

# ***GST Direct:*** State of the nation March 2013

Issue  
**16**

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## ***GST snapshot of the economy***

*How important is GST to our economy and what portion of the overall tax take and GDP does it represent? What is the future outlook? You will find some interesting GST statistics below.*

***In 2012, \$13.1 billion of GST was collected***

***GST continues to be the 2nd largest source of tax revenue***

***GST contributed to 26.6% of Crown tax revenue for 2012***

***GST revenue in 2012 was \$0.1 billion (or 0.5%) lower than forecasted***

***GST is approximately 8% of GDP***

***An increase in private consumption and the rise in the GST rate led to an increase in GST revenue in 2011 /12 of \$0.9 billion compared to 2010 / 11***

***GST revenue is forecasted to increase from \$15 billion in 2013 to up to \$20 billion in 2017***

The first half of the current financial year has reported GST revenue at \$7.07 billion – this means we are on track for a record GST year. Although slightly below the Government’s forecast, by 1.4%, this is an encouraging sign.

## ***Finalising your 2012 income tax return?***

*While you finalise your accounts and work through your tax provisions, remember there are a number of GST adjustments that could affect this process.*

In relation to the GST apportionment rules, we have found there is a common misconception that the rules are not compulsory. Not only are GST apportionments (for mixed use) compulsory, there is also a requirement to make annual adjustments to GST apportionment when certain thresholds are exceeded.

More detail on these GST adjustments can be found in our March 2012 GST Direct [here](#).

### ***Have you thought about:***

- 1. Entertainment expenditure*
- 2. Insurance receipts*
- 3. Bad debt write offs*
- 4. Management fees between associated parties*
- 5. GST return period thresholds*
- 6. GST apportionment adjustments*



## ***Proposal to limit GST refunds for overpaid GST***

*The GST remedial issues paper (December 2012) is proposing a new GST rule under which businesses would not be allowed to obtain refunds for GST paid in excess of the GST law. As the proposal will impact every business in New Zealand, the intention in the issues paper is to generate further discussion.*

Under the proposal if a business is not required to account for GST, or GST has been incorrectly accounted for, credit notes will need to be issued. However, the proposal also states the new rule would operate as a general 'unjust enrichment' rule. What this means is that any overpaid GST will only be refunded to a business if the refund is passed on to the customer who bore the GST cost. There is no similar rule for other taxes in New Zealand, and the question is whether an exception for GST is justified?

Under current law, any overpaid GST must be refunded to a business taxpayer because the payment is in excess of the requirements of the GST law. Inland Revenue would be unjustly enriched if it retained the overpaid GST. Inland Revenue is contending overpaid GST should not be refunded to a business – unless the refund is passed on – because the consumer pays GST.

Established principles in New Zealand demonstrate that no part of the price (regardless whether expressed as \$x including GST (if any), or \$y plus GST (if any)) comprises a payment of GST. The vendor's liability to pay output tax on supplies is an independent liability of the vendor. Reference to GST is simply a method by which the total price is assessed and is useful to avoid doubt as to the total payable in the situation where GST is relevant. A customer paying a price of \$100 does not pay a GST component of \$13 and a remaining amount of \$87 – the customer pays a price of \$100. The vendor has a separate liability under the GST Act for

GST of \$13 (rounded to the nearest dollar for ease of reference).

At the time of introducing GST there was much discussion about GST-inclusive and GST-exclusive pricing – businesses were given a choice as to their preferred pricing expression. The Minister of Finance indicated that any expressions as to GST in the price were about ensuring the consumer was aware of 'the all up price of the goods on the ticket'.

GST applies to supplies made to both businesses and consumers, and not only to supplies to consumers. GST is a form of tax imposed on businesses. To contend a consumer pays GST in the price would be the same as contending a consumer also pays a portion of (the seller's) corporate tax when they pay for goods or services, but this is not the case.

The recent GST rate increase experience is informative because it proves that not all businesses passed the GST increase to consumers – many businesses held prices and indeed in some cases prices dropped. The market sets the price and not GST.

On Inland Revenue's analysis that the consumer bears the cost of GST, so too do GST-exempt suppliers. Exempt suppliers will automatically be entitled to GST refunds (for overpaid GST) compared to other businesses who will need to demonstrate whether the GST was passed on or not. This inconsistency is another good reason to reconsider the proposal.

The proposal has serious ramifications as it is seeking to rewrite the contract between a business and its customer. The contract sets out rights between the parties and will often deal with refund rights. Under the law of restitution, unjust enrichment cannot arise if the contract between the parties is effective and governs the rights between them.

If Inland Revenue is concerned about significant GST refunds being released for overpaid GST, there are set off powers in the legislation allowing other outstanding taxes to be set off against expected refunds.

The proposal raises a tension between economic thinking (that GST is a tax on consumption) and the reality that GST is a tax on businesses imposed and collected under the GST Act.

In summary, we are concerned the proposal will not be welcomed by business because it will rewrite the contract and have an adverse impact. In this respect the proposal can be contrasted with the other business friendly measures in the issues paper (discussed further below). We believe the policy of preventing genuine overpayments of GST to be refunded – where there is no similar rule for other taxes – needs to be revisited. PwC has submitted on this proposal.

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## Recovery of GST costs by non-residents

The Taxation (Livestock Valuation, Assets Expenditure and Remedial Matters) Bill ('September 2012 Bill') includes a proposal to allow non-resident businesses to deduct GST on costs incurred in New Zealand. A special class of GST-registration will be introduced for non-residents and they will be required to file GST returns in order to be refunded GST incurred.

This is a welcome development as it promotes cross-border business-to-business neutrality and would bring New Zealand into line with international practice allowing non-residents to claim GST on costs.

There are still some issues to be ironed out in relation to how the proposed rules would work:

1. How the special registration regime would work in tandem with existing rules in the GST Act in relation to the GST registration of non-residents?
2. Will non-residents be required to calculate GST deductions in New Zealand based on their worldwide GST recovery percentage?

It would be a difficult, if not impossible task, for multi-national companies to re-evaluate global supplies from a New Zealand perspective simply to calculate GST recovery. Given that the proposal is intended to promote cross-border business-to-business neutrality, it should be as business friendly as possible. It would be simpler if GST recovery is calculated based on the non-resident's GST profile in New Zealand rather than with reference to worldwide supplies.

3. The further technical work required raises the issue as to whether a direct refund scheme (similar to those currently used in the European Union) should instead be introduced. A direct refund scheme is likely to be simpler and more business friendly than a formal GST registration.

### *Changes to the GST grouping rules*

In a related proposal, non-resident businesses will no longer be able to form a GST group with resident businesses. If enacted, this change would apply from 13 September 2012, being the date the September 2012 Bill was introduced. Existing GST groups that include non-residents will not be impacted by the proposal.

This is a base protection measure to enable the Commissioner to monitor the level of GST deductions claimed by non-residents.

The GST grouping rules are a simplification measure intended to reduce compliance costs by permitting a single return instead of multiple returns. Non-residents commonly group register with associated companies in New Zealand. Allowing the New Zealand company to prepare and file the GST return for the group as a whole reduces risk and improves compliance for non-residents who may be unfamiliar with the GST rules in New Zealand. This aspect of the proposal would significantly detract from the other positive features of the development.

Alternative measures could be considered to monitor GST deductions claimed by non-residents (eg. disclosure in the GST return).



## ***GST remedial issues paper***

*The Government is considering a number of GST changes which are aimed at providing clarity to taxpayers and ensuring the rules are operating according to the policy objectives.*

The GST remedial issues paper referred to earlier was released at the end of last year raising several proposed changes. Submissions may be made up until 1 March 2013.

The areas in which changes are proposed include:

- Hire purchase time of supply rule and land transactions
- Directors' fees
- Apportionment rules
- Compulsory zero-rating of land
- 'Dwelling' and 'commercial dwelling' definitions
- Credit notes and overpaid GST.

We generally welcome changes to the GST rules that provide greater certainty to taxpayers, however, we have concerns over the proposed changes to credit notes (see our earlier discussion of the unjust enrichment rule). We discuss some of the other proposed changes below.

### ***Hire purchase agreements and land***

There is some uncertainty as to whether the term 'hire purchase agreement' as used in the GST Act includes the sale of land on deferred terms. The issues paper proposes to amend the definition so that land is excluded from the scope of hire purchase agreements. To avoid any potential for timing advantages, it is also proposed that in respect of land transactions involving deferred settlement and periodic payments, the registered supplier will be required to account for GST on the supply at the time the agreement is entered into, rather than periodically.

One area to clarify in relation to any changes is for staged sales of separate lots of land, which may have different settlement dates and prices. These may constitute progressive supplies in any event.

### ***Treatment of directors' fees***

Inland Revenue considers that the current GST rules do not achieve the right policy outcome in certain situations. This is proposed to be clarified to achieve GST neutrality and ensure GST deductions can be claimed in certain situations. The proposed changes are business friendly and we welcome them.

### ***Zero-rating of land rules***

The compulsory zero-rating (CZR) rules for land transactions provide for a 'domestic reverse charge' in circumstances where a transaction is incorrectly zero-rated. An example of this is where a purchaser purports to be a registered person in order to zero-rate a land transaction, when in fact they are not. The effect is that the purchaser is treated as the supplier and is required to return the GST on the transaction but is not entitled to an input tax deduction. However, there is a proviso in the rules that allows an input tax deduction to be claimed if the person later becomes registered and uses the land in a taxable activity.

While the charging rule applies in all cases where a transaction has been incorrectly zero-rated, the proviso which allows the input tax deduction at a later time only applies if the person was not registered at the time the transaction took place. This would deny an input tax deduction where a transaction was incorrectly zero-rated even if at the time the purchaser was already registered. In a welcome development, the proviso will be extended to persons that are already registered.

### ***Other land changes***

The issues paper also proposes changes to the rules relating to the sale of land where only a partial GST recovery has occurred in relation to the GST paid on acquisition. This could occur where, for example, a rental property is sold which includes a minor area used for taxable purposes. Inland Revenue is proposing that GST be paid on the disposal of the 'taxable' portion of the land. Under the current rules such a sale would not be subject to GST.

This change is intended only for land (an appreciating asset), but not for any other (depreciating) assets.

The issues paper does not address the impact of the CZR rules in these situations.

### ***'Dwelling' and 'commercial dwelling'***

Changes to the definition of 'dwelling' and 'commercial dwelling' from 1 April 2011 meant that some premises that were a 'dwelling' became a 'commercial dwelling' and as a result owners of those premises were considered to be making taxable supplies. To cater for this change, a further rule was introduced which allowed an input tax deduction in relation to these premises but only if the person was required to register (ie. making taxable supplies in excess of \$60,000).

While the policy intent of the rule was to prevent persons who only make minimal supplies in relation to a commercial dwelling from claiming large deductions, the practical application has been that holiday homes that are occasionally rented out (and well below the registration threshold) have also been caught by virtue of their owners' other business activities.

Officials recognise that holiday home owners may prefer not to be forced to include their holiday home into their taxable activity. Instead a change is proposed so that a person will have the option of including the 'commercial dwelling' (ie. the holiday home) as part of their taxable activity if the supplies in relation to the 'commercial dwelling' are less than \$60,000.

## ***GST on importation – timing of deduction***

*Many businesses recover GST they pay on imports later than they are entitled to do so.*

This means businesses may be missing out on the one-off timing benefit that would be available by advancing the timing of their GST input tax deductions.

GST is payable to Customs on imported goods. Businesses that are registered can generally recover this GST as a deduction in their GST return. Most businesses claim the GST in the return covering the month in which the GST is actually paid to Customs.

Customs offers a deferred payment scheme which businesses may apply to join. Once accepted, businesses are able to defer the payment of GST (and other custom duties), in some cases for up to seven weeks. The scheme effectively allows goods to be removed from the port of entry without requiring prior payment of GST.

Businesses that are registered on an invoice basis will be entitled to claim the GST in the return covering the month in which the goods are imported (that is, before the GST is actually paid to Customs under the deferred payment scheme). The import entry documentation constitutes an 'invoice' and therefore triggers the time of supply for the importer.



## ***GST and cloud computing***

Cloud computing is fast becoming a global phenomenon. The PwC US Indirect Taxes Team have prepared an article summarising the GST / VAT implications of cloud computing (eg. web hosting and e-storage services) around the globe.

The article can be found at the following link [here](#).

***The relevance for New Zealand businesses is:***

***Suppliers of 'cloud' services into other countries – potential liability and registration obligations may exist in some countries; and***

***Recipients of 'cloud' services - businesses making GST-exempt supplies (eg. banks, funds managers, life insurers and retirement sector operators) may have an obligation to account for GST on the imported 'cloud' services under the 'reverse charge' rules. This is a good opportunity to assess the current treatment of imported services from a GST accounting and systems perspective.***

