

SUBMISSION

NEW ZEALAND
INSTITUTE OF
CHARTERED
ACCOUNTANTS

SUBMISSION ON

GST remedial issues

15 April 2013

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GST issues
C/- Deputy Commissioner, Policy
Inland Revenue Department
PO Box 2198
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Dear Sir/Madam

GST Remedial Issues

Thank you for the opportunity to comment on the Officials' Issues Paper entitled GST Remedial Issues (the Issues Paper).

In summary, we:

- suggest that more detail of how the saving provisions will apply is required.
- agree that the definition of "hire purchase agreement" in section 2(1) of the GST Act should be amended to specifically exclude land.
- agree with the proposed change to the treatment of directors' fees.
- believe consideration should be given to a comprehensive one-off adjustment regime within the apportionment rules.
- support the clarifications to the land zero rating rules.
- consider the changes to the definition of "dwelling" will not adequately address all situations where the occupant lives independently but arguably does not have "quiet enjoyment" as that term is used in the Residential Tenancies Act 1986.
- support the amendment to section 21HB.
- disagree with the proposal to amend section 25(1). In particular, we do not support the proposal to require any GST refund to be returned to the recipient of the supply. The requirement to do this will depend on the contract between the parties.

We expand on these submissions below.

Detailed submissions

1. Saving Provisions and Timing of Application

NZICA is pleased that the changes identified in the Issues Paper will generally apply retrospectively. Although the Issues Paper mentions saving provisions, there are no details as to how those provisions will apply to those who have taken tax positions based on the legislation as it stood.

NZICA suggests that the savings provisions should be effective for positions taken up to the end of the quarter following the date of enactment of the Bill that includes the proposed amendments.

2. Hire purchase time of supply and land transactions

NZICA welcomes the discussion on the definition of hire purchase in relation to determining the time of supply in land transactions.

We believe the 'sharing' of definitions between the Income Tax and Goods and Services Tax Acts and, more significantly, subsequent amendments to those definitions to achieve specific outcomes on issues that have arisen in respect of either Act (but not generally both Acts) is the cause of this problem. A change for income tax purposes can have unintended GST consequences. NZICA believes there needs to be closer consideration of the practical effects of the use of joint definitions. Changes made in the Income Tax Act to address income tax issues should be examined closely to ensure there are no GST consequences.

2.1 Scope of the "hire purchase" agreement

NZICA agrees that the definition of "hire purchase agreement" should be amended to specifically exclude land.

NZICA understands that some Inland Revenue assurance staff have taken the position that a transaction involving real property could be characterised as a hire purchase agreement for GST purposes where the other criteria were met. This was of concern because real property was not covered by the now repealed Hire Purchase Act 1971 and no policy change was heralded at the time of the change.

In our view, an appropriate outcome could be achieved by either amending section YA 1 of the Income Tax Act 2007 (to exclude "real property" from the definition of hire purchase agreement), or by enacting a separate definition of "hire purchase agreement" for GST purposes (that excludes "real property"). An amendment to section YA 1 would be preferable to ensure that the position is also clear for income tax purposes.

2.2 Timing advantages

NZICA does not support the proposal to amend section 19D of the GST Act to include deferred settlements of land that include periodic payments. In our view further evidence of revenue risks arising from these transactions needs to be produced. In our view, the GST outcome in the example provided follows the cash flows and is therefore appropriate.

Changes to the law which depart from the default time of supply rules create increased opportunities for errors with penal consequences. There should be a high threshold to depart from those rules. We consider that the case for treating land differently from other large value assets that would seem to give rise to similar issues has not been made.

2.3 Scope of definition

We understand that this change is being made to bring the GST Act into line with the definition of “hire purchase” in the Hire Purchase Act 1971. The definition in the Hire Purchase Act does not require that the option to purchase be exercised or a future purchase be contemplated at the time the agreement is entered into.

The proposed change is stated to be consistent with the original policy intent for GST and the need arises from an error arising from the rewrite of the definition for Income Tax Act purposes.

The original policy intent is confirmed by an item in TIB Vol6, No 4 of October 1994.

The issue was further considered in BR Prd 02/16 where the Commissioner concluded that, on the facts, the agreements were not hire purchase agreements. This ruling may have led to confusion regarding the intended scope of the definition. (It would appear that the essence of the ruling is that the agreements did not have an option to purchase at all, rather than any option not having been exercised at the time the agreement was entered into).

Accordingly, the original policy intent appears to be that an option to purchase does not need to be exercised, so the amendment is required.

However, we consider that the overlap and differences between the income tax tests and GST tests for hire purchase agreements, finance and operating leases and agreements to hire still remain an area of confusion. We suggest that it would be useful to add consideration of these differences to confirm that they are required for the respective tax policies to the work programme. It may be that the rules could be made easier to apply.

3. GST treatment of directors’ fees

We agree with the proposed change to the treatment of directors’ fees from a GST perspective, which is intended to achieve a neutral outcome without imposing an obligation to register for GST. As the Issues Paper notes, the amendment would also apply to members of local authorities and statutory bodies.

3.1 Interaction with other taxes

The proposal in the Issues Paper assumes that a company is supplying the director services to the other company and on that basis deems a supply for GST purposes between the two companies. As the Issues Paper acknowledges, any legislative change would need to make explicit that this is a deeming provision for GST purposes only. It is not intended to alter the income tax consequences, the withholding tax consequences or any contractual relationships between the parties.

4. Apportionment rules

The Issues Paper proposes practical solutions to four issues arising under the apportionment rules. The first and third of these issues arise because of a fundamental difference between the “new” apportionment rules and the “old” change of use rules. In both cases, the issue could be easily solved by allowing a registered person to make a full change of use adjustment. We expand on this at paragraph 4.3, below.

4.1 Wash-up rule for taxable or non-taxable use

We agree with the proposed change to allow a wash-up calculation in the circumstances described. However, see also our comments at 4.3, below.

4.2 Ensuring apportionment rules apply to all entity types

The Issues Paper proposes an amendment that would allow companies effectively to apportion for “private” use where an asset is used by an associate.

NZICA agrees that this would be a useful compliance saving. It would allow small businesses to treat their assets in the same way for GST purposes whether or not they operate through a company.

However, the consequential compliance costs should be considered further.

The FBT rules would need to be amended so there is no FBT on the use of assets by shareholder-employees.

In addition, we believe the income tax consequences need consideration. The present proposals are aimed at simplification, which we support. Under the proposed change, the expenses incurred would not be fully deductible for income tax purposes and would need to be apportioned. If the effect of this change is a swap of GST compliance costs for income tax compliance costs then the amendment will not provide simplification.

It is not clear from the Issues Paper that this has been fully considered and that the swap provides an overall net compliance cost benefit.

We recommend that you undertake this analysis.

Anecdotally, we understand that some small businesses are not complying fully with the FBT rules. We understand some small businesses are unaware of the need to return FBT on vehicles provided to owner-operators until they consult a Chartered Accountant. The removal of the FBT requirement would resolve this issue of non-compliance. However, if there is no net compliance cost saving and the proposal does not proceed, Inland Revenue should consider how it can assist small businesses to understand and meet their FBT obligations.

The Issues Paper proposes a retrospective application date. We do not believe this is appropriate. We believe that this change should be optional and should apply prospectively.

4.3 Output tax and the disposal of land

The Issues Paper notes that there appears to be a risk that a person can dispose of land (and other assets) outside the course or furtherance of their taxable activity, while still not returning all of the input claimed in relation to that asset. The Issues Paper states that “from a policy perspective, when input tax has been claimed on an asset and that asset is then on-sold, the on-selling should generally be subject to output tax”. In our view, output tax is payable when the on-selling is “in the course or furtherance of a taxable activity”.

“Course or furtherance”

The issue of when a supply is “in the course or furtherance of a taxable activity” is fundamental. Prior to the introduction of the apportionment rules, it was generally accepted (by Inland Revenue and taxpayers) that use which was less than 50% taxable was not sufficient to bring the asset within the taxable activity. As a consequence, a sale of the asset did not attract GST.

We understand that NZICA members submitted to the Finance and Expenditure Committee on this matter and the Officials Report stated that there was no intention to change the rule. However, Inland Revenue has yet to provide a formal public statement as to whether the amendment has changed the law regarding when a sale is in the course or furtherance of the taxable activity.

We submit that Inland Revenue should clarify its position on the application of the phrase “in the course or furtherance” of a taxable activity, particularly in respect of assets subject to the apportionment rules. The statement should also consider whether any conclusion reached is consistent with the policy intent and, if not, whether any legislative amendment is required. This should be done with public consultation.

Comments on specific proposal

A fundamental difference between the previous “change of use” rules and the current apportionment rules is that there is no “principal purpose” test for claiming input tax and no “change of use” adjustment. GST payable or claimable is calculated on a time and use basis, taking into account the use of the asset over the time it is owned.

Where an asset is used for a taxable purpose initially and then for a non-taxable purpose, there is no mechanism to remove it fully from the GST base. Instead, it is subject to apportionment adjustments under section 21. The percentage of taxable use would reduce over time.

Where an asset is used partly for taxable and partly other purposes consistently, the registered person will claim a single input tax deduction to the extent that the asset is used for taxable purposes.

In either case, the input tax percentage claimed does not reflect whether the asset is in the taxable activity or not. This makes it difficult to determine whether a full output tax liability arises on a sale or deregistration.

For example, if an apartment complex was used on a 60% taxable basis for two years from acquisition and then the use changed to fully exempt, the registered person would need to continue to make output tax adjustments under section 21 until the percentage taxable use over time approached 0%.

Let us assume the property is sold when the percentage reaches 20%. The question then arises as to whether or not the sale is “in the course or furtherance” of the taxable activity. The previous legislative regime contained a “principal purpose” test. If the taxable percentage was above 50% then the sale would be taxable, below 50% it would not be. Given that there is no longer a “principal purpose” test, is the sale of an asset with a taxable percentage of 20% “in the course or furtherance” of the taxable activity and subject to GST?

It seems logical that the sale would be “in the course or furtherance” of the taxable activity. The apartment was committed to the taxable activity on acquisition and no transaction has occurred to take it out of the taxable activity. Further, technically, the ongoing adjustments have given rise to regular payments of “output tax” under section 21D(3)(b).

If our conclusion is correct, the registered person would be subject to an output tax liability either when the property is sold or when the person deregisters. In addition, such a sale would require the vendor to perform the wash-up calculation in section 21F.

We have not seen anything in the legislation to suggest that the requirements are different if the land is originally used for a fully taxable purpose and then changed to fully exempt use for two years prior to sale.

In these circumstances, we do not believe that the amendment is necessary. Instead, we would recommend the issue is covered in an Inland Revenue public statement.

It is possible that the amendment is being proposed to promote compliance. Registered persons who initially claimed full input tax on their land purchase may not be aware that they are required to perform apportionment adjustments once the land is applied for an exempt purpose. If this is the case, we would recommend that this be stated explicitly.

Notwithstanding the above, we agree with the comments in paragraph 4.24 that a targeted solution involving only land is appropriate. In our view, however, the proposed solution seems very complex and a simpler solution is desirable.

One-off “change of use adjustment”

The previous “change of use” rules allowed a one off adjustment where there was a change of use of an asset from taxable to non-taxable and vice versa. This adjustment was also used to transition an asset into or out of the taxable activity. This option no longer appears to be available.

We submit that Inland Revenue should consider a comprehensive one-off “change of use adjustment” regime. We would be happy to discuss this further with you.

4.4 Non-profit bodies and the apportionment rules

Given that the apportionment rules were not intended to alter the input entitlements of non-profit bodies we agree with the proposed solution to amend section 20(3K).

5. Zero-rating of land rules

5.1 Allowing input tax credits to registered persons subject to the reverse charge

We agree with the proposed change.

The example used highlights a small issue that has been exacerbated by the Commissioner’s statement in QWB0111 *Goods and Services Tax – Treatment of Transitional Services Supplied as Part of the Sale of a Business (that includes the supply of land)*. In our view, this statement has made interpretation of the provisions more difficult for taxpayers. The proposed clarifications are necessary as a result.

5.2 Clarifying section 11(8D)

We agree with the proposed amendment to clarify that the assignment or surrender of interests in land should be zero rated. This will allow these interests in land to be zero rated in the same way as other land rights. Given this, we believe they should be included within the definition of “land” in section 2(1).

5.3 Procurement of a lease

We agree with the suggested solution to add procurement of a lease to the list of “land” transactions. As above, we believe this should be included within the definition of “land”.

6. “Dwelling” and “commercial dwelling” definitions

6.1 Rest homes and retirement villages

The Issues Paper proposes that the definition of “dwelling” be amended to make clear that independent living units in retirement villages should fall within the “dwelling” definition.

We agree that there seems to be an issue as to whether the current definition captures these types of accommodation. However, in our view, the proposed solution does not go far enough. The same issue arises with supervised student flats and assisted living accommodation for those with disabilities.

We have had some discussions with staff from the Office of the Chief Tax Counsel on this matter. In those discussions, it was noted that the main issue seemed to be the meaning of “quiet enjoyment” as contemplated within the Residential Tenancies Act 1986. The phrase, as used in that Act and interpreted by OCTC, is intended to have a narrow meaning. We suggested that the issue could be solved if sub-paragraph (a)(ii) of the definition of dwelling were amended to remove the reference to the Residential Tenancies Act 1986. That is, the provision would read:

“(ii) in relation to which the person has quiet enjoyment;”

This would allow the phrase “quiet enjoyment” to be given a broader and more purposive meaning, rather than any meaning given by the Residential Tenancies Act 1986.

Whether or not the above solution is adopted, we would strongly recommend the situation be addressed at a practical level through the issue of some guidelines on the subject.

The guidelines should specify which additional services are important and at what point Inland Revenue officers will consider accommodation in a dwelling to be taxable. This has already been undertaken for the retirement village industry. However, as noted above, the issue affects other sectors including some which involve businesses that may be less sophisticated than retirement village operators. Registered persons in these sectors would benefit from a clear and concise Inland Revenue statement on the issue. In our view, the availability of additional, optional services that may be purchased separately from the accommodation should not prevent the accommodation being a “dwelling” as defined, where all other criteria are met.

6.2 Requirement to be registered

We welcome the inclusion in the Issues Paper of an amendment to section 21HB so that a sole trader who owns a rented property is not automatically registered for GST in relation to that property. This is consistent with the representations made by NZICA to the Policy Advice Division. This proposed amendment will remove some of the distortionary effects that the change to the definition of “dwelling” had made to the GST system.

7. Credit Notes

The Issues Paper appears to assume that in all circumstances where GST is incorrectly charged and refunded that the supplier will be obliged to refund the GST to the purchaser. There will be cases, particularly where the supplies are made to consumers rather than businesses, where the sale price is inclusive of GST if any. If the contract is such that there is no variation in the consideration, then a credit note will be matched by offsetting debit note for the amount of the GST. The mandatory issue of a credit note would be misleading and of no practical effect.

NZICA believes that the terms of the contract should dictate the position. The supplier is liable to return the GST, not the recipient. The incidence of GST in relation to consideration will depend on the contractual arrangement between the parties.

If there are specific situations where GST is not being charged, or is incorrectly charged, and this poses a high risk to New Zealand’s revenue base then we assume the Government would legislate to make the supply taxable. For this reason, we do not believe that the suggested amendment is appropriate or necessary.

If you have any queries regarding our submissions, please feel free to contact either of us.

Yours faithfully



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