



Application of the reverse charge provisions – findings of reviews

Background

One area of focus under our GST Financial Services and Insurance Strategy is ensuring that goods and services tax (GST) is correctly remitted on cross-border transactions under the reverse charge provisions in Division 84 of the *A New Tax (Goods and Services Tax) Act 1999* (GST Act).

The reverse charge provisions are relevant to a range of entities, including domestic and foreign banks, Fintech entities (such as buy-now, pay-later providers, and online lenders or account providers), life insurers and funds.

Across reviews in the Top 100, Top 1000 and Medium and Emerging populations, the most common GST error identified for taxpayers in the financial services industry has been the failure to identify acquisitions where GST is payable under these provisions. Such errors can lead to significant amounts of underpaid GST.

While we have previously communicated to the market that this is an area of focus for the ATO, we would like to particularly draw attention to the errors we have observed, as we need to see a lift in the level of compliance with these provisions across the industry.

This document summarises our review findings and highlights both examples of best practice and errors we have seen. We set out the ATO's expectations and make recommendations to help you minimise compliance risk, and which can also assist you to demonstrate that you have taken reasonable care in reporting your reverse charge GST obligations.

Review findings

In our reviews, we request taxpayers' documented procedures to account for reverse charge GST, and conduct data and transactional testing to obtain assurance that transactions have been correctly treated.

We have seen examples of best practice where taxpayers have robust processes in place to account for reverse charged GST. For instance, one taxpayer's processes involved:

- All offshore vendor invoices without Australian GST being flagged upfront by the accounts payable team using a dedicated tax code.
- A well-documented, comprehensive monthly manual review by the tax team of all offshore acquisitions as part of business activity statement (BAS) preparation procedures, including the manual review of GST coding applied to offshore invoices.
- Use of a separate GST clearing account to track reverse charged acquisitions and to undertake trend analysis and monthly reconciliations.
- Reverse charge GST applied to related party transactions and intra-entity transfers, with the pricing used being equivalent to that used for income tax transfer pricing purposes.

In a number of reviews, however, errors were identified in applying the reverse charge provisions. For example, we have seen instances where:

- No documented processes were in place as part of the BAS preparation procedure to account for reverse charge on cross-border acquisitions.
- Procedures for accounts payable staff to escalate offshore transactions to the tax team were not lived in practice (as procedures were not embedded in day-to-day procedures for data processing, and staff training was limited).
- There was no involvement from the tax team in identifying relevant offshore acquisitions subject to reverse charge, indicating a lack of any detective controls in the BAS preparation process.
- The review of offshore acquisitions as part of the BAS preparation process was restricted to particular areas of the business or to high-value transactions, rather than being a comprehensive process covering the entire business.
- Identification of transactions subject to the reverse charge by the accounts payable team was based on a vendor list and the nature of supplies made by a particular vendor changed since the initial vendor list was prepared. This highlights the need to review reverse charge vendor lists on a regular basis.
- Certain subsystems were inadvertently not set up with built-in controls to flag offshore acquisitions for the application of the reverse charge.
- Input tax credits were claimed on offshore acquisitions despite no GST being remitted, due to the failure to apply the reverse charge.
- A particular offshore supplier's supplies ceased to be connected with Australia, which was not identified. Note that from 1 October 2016, GST law changes 'disconnected' inbound intangible supplies from non-residents to Australian-based business recipients, unless they are made through an enterprise the supplier carries on in Australia.

ATO's expectations

We would expect financial suppliers to have well-designed and documented processes to ensure the reverse charge is correctly applied on acquisitions from offshore suppliers where the acquisition partly or solely relates to making input taxed supplies.¹ Robust controls should be in place to ensure relevant transactions are identified, are correctly accounted for and disclosed in the lodged BAS.

Best practice is to have procedures at the time transactions are processed to make sure these acquisitions are flagged as being subject to the reverse charge. If not, there is an **absolute expectation** that a documented process is followed prior to lodging the BAS to ensure that acquisitions from offshore are not recorded without GST being remitted, such as a comprehensive review as part of the BAS preparation process.

For related-party transactions (including intra-entity transfers, such as administrative and support services provided by head office to the Australian branch of a foreign bank), GST must be accounted for at the GST-inclusive market value where the reverse charge provisions apply.² Consideration should be given to the special rules around reduced input tax credits on offshore supplies, such as those for unabsorbed contributions.

¹ Refer to the *GST Governance, Data Testing and Transaction Testing Guide* for guidance on the core elements of a well-designed tax control framework.

² Refer to sections 84-15 and 84-20 of the GST Act.

Data analytics tests can assist you in identifying potential errors. Where you identify errors, you should let us know. If you make a voluntary disclosure, we may reduce any penalties that may otherwise apply. We expect you to identify the root causes of the error to uncover any control gaps, and to take appropriate actions to enhance your tax control framework. It is critical that better practices are put in place when errors are identified, so that errors do not occur repeatedly.

ATO recommendations

We encourage all financial suppliers to consider the following recommendations to ensure compliance with Division 84 of the GST Act:

1. Review your tax control framework to ensure that well-designed controls are in place to mitigate risks of non-compliance with the reverse charge provisions.
2. Implement best practice processes and controls, such as in-built rules to flag offshore acquisitions at the time of processing transactions, in combination with a comprehensive review by the tax team during the BAS preparation process.
3. Ensure you have well-documented procedures to set out the relevant steps involved in data processing and in reviews performed by the tax function as part of preparing the BAS. This will help mitigate key person risk, such as where the knowledge sits with the same person in the tax team who has been doing the reviews for a substantial period.
4. Use data analytics tests to obtain confidence in your reporting with respect to these transactions, which can be conducted on a regular basis. For instance, tests can identify exceptions for further analysis where the billing address of the vendor is overseas or the transactions are in a foreign currency, but no reverse charge liability has been accounted for, or identify mismatches where some transactions from a particular vendor have a reverse charge liability but some do not.
5. Ensure monthly acquisitions subject to the reverse charge are clearly identifiable, and undertake trend analysis to identify potential anomalies in the value of reverse charge liabilities being reported in the BAS disclosures. This can assist in identifying system or transposition errors occurring in the reporting of these values.
6. Review your treatment of cross-border related party transactions and intra-entity transfers to ensure the reverse charge is being correctly applied.
7. Ensure that the scope of your periodic controls testing plan includes testing the operating effectiveness of your reverse charge procedures.

Amendment history

Date of amendment	Part	Comment
6 September 2022	Footnote 2	Replaced section 85-15 with section 84-15.