information provided by a particular user to Yahoo as the fee to access the Yahoo mail service?[10]

It is difficult to determine the value of a transaction or the result of a transaction. This also applies to a product such as free software.[11] At this stage there is no industry standard for valuation. In the event that an industry standard is established there is a strong chance that the standard itself will change at an unrealistically rapid pace.

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10 Another example: groups of websites often band together and agree to advertise the other's websites for no payment. This is often called banner exchange. For example, Site A will advertise Site B for no fee provided that Site B advertises Site A for no fee. It is like a barter arrangement. If a user clicks on the advertisement, the user is often taken to the site of the advertiser. Although there are a number of businesses who charge fees for Internet advertising on their sites, it is not yet clear how to best value (or price) such advertising. Factors that effect the cost of advertising on an Internet site include: the number of users of the site, how many users see the advertisement, how many users "click through" to the advertiser's site, how many users in response to the advertisement actually purchase something from the advertiser, whether the advertisement is targeted at particular types of customers, the location of the advertisement on the site, and the demographics of the people who visit the site where the advertisement is located.

11 For example, it is common to see on the Internet "free" software that can be downloaded. There is a trend that this software is open source. The source code is provided free to developers, provided that, if the developers improve the software, they must also make their improvements publicly available for free on the Internet for others to use and modify. In some cases, such as in relation to the Linux operating system, the software took many years to develop and could be considered quite valuable. But how do you value the transaction where the developer is provided with a "free" license to use and improve the software, in return for making his or her developments available to others for free?

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A further difficulty is determining the site associated with the transaction. Even where this is achieved there are "boundaries" as between sites that confuse transactions.

What is the nature of a website?

A website is a collection of files stored on a computer (called a server) that is connected to the Internet. These files, which can contain formatted text, images, sound, data and programs, are stored in digital form and are electronically delivered to users at the request of the users.

In reality, it is sometimes hard to determine where one website starts and another ends. It is important to remember that:

- A website can be stored on more than one server;
- The physical location of the website (or the server on which it is stored) is often irrelevant;
- Different people may control different parts of the same website;
- Some websites are passive and some are interactive;
- Websites are dynamic, and can change regularly, and in some cases, in real time;
- Websites can be tailored, so what you see and what I see on the same website may be different;
- Technology is becoming more sophisticated, so what is true today may not be so tomorrow.

For example, if a user requests one page of the website, part of that page may be delivered from one server and part of that page may be delivered from another server located in a different country. Often, a third party delivers the advertisements you see on a website from a different server. It is typical for the transaction part of the website, for example, the part that does credit card processing, to be carried out on a different server, and sometimes by an intermediary.

The same website is often "mirrored" on different servers in different countries, and the actual website that the user is directed to (without knowing it) may depend on Internet traffic patterns that day.

Websites may be moved around. For example, websites providing pornography often move from country to country to avoid scrutiny by the authorities. Users do not know that this is occurring. To complicate matters, the website owner often cannot determine where its users are located, who they are, or whether any particular user is an adult, a company or a minor.

Determining the location of an Internet transaction

As it is often difficult to determine the location of a website, it is often difficult to determine physical location (of the parties and of the transaction) for e-commerce transactions. This is because each party may not know or be able to determine the physical location of the other party. In fact, if a website automates the transaction for one party, as is often the case, the computers that complete the transaction may be located in different places. For example, there may be different computers in different locations, each responsible for one task in the transaction processing process (eg, one computer for each of: receiving order details, processing credit card payment, accepting the order, arranging delivery of the product or service.) The entity controlling these computers may be in another location, and the customer may be in yet another (unknown) location.

Where this is the case, what is the location of the transaction? In the above example, there may be a choice of: the location of the customer, the location of the computer that is used to make the offer, the location of the computer that sends the acceptance to the offer, the location of the computer that accepts the offer, the location of the entity controlling the website that processes the transaction, where payment is received, where the goods are shipped from, where the goods are shipped to, where the work is carried out, where the benefit of the services is received, where the data or content is located, where the regulator is located, and finally the place specified in the "choice of jurisdiction" section whether that is in the contract or on the website.

Furthermore it is interesting to consider whether there can there be more than one location of a transaction; this might arise for example where a team of people and computers, each located in a different place, carry out the services provided. The customer may be a global company that receives the benefit of the services in a number of places.[12] The importance of location depends upon the purpose for determining the location.[13]

Determining the characteristics of digitised products

The Internet is a medium of distribution. Certain products and services may be cheaply distributed in electronic (or digital) form, via the Internet, to

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12 For example, look at <www.multex.com,> where stock market research reports are created by teams of people in different places, and provided to global institutional investors, all via the Internet.

13 For example, the location of the transaction may be different when considering issues of criminal law, consumer protection law, tax law, contract law and intellectual property law.

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customers. Examples of products distributed in electronic form include software, books, movies, photographs, newspapers, music, and research reports, including financial data.

When a digital product is delivered via the Internet, what really happens is that bits of information are transmitted electronically to the customer's computer, and generally stored on the customer's hard disk drive. There is a physical change to the disk drive as a result. But unless the customer does something further, such as print out the downloaded book, it is hard to say that there has been something physical provided to the customer. We may say that the customer has purchased and downloaded a book, but really, the term "book" is being used here in a different sense to its normal use.[14] The law has yet properly or adequately to characterise digitised products.

APPLICATION OF GST PRINCIPLES

The political response

In some parts of the world, the response has been to keep e-commerce activities out of the taxation net, for the short term at least. To quote Alan Kohler again:[15]

> And politicians, by fervently promoting e-commerce, seem bent not only on endangering the lives of kiddies [because of all of those vans rushing up and down streets delivering Internet purchased goods] but also their own tax budgets.
>
> US Republican candidate John McCain, for one, is spending plenty on advertisements pushing a ban on Internet sales taxes. The ad says, in part: "For John McCain, it's just this simple: the internet is creating new jobs and wealth...it's giving you and your family a place to shop for the best products with the best prices ... government should not ruin this new economic engine by taxing it. Join John McCain's fight to ban Internet taxes."
>
> Australian politicians have been likewise keen to rub the Internet over themselves, believing it makes them smell young and cool.

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14 Characterisation becomes more complex when considering licensing. For example, assume that the customer is licensed to read or print the downloaded book twice, after which the book becomes inaccessible to the customer unless an additional fee is paid. Is the customer provided with a book, the right to read a book, a stream of bits, or the delivery of a digitised version of a book?

15 Kohler, above n 2.

> In the face of all this Internet hype in the stockmarket, in business and in politics, it is a brave person who raises a hand to question it. Nevertheless there are a few.
>
> For a start the idea of forever banning all taxes on the Internet and e-commerce is so absurd there is a growing movement advocating the opposite and led, naturally, by tax collectors. It won't be easy to tax e-commerce, but it's becoming clear that governments will have to do it somehow or risk a big decline in the services and welfare they can provide as e-commerce replaces normal commerce.

In the US, the Internet Tax Freedom Act (1997) lasts until 2001 and prevents US states from imposing any new sales taxes on e-commerce.

In Australia we have yet to see any significant political debate regarding the taxation of Internet based transactions. The Australian Taxation Office ("ATO") has considered the matter in some detail.

The Australian Taxation Office view

The ATO has established the Electronic Commerce Project that has issue two discussion papers,[16] the second of which noted:[17]

> [T]here is still considerable uncertainty about how quickly electronic commerce will take off, the form it will take and what implications it will have for tax administration. ... Time will show what form electronic commerce will take in the global economy. But in the meantime it is important for tax administrations to explore possible scenarios and to develop a range of options for response, so that they will be well placed to deal with the future impact of electronic commerce.

Other revenue authorities around the world have set out with a similar aim in mind, for example the OECD.[18]

The report *Tax and the Internet* is very significant in the discussion of tax administration and e-commerce. Any study of that subject requires a detailed

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16 ATO, *Tax and the Internet* (1997 AGPS) ("*ATO 1st report*") and ATO, *Tax and the Internet: Second Report - December 1999* (1999 AGPS) ("*ATO 2nd Report*").

17 *ATO 2nd Report*, above n 16 at 5.

18 *ATO 1st report*, above n 16 at para 2.3.34.

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review of that Report. This paper only touches on some of the points that are comprehensively dealt with in the ATO paper.[19]

The thrust of *Tax and the Internet: Second Report* is one of a watching brief:[20]

> 7.3.3 Electronic commerce will have significantly greater impacts for tax administration in a GST environment than under the WST system. In its Report 360: *Internet Commerce - To buy or not to buy?,* the JCPAA noted that "the supply of intangible products from outside the tax jurisdiction is a major issue for overseas GST/Value Added Tax (VAT) regimes", and that many of the issues noted in the Discussion Report concerning monitoring and taxing Internet commerce would also be of relevance in a GST context.

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19 *ATO 1st report*, above n 16, ch 7 "Indirect tax issues" is devoted to indirect tax issues. That chapter however, must be read in the context of the Foreword to "Part II Discussion Papers" at 74:

> Electronic commerce has the potential to challenge the effectiveness of existing jurisdictional rules and administrative measures relating to the imposition and collection of tax. Depending on how the market develops and how these issues are resolved, the tax base of some countries may be affected and there may be substantial shifts in the balance of revenues between countries.
>
> The Committee on Fiscal Affairs (CFA) of the OECD has initiated intensive discussion of the jurisdictional and administrative issues surrounding electronic commerce over the past few years. Australia, through officers of the ATO, has been a major player in those discussions.
>
> To further international deliberations, and with a view to seeking community input into developing solutions to the challenges posed by electronic commerce, a series of discussion papers is included in this Report addressing a number of issues. These discussion papers review certain existing jurisdictional rules and administrative measures, and their application in the electronic commerce context. They also examine potential implications for tax administrations and suggest some possible options for dealing with different problems if and when they arise.
>
> It should be noted that these discussion papers have been prepared in the context of an emerging environment, where the full extent of the impact of electronic commerce and the form it will take are not yet known. The options canvassed in the discussion papers do not necessarily reflect final views of the ATO or actions that the ATO **will** take. Rather they are intended to indicate possible approaches that could be taken in resolving some of the issues and technical aspects of these discussions. The final views of the ATO will be developed in response to actual issues as they emerge in the electronic commerce environment, taking into account any international consensus on appropriate solutions to those issues.
>
> The discussion papers do not constitute public rulings for purposes of Part IVAAA of the Taxation Administration Act 1953.

20 *ATO 1st report*, above n 16, paras 7.3.3 – 7.3.7.

> 7.3.4 The JCPAA recommended that the ATO and Treasury should... "report on international developments concerning possible strategies for collecting GST on products and services that are ordered and delivered electronically."
>
> 7.3.5 The OECD is currently considering the taxation administration implications for VAT/GST systems in member countries. An overview of their analysis of consumption tax issues can be found later in this chapter.
>
> 7.3.6 The ATO will be examining these issues in the context of Australian GST legislation, and will continue to monitor international developments on consumption tax issues relating to electronic commerce. The ATO will also participate in the debate on these issues in international forums such as the OECD.
>
> 7.3.5 However, the challenges described in paragraph 7.4.11 need to be kept in perspective, and it is important to note that although the growth of electronic commerce is exponential, it is still in an embryonic state and a minor component of the total economy. Chapter 3 "The market today" provides more information on the growth in use of the Internet in Australia.

The ATO is not alone in that approach one commentator has noted that:[21]

> To date, the response of the world's taxing authorities to the rise of electronic commerce can best be described as "hurry up and wait". Conferences have been convened; white papers have been issues; commissions have been appointed, but there is still precious little concrete advice that tax advisors can give to their clients.

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[21] Forst D, "Old and New Issues in the Taxation of Electronic Commerce" (2000) 14 *Berkeley Technology Law Journal* 711.

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The ATO has noted that:[22]

- So far as e-commerce activities wholly within Australia are concerned, GST legislation applies in the same way that it does to conventional business;
- When supplies from outside Australia are concerned, GST legislation:
  - Applies to the supply of physical goods to both business and private consumers;
  - Applies from business to business of services or intangible products when a full input tax credit is not available;

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22 *ATO 1st report*, above n 16, paras 7.3.8 – 7.3.13:

Australia's GST and electronic commerce

7.3.8 For supplies occurring wholly within Australia, the GST legislation does not differentiate between business conducted electronically and conventional business.

7.3.9 The principal challenge to the GST posed by electronic commerce is in the area of supplies from off-shore to Australian consumers. As described earlier in this chapter, it is helpful in looking at the application of the GST to cross border electronic commerce to consider three broad categories of supplies:

- supplies of physical goods to both businesses and private consumers;
- supplies from business to business of services or intangible products; and
- supplies from businesses to private consumers of services and intangible products.

Supplies of physical goods to both business and private consumers

7.3.10 Supplies of this nature are identifiable in the same manner as physical goods, with imports currently subject to tax at the border, and low value thresholds applying in much the same manner as under the WST system. GST-free provisions cater for exports of goods. The method of ordering, for example, electronic, phone or mail, is largely irrelevant in terms of the application of taxation requirements.

Supplies from business to business of services or intangible products

7.3.11 Supplies in this category one dealt with by the reverse charge mechanism, whereby GST-registered businesses receiving such supplies from off-shore are required to self-assess their GST liability, but only if they would not be entitled to full input tax credits on the supply. GST-free provisions apply to certain supplies for consumption outside Australia.

Supplies from business to private consumers of services and intangible products

7.3.12 To date, no revenue authority has found a practical method for collecting consumption taxes on the third category, and Australia's GST does not presently seek to do so. While currently small in volume, this category potentially poses the most significant problem to the effective administration of consumption taxes, and is currently the focus of international attention.

7.3.13 The ATO will continue to monitor international developments on consumption tax issues relating to electronic commerce, and participate in the debate on these issues in international forums such as the OECD."

- Applies to the supply from business to private consumers of services and intangible products but cannot be collected;
- Exports may be GST free.

One might expect the GST legislation to impact in this way, but the proposition in paragraph 7.3.12 is very significant:[23]

> To date no revenue authority has found a practical method for collecting consumption taxes on the third category, [services and intangible products to private consumers] and Australia's GST does not presently seek to do so.

That does not mean that there can never be a GST liability for an offshore entity: it means it cannot be collected even if there is a liability. It follows that there will be a competitive disadvantage for Australian companies doing business that falls outside the export provisions.

After reviewing OECD developments, the chapter finishes with the ATO position in 7.4.17:[24]

> The GST Act reflects the recommendations of the OECD, in that:
>
> - In principle, the Australian GST legislation seeks to tax consumption in Australia;
> - The legislation includes a definition of "goods" as "tangible personal property". Digital information is not tangible personal property and is therefore not "goods".

Clarification of GST and internet issues

The ATO has sought to clarify these issues[25] stating that it will:[26]

> [C]larify GST technical and administrative issues considered by members to be of wide interest to the electronic commerce sector; and to communicate resolved issues widely through ATO and sector networks.

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23 *ATO 1st report*, above n 16, paras 7.3.13.

24 *ATO 1st report*, above n 16, paras 7.3.17.

25 The ATO has created the Electronic Commerce Consultative Forum and the GST Consultative Forum on Electronic Commerce.

26 ATO, GST Consultative Forum on Electronic Commerce.

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Issues identified

Many issues have been identified that are central to an understanding of the GST implications. For example, it is important to understand how one determines if a customer is outside Australia when making a sale via the Internet or indeed how payments are treated for GST in the circumstances of a hosted web site if the period covered spans 1 July 2000. The treatment of ISP membership subscriptions, "click-through" advertising payments, portal site advertising payments and acceptability of electronic copies of records including invoices, and referral commissions[27] are examples of further issues.[28]

While discussion continues on many of those issues, resolution on some has been reached or proposed at least to the stage where a draft "Resolved Issues" paper has been produced.

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27 Where a site refers a person to another site and the operator of the first site receives a payment based on purchases made at the other site.

28 Further issues include determining the GST treatment of Australian resident consumers purchasing digital products from non-resident businesses via the Internet; understanding the tax information requirements on websites; finding out the invoice requirements for business-to-business EDI; knowing whether there is neutrality of treatment if physical business do not have to pay GST on rent on physical premises; finding out the points where GST is collected and remitted; understanding how the inclusion of GST in micro payments will be handled; determining how pricing for Australian and non-resident customers is to be addressed on the Internet; knowing the treatment of substantial value contracts, where the first payment or invoice may only represent a fraction of the contract value; locating for small business useful information about the GST when they do not have access to the Internet; determining whether the terms "content" and "medium" are mutually exclusive in Div 85; knowing the tests to determine ABN eligibility; understanding how non-ABN withholding tax applies; determining how the ABN requirements affect joint ventures over the Internet; understanding the GST treatment where digital products or rights are transferred between associates; determining how barter or contra agreements are treated for GST; knowing when RCTI's can be used; Applying Div 84 to acquisitions of supplies not connected with Australia for resale and subsequent GST treatment on re-sale; and ISP's and the application of Div 85 to offshore telecommunication supplies.

(2000) 10 Revenue LJ

Draft "Resolved Issues" paper

A draft "Resolved Issues" paper was produced that makes some important points:[29]

- *Chapter 1 - Consumption outside of Australia*:
  How one determines if a customer is outside of Australia when making a sale via the Internet is one of great practical difficulty; the use of registered mail or fax to verify identity, the use of IP numbers and credit cards was discussed. The proposal in Chapter 1 to tackle this difficult issue does not suggest it is the only way and certainly the ATO is of the view that if anybody has a better way to determine identity then by all means adopts it; the ATO's proposal is a good starting point.

- *Chapter 2 - Transitional Issues*:
  The application of s 11 of the Transition Act where there is an Internet access agreement that entitles the user to a fixed number of hours access will unfortunately continue to create problems.

- *Chapter 3 - Record Keeping, Electronic Tax Invoices*:
  The decision that electronic records and tax invoices are acceptable for GST purposes are appropriate: note the reference by the ATO to s 70 of the Tax Administration Act and to TR97/21.

- *Chapter 4 - Application of GST to supplies of digital products made to Australian recipients from non-resident suppliers*:
  It is interesting that at the meeting on 28 March the ATO indicated that, although such sales may well be subject to GST, the ATO would not be trying to enforce that liability because there would be no way that that can be done overseas. The Double Tax Agreements do not apply. The Forum indicated that this would provide a competitive advantage to suppliers from overseas. The ATO indicated quite clearly at that meeting that it was willing to work with interested parties to try to collect GST on such sales but it has not been able to come up with a satisfactory method of doing that. The statements in this Chapter therefore show a 180-degree change of attitude by the ATO. This Chapter will be referred to again later in this paper. Note the introduction in the explanation in the examples of why s 9-25(5) does not apply of a new concept of "prepared" and note the following: [30]

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29 ATO, "GST Consultative Forum on Electronic Commerce" (May 2000) Version 1.

30 ATO, "The Communications Industry and The New Tax System" (March 2000) at 31.

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NOTE
GST is payable on goods purchased via the Internet from an overseas supplier. For more information please refer to the section on importations.

The supply of internet access to a customer in Australia by an offshore provider will be "connected with Australia". This applies even if the supply is not done in Australia.

- *Chapter 5 - GST treatment of supplies made on a progressive or product basis for a fixed fee*:
  Section 156 of the Act will apply and the worked example demonstrates its operation in these circumstances.

- *Chapter 6 - Contra trade (barter) arrangements*:
  The problem with this is that "market value" has to be determined and no basis is shown as to how that can be done.[31]

HOW DOES THE GST TAX INTERNET TRANSACTIONS?

Introduction

The essential question is whether VAT/GST legislation now taxes Internet transactions and if it does not, can it ever? If VAT/GST legislation is to apply to Internet transactions then the issues are whether or not the legislation has been designed to in fact tax the Internet transactions, whether the actual drafting fits the design intent and in the event that both of those issues can be satisfied, determining the compliance cost issues associated with them.

Whilst the tax design question might be clearly articulated, the drafting may or may not reflect that design, particularly when the courts have a look at it in the context of the facts of a case, inevitably apply notions of the principles driving the legislation and end up with either a legalistic or economic approach or something else. Without the means of ensuring compliance, the whole exercise is hollow.

The difficulty in this area and indeed with so much arising out of the GST legislation is that the legislation will in time develop its own jurisprudence. This happens with any piece of revenue legislation. We saw this happen in income tax, sales tax, and stamp duty and again in relation to the capital gains tax regime. The Courts will have to interpret such central concepts as

31 The ATO invites submissions on these and other issues from interested parties as soon as possible.

"supply" and in doing so will give the legislation a more clearly defined form and operation.

Possible approaches

Courts in this country could conceivably take one of two courses in their approach to the interpretation of the Act:

Economic approach:
endeavouring to determine in any particular fact situation whether there is something that in an economic or commercial sense is actually passing between entities in exchange for a price;

Legalistic approach:
simply examining a fact situation against the template of the legal concepts in which the legislation is drafted.

In *Customs and Excise Commissioners v British Telecommunications PLC*, Lord Hope of Craighead referred to: [32]

> [T]he guidance which the [European Court of Justice] gave in *Car Protection Plan Ltd v Customs and Excise Commissioners* ... that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system.

In a sense, GST is an economic tax. But its operation has been mainly drafted by incorporating familiar legal concepts. That is where the problems arise because the reader is more than likely to bring to bear a mechanistic legal approach with the result that some unexpected consequences could then arguably follow. For example, where there is the execution of an executory contract or a loan of money: why aren't there two supplies in each case?[33]

Neither of those two possibilities can surely be within the terms of this legislation, one would think, but we may be in for a rude shock. Another good example is in the area of liquidated damages or indemnity payments: is there really in some of those circumstances a surrender of a right or a release of an obligation giving rise to a taxable supply? Overseas experience would demonstrate that some of those circumstances are taxable but many are not.

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32 [1999] 1 WLR 1376.

33 Compare the stamp duty situations exemplified by *George Wimpey & Co Ltd v Commissioners of Inland Revenue* [1975] 2 All ER 45 and *Suncoast Milk Pty Ltd v Commissioner of Stamp Duties (Qld)* 96 ATC 4914 on the dutiability of instruments creating new property.

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It is more than likely that the Courts will take neither a mechanistic legal approach to the application of the legislation nor an economic or commercial approach. It may be somewhere in the middle. The approach may well be that exhibited by Lord Hope in the *British Telecommunications* case (above). But in the early days of the application of this legislation, what will be the ATO's approach? Until the Courts develop jurisprudence for this legislation, what approach will be reflected in public and private rulings?

Examples of transactions

Some examples of Internet transactions are:

- Supplies of goods, particularly from overseas;
- Supplies of software;
- Supplies of information; and digitised products.

Consider these fact situations:

Day 1

US Shirt Co carries on business in the US as a maker of shirts. It has no other business. The business consists of receiving orders via the Internet from residents of Australia. Shirts are sold for $15 and are posted to customers who pay via the Internet upon delivery in Australia. US Shirt Co started business in 1998 and presently has a current annual turnover of $1 million. Of that, sales into Australia account for $500,000.

1 Should US Shirt Co register for GST purposes?
2 Should US Shirt Co have an ABN?
3 Is US Shirt Co making taxable supplies?
4 How would the Commissioner collect the tax?

Day 2

US Shirt Co changes its operations. It commences to sell shirts to Aussie Shirt Co Pty Ltd, an Australian resident company that carries on the business of buying shirts and onselling them to Australian retailers. Shirts are sold under terms of trade requiring their delivery in Sydney. On receipt, Aussie Shirt Co Pty Ltd makes payment via the Internet.

1 Is US Shirt Co still liable to pay GST?
2 What is the position of Aussie Shirt Co Pty Ltd?
3 How does the Commissioner collect the GST payable by US Shirt Co?

Day 3

US Shirt Co changes the nature of its business and calls itself US Software Co. It becomes a provider of software programs and downloadable books. Australian residents can access these services via the Internet and pay via the Internet. John, a Sydney resident, downloads a software program onto his computer in Sydney and pays a fee. Bill, a Melbourne resident, downloads a book, paying for it through the Internet.

1 Is US Software Co liable for GST?
2 Can the Commissioner collect that GST?

Day 4

Bill travels to Hong Kong. He visits the office of US Software Co, takes delivery of a new software program on a CD and pays for it there. He travels back to Australia with the CD and accesses the information on it using his computer. This will enable Bill to more efficiently carry on his business of money-lending.

1 Is US Software Co liable for GST?
2 What is Bill's position?

Day 5

Aussie Shirt Co Pty Ltd commences selling shirts to US residents. Its business is similar to the business conducted by the old US Shirt Co but it sells only to US residents.

- Is Aussie Shirt Co Pty Ltd liable to pay GST?
- Should Aussie Shirt Co Pty Ltd have an ABN?
- How would the Commissioner collect the tax?

Day 6

Aussie Shirt Co Pty Ltd starts to sell shirts to Australian residents, and has a current annual turnover of $1 million.

- Is Aussie Shirt Co liable to pay GST?
- Should Aussie Shirt Co have an ABN?
- Is Aussie Shirt Co making taxable supplies?
- How would the Commissioner collect the tax?

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Day 7

Aussie Shirt Co Pty Ltd changes its operation and sells only digitised products through the Internet to US residents and Australian residents.

- Is Aussie Shirt Co Pty Ltd liable to pay GST?
- How would the Commissioner collect the tax?

A GST analysis of these kinds of situations

First one needs a methodology in order to analyse the situation:

- Recall the GST basics,
- Recall the GST templates, and
- Apply both to Internet transactions.

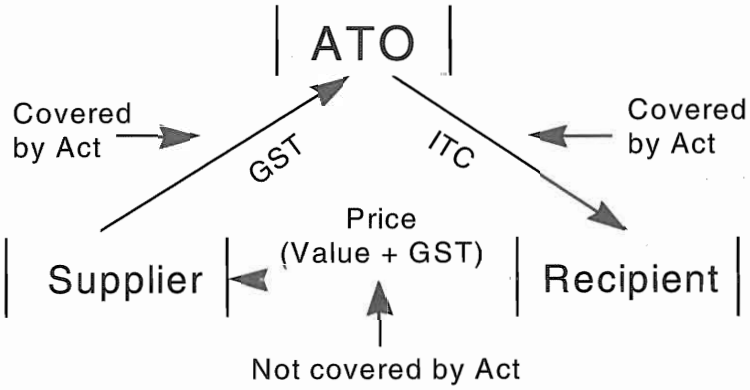
GST basics

In addition to the widely accepted GST practice points it is worthwhile suggesting that the following questions might be usefully considered for each situation:

- Am I (or am I acting for) the supplier or the recipient? The "GST Triangle" highlights the fact that although in the business to business situation one would expect that the GST would simply flow through, in a consumer to business situation it is certainly not going to happen. In some business to business situations, the recipient may well try to get an advantage if a price is unwittingly, so far as the supplier is concerned, GST inclusive, that is, the supplier has forgotten to gross up?[34]

[34] Mann JG, "GST and property - Issues in contractual transactions and negotiations", a paper presented at Television Education Network, December 1999.

GST Triangle



- Do the taxable supply/taxable importation/reverse charge templates apply, that is, have the essential elements for eligibility to tax been triggered?
- Do any of the special rules apply, that is, (eg), is the supply GST-free?
- How is the price to be structured to ensure is there no breach of the ACCC Guidelines?
- What are the timing issues so far as the supplier/recipient are concerned?
- Do the transitional provisions in the Transition Act apply?

GST templates

The "taxable supply template" requires an examination of the following:

- Supply: what is it that is being dealt with?
- Consideration: what is the consideration/value of consideration?
- Enterprise: what is the nature of the supplier's activities?
- Australian connection: where is the supply made?
- Registration/requirement to register: what is the volume of the supplier's activities?

The "taxable importation template" requires consideration of:

- Goods: what is the nature of the supply?

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- Importation: how has it come to Australia?
- Home consumption: have Customs been informed?
- Concession/exemptions: do any Customs/GST exemptions apply?

The "reverse charge template" requires examination of:

- Thing: what is it that is being dealt with?
- Connection with Australia: where is the supply made?
- Enterprise in Australia: what is the nature of the recipient's activities?
- Consideration: what is the consideration/value of consideration?
- Registration/requirement to register: what is the volume of the recipient's activities?

Internet transactions

How does this come together in the context of Internet transactions?

Perhaps an application of the flow chart might assist (see "Internet Transactions" chart in appendix). The chart highlights the following issues:

- The difference between content acquired through or by way of the Internet and the Internet itself as a medium;
- The distinction which must then be drawn between goods, real property and things (because the connection/place of supply rules are predicated on that distinction);
- Whether the taxable supply template, taxable importation template, or reverse charge template applies;
- Whether one of the export provisions applies.

This is simply an exercise of applying the usual GST analysis principles to Internet situations. But it is quickly evident that some issues are more in focus when it comes to Internet transactions.

There are some questions that arise from an examination of the chart, namely:

- Is the dealing with respect to the content or the medium? Is it a supply of goods, real property or things?
- Is there an Australian connection? What is the place of supply?
- Who is the supplier/recipient?
- Is an export involved?
- Are businesses treated differently from private consumers?

(2000) 10 Revenue LJ

Content versus medium

The short point is that the GST legislation requires a differentiation between content and medium.

When Division 85 was introduced into the GST Act by: A New Tax System (Indirect Tax and Consequential Amendments) Act (No. 2) 1999 (Act 177 of 1999), Explanatory Memorandum paragraph 1.49 stated:

> New section 85-10 provides a definition of "telecommunications supply". This definition is consistent with a definition recently enacted by the European Council. The definition is designed to capture the means of communication but not the content, where that content is clearly a different type of supply. The treatment of the content depends on the nature of the service provided.

The Explanatory Memorandum set out the purpose of the inclusion of Division 85:

> **Overview**
>
> The Australian GST system is designed to tax consumption of goods, services and other things in Australia. In the case of telecommunication supplies, consumption is taken to occur where the recipient of the supply effectively uses and enjoys the supply. Telecommunication services that are provided by an overseas supplier and are used or enjoyed in Australia may currently fall outside the scope of the GST system.
>
> 1.37 This amendment will ensure that telecommunications services that are used or enjoyed in Australia are subject to GST regardless of whether the supplier is in Australia or offshore. This is consistent with the treatment of telecommunication services in a number of other GST/VAT countries.
>
> 1.39 As the effect of the amendment is to make offshore telecommunication supplies "connected with Australia", Division 84 of the GST Act (the reverse charge) will not apply where those supplies are subject to GST under the new Division 85.
>
> 1.40 The amendments provide a definition for the term "telecommunication supply".

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Telecommunications supplies connected with Australia

1.41 Under the general rules, a supply of anything other than goods or real property is "connected with Australia" if it is either done in Australia or made through an enterprise that the supplier carries on in Australia.

1.42 Item 43 inserts new Division 85 - Telecommunication supplies, into the GST Act. This Division provides an additional criterion for "connected with Australia" specifically for telecommunication supplies. That is, if the effective use or enjoyment of a telecommunication supply is in Australia the supply will be "connected with Australia". This is of particular relevance to the application of section 9-5. [New subsection 85-5(1)]

1.43 For example, where an offshore telecommunication provider supplies Internet access to a customer in Australia, the supply will be "connected with Australia", even though the supply is not done in Australia or made through an enterprise that the supplier carries on in Australia."

Paragraph 1.50 and 1.51 provide examples of where it is considered Division 85 will and will not apply:

1.50 Telecommunications supplies include the supply of:

- Telephone calls;
- Transmission element of international data exchange;
- Call back services;
- The provision of leased lines, circuits and global networks;
- Email and Internet access; and
- Satellite transmissions.

1.51 Telecommunications supplies do not include the following supplies delivered through telecommunications mediums:

- Licences to use intellectual property such as computer software; and
- Consultancy services provided via the Internet.

There is then in those paragraphs, the clear intent to distinguish, so far as Internet transactions are concerned:

- The supply of something through or using the Internet;
- The supply of the medium of the Internet.

Immediately it forces a characterisation exercise: paragraph 1.49 says that the "...definition is designed to capture the means of communication but not the

content, where that content is clearly a different type of supply. The treatment of the content depends on the nature of the service provided."

So it is important to ask whether the supply of the content and the supply of the medium are mutually exclusive? Immediately the whole thing becomes fuzzy. The difficulty of this characterisation exercise is evident in paragraph 1.49 of the Explanatory Memorandum:

> The definition is designed to capture the means of communication but not the content, *where that content is clearly a different type of supply. The treatment of the content depends on the nature of the service provided.* [Emphasis added].

The fuzziness is not expunged by the definition of "telecommunications supply" in s 85-10:

> A telecommunications supply is a supply relating to the transmission, emission or reception of signals, writing, images, sounds or information of any kind by wire, radio, optical or other electromagnetic systems. It includes:
> (a) The related transfer or assignment of the right to use capacity for such transmission, emission or reception; and
> (b) Provision of access to global information networks.

Note that a telecommunications supply is not the supply constituted by the transmission, emission or reception of signals etc. It is a supply "relating to" the transmission, emission or reception of signals etc. The phrase "relating to" has been held in numerous cases to be a concept of wide import[35]

Does this therefore mean that "telecommunications supply" extends to the acquisition of a radio or TV? After all, why would one buy a radio or TV other than to receive "signals, writing, images, sounds or information of any kind by … electromagnetic systems"?

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35 *Inland Revenue Commissioners v Maple & Co (Paris) Ltd* (1908) AC 22 at 26: "There is no expression more general or far-reaching than [relating to certain objects]." See also: *Coles Myer Ltd v Commissioner of State Revenue* (1997) 97 ATC 4110; *Federated Miscellaneous Workers Union of Australia (WA Branch) v Nappy Happy Hire Pty Ltd t/as Nappy Happy Service* (1994) 74 WAIG 1493; *Westpac Banking Corporation v Commissioner of Stamp Duties (Qld)* (1992) 92 ATC 4571; *IBM Australia Ltd v National Distribution Services Ltd* (1991) 22 NSWLR 466; *Wilson v Commissioner of Stamp Duties (NSW)* (1986) 6 NSWLR 410; *ACI Resources Ltd v Commissioner of Stamp Duties (NSW)* (1986) 86 ATC 4810; *Comptroller of Stamps v BH South Ltd* [1984] VR 463; *Ansett Transport Industries (Operations) Pty Ltd v Comptroller of Stamps (Vic)* [1983] 2 VR 305; *Mornan Nominees Pty Ltd v Comptroller of Stamps (Vic)* (1982) 13 ATR 947.

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If, as will be suggested later, GST requires a good working knowledge of metaphysics, then "telecommunications supply" requires equally a good working knowledge of physics. The definition throws up into consideration, what it is that happens when one uses a mobile phone, a GPS system, or optical fibre, what are "electromagnetic systems", what "capacity" is, and what is meant by "global information networks". Is a sale of a radio or a television "access to global information networks?"

The lesson from all of this is that the characterisation exercise is crucial. That exercise is central to many GST situations but the characterisation exercise is exacerbated in Internet transactions.

A couple of additional points can be made about Division 85:

- Division 85 is really about providing a connection rule for telecommunications supplies as defined;
- the Division 85 connection rule is in addition to those in s 9-25;
- where Division 85 applies, Division 84 is not applicable;
- if the Commissioner "switches off" Division 85 by exercising the discretion in s 85-5(2), Division 84 may apply. (An example of this "switch off" is given in paragraph 1.45 of the Explanatory Memorandum: "For example, the Commissioner may decide to use this discretion in relation to mobile telephone calls made by an overseas tourist visiting Australia using a mobile roaming service provided by their overseas telecommunications supplier").

Is it a supply of goods, real property or things?

But even if the medium and the content are mutually exclusive so far as dealings with Internet transactions are concerned, one still has to characterise what it is which is being supplied or imported. The GST legislation really only deals with supplies that are:

- Goods; or
- Real property; or
- Telecommunication supply; or
- Things.

There is no fifth category.

Section 9-25, s 38-185 and s 38-190 evidence the distinction. Since different rules will apply depending on which of those four categories is relevant to a particular transaction, the first question has always to be whether the subject of the supply is goods, real property, telecommunications or things.

The concept of "goods" is simple: "any form of tangible personal property". The concept of "real property" is a bit wider than usually encountered. It includes:

(a) Any right in or over lands; or
(b) A personal right to call for or be granted any interest in or right over lands; or
(c) A licence to occupy land or any other contractual right exercisable over or in relation to land.

This is not the place to go into detail about this definition. It is going to present difficulties in the future. How, for example, does it work in the context of fixtures? Will the decisions in *National Dairies WA Limited v Commissioner of State Revenue (WA)*,[36] *Eastern Nitrogen Limited v Commissioner of Taxation*[37] and *Metal Manufactures Ltd v Commissioner of Taxation*[38] apply?

Although "thing" will cover both "goods" and "real property" and for that matter "telecommunications supply", the characterisation exercise has to be completed, simply because there are different connection rules applying to each.

The characterisation exercise is the first thing to do in considering the GST implications of a fact situation. But that exercise is not always easy. Two cases illustrate this.

In *TP Rowledge*,[39] the Tribunal held that what R had purchased was a software program with the rights to use, make 50 copies and distribute. So the supply was not one of goods but of services.

In *British Telecommunications*[40] BT bought a large number of motor vehicles. Transport companies delivered the vehicles on behalf of the manufacturer to BT's premises. BT paid value added tax to the manufacturer on the cost of transport and delivery. It sought to set this off against its liability for input tax. Whether it was entitled to do so depended upon whether the supplier of the vehicles and the provision of the transport were separate supplies for VAT purposes or whether there was one supply of a delivered car. In the former case, input tax paid on transport costs could be deducted but not in the latter. The House of Lords held that the supply was one for a delivered vehicle: the delivery was incidental or ancillary to the supply of the vehicle.

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36 99 ATC 5155.
37 99 ATC 5163.
38 99 ATC 5229.
39 LON/93/237A (12590).
40 [1999] 1 WLR 1376.

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Lord Slynn of Hadley looked at the relevant contracts with the motor vehicle manufacturers. Risk either passed on or after delivery or payment was to be made after delivery: in other words "what BT wanted was a delivered car "[41]

Lord Hope of Craighead was of the view that "the question is one of fact and degree, taking account of all the circumstances",[42] stating that:[43]

> In the present case, the essential feature which can be seen in each of the sample transactions is the purchase by BT from the manufacturer of a delivered motor car. Property and risk were to remain with the manufacturer until the point of delivery. BT could have gone to the factory to take delivery of the motor car, but it was more convenient to get the manufacturer to deliver the car to BT. This seems to me to be a good example of the kind of case, in the context of a transaction which involves the supply of both goods and services, which the Court had in mind when it referred in *Car Protection Plan Ltd v Customs and Excise Commissioners* ... to a service which did not constitute for customers, "an aim in itself, but a means of better enjoying the principal service supplied".

In that case, there was discussion as to whether the relevant principle was the "physically and economically dissociable" test that would hold that the supply of medicines by a medical practitioner is physically and economically dissociable from the service of that practitioner. Lord Slynn was of the view that the "physically and economically dissociable" test may be the same thing as the "ancillary test" but his Lordship preferred the "ancillary test" because it:[44] "avoids the more difficult question as to whether something which is physically separate and economically separate (eg, because a separate charge is identified) is thereby necessarily 'dissociable.'"

Lord Slynn also looked at the "commercial reality" of the situation:[45] "In my view here if the transaction is looked at as a matter of commercial reality there was one contract for a delivered car: it is artificial to split the various parts of the transaction into different supplies for VAT purposes."

So one might have recourse to any of:

- The "ancillary" test; or
- The "commercial reality" test; or
- The "economic" test.

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41 Ibid at 1384.
42 Ibid at 1386.
43 Ibid at 1387.
44 Ibid at 1383.
45 Ibid at 1384.

The above tests may be used in seeking to determine whether it is necessary to split "an actual supply" into its "components" (to use the words in s 156-5(2)) or to bundle separately identifiable components into an actual supply.

In the end, the test applied in British Telecommunications[46] was the "ancillary test". In other words, it looked at the essential features of a transaction and where it can be seen that one supply is ancillary to another or that what is taking place between the parties is a single service from an economic point of view or is a matter of commercial reality there was one supply, then there is only one supply for GST purposes. It seems therefore that the "ancillary test", the "single service from an economic point of view test" and the "matter of commercial reality test" are really all the same thing. But that does not and will not assist in the easy resolution of how one advises in this area.

The problem stems from the fact that "supply" is defined in s 9-10 in such a way that in relation to one transaction it is often possible to identify several "supplies". For example, in a transaction by which someone agrees to provide advice, one can identify each of the following that may be the "supply":

- The creation of the right to call for the advice: s 9-10(e);
- The entry into of the obligation to do something: s 9-10(g);
- The supply of the service: s 9-10(b);
- The provision of the advice: s 9-10(c).

Section 9-10(h) then acknowledges that all of these can be operating at the same time in a transaction: "(h) any combination of any 2 or more of the matters referred to in paragraphs (a) to (g)."

Mostly it will not matter that several "supplies" may be identified, (assuming of course that one can apply the British Telecommunications "ancillary test") because they may well all be done in Australia. But there is no taxable supply unless it is possible to establish an Australian connection. So when the connection rule is "the thing is done in Australia" in s 9-25(5), eligibility to tax is dependent on just which supply is identified.

For example, if A and B agree in the US that A will provide B advice on a project and the advice is provided in Australia, it is necessary to determine which of the above list is the "thing" before it can be determined if it has been "done in Australia". If it is the creation of the right then there will be no GST; but there will be if the "thing" is the advising in Australia. It becomes problematic when s 9-10(h) is applied because both the creation of the right and the provision of the advice are combined to form the "thing" which means s 9-25(5) cannot be applied because one part of the "thing" is done in Australia, and the other part out of Australia.

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46 Ibid at 1376.

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GSTR 2000/D7 looks at this sort of problem but in the end is not helpful. Paragraph 70 concludes that the answer is to concentrate on where the advice was "prepared". But while it is true that in many cases advice simply cannot be compartmentalised to one geographic area, what paragraph 70 demonstrates is the inevitable problem of having to stand back and try to characterise what is going on from an economic/commercial reality perspective; in other words to cut through a legalistic application of the Act. But that exercise is not always easy and GSTR 2000/D7 is too simplistic in its conclusions of where some "things" are "done"; see, for example, paragraphs 68-75.

The Pocket Oxford Dictionary defines "metaphysics" as "speculations on the nature of being, truth and knowledge". It is most certainly the case that a good working knowledge of the operation of GST legislation in this country will require a good working knowledge of metaphysics.

It would have been far more appropriate to name this legislation "A New Tax System (Things Tax) Act 1999". The subjects of our attention in looking at this legislation are "goods", "real property", "telecommunications supply" and "things". "Goods" is defined in s 195-1 as "any form of tangible personal property", whereas a "thing" is defined to mean "anything that can be supplied or imported". The Pocket Oxford Dictionary definition of "anything" is "a combination of any and thing in the wider sense of the latter". And "thing" is defined as, "any possible object of thought including persons, material objects, events, qualities, circumstances, utterances and acts". In other words, all goods are things but not all things are goods; and similarly for "real property" and "telecommunications supply", each is a thing.

This legislation is concerned with taxing supplies or importation of things. And if a "thing" is any possible object of thought, is this legislation concerned to tax the supply of, for example, eternal life or good health or good fortune? Does it follow therefore that, since nothing is a possible object of thought, the provision of nothing by a person registered and in a course of an enterprise for consideration is a taxable supply?

But it is only "possible objects of thought" (that is, "things") that can be "supplied or imported" which fall in the relevant class of things for the purposes of GST legislation.

What then has to be considered is the concept of "supply" in s 9-10 and the nature of "import". Certainly, if one can characterise the subject of the supply in terms of the specific examples in s 9-10 then it is easier to say that you will have a supply of a thing. But in other circumstances, how do you handle the situation? The answer is by re-characterising what you are giving or getting using GST phraseology. You redefine the supply according to GST-able

principles. For example, "I supply you with eternal life for $100", can be re-characterised/rephrased as "I provide you with religious services for $100". The provision of religious services for a consideration would be a taxable supply if s 38-220 were not in the Act. This requirement of the Act to characterise or re-characterise what is going on is inevitable simply because of the fuzziness of this tax design approach.[47]

How does this apply to Internet transactions?

If the "what is being supplied" question is pivotal for a non-Internet transaction, it is exacerbated for an Internet transaction because it is possible to characterise what is happening in several ways. Is it necessary to examine the "question" from the supplier or the recipient's point of view? A book provided through the Internet, downloaded and then printed in Australia is not a book when despatched from the supplier. Tradeable things can change their nature. Things can change into goods and vice versa. For example, is the process of downloading and printing a book?

- A grant of a right of access to a site; or
- The provision of information; or
- The grant of a licence to print the book; or
- The sale of a book; or
- The sale of bits?

The bottom line in all of this is that, so far as Internet transactions are concerned, you have to:

- Identify what is the supply; and
- Characterise that supply into goods, real property, telecommunications supply or things.

The problem is evident. Since "things" covers goods, real property and telecommunications supplies, whatever is supplied in an Internet transaction can be characterised as a thing. Until there is judicial, legislative or international agreement on how to handle such an illusive will of the wisp, it is not possible to solve with certainty many of the issues arising from Internet transactions for GST.

The traditional tax design process requires the working out of what it is that is being taxed and then to draft it in legal terms using familiar legal concepts. If the GST were drafted by reference to goods or services, then the choice would be between characterising intangible products as goods or services. The result may be thought a bit artificial from time to time, however the result

47 Refer GSTR/D7, from para 62.

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makes some sense because the place of supply rules for goods or services is relatively easy to understand.

The GST enables one to let the thing supplied continue as a "thing" and then it is a matter of applying the "thing is done in Australia" place of supply rule (if no permanent establishment is relevant). However, as already seen, that means a supply of nothing can be a taxable supply. That makes no sense and no one would argue for that result. Therefore one must characterise it into GST-able terms. If so, how is this done? Since the GST does not require characterisation of the thing supplied in familiar legal concepts, one is left trying to work what it is that it is being dealt with.

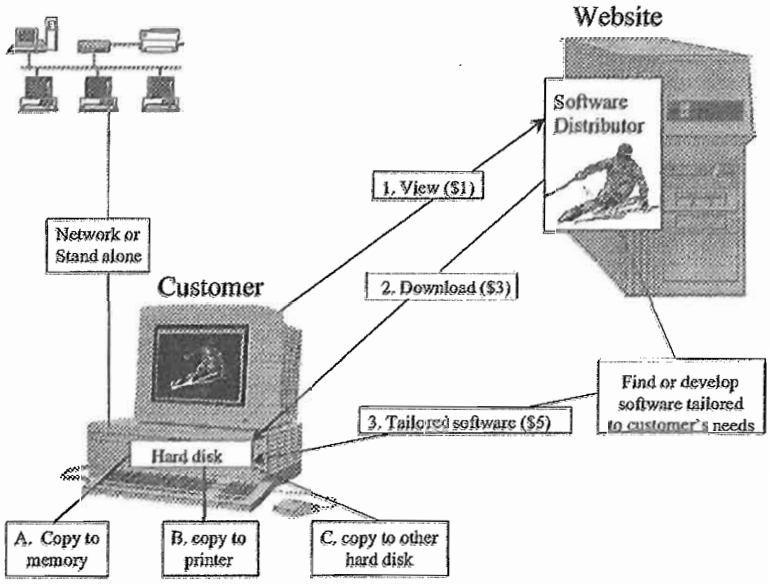
A new legal concept - "thing" - has been invented and there is no clear way forward as to how to handle it. So if the design has been to tax widely, the drafting is consistent with that intent. However the result is a difficult characterisation exercise to bring the supply within the perceived purpose of the legislation of taxing certain economic events.

This issue of characterisation is not confined to GST. The ATO has examined this issue in relation to payments for digital products:[48]

> 5.4.9 For tax purposes, the character of a payment in relation to digital products will depend on the nature of the transaction which gives rise to the payment. Depending on the nature of the rights that are transferred under the transaction, the payment might be characterised as payment for:
>
> - the supply of goods;
> - the provision of services;
> - the use of or right to use an intangible;
> - transfer of know-how; or
> - the disposal of an asset.
>
> 5.4.10 To take a simple example, a distributor of computer software products may, in addition to (or as alternative to) the traditional mode of worldwide distribution and sale of packaged software, store the software on its websites located in one or more countries. By storing the software on its websites on the Internet, the distributor is not limited to sales of physical copies, but could allow varying types of access to the product.
>
> 5.4.11 For example, the distributor could allow the consumer, for an appropriate fee, to:
>
> - View the software and/or a description of its operations;

[48] *ATO 1st report*, above n 16, para 5.4.9 – 5.4.11.

- Download a modified version for the purpose of "test-driving" the software;
- Download one copy of the full version of the software for operation on the consumer's computer;
- Download the software for the purpose of copying it to other computers;
- Download the software, or a part of it, for the purpose of modifying and/or reproducing it in another computer program;
- Run the software on the distributor's website; or
- Utilise a computer service provided by the publisher that will find and/or tailor a software program to the requirements of the consumer.



These options involve different types of transaction.

If determining what is being supplied is the pivotal question, how is the supplied characterised in the following Internet transactions? Is the supply the supply of goods, things or telecommunications?

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Examples of characterisation problems abound:

Example 1:

A website in the US allows a customer to download a movie (in digital format) and store the digitised version of the movie on the customer's hard disk drive. The customer can then watch the movie on her computer as many times as she wishes, but the technology prevents the customer making a copy of the movie. The customer pays $25 to do this.

What has been supplied? As far as the customer is concerned, she has purchased something similar to a video recording. The only differences are the media on which the movie is embodied and the delivery mechanism. Bits of information (representing the movie) were transmitted to the customer via the Internet and stored on the customer's hard disk drive. Something physically has happened to the customer's hard disk drive in the process of downloading the video. But was the customer supplied with tangible personal property?

From the supplier's viewpoint, what was supplied? Was it a movie, or the delivery of a movie, or a delivered movie, or a database service that allows customers to search for a movie and download a stream of bits?

How many supplies were there? Were there two supplies - a movie and the electronic delivery of the movie? Or, in the alternative, was there one supply - a delivered movie?

Assume in the above example that the customer could only watch the movie once, and then it was automatically disabled or deleted from the user's hard disk drive. This would appear to be more like the rental of a video, and less like the supply of goods.

In this example, when valuing what was supplied, does one value the bits or what the bits represent? Assume that the customer can also purchase movie tickets from the website, paid for by credit card, and the tickets are emailed to the customer for the customer to print out. Surely the value of the supply is what the bits or the ticket represents. But is it possible to differentiate the different values of the different kinds of bits and what they represent? If so, is it what the bits represent to the customer or the supplier that is important?

Example 2:

A website in Seattle allows customers to mail films to them. The films are processed, and the photos are placed on the website for the customer and friends to view. Each customer can maintain an electronic photo album on the website. The customer can print out the photos.

What has been supplied? Is it a photo processing service, a photographic web hosting service or developed photos? Is there any difference if the customer has the option of physically delivering the undeveloped film to a pickup point at the local mall, and can also have an expert print out the photos from the website for the customer at the mall.

Example 3:

The Wall Street Journal allows subscribers to access the WSJ website and read the latest edition online. The WSJ also emails subscribers a tailored news bulletin each day, as well as "news flashes" on the happening of important events. The customer can print out articles from the website. Subscribers can search a database of past editions.

What has been supplied? Is it a newspaper, or a subscription service, or a newswire, or a stream of bits, or access to a database service?

Example 4:

A software company in India creates computer programs using Indian programmers. Customers submit job specifications via a website to a software company. The software company, the programmers and the website are all located in India. When the software has been created, the customer can download the completed product from the website.

What has been supplied? Is it a computer program or computer programming services? Or is it just a supply of bits? In some instances, the customer will own the intellectual property. Is the supply a supply of intellectual property ownership rights? In other instances, the Indian software company will keep ownership of the intellectual property, and licenses the customer to use the program that was created. So is the supply merely the supply of a license? Does it make any difference if the Indian software company mails the completed program on disk to the customer?

In all the above examples, where does the supply take place? The ATO has acknowledged that:[49]

> payments arising from digital products and delivery mediums used in electronic commerce do not easily fall within traditional taxation characterisations...Revenue authorities around the world, including the ATO are currently examining possible approaches to the application of the existing definition and concepts in the electronic commerce context.

[49] Ibid at para 5.4.45.

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Sooner or later the tax gatherer and tax collector are going to have to come to a view on these sorts of circumstances. This appears to be an area where future court decisions will be fundamental.

But if one has to have a view at this stage, the possible choices are:

- That there is a supply of goods;
- That there is a supply of a right;
- That there is a supply of bits.

Each of those possibilities is defensible. But remember that s 9-25(5) requires (where there is no suggestion that the relevant supply is through an enterprise that the supplier carries on in Australia) that the "thing is done in Australia". Surely in characterising the relevant supply the courts will, as the court did the in British Telecommunications, stand back and come to a view consistent with what they consider to be the GST system. In other words, the courts will look to see what is the nature of the supply from an economic point of view.[50]

On that basis, why is it not possible to conclude that the supply is really the supply of the bits that have enabled the recipient to use/enjoy/consume the thing for which payment has been made? Further, why cannot it be concluded that that has happened in Australia with the result that the s 9-25(5) connection rule has been fulfilled and there is a potential taxable supply? Such issues as to characterisation have been considered in the context of the characterisation of income.[51] The ATO states that:[52]

> It has been argued that the acquisition of digital products by downloading from the Internet is simply another method of delivering goods to the consumer. Although the means of achieving delivery of a product electronically is different from the delivery of a physical good (in that electronic signal is sent to the consumer which is then recorded by the consumer's computer to produce the digitised product), the end result is the consumer acquires a product. On this view, the transaction should be regarded as economically equivalent to a supply of goods, and the payments should be so characterised for tax purposes.

One might understand a tax gatherer arguing that in Internet transactions the relevant supply can be characterised as a supply of bits. The further examples that have been provided are interesting:[53]

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50 This is how GSTR 2000/D7 tries to characterise such things as an architect's work on plans or a lawyer's advice: see paras 68 and 70.

51 *ATO 1st report*, above n 16, para 5.4.34 ff.

52 Ibid at para 5.4.35.

53 ATO, GST Consultative Forum on Electronic Commerce (May 2000) ch 4.

Examples:

The following examples will use these basic facts:

Virus protection software is purchased from <www.viruses-R-us.com>, after payment the files are down loaded to the recipient's computer.

Viruses-R-us.com is owned and operated by Money Maker Corp a US controlled and owned corporation. All of the equipment (servers etc) is located in the United States.

Private consumer - J Briko

Under subsection 9-25(5) the supply of the software is not connected with Australia because it is not prepared in Australia and Money Maker Corp has no permanent establishment in Australia.

In this instances paragraph 84-5(1)(c) the recipient is registered, or required to be registered is not satisfied.

J Briko is not registered or required to be registered for GST purposes and therefore the supply of the software in this instance is not a taxable supply.

Fully creditable - Useless Software Pty Ltd

Under subsection 9-25(5) the supply of the software is not connected with Australia because the software is not prepared in Australia and Money Maker Corp has no permanent establishment in Australia.

In this instance the requirements in paragraph 84-5(1)(a) the recipient of the supply acquires the thing supplied solely or partly for the purpose of an enterprise that the recipient carries on in Australia, but not solely for a creditable purpose is not satisfied.

Useless Software has acquired the software for a solely creditable purpose and therefore the supply is not a taxable supply in this instance.

If the item was to be considered a taxable supply Useless Software would be entitled to an input credit equal to the amount of GST payable on the acquisition.

Not fully creditable - Hidden Bank Ltd

Under subsection 9-25(5) the supply of the software is not connected with Australia because the software is not prepared in Australia and Money Maker Corp has no permanent establishment in Australia.

In this example, we assume that the requirements of paragraphs 84-5(1)(b) and 84-5(1)(c) are satisfied. Hidden Bank acquires the supply

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> for the purpose of its enterprise carried on in Australia. By virtue of subsection 11-15(2), the acquisition made by Hidden Bank is not solely for a creditable purpose because the acquisition relates to making supplies that are input taxed. Thus the supply by Money Maker Corp is a taxable supply under s 84-5.
>
> Under s 84-10 Hidden Bank, the recipient of the supply, is liable to pay GST on the taxable supply.

The ATO has previously indicated that although supplies from overseas could well by subject to GST, there was simply no way of collecting that tax. The Double Tax Agreements, for example, simply do not extend to GST.

The approach now adopted by the ATO is that the supply from overseas itself is not taxable because it is not connected with Australia within the meaning of s 9-25(5).

Consequently the ATO has formed a view on the characterisation of the supply of software in these examples. That requires one to concentrate on what is the "thing" and whether it is "done" in Australia. The answer, according to the ATO in these examples, is that "... the supply of the software is not connected with Australia because it is not **prepared** in Australia ..." (Emphasis added) a concept that is echoed in GSTR 2000/D7: see for example, paragraphs 39 and 70. So what does "prepared" mean? Does it follow that if software is "prepared" overseas, reduced to a disk, then it is sold in Australia and downloaded here that the same result applies?

Frankly, to come to the conclusion in these examples that there is no GST liability on Money Marker Corp is to cut across what has been previously indicated:[54] "To date, no revenue authority has found a practical method for collecting consumption taxes on the third category, and Australia's GST does not presently seek to do so."

Is there an Australian connection? What is the place of supply?

Having then determined that one may be dealing with either a taxable supply or a taxable importation or the reverse charge rule, the GST Act requires the Australian connection rules to be fulfilled.

For goods, a different rule applies where the goods are imported from those where the goods are simply supplied. Goods can be supplied within Australia, to Australia and from Australia, but only goods can be imported into Australia. Accordingly, the next stage is to concentrate on:

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54 *ATO 1st report*, above n 16, para 7.3.12.

- Supply of goods: s 9-25 Rules 1-3;
- Importation of goods: s 13-5.[55]

Section 9-25 Rules 1-3 provide:

> Supplies of goods wholly within Australia
>
> (1) A supply of goods is connected with Australia if the goods are delivered, or made available, in Australia to the recipient of the supply.
>
> Supplies of goods from Australia
>
> (2) A supply of goods that involves the goods being removed from Australia is connected with Australia.
>
> Supplies of goods to Australia
>
> (3) A supply of goods that involves the goods being brought to Australia is connected with Australia if the supplier either:
> (a) imports the goods into Australia; or
> (b) installs or assembles the goods in Australia.

Section 13-5 provides:

> (1) You make a taxable importation if:
> (a) goods are imported; and
> (b) you enter the goods for home consumption (within the meaning of the Customs Act 1901).
>
> However, the importation is not a taxable importation to the extent that it is a non-taxable importation.

Section 9-25 is concerned with the Australian connection rules. But inside those sections are in fact place of supply rules. In other words, it is necessary to determine the place of the supply before it is possible to determine the connection with Australia.

In that section, for goods, it is necessary to consider variously:

- Delivered;
- Made available;
- Removed;
- Imported; or
- Installed/assembled.

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55 In this area, there is no suggestion of the reverse charge rule applying since Div 84 is only concerned with things and not goods or real property.

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The majority of those terms are not defined and even though "import" is defined,[56] its definition really leads nowhere in the sense that some common law definition or customs duty notion or something else is to be inserted.

For "real property", the connection is "the real property, or the land to which the real property relates in is Australia". The definition of "real property" can extend to a contractual right in relation to land.[57]

For "things", the problem of characterising the "thing" as discussed above, is compounded by the formula in s 9-25(5). The connection rule in this section is dependent on either:

- Identifying that the "thing" is done in Australia; or
- The supply is through an enterprise that the supplier carries on in Australia, which then requires an examination of the ITAA definition of "permanent establishment".

Where "the thing is done in Australia", there is simply no clarification of meaning.[58]

An "enterprises carried on in Australia", s 9-25(6) incorporates into the GST Act, the Income Tax Assessment Act ("ITAA") concept of "permanent establishment". So, what is the result? Does that exercise give an answer to whether a website or a server is a permanent establishment for GST purposes?

Section 6(1) of the ITAA states:

> permanent establishment, in relation to a person (including the Commonwealth State or an authority of the Commonwealth or a State), means a place at or through which the person carries on any business and, without limiting the generality of the foregoing, includes:
>
> (a) a place where the person is carrying on business through an agent;
> (b) a place where the person has, is using or is installing substantial equipment of substantial machinery;
> (c) a place where the person is engaged in a construction project; and
> (d) where the person is engaged in selling goods manufactured, assembled, processed, packed or distributed by another person

---

56 This is no doubt defined in such a way as to make it clear that "import" is a concept limited to goods.

57 Section 195-1.

58 *ATO 1st report*, above n 16, para 5.2.23, for a discussion on the "place of contract of sale".

> for, or at or to the order of, the first-mentioned person and either of those persons participates in the management, control or capital of the other person or another person participates in the management, control or capital of both of those persons - the place where the goods are manufactured, assembled, processed, packed or distributed;
>
> but does not include:
>
> (e) a place where the person is engaged in business dealings through a bona fide commission agent or broker who, in relation to those dealings, acts in the ordinary course of his business as a commission agent or broker and does not receive remuneration otherwise than at a rate customary in relation to dealings of that kind, not being a place where the person otherwise carries on business;
>
> (f) a place where the person is carrying on business through an agent:
>
> (i) who does not have, or does not habitually exercise, a general authority to negotiate and conclude contracts on behalf of the person; or
>
> (ii) whose authority extends to filling orders on behalf of the person from a stock of goods or merchandise situated in the country where the place is located, but who does not regularly exercise that authority;
>
> not being a place where the person otherwise carries on business; or
>
> (g) a place of business maintained by the person solely for the purpose of purchasing goods or merchandise.

Why can't then a website or a server be a PE? There is very little by way of decided case law on this concept but in *Case 98*[59] it was stated that, in relation to "substantial equipment or machinery" that: "The meaning of 'substantial' is relative and in the case where the machinery required is not extensive and the whole is involved, it is 'substantial'."

GSTR 2000/D7 is of no assistance in answering those issues.

What constitutes a permanent establishment is discussed at length in *Tax and the Internet*[60] from which the following points emerge:

- It is not certain that a website located on a server in a jurisdiction constitutes a place of business (paragraph 5.3.12);

- It is likely that a server constitutes a place of business (paragraph 5.3.13);

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59 1957 7 CTBR (NS) 649.

60 *ATO 1st report*, above n 16, paras 5.3.1 - 5.3.72, Ch 5: Jurisdictional Issues.

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- "An enterprise that maintains a server located within a jurisdiction and carries on business through that server (eg, by hosting websites of other enterprises or by conducting commercial activities through a website on that server)" would be a permanent establishment in that jurisdiction whether the enterprise owned or leased the server (paragraph 5.3.14);

- Where a website is hosted on a server that is operated by another enterprise "the server would not constitute a PE of the enterprise that carries on business through the website since the server in these circumstances would not be owned, rented or otherwise at the disposal of the latter enterprise" (paragraph 5.3.15);

- "where a website is used by an enterprise to conduct business or commercial activities, the business of the enterprise is being carried on through that website, regardless of whether personnel of the enterprise are present in that jurisdiction" (paragraph 5.3.22);

- A database of digital products located on a server may not be a PE (paragraph 5.3.33).

The ATO's view of the application of the existing PE definition to websites and servers is clearly stated in paragraphs 5.3.30 - 5.3.32:

> 5.3.30 While it is arguable that, under the existing definition of PE in Australia's DTAs, a website or server may constitute a PE, it is clear that the existing definition will be difficult to apply in practice.
>
> 5.3.31 These difficulties will be compounded by the fact that there is considerable scope for an Internet business to structure its activities to ensure they do, or do not, result in a PE being established in the source country. The physical location of a website or server is becoming increasingly irrelevant as bandwidth and response time problems are being overcome. An enterprise will soon be able to access a market within a jurisdiction just as easily from a website located outside that jurisdiction as from one within that territory.
>
> 5.3.32 The resulting tax-planning opportunities are far from desirable, particularly if different countries take different approaches in relation to whether websites or servers can constitute PEs. If within the OECD it becomes generally accepted that a website is not itself a PE, a number of the jurisdictional complexities and planning opportunities discussed above become less relevant.

The operation of the reverse charge rule in Division 84 is equally dependent upon an analysis, of what constitutes "enterprise" and "carries on in Australia". Under s 84-5 (1)(a) the thing acquired has to be acquired solely or partly for the purpose for an enterprise "that the recipient carries on in Australia..." What is the position then if the recipient carries on that enterprise partly in and partly out of Australia?

Division 85 (Telecommunications Supply) links the connection with Australia on "effective use or enjoyment". Why adopt such a formula? Is it possible to have ineffective use or enjoyment? Is it possible to have use without enjoyment? Is the reverse true? (ie, enjoyment without use).

However Division 85 contains a place of supply rule before the Australian connection can be determined: the ability of the Commissioner to switch off the operation of Division 85 is dependant upon the supply not being made through an enterprise carried on in Australia.

Notice however that in relation to Division 85:

- The connection rules in s 9-25 still have effect: s 85-5 (3); and
- Division 84 can apply in relation to a telecommunications supply where it is not a taxable supply under Division 85: Explanatory Memorandum paragraph 1.39 says so (which means that if the Commissioner switches off Division 85 by exercising the power in s 85-5(2)(b), Division 84 could then apply).

Apart from waiting for rulings from the ATO, court decisions (that will be made against a framework of the courts then perception of the operation of the GST legislation) will be eagerly awaited.

Who is the supplier/recipient?

This has been dealt with previously in the paper and the GST Consultative Forum on Electronic Commerce is considering the issue further.

Is an export involved?

A transaction on the Internet can either lead to exports or be viewed as exports:

- Goods: s 38-185 and 38-187;
- Things: s 38-190.

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For real property, conceptually a situation could arise where a sale of Australian real property is made to someone overseas and to that extent may be determined as having been "exported". Sections 38-185 and 38-190 expressly exclude any operation in relation to real property and s 9-25 is quite specific in its connection between a supply and real property in Australia.

For telecommunications supplies, there seems no reason why s 38-190 can't apply, for example, item 3 could apply to a telecommunications supply.

Are businesses treated differently from private consumers?

The ATO's first report, *Tax and the Internet*, quite rightly draws a distinction between supplies occurring wholly within and outside Australia and for the latter between:

- Supplies of physical goods to both business and private consumers;
- Supplies from business to business of services or intangible products; and
- Supplies from business to private consumers of services and intangible products.

But the above analysis applies equally to business to business transactions as well as business to consumer transactions, except of course if the reverse charge rule is concerned, which can only apply to business to business situations.

What compliance issues are special for Internet transactions?

Some of the problems facing the ATO on Internet transactions have already been identified:

- Identity of the parties;
- Value/consideration particularly between associates;
- Where the place of supply has taken place and therefore whether the connection rules have been fulfilled;
- When the transaction has taken place and been made.

Two additional issues should be considered:

- Pay As You Go (PAYG) and the Australian Business Number (ABN); and
- International enforcement of tax liabilities.

Pay As You Go (PAYG) and Australian Business Number (ABN)

Can PAYG and the ABN help the ATO to administer Internet transactions? Yes, in theory, but only in business to business transactions where the parties are Australian businesses.

The fact sheet issued on the new PAYG system says that under this system,

> if a business supplies goods or services to another business and does not quote an Australian Business Number (ABN) on their invoice, the business that receives the goods or services is required to withhold tax from the payment to the supplier. This will make it difficult for unscrupulous operators in the cash economy.

Where a supplier does not quote its ABN on invoices then the recipient is to withhold payment at the top marginal rate plus the Medicare levy (currently 48.5% in total). That withheld amount can be claimed as a credit in the recipient's next tax return: ss 12-190, 18-15, 18-20, 18-25, 18-30 of the Taxation Administration Act 1953 (introduced by: New Tax System (Pay As You Go) Act 1999 - Act No. 178 of 1999.

At first glance this appears to be a significant weapon for the ATO, but (for example):

- The recipient only has to withhold if "the payment is for a supply that the other entity has made, or proposes to make, to the payer in the course or furtherance of an enterprise carried on in Australia by the other entity..." [Emphasis added]; s 12-190(1);
- The recipient need not withhold in circumstances where a quoted ABN is false but the recipient has no reasonable grounds to believe that the supplier does not have an ABN; s 12-190(3);
- The recipient need not withhold if the recipient is an individual and the payment is for the recipient wholly of a private or domestic nature or the payment does not exceed $50 or such higher amount as is specified in regulations; s 12-190(4).

It seems to follow that this withholding system will be ineffectual where, (for example):

- The supplier carries on an enterprise overseas;
- Even if the supplier carries on business in Australia, the recipient being a business has quoted to it a false ABN and the recipient has no grounds to believe that the supplier does not have an ABN;
- Even if the supplier is carrying on business in Australia, the supply is to a recipient for private or domestic purposes.

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International enforcement

Where the ATO considers that the supplier in another country has been making taxable supplies but not remitting GST, what does the ATO do? An assessment can be raised under s 23 of the Taxation Administration Act 1953 and proceedings could be instituted.

But what does the ATO do by way of service and, if it gets a judgment, how does it enforce that judgment? Section 34 of the Taxation Administration Act is the equivalent in the GST legislation to s 218 of the Income Tax Assessment Act but the Double Tax Agreements do not address GST. In short, there appear to be limited ways of enforcing a GST liability of an entity outside Australia.

Tax and the Internet (paragraphs 6.4.1 - 6.4.26) looks at the collection issue particularly the necessity for international co-operation. Figures 6.2, 6.3 and 6.4 (at 154-155) raise for debate some possible collection points: (see figures in appendix). To assist in enforcement overseas, *Tax and the Internet* Administrative Strategy A.5 makes it clear that the ATO will "Where appropriate ... seek agreement to obtain access to transaction and other financial records held by payment system providers outside Australia" generally to set up systems to access records held offshore, including make use of exchange of information provisions in existing Double Tax Agreements: see paragraphs A.5.5 ff. and paragraphs 6.3.1 ff.

Examples revisited

Day 1

US Shirt Co carries on business in the US as a maker of shirts. It has no other business. The business consists of receiving orders via the Internet from residents of Australia. Shirts are sold for $15 and are posted to customers who pay via the Internet upon delivery in Australia. US Shirt Co started business in 1998 and presently has an current annual turnover of $1 million. Of that, sales into Australia account for $500,000.

1 Should US Shirt Co register for GST purposes?
2 Should US Shirt Co have an ABN?
3 Is US Shirt Co making taxable supplies?
4 How would the Commissioner collect the tax?

Suggested view:

1 Yes. Section 188-15(3) disregards supplies that are not connected with Australia. Under s 9-25(1) the shirts are delivered in Australia and so the supplies are connected with Australia. The registration turnover threshold under s 23-15(1) is exceeded.

2 It can get an ABN but, A New Tax System (Australian Business Number) Act 1999 does not compel it to.

3 Yes. There is:

- A supply of shirts;
- Consideration;
- A supply made in course of furtherance of the enterprise of US Shirt Co;
- A supply connected with Australia (s 9-25(1));
- US Shirt Co is required to be registered for GST purposes.

4 Since supplies are made to private residents, at figures under the customs threshold, there will be no taxable importation and there does not appear to be any way in which GST payable by US Shirt Co can be collected.

[Note: *Importing and the New Tax System* booklet published by the ATO at 15 November 1999 states at page 16: "Imports that qualify for certain customs duty concessions are not subject to GST. These include:

Low Value Goods

Low value goods are goods whose value is insubstantial (customs value less than $1,000 for postal goods or less that $250 otherwise) and on which the revenue is nil or insubstantial ($50 or less)."

Enquiries indicate that duty on clothing reduced to 25% from 1 July 2000.]

Day 2

US Shirt Co changes its operations. It commences to sell shirts to Aussie Shirt Co Pty Ltd, an Australian resident company, which carries on the business of buying shirts and onselling them to Australian retailers. Shirts are sold under terms of trade requiring their delivery in Sydney. On receipt, Aussie Shirt Co Pty Ltd makes payment via the Internet.

1 Is US Shirt Co still liable to pay GST?

2 What is the position of Aussie Shirt Co Pty Ltd?

3 How does the Commissioner collect the GST payable by US Shirt Co?

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Suggested view

1 Yes - the analysis above still applies.
2 Aussie Shirt Co Pty Ltd makes a taxable importation since under s 13-5(1) goods are imported and Aussie Shirt Co Pty Ltd will be entering them for home consumption. However, Aussie Shirt Co Pty Ltd would enjoy a creditable importation. Sales by Aussie Shirt Co Pty Ltd to customers in Australia are subject to GST in the normal way.
3 Aussie Shirt Co Pty Ltd is not required to withhold the 48.5% of the price under the PAYG provisions because US Shirt Co is not carrying on an enterprise in Australia (s 12-190 of Taxation Administration Act 1953).

Day 3

US Shirt Co changes the nature of its business and calls itself US Software Co. It becomes a provider of software programs and downloadable books. Australian residents can access these services via the Internet and pay via the Internet. John, a Sydney resident, downloads a software program onto his computer in Sydney and pays a fee. Bill, a Melbourne resident, downloads a book, paying for it through the Internet.

1 Is US Software Co liable for GST?
2 Can the Commissioner collect that GST?

Suggested view

1 Yes because "the thing [delivery of the bits enabling the recipient to consume the software/book] is done in Australia"; Division 85 does not apply: the Explanatory Memorandum (paragraph 150) excludes licences to use intellectual property where that supply is delivered through telecommunications mediums.
2 No because *Tax and the Internet* says "Australia's GST does not presently seek to ... collect consumption taxes on supplies from business to private consumers of services and intangible products."

Note: the ATO would answer these questions:

1 No, because neither the software nor the book are "prepared in Australia": see Chapter 4 of the draft "Resolved Issues" paper;
2 Not applicable, because there is no GST liability.

Day 4

Bill travels to Hong Kong. He visits the office of US Software Co, takes delivery of a new software program on a CD and pays for it there. He travels

back to Australia with the CD and accesses the information on it using his computer. This will enable Bill to more efficiently carry on his business of money lending.

1 Is US Software Co liable for GST?
2 What is Bill's position?

Suggested view:

1 No, because delivery of the CD was made outside Australia.
2 Bill will be required to pay GST under Division 84 ("Reverse Charge").

Note: the ATO would probably answer these questions:

1 No, because the software was "prepared" outside Australia: see Chapter 4 of the draft "Resolved Issues" paper;
2 Yes, because of the "Reverse Charge" rule.

Day 5

Aussie Shirt Co Pty Ltd commences selling shirts to US residents. Its business is similar to the business conducted by the old US Shirt Co but it sells only to US residents.

1 Is Aussie Shirt Co Pty Ltd liable to pay GST?
2 Should Aussie Shirt Co Pty Ltd have an ABN?
3 How would the Commissioner collect the tax?

Suggested view:

1 No; s 38-185 will apply to any export;
2 Yes.
3 Not applicable

Day 6

Aussie Shirt Co Pty Ltd starts to sell shirts to Australian residents, and has a current annual turnover of $1 million.

1 Is Aussie Shirt Co liable to pay GST?
2 Should Aussie Shirt Co have an ABN?
3 Is Aussie Shirt Co making taxable supplies?
4 How would the Commissioner collect the tax?

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Suggested view:

1 Yes.
2 Yes.
3 Yes.
4 Pursuant to s 12-190 of the Tax Administration Act.

Day 7

Aussie Shirt Co Pty Ltd changes its operation and sells only digitised products through the Internet to US residents and Australian residents.

1 Is Aussie Shirt Co Pty Ltd liable to pay GST?
2 How would the Commissioner collect the tax?

Suggested view

1 No, if s 38-190 applies.
2 By using s 12-190 where applicable.

CONCLUSION

There are a number of issues that arise in this complex area. Forst has stated that:[61]

> While black letter rules have yet to materialise, statements of principle have abounded. Certain of the stated principles are more or less self evident, such as the idea that electronic commerce taxing regimes need to be fair, consistent, administrable and the like. However, other principles are neither self evident nor harmonious, suggesting that the real work of developing an electronic commerce taxing regime will be neither easy nor quick. The principle difficulty in developing an electronic commerce taxing regime is that the Internet is still a new medium whose full ramifications are not close to being understood. Accordingly, at least for now, governments at all levels are not eager to commit to rules that could potentially erode their tax basis. Business is not pushing for new rules either since existing rules can be interpreted favourably. Thus it seems that electronic commerce tax law will not be a radical departure from existing rules, but instead will develop piecemeal and reactively to cure perceived taxpayer abuses or revenue misallocations.

61 Forst D, "Old and New Issues in the Taxation of Electronic Commerce" (2000) 14 *Berkeley Technology Law Journal* 711.

One outcome already canvassed as a distinct possibility by the Australian authorities is:[62] "International agreements are likely to be necessary to allocate consumption and sales tax rights to avoid Double Taxation or unintentional non-taxation."

In general, it is possible to state that:

- So far as Internet transactions within Australia are concerned, the normal GST provisions will apply;
- So far as exports either through or using the Internet are concerned, ss 38-185 and 38-190 may well apply;
- So far as things supplied by or through the Internet from overseas are concerned, there may well be a taxable supply or a taxable importation. However, the extent to which a taxable supply is affected by an overseas entity, appears to leave few avenues open to the ATO to collect that tax.

There are at least four fundamental issues affecting GST and the Internet:

1 The characterisation issue:
How does one characterise Internet transactions?

2 The place of supply for "things" issue:
When is a "thing" done in Australia and can the concept of permanent establishment apply to such things as websites and servers?

3 The identity issue:
How does one know when dealing with an Australian or non-Australian resident?

4 The enforcement issue:
How will the ATO enforce overseas liabilities of GST and hence create a level playing field for Australian sourced transactions?

The ATO is keen to consult widely on these and other issues. That process of consultation, the ATO's deliberations and the deliberations of overseas organisations such as the OECD will have to be watched carefully by those who now and in the future will use the Internet for their transactions.

(See appendix figure 6.4 – Some of the administrative challenges and options for tax collection).

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62 *ATO 1st report*, above n 16, para 7.4.3.

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APPENDIX

Internet Transactions
Type
What
Taxable
Connection/ Place of Supply
Export
Application
Example
Mediu
Content
Div 85 Definition
Taxable Supply
Connection rules: • S. 85-5 • S. 9-25
S. 38-190
Applies to B2B B2C
So (eg) if no use or enjoyment in Australia, no GST
Goods
Real Property
Things
Taxable Supply
Taxable Importation
Reverse Charge (RC)
S. 9-25 Rules 1-3 No RC
S. 13-15 No RC
S. 9-25 Rule 4 No RC
S. 9-25 Rules 5-6
Div 84
S. 38-185 & 187
N/A
Nil
S. 38-190
N/A
Applies to B2B B2C
Applies to B2B only
So (eg) if below Customs & GST thresholds, no GST
So (eg) if below GST thresholds, no GST
So (eg) if thing not done here, no GST
So (eg) if recipient not in business, no GST

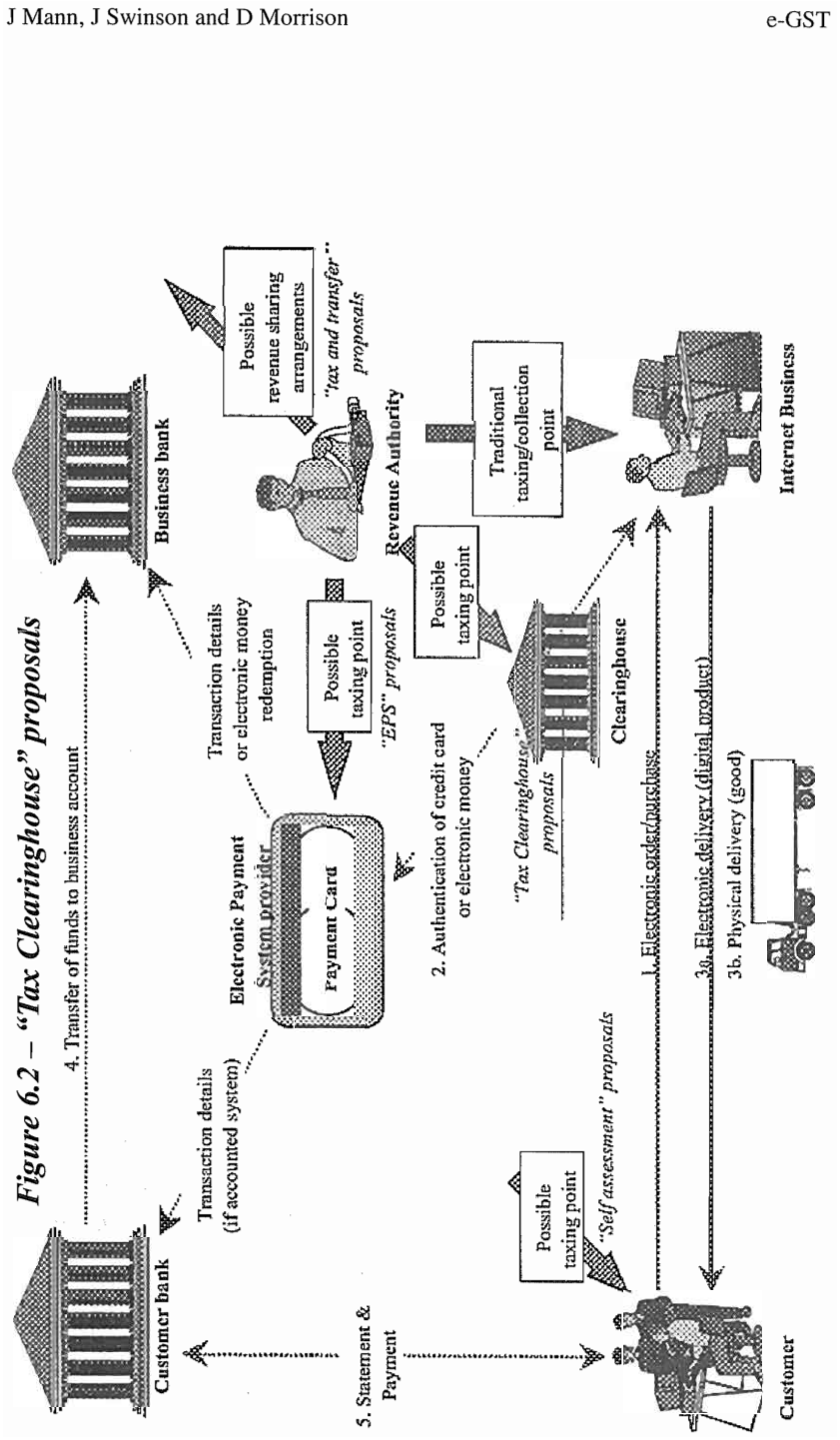
Figure 6.2 – "Tax Clearinghouse" proposals
4. Transfer of funds to business account
Business bank
Possible revenue sharing arrangements
"tax and transfer" proposals
Revenue Authority
Transaction details or electronic money redemption
Possible taxing point
"EPS" proposals
Possible taxing point
Traditional taxing/collection point
Internet Business
Electronic Payment System provider
Payment Card
2. Authentication of credit card or electronic money
"Tax Clearinghouse" proposals
Clearinghouse
Transaction details (if accounted system)
Customer bank
Possible taxing point
"Self assessment" proposals
1. Electronic order/purchase
3a. Electronic delivery (digital product)
3b. Physical delivery (good)
5. Statement & Payment
Customer

Figure 6.3 - Some of the administrative challenges and options
Some administrative challenges
Some options to address the challenges
The ability to identify a taxpayer
Unaccounted electronic payment systems
Strong encryption systems
Weak record integrity
Access to offshore banking facilities
.Business entity name/Number/Address display requirements
.Digital certificate Proof of identification requirements
.Web shop registration requirements - via business entry point
.Strengthened Domain Name System (DNS) requirements
.Use DNS/IP no. database for tracing (whois & traceroute)
.Detail ISP record keeping requirements re webshop contacts
Identity
.Electronic Payment Systems (EPS) accountability standards
.Electronic Payment System load and value limits
.Extension of AUSTRAC requirements to EPS arrangements
.Withholding systems in appropriate circumstances
.Encourage key management & recovery system use
.Maintain access requirements and penalties
.Revise burden of proof for encrypted records
.System record integrity standards for functionality and data
.Time based message digests/logs/digital notarisation/hash functions
.Write Once Read Many (WORM) technology (CD/DVD)
Information
.Exchange of Information provisions, Mutual assistance
.Addressing harmful tax competition internationally
.Preferential tax regime record keeping requirements
.Withholding systems in appropriate circumstances
.Accrual taxation systems eg treat overseas digital sales as tainted income for CFC purposes.
.Access restrictions, Web site 'takedown' / blocking

Figure 6.4 - Some of the administrative challenges and options for tax collection.