

# GST: Cross-border services, intangibles and goods

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*A government discussion document*

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Minister of Revenue



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# CHAPTER 1

## Introduction

- 1.1 This discussion document seeks submissions on proposed new rules that would apply Goods and Services Tax (GST) to cross-border services and intangibles (including e-books, music, videos, and software purchased from offshore websites). The proposed rules would require offshore suppliers to register and return GST when they supply services and intangibles to New Zealand-resident consumers.
- 1.2 The proposed rules are broadly aligned with the Organisation for Economic Co-operation and Development (OECD) draft guidelines on the GST treatment of cross-border services and intangibles as well as international practice.
- 1.3 This paper also contains some discussion on the collection of GST on low-value imported goods but does not, at this time, propose extending any registration system to offshore suppliers of low-value goods. It does, however, acknowledge the issue around the de minimis threshold under which GST does not have to be paid on imported goods and the wider issue of the cost of collecting GST on low-value imported goods.
- 1.4 By seeking to address the question of GST on cross-border services and intangibles, this discussion document is the first step in a review of the collection of GST on imported goods. Submissions are therefore sought on both the services and intangibles proposals, and on the collection of GST on goods. It is anticipated that a paper on goods, specifically focusing on the GST treatment of low-value imported goods will go to Ministers by October this year. This is anticipated to be followed by public consultation and further submissions will be able to be made as part of that process.

## Background

- 1.5 GST is not usually collected on cross-border services and intangibles purchased from offshore suppliers. When GST was introduced in 1986, New Zealand consumers purchased few services from offshore, and online digital products were not yet available. At that time, the compliance and administrative costs involved in taxing imported services potentially outweighed the benefits of taxation.
- 1.6 The growth of e-commerce means the volume of services and intangibles on which GST is not collected is becoming increasingly significant. This raises the question of whether the existing tax rules will remain suitable and sustainable in the future. In particular, concerns have been raised about the impact that the uneven GST treatment may have on the competitiveness of domestic providers, and on future tax revenues.

- 1.7 Non-collection of GST on cross-border services and intangibles is an international issue faced by countries that have a GST or Value Added Tax (VAT) system. The OECD draft guidelines focus on establishing an international set of principles for determining when countries should have the right to tax these supplies.
- 1.8 The draft guidelines were released for consultation on 18 December 2014 and divide services into two main groups:
- **“on-the-spot” services** – where the supplier and the customer are likely to be in the same place when the services are supplied – for example, a person receiving a haircut; and
  - **“remote” services** – where it is not necessary for the supplier and customer to be in the same location when the services are supplied – for example, a person downloading a song from a website.
- 1.9 The draft guidelines suggest that, for remotely provided services and intangibles, the consumer’s usual place of residence is the predominant test for determining which country has the right to tax. They also suggest that offshore suppliers could be required to register and return the GST on remote supplies, as is the case in the European Union. The guidelines are expected to be finalised later this year.
- 1.10 Apart from the European Union, the offshore supplier registration model has been adopted for cross-border services and intangibles by a number of countries, including Norway, South Korea, Switzerland and South Africa. Other countries, including Japan and Australia have also announced plans to introduce the model. The countries that have implemented a system report some success in collecting the GST/VAT.
- 1.11 Chapter 3 discusses the collection of GST on low-value imported goods. It explains why GST is not currently collected on low-value imported goods and the issues that would be involved in addressing this.

#### **Proposed new rules for taxing cross-border supplies of services and intangibles**

- It is proposed that services and intangibles supplied remotely by an offshore supplier to New Zealand-resident consumers will be treated as performed in New Zealand and therefore subject to GST.
- Offshore suppliers will be required to register and return GST if their supplies of services to New Zealand-resident consumers exceed a given threshold in a 12-month period. Submissions are sought on the value of that threshold.
- A wide definition of “services” is proposed, which includes both digital services and more traditional services.
- In some situations, an electronic marketplace or intermediary may be required to register instead of the principal offshore supplier.

- While GST is about taxing business-to-consumer supplies, submissions are sought on whether offshore suppliers should be required to return GST when they supply services and intangibles remotely to New Zealand GST-registered businesses (which would normally be able to claim the GST back) and whether these services would count towards the registration threshold.
- Offshore suppliers would be able to rely on certain objective proxies in order to determine whether a customer is a New Zealand resident.
- If supplies to New Zealand-registered businesses are excluded, New Zealand businesses would be required to identify themselves as a business by providing their IRD number to the offshore supplier when acquiring services that would otherwise be covered by the rules.
- If business-to-business supplies are excluded, the existing reverse charge rule would apply to GST-registered businesses that receive services and intangibles from offshore suppliers when the services and intangibles relate to non-taxable activities.
- Again, if business-to-business supplies are excluded and a person misrepresented themselves as a business to avoid being charged GST, the existing “knowledge” offences may apply and, if applicable for more egregious cases, the Commissioner of Inland Revenue would have the discretion to register the person for GST and require the GST to be paid.
- The following three registration systems for offshore suppliers are being considered:
  - the domestic registration system;
  - a “pay only” registration system; or
  - a regional “one-stop-shop” registration system.
- It is proposed that the new rules would be included in the next omnibus tax bill.

## **Consultation**

- 1.12 If you would like to make a submission on the proposals in this paper, e-mail [policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz) or write to the following address:

GST: Cross-border services, intangibles and goods  
 C/- Deputy Commissioner Policy and Strategy  
 Inland Revenue Department  
 P O Box 2198  
 Wellington 6140

- 1.13 Submissions on the discussion document can be made until 25 September 2015.

- 1.14 It would be helpful, but not essential, for submissions to include a brief summary of major points and recommendations. They should also indicate whether the authors are happy to be contacted by officials to discuss the points raised, if required.
- 1.15 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason will be determined in accordance with that Act. You should make it clear if you consider any part of your submission should be withheld under the Official Information Act and the grounds you consider justify its withholding.



## CHAPTER 2

### Background

- 2.1 In principle, GST should apply evenly to all consumption that occurs within New Zealand as this helps to ensure GST is fair, efficient and simple. However, GST is not typically collected on cross-border services and intangibles (including internet downloads and online services) purchased from offshore websites.
- 2.2 The growth in online purchases means that the volume of imported services on which GST is not collected is becoming increasingly significant. This raises the question of whether the existing tax rules will remain suitable and sustainable in the future.

### Implications of non-collection

- 2.3 In general, the growing ability to easily purchase services online has benefited New Zealand. It has given consumers greater access to a wider range of services from around the world and increased competition in the domestic retail market. Increased competition tends to encourage the efficient use of resources, which can result in lower prices, greater innovation, and better quality goods and services for consumers.
- 2.4 Despite these benefits, when GST does not apply evenly, it may bias consumer and business decisions, which could lead to unfair and inefficient outcomes. Many domestic providers feel the current tax settings place them at an unfair disadvantage compared with offshore businesses supplying products with no GST added to the price. This is having the greatest impact on sellers that provide services that are similar to services provided from offshore (or substitutable products).
- 2.5 There are a number of reasons why New Zealand consumers purchase services online from offshore, such as overall cheaper prices, product availability and convenience. However, ideally, the tax treatment should not be a factor in consumers' purchasing decisions.
- 2.6 Furthermore, the growing e-commerce market means the amount of GST not being collected on services, intangibles and goods supplied from offshore, but consumed in New Zealand, is increasing. It is likely that around \$180 million of GST is forgone on cross-border services, intangibles and goods per year (of which about \$40 million relates to services and intangibles). The growth of imported goods and services is a relatively recent development and the amount is expected to continue to grow – estimates vary but the growth could be around 10 percent a year.

2.7 Government revenues pay for important public services such as education, healthcare, roads and superannuation. Given that 18 percent of total Government revenue is collected from GST,<sup>1</sup> an increasing gap in that revenue base is a concern for the Government. A shortfall in GST revenue may eventually have to be paid for by tax increases or spending cuts.

### **New Zealand's GST system**

2.8 New Zealand's GST is a "consumption tax". Consumption taxes seek to tax consumer spending on goods and services. The country that has the right to tax this consumer spending is generally the country in which the good or service is consumed. This is known as the "destination principle".

2.9 Conversely, goods and services that are exported, and therefore consumed offshore, are generally untaxed (under GST, exports are zero-rated, meaning GST is charged at a rate of zero percent and businesses can claim GST back on their inputs). Allowing exporters to claim back GST on their inputs ensures that GST is not a cost on business or offshore consumers.

2.10 If countries apply the destination principle and also recognise that GST is a tax on consumers not businesses, double taxation and non-taxation in cross-border trade should largely be averted.

2.11 New Zealand's GST system is regarded throughout the world as a model consumption tax. This is because our GST system is very broad-based – it applies to a wide range of goods and services and there are very few exemptions. When GST applies broadly it ensures that consumer decisions to purchase particular goods or services are not influenced or driven by tax considerations. This improves its efficiency and fairness, and provides simplicity.

2.12 Despite New Zealand's broad-based GST system, GST does not generally apply to cross-border services and intangibles consumed in New Zealand. This is contrary to the destination principle and means that these services are not taxed in any country.

2.13 The Goods and Services Tax Act 1985 (the GST Act) defines "services" as anything other than goods or money, and therefore includes intangibles like digital content. GST generally only applies to services which are:

- performed by New Zealand tax residents;<sup>2</sup> or
- supplied by a non-resident, but physically performed in New Zealand.<sup>3</sup>

2.14 When GST was introduced in 1986, few New Zealand consumers purchased services from offshore, and online digital products were not yet available. At that time, the compliance and administrative costs involved in taxing cross-border services potentially outweighed the benefits of taxation.

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<sup>1</sup> A Snapshot of the 2014 Financial Statements of the Government.

<http://www.treasury.govt.nz/government/financialstatements/yearend/jun14snapshot/fsgnz-snap-jun14.pdf>

<sup>2</sup> Section 8(2) of the GST Act – *Supply in New Zealand*.

<sup>3</sup> Section 8(3)(b) of the GST Act – *Deemed supply in New Zealand by non-resident*.

- 2.15 Since the introduction of GST, steps have been taken to apply GST to some cross-border services consumed in New Zealand:
- Since 2003, offshore suppliers of telecommunications services have been required to return GST on telecommunications services initiated by consumers in New Zealand.<sup>4</sup> Note, however, that the definition of “telecommunications services” excludes the content of the telecommunication so would exclude services such as internet downloads that are delivered electronically.<sup>5</sup>
  - Since 2005, the GST reverse charge was made applicable to imported services by businesses making exempt supplies and other non-taxable supplies. A reverse charge treats the purchaser as having made the supply and therefore being liable for the GST. The reverse charge also applies to unregistered persons who acquire imported services that bring them within the \$60,000 taxable supplies threshold for registration.

### **International developments**

- 2.16 The OECD work on GST and cross-border services and intangibles is connected with the work on “base erosion and profit shifting” (BEPS). BEPS refers to tax planning strategies employed by multinational companies that exploit gaps and mismatches in international tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.
- 2.17 In the consumption tax context, the focus is on which country has the right to impose consumption tax on imported goods and services. In the case of goods, the place of consumption will be clear – the consumption occurs in the country of import.
- 2.18 There is less certainty when applying GST to cross-border services and intangibles supplied remotely. In many cases it is not clear where the consumption occurs and therefore which country has the taxing right. For example, a New Zealand resident could purchase and download a movie while overseas on holiday. Without international consensus on taxing rights, it is possible that the download could be taxed in New Zealand, the country where the download took place, neither or both.

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<sup>4</sup> See section 8(6) of the GST Act. Assuming they are registered for GST or are required to register for GST because they have more than \$60,000 of supplies to New Zealand customers.

<sup>5</sup> The definition of telecommunications services in the GST Act under section 2 states that telecommunications services means the transmission, emission or reception, and the transfer or assignment of the right to use capacity for the transmission, emission or reception, of signals, writing, images, sounds or information of any kind by wire, cable, radio, optical or other electromagnetic system, or by a similar technical system, and includes access to global information networks but does not include the content of the telecommunication.

- 2.19 The OECD has been working on a set of guidelines addressing these issues of double taxation and non-taxation that may arise from inconsistencies in the application of VAT/GST to international trade. The first stage considered VAT-neutrality and place of taxation rules for cross-border business-to-business supplies of services and intangibles. These guidelines have now been finalised and the OECD recommended that the country in which the business customer is located has the right to tax.
- 2.20 New Zealand adopted this approach in 2014 with the introduction of rules governing when a non-resident business can register for GST and claim input tax deductions for GST charged in New Zealand. These rules ensure GST is neutral for cross-border business-to-business supplies in the same way as for domestic businesses.
- 2.21 As noted in Chapter 1, the OECD is developing guidelines that establish international best practice for determining taxing rights in regard to cross-border business-to-consumer supplies of services and intangibles. The draft business-to-consumer guidelines can be found at:
- <http://www.oecd.org/ctp/consumption/discussion-draft-oecd-international-vat-gst-guidelines.pdf>*
- 2.22 The draft business-to-consumer guidelines broadly divide cross-border services into “on-the-spot” services and “remote” services. In relation to remote services, the draft suggests the consumer’s usual place of residence as the predominant test for determining where the consumption occurs. It also suggests requiring offshore suppliers of services to register in the country of consumption as a suitable method of taxing these supplies.
- 2.23 The offshore supplier registration model has already been adopted for cross-border services and intangibles by the European Union, and a number of countries including Norway, Switzerland, South Africa, and will be followed by Japan and South Korea. The countries that have implemented a system report some success in collecting the GST/VAT.
- 2.24 Australia has also recently announced measures to apply GST to cross-border services and intangibles from 1 July 2017. Following consultation, the measures will apply to a broad range of services and intangibles received by Australian-resident consumers.
- 2.25 For more information on how other countries tax, or propose to tax, cross-border services and intangibles, see the attached appendix.

## CHAPTER 3

### Low-value imported goods

- 3.1 The non-collection of GST on low-value imported goods raises similar concerns as with cross-border services and intangibles. In particular, domestic suppliers of goods are concerned they are at a competitive disadvantage compared with offshore suppliers that are able to transport low-value goods directly to their customers without the imposition of GST.
- 3.2 Ideally, GST should be collected on all imported goods, as these goods are likely to be consumed in New Zealand. However, New Zealand and other countries apply de minimis thresholds below which no duty, including GST, is collected on imported goods. De minimis thresholds are applied to facilitate the flow of goods and to ensure that the cost of collecting GST on low-value goods does not outweigh the benefits of doing so.
- 3.3 The growth of e-commerce and the practice of supplying goods directly to customers have meant that the volume of low-value goods imported by final consumers has significantly increased. Given the nature of the current methods of collecting GST on imported goods, the growing volume has meant the cost of collecting GST on these goods, and the GST revenue forgone, have both increased.
- 3.4 Since customs authorities, including New Zealand's, apply similar processes for collecting GST/VAT on imported goods, the high cost of collection is an international challenge. Many countries are seeking lower cost methods of collecting GST/VAT on imported goods, however, no country has yet developed a low-cost alternative to traditional collection systems.
- 3.5 While low-value imported goods are not considered in the OECD draft guidelines (discussed in the previous chapter), the OECD does recognise the impact of the growth of e-commerce is having on the volume of imported low-value goods. In particular, the administrative costs of collecting GST on these goods and competitive distortions de minimis thresholds may create are recognised.<sup>6</sup>
- 3.6 The Government is engaging in international discussions about lowering the cost of collecting GST on imported goods to determine whether any developments have the potential to lower the cost of collecting GST in New Zealand.
- 3.7 This document outlines current processes for collecting GST and tariffs on low-value imported goods, and the work that the New Zealand Customs Service (Customs) has underway to look at how processes might shift over time. Readers with an interest in the collection of GST on low-value imported goods and the de minimis are invited to include concerns about this issue in their submission. This document is the first step of a wider review of the GST treatment of imported goods and it is expected that there will be

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<sup>6</sup> The OECD, *Addressing the Tax Challenges of the Digital Economy*.

further opportunity to make submissions in a subsequent consultation paper, specifically focusing on the GST treatment of low-value imported goods.

### **Current imported goods rules**

- 3.8 GST on imported goods is collected by Customs at the border. However, GST is not collected if the total duty value (including GST, tariffs and other duties) is less than \$60. This is known as the “de minimis” threshold.
- 3.9 Depending on freight costs, the \$60 de minimis threshold can roughly equate to a parcel worth \$400 if GST is the only duty applying. It can equate to a parcel with a much lower value when tariff duty applies or the freight and insurance costs are high. A 10 percent tariff duty applies to a range of goods, including some apparel and footwear.
- 3.10 The de minimis does not apply to shipments of alcohol or tobacco products.

#### **Example**

Fiona purchased a new stereo for her car online from an offshore website. She paid \$250 for the stereo and \$50 for shipping. Since the duty on the stereo is only \$45 ( $250 + 50 \times 15$  percent), which is below the de minimis, Customs will not require Fiona to pay GST.

A few months later, Fiona purchased some shoes from an offshore website with a value of \$250 and paid \$50 for shipping. Footwear has an additional 10 percent tariff which means the total duty owing is now \$73.75 (the 10 percent tariff of \$25 plus the GST amount of \$48.75), which is above the de minimis. Fiona is now required to pay the GST and the tariff.

- 3.11 Customs has an online calculator by which people can estimate how much duty (including GST) they may need to pay. The calculator can be found using the link below:

*<http://www.whatsmyduty.org.nz/>*

- 3.12 New Zealand is required to have a de minimis threshold to comply with international obligations.<sup>7</sup> The rationale behind the de minimis is to facilitate trade and achieve a balance between the cost of collection and the revenue received. In the New Zealand context, the de minimis is set at a level under which it is estimated that the costs of collecting the duty begin to exceed the revenue the duty generates.
- 3.13 While collecting revenue for the Government, Customs looks to ensure that the flow of goods across the border remains as smooth and uninterrupted as possible, while still managing the risks that these goods may pose to our borders. Risks include the entry of banned or prohibited items such as drugs or objectionable material.

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<sup>7</sup> Protocol of Amendment to the International Convention on the Simplification and Harmonization of Customs Procedures.

## **Government consideration of the cost of collection**

- 3.14 The Government is looking at how the collection of GST on low-value imported goods can be improved. In particular, the Minister of Customs has asked Customs to report back by October this year on:
- options to strengthen and streamline GST collection on low-value goods while maintaining current levels of risk assessment;
  - a recalculation of the future costs of collecting GST on low-value goods; and
  - options to change the level of the de minimis and simplify it.
- 3.15 Following this report, a consultation document is anticipated to be released that will seek public feedback on options to improve the collection of GST on low-value goods, with a view to making changes to the current system of collecting GST on these goods. This could also look at the de minimis. Below is a summary of how current collection systems work and how these could be strengthened in the near future.

## **Existing collection systems**

- 3.16 The most common approach for collecting GST on imported goods internationally is assessment and collection by government customs authorities. This may be because GST/VAT collection by customs authorities complements their roles in processing and inspecting goods for border security purposes and in applying other duties such as tariffs (where applicable). The customs authority calculates the GST (and other duties such as tariffs) on goods entering the country and then collects the GST from the recipient of the good.
- 3.17 New Zealand does have elements of this approach depending on whether goods are sent via the courier or postal stream. In regard to the courier stream, courier organisations collect GST on the goods they handle and remit it to Customs. Whereas, New Zealand Post bills recipients for the GST owing on postal parcels on behalf of Customs, which is then either paid directly to Customs or via a broker. Manual processing post-border is expensive and delays delivery. New Zealand Post is now also operating a model closer to the courier approach with their YouShop business stream.
- 3.18 One barrier to developing more cost-effective GST collection systems for imported goods is that, unlike goods that arrive by couriers, electronic information is not currently supplied in relation to most postal mail packages or is not supplied in a format that would enable automated risk assessment and revenue collection. The information provided on mail packages and its format is set by an international organisation known as the Universal Postal Union (UPU).
- 3.19 Since customs authorities around the world apply similar processes for collecting GST/VAT, and are under similar information constraints, reducing the cost of processing postal parcels is an international challenge.

- 3.20 The UPU is currently considering ways of providing advanced electronic information on postal consignments to customs administrations before the goods arrive at the border. Advanced electronic information is being considered mainly for border security purposes. However, the receipt of this information could also enable more streamlined GST/VAT collection processes to take place before the good's arrival.
- 3.21 If improved mechanisms for electronic data transfer on the mail stream can be implemented, New Zealand Post's business model could shift to more closely resemble the courier business model. Customs and New Zealand Post are exploring what this might mean in the future and looking at how this approach might be progressed.

### **Changes to the de minimis threshold**

- 3.22 Some New Zealand businesses have requested that the Government reduce the current level of the de minimis threshold to reduce the competitive distortions it creates. As a result, Customs has been asked to look at options for simplifying and changing the level of the threshold, with a report to Ministers later in the year. This is anticipated to be followed by public consultation.
- 3.23 In providing this advice, the impact of additional costs for consumers (for example, brokerage fees) and the compliance implications for courier companies and New Zealand Post will need to be taken into consideration. So too will factors such as the potential increased revenue relative to the costs of collection, and the possible economic benefits for the New Zealand economy.

### **Potential future changes to collection mechanisms**

- 3.24 In addition to strengthening or streamlining current collection mechanisms, other collection mechanisms will need to be developed.
- 3.25 There has been some interest internationally in whether offshore suppliers could be required to return GST/VAT on imported goods given the success of offshore supplier registration models in relation to services and intangibles, in particular the success of the "one-stop-shop" registration systems operating in Europe.
- 3.26 Given that this document is proposing that offshore suppliers be required to register and return GST in relation to services and intangibles, it is currently the Government's intention to align, where possible, the collection of GST on imported goods with the proposals in the paper relating to the collection of cross-border services and intangibles. Electronic marketplaces supplying goods could also be required to register and return the GST and tariffs as suggested for services and intangibles.
- 3.27 There are inherent advantages and efficiencies with applying similar systems to both services and goods, particularly for those suppliers that sell both



services and goods. However, we are not aware of any country having yet applied the offshore supplier registration model to low-value imported goods and, therefore, the success of its application to goods is currently uncertain.

3.28 Another option could be for New Zealand consumers to voluntarily pay the tax ahead of goods arriving in the country. However, self-assessment approaches applied in other countries have typically resulted in low compliance rates.

3.29 Looking ahead, it would appear that a combination of approaches to collecting GST would likely be required. Further work is also required to determine the viability of the options and whether they would in fact lower the cost of collection. Some key issues to be resolved are:

- the extent to which the goods could be traced in a way that allows Customs, courier companies or New Zealand Post to be assured that the revenue has been collected, without a significant increase in administrative costs;
- the extent to which administrative changes would be required for current government information technology systems;
- how information could be shared between Inland Revenue and Customs, where GST on the goods is collected by GST-registered suppliers; and
- the willingness of intermediaries – such as offshore suppliers of low-value goods to collect the tax.

3.30 As previously mentioned, readers with an interest in the collection of GST on low-value imported goods and the de minimis are invited to submit on this issue. However, it is expected that there will be further opportunity to make submissions in a subsequent consultation paper, specifically focusing on the GST treatment of low-value imported goods.

### **Questions**

Your views on the following questions will help the Government in developing its views:

- How does the non-collection of GST on imported goods affect you?
- How do you think the collection of GST on low-value goods could be made more cost-effective while still protecting New Zealanders from imported threats?
- What do you consider is the best structure and level of the de minimis threshold?

## CHAPTER 4

### A new place of supply rule

- 4.1 As discussed previously, the consumption of goods and services within New Zealand should be subject to GST. However, in relation to cross-border services and intangibles, there is some uncertainty over which country has the right to apply GST as it is often unclear where the consumption of the service or intangible occurs. Consistent with the OECD guidelines and growing international practice, it is proposed that New Zealand should apply GST to “remote” services supplied to a “New Zealand-resident”.
- 4.2 This chapter discusses the use of a person’s tax residence as a proxy for place of consumption and why the rules only apply to “remote” services. The chapter also discusses the legislative framework for implementing the proposal, and Chapter 5 discusses what specific services should be included or excluded from the proposed rules.

#### **Cross-border services and intangibles supplied to New Zealand-residents**

- 4.3 The current rules for services generally apply GST only on the basis of where the services are physically performed (known as the “place of supply” rules). Supplies of services physically performed outside of New Zealand by a non-resident are not subject to GST even if they are supplied to a New Zealand-resident.
- 4.4 The OECD draft guidelines and growing international practice suggest that New Zealand should apply GST to cross-border services and intangibles supplied to a New Zealand-resident. This is because residence is regarded as a reasonable proxy for determining where a cross-border service or intangible will be consumed. Using residence as a proxy is also considered to be relatively simple for offshore suppliers to apply in practice.
- 4.5 While other proxies could be used to determine where a person consumes a cross-border service or intangible (such as the physical location of the consumer when the service is received), it is proposed that New Zealand follows international consensus. Following international guidance and practice will better ensure that cross-border services and intangibles are only subject to GST/VAT in one country, thus avoiding double taxation or double non-taxation.

### **Example**

Elizabeth is a resident of Country B but is on holiday in Country A. She receives and pays for a cross-border service from a supplier located in Country C.

Consider the scenario where Country A applies GST on the basis of the customer's physical location and Country B applies GST on the basis of the customer's residency. Country A will seek to apply GST to the service since Elizabeth is located in Country A and Country B will also seek to apply GST to the service since Elizabeth is a resident of Country B.

In this situation, GST may be applied to the service in two different countries. Alternatively, no country would seek to apply GST if instead Elizabeth was a resident of Country A and on holiday in Country B.

- 4.6 The potential for double taxation and double non-taxation is particularly evident in places like Europe where consumers can easily travel across borders. The issue is also relevant for New Zealand when New Zealand residents receive cross-border services while travelling abroad.
- 4.7 The proposed rules would, however, only apply to "remote" services and would exclude "on-the-spot" services. Therefore, a clear understanding of the distinction between "remote" and "on-the-spot" services, and their preferred GST treatment, is required.

### **"Remote" and "on-the-spot" services**

- 4.8 As well as concluding that "remote" services ought to be regarded as being consumed in the country where the recipient has his/her usual residence, OECD draft guidelines conclude that the place of consumption for "on-the-spot" services should be based on where the services are physically performed.

### ***"On-the-spot" services***

- 4.9 On-the-spot services are services physically performed at a certain location and typically consumed at the same time and place as they are physically performed. Generally, the recipient is required to be in the same location as the supplier in order for the services to be physically performed. The OECD recommends that for these types of services, the place of physical performance generally determines the place of consumption.
- 4.10 The OECD lists examples of "on-the-spot" services, which include:
- hairdressing, massage, beauty therapy, physiotherapy, accommodation, restaurant and catering services, entry to cinema, theatre performances, trade fairs, museums, exhibitions, and parks, and attendance at sports competitions.

- 4.11 On-the-spot services that are physically performed in New Zealand are already subject to GST, and services physically performed outside New Zealand are not subject to GST.<sup>8</sup> The current rules relating to on-the-spot services generally produce the right outcome in that they tax consumption of services in New Zealand and do not tax consumption outside of New Zealand.

#### **Example**

Danny is a New Zealand resident and goes on holiday to Australia. While in Australia Danny pays for and visits a theme park.

The theme park visit is considered to be an “on-the-spot” service. The OECD draft guidelines suggest that the place of consumption is in the place where the service is performed. Therefore, despite the fact that the theme park visit is consumed by a New Zealand resident, Australia has the right to tax that service.

#### ***“Remote” services***

- 4.12 Any new rule would be targeted at remote services. These services are generally not consumed at the place where they are physically performed and the recipient is not generally required to be in the same location as the supplier in order for the service to be performed. For remote services, the OECD considers that the supplier’s location does not provide a good indication of the likely place of consumption.
- 4.13 Instead, the place of residence of the customer is considered to be the appropriate proxy for the country in which the consumption occurs, as it can be assumed that these types of services will ordinarily be consumed in the country where the customer has his or her usual residence.
- 4.14 The OECD lists examples of services that could be provided remotely. These include:
- consultancy, accountancy and legal services, financial and insurance services, long-term rental of movable property, telecommunication and broadcasting services, online supplies of software and software maintenance, online supplies of digital content (movies, TV shows, music), digital data storage and online gaming.
- 4.15 To ensure New Zealand’s rules are consistent with the above principle, a new place of supply rule would be required that would apply GST to remote services supplied to a New Zealand resident. The new rule would apply when a remote service or intangible was supplied by a non-resident supplier to a New Zealand resident.

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<sup>8</sup> Note that if services are performed by a New Zealand resident they are deemed to be supplied in New Zealand (see section 8(2) of the GST Act) but will typically be zero-rated if they are performed outside New Zealand (see section 11A(1)(j) of the GST Act).

### **Example**

Danny often purchases and downloads songs from a website based in the United States.

The song download is regarded as a “remote” service. The OECD draft guidelines suggest that the place of consumption of the song will be in New Zealand since Danny is a New Zealand resident. Therefore, New Zealand has the right to tax that service.

### **“Place of supply” options**

4.16 In general, the New Zealand GST Act adopts an iterative approach to determining the place of supply. That is, we have very broad rules for determining in the first instance whether the place of supply is in New Zealand and these are followed by a range of exclusions to determine the outcome.<sup>9</sup>

4.17 Under this framework, there are two main options for a new place of supply rule:

- *Option one:* Treating all supplies by a non-resident to a New Zealand resident (both remote and on-the-spot services) as being *prima facie* subject to GST, but then excluding the on-the-spot services by, for example, making them zero-rated; or
- *Option two:* Only seeking to impose GST on the remote services – and treating any on-the-spot services received by a New Zealand resident offshore as being outside the GST net altogether.

4.18 Either option would make offshore suppliers liable to return GST because, at the very least, remote supplies would be treated as “taxable” for New Zealand GST purposes. Option two, however, would leave the existing settings in place for on-the-spot services, meaning that on-the-spot services performed in New Zealand would remain taxable and on-the-spot services performed outside New Zealand would not be taxable.

4.19 On balance, we consider that option two is preferable because:

- It is more closely aligned with our understanding of the European Union’s approach and may therefore be more accessible to offshore suppliers.
- It would obviate the need for a new zero-rating rule. On-the-spot supplies by a non-resident to a New Zealand resident offshore would be subject to the existing rules – they would be outside the scope of GST. There may be very little practical difference between zero-rated supplies and those that are not subject to GST (particularly if, as discussed in Chapter 5, zero-rated supplies do not count towards any registration threshold). However, to avoid any uncertainty, it is considered preferable to have on-the-spot suppliers that have no

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<sup>9</sup> Section 8 (Imposition of tax), section 11 (Zero-rating of goods), section 11(A) (Zero-rating of services), and section 14 (Exempt supplies).

connection at all with New Zealand outside the GST net in the first instance.

- Either option would require some sort of definition of “remote services”, either positively or by exclusion. Option two allows on-the-spot services to be excluded from the scope of GST and other cross-border supplies by non-resident suppliers treated as “remote” and taxable (with subsequent exclusions as outlined in the next chapter).

4.20 A special input tax rule may be required if option two were to be adopted. The rule would ensure that input tax deductions would be available to offshore suppliers of on-the-spot services to the extent that the supplies would be taxable if they were made in New Zealand. This would be consistent with the business-to-business neutrality rules introduced in 2014.<sup>10</sup>

### **Questions**

Do you agree with the proposed approach for taxing cross-border services and intangibles?

Do you think an approach that distinguishes between “remote” and “on-the-spot” services will produce the right outcomes and do you consider there will be problems in practice in making this distinction?

Do you prefer an approach that excludes on-the-spot services so they are outside New Zealand’s tax net, or an approach that treats all supplies as being subject to GST, but then excludes on-the-spot services by making them zero-rated?

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<sup>10</sup> See section 20(3L) of the GST Act.

## CHAPTER 5

### Services included and excluded

- 5.1 Before considering which offshore suppliers might be required to register and return GST (discussed in the next chapter), it is important to consider what services are included and whether there should be any exceptions to the proposed rules.
- 5.2 It is proposed that the new rules would cover a broad range of services with the main exceptions being for supplies to New Zealand-registered businesses, as well as for existing exemptions and zero-rated provisions that currently apply to domestic suppliers. To ensure neutrality is maintained, it is critical that supplies by non-residents and resident businesses are placed on an equivalent footing.

#### Services included

- 5.3 The definition of “services” in the GST Act includes anything other than physical goods or money. It is proposed that any new place of supply rule would, subject to the stated exceptions, cover services as defined in the Act.
- 5.4 This is a broad definition, and in the context of supplies of remote services and intangibles, would include digital services that are typically electronically delivered (such as digital downloads, online music and video streaming services, online gaming and other digital services), as well as more traditional cross-border services supplied remotely by a person offshore (such as professional advice like legal and accountancy services).
- 5.5 While some countries have limited their rules to digital services only, in the New Zealand context we consider a broader definition of services would be more appropriate. If the rule was limited to digital services there is a risk that the rule could:
- Bias consumer decisions on whether to purchase digital or non-digital services. For example, the rules may create an artificial distinction between a legal opinion produced by a non-resident that is provided via email and one that is sent through the postal service. (Ideally, tax should not influence people’s decisions to purchase a particular type of service or influence the delivery method of a particular service).
  - Make the rules more complex as suppliers would be required to determine whether a supply of services is “digital” and therefore subject to GST.
- 5.6 As mentioned above, a broad definition of “services” is consistent with New Zealand’s broad-based GST system and is also consistent with the approach recently announced in Australia. (See attached appendix for more information.)

## **Supplies to GST-registered New Zealand-resident businesses**

- 5.7 An important consideration in looking at the scope of any new rules is whether offshore suppliers should be required to return GST in relation to:
- both supplies to New Zealand consumers (business-to-consumer supplies) and registered businesses (business-to-business supplies); or
  - to business-to-consumer supplies only.
- 5.8 In Europe, similar rules are limited to business-to-consumer supplies. This approach is also more consistent with the OECD draft guidelines. However, other countries (such as South Africa) have applied the rules to both business-to-consumer and business-to-business supplies, one reason being to reduce the compliance costs associated with suppliers having to distinguish between individual consumers and businesses.
- 5.9 There are, however, a number of perceived advantages in applying the rules only to business-to-consumer supplies:
- From a revenue perspective there is little value in applying GST to business-to-business supplies. This is because New Zealand businesses, if registered, would be able to claim back any GST they were charged by an offshore supplier to the extent the GST costs were incurred in making taxable supplies.
  - Tax invoice requirements could be relaxed because no New Zealand consumers charged with GST would be in a position to claim back the GST. Relaxed invoice requirements would lower compliance costs for offshore suppliers.
  - There are some fiscal risks associated with applying GST to business-to-business supplies as less reputable offshore suppliers may purport to charge GST but not return the GST. Registered New Zealand businesses would then seek to claim the GST back in the normal manner.
  - If the rules applied to business-to-business supplies there could in some cases be timing disadvantages for New Zealand businesses if they charged GST and then had to claim that GST back. This could be particularly problematic in relation to high value business-to-business supplies (for example, a high-value software package purchased by a New Zealand business).
  - The European Union, which has applied an offshore supplier registration system since 2003, only requires offshore suppliers to return GST on business-to-consumer supplies. Considering the size of this market, it is likely that suppliers would have built systems to operate in this environment. Therefore, this option may be more readily accepted by offshore suppliers.
  - The approach proposed in Australia is also limited to business-to-consumer supplies and there will be inherent advantages with adopting similar rules, particularly for offshore suppliers that supply services to Australia and New Zealand.



- 5.10 There are, however, some disadvantages in applying the rules only to business-to-consumer supplies:
- Excluding business-to-business supplies would mean offshore suppliers would be required to determine whether they were supplying to a business or an individual consumer. This could be difficult and may impose compliance costs on suppliers.
  - Revenue could be foregone if individuals represented themselves as a registered business and were able to avoid the GST.
- 5.11 There are pros and cons to each approach and submissions are sought on which approach is preferred.
- 5.12 If business-to-business supplies are included, consideration would need to be given to the invoice requirements that would be placed on offshore suppliers to enable business recipients to claim back the GST. This would involve a trade-off between the need to make requirements simple for offshore suppliers but for sufficient information to be held by domestic businesses to substantiate input tax claims.
- 5.13 Alternatively, if business-to-business supplies are excluded, these supplies may need to be treated as zero-rated supplies. This would ensure that any New Zealand GST incurred in relation to these supplies could be claimed back by the offshore supplier. In addition, submissions are sought on whether offshore suppliers that solely supply services to New Zealand-registered businesses would be required to register and whether these supplies would be included in calculating the registration threshold (as discussed in the next chapter).

**Example**

Ad Co is an offshore supplier of online advertising services. Ad Co supplies advertising services to New Zealand businesses all of whom are GST-registered.

If business-to-business supplies are excluded, Ad Co would not be required to register for New Zealand GST as it only makes supplies to GST-registered businesses. If Ad Co decided to voluntarily register, the services it supplies could be zero-rated for GST purposes and Ad Co would be able to claim back any New Zealand GST it incurs on its costs in the course of making those supplies.

- 5.14 In many instances, offshore suppliers would be able to assume their services were being received by individual consumers given the nature of their supplies. Chapter 7 discusses how offshore suppliers would practically be able to determine whether their customer was a registered business if business-to-business supplies are excluded.

## **How the rules apply to certain supplies**

5.15 As we have noted, the legislation would need to ensure that a non-resident is not materially disadvantaged or advantaged compared with a New Zealand-resident business making comparable supplies. This would ensure that GST remains fair and equitable. In particular there would need to be comparable treatment for:

- exempt supplies;
- zero-rated supplies; and
- specific industries.

### ***Exempt services***

5.16 Services that are already exempt from New Zealand GST should retain that character irrespective of the residence of the supplier. New Zealand has a very broad-based GST system, with very few exemptions. The main exemptions are the supply of financial services to final consumers (financial services to businesses would be excluded by the business-to-business exclusion discussed above) and residential accommodation.<sup>11</sup> Having few exemptions should make it easier for offshore suppliers to comply with the New Zealand GST system compared with countries that have many exemptions.

### ***Zero-rated services***

5.17 It is proposed that supplies currently zero-rated for domestic suppliers be similarly zero-rated for non-resident suppliers. In these situations, the consumption is generally attributed to a location outside New Zealand and therefore should not be subject to New Zealand GST. An example would be services supplied directly in connection with land or other immoveable property that is located outside New Zealand.<sup>12</sup>

5.18 In saying this, the interaction between a non-resident registration system and the current zero-rating rules would need to be reviewed in detail to ensure that remote services received by New Zealand residents or otherwise consumed in New Zealand are not inappropriately zero-rated.

### ***Specific industries***

5.19 The GST Act contains some special rules that allow certain industries to pay GST on the net value of their supplies (payments received less payments made) – principally the gambling and insurance industries. Any new rules would need to ensure that the overall policy objective of putting resident and non-resident suppliers on a relatively even footing is also applied to these industries. This may require special rules such as, in the insurance context, switching off input tax deductions for payments received by an offshore insurance provider if no GST is returned on payments received because the

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<sup>11</sup> Section 14 of the GST Act contains the current exemptions from GST.

<sup>12</sup> Section 11A of the GST Act contains services that are zero-rated.

recipient is a New Zealand-registered business (assuming business-to-business supplies are excluded).

### **Questions**

Do you consider that a rule that covers a wide range of services is appropriate for New Zealand, and do you foresee any problems with such a broad approach in practice?

Do you prefer an approach that only taxes business-to-consumer supplies or an approach that taxes both business-to-consumer and business-to-business supplies?

Do you consider that the other proposed exclusions for services and intangibles supplied by a non-resident should ensure that non-residents and resident suppliers received comparable treatment?

## CHAPTER 6

### Requirement for suppliers to register

- 6.1 This chapter discusses the proposed registration threshold that could be applied to offshore suppliers, and situations when an electronic marketplace might be required to register instead of the principal supplier.

#### Registration threshold

- 6.2 Currently, domestic businesses are required to register and return GST if their turnover exceeds \$60,000 in a 12-month period. They are also able to voluntarily register if their turnover falls below that amount. While the registration threshold could be considered as an exception to New Zealand's broad-based GST policy, as some suppliers would not be required to register and return GST, it is intended to reduce compliance costs for very small businesses.
- 6.3 For similar reasons, a registration threshold is also likely to be favoured by offshore suppliers and could be either based on supplies to New Zealand residents or on worldwide supplies.
- 6.4 The main benefit of a registration threshold for offshore suppliers is that it will lower the compliance costs for small suppliers and suppliers that do not supply many services to New Zealand residents. For some suppliers, the compliance costs of registering and returning GST may outweigh the revenue collected in supplying services to New Zealand residents. As far as possible, given their objectives, any new rules should be designed in a way that does not pose a barrier to trade with New Zealand.
- 6.5 There are, however, some disadvantages with a threshold that is too high:
- It would be possible for some offshore suppliers to break up their supplies into different entities in order to stay under the registration threshold. This behaviour is likely to be easily identified in the domestic context but may be more difficult to identify abroad.
  - If a non-resident is making supplies into New Zealand, it is likely that this is just part of their global market. If each country was to have a high registration threshold, this may mean some reasonably large businesses (in terms of their global supplies) could escape having to register anywhere. This may result in them having a competitive advantage over similarly sized domestic businesses and larger international businesses.
  - Our proposals are intended to ensure that domestic suppliers compete on a level playing field with offshore suppliers. However, a threshold based on that which applies to domestic suppliers may not necessarily result in competitive neutrality. This is because in some countries offshore suppliers may not incur GST or VAT, or will be able to claim any GST or VAT costs back in their home country in the process of

exporting services to New Zealand residents. In contrast, domestic businesses below the registration threshold that are not registered are not able to claim back their GST costs. Similarly, domestic suppliers that have voluntarily registered would be able to claim back GST costs but would also be required to return GST on any supplies they make.

- 6.6 The countries that have introduced offshore supplier registration systems have typically adopted low or nil thresholds. European Union countries have no thresholds, South Africa has a threshold of R50,000 (around NZD\$6,000), and Norway has a threshold of NOK50,000 (around NZD\$9,000).
- 6.7 Submissions are sought on the level of the registration threshold, specifically whether a lower threshold (such as NZD\$10,000) or a threshold based on the domestic registration threshold (NZD\$60,000) is preferred.
- 6.8 If business-to-business supplies are excluded from the proposed rules, submissions are also sought on whether supplies to New Zealand-resident businesses should count towards this threshold.

### **Electronic marketplace**

- 6.9 In some instances, offshore suppliers would not directly supply services to their customers. Instead they may use an electronic marketplace to market and sell their services or intangibles. For example, an app developer may make their app available on a mobile app store. In these situations, it is proposed that the electronic marketplace would be treated as the supplier and be required to register.
- 6.10 The electronic marketplace is generally in a better position to register and return GST on supplies compared with the underlying supplier. Typically, the electronic marketplace would be larger, better resourced and have a closer relationship with the customer. Requiring the electronic marketplace to register may also reduce compliance costs, as potentially, a large number of smaller suppliers may not be required to register. It is anticipated that the marketplace and the underlying supplier will have commercial arrangements in place that could take any GST costs into account.
- 6.11 Requiring intermediaries to register for GST in this context has been a relatively recent international development. Australia announced proposed rules that would require an operator of an “electronic distribution service” to register and return the GST. This will occur when the operator controls any of the key elements of the supply such as delivery, charging or terms and conditions. These proposed rules are broadly modelled on similar rules currently in operation in the European Union and Norway.
- 6.12 To ensure these rules are easily applied in practice, it is important to clearly define the circumstances in which the electronic marketplace would be required to register, and therefore, the underlying supplier would not be required to register. Without this clarity there is a risk that both parties may register or fail to register.

- 6.13 It is proposed that an electronic marketplace would be required to register when customers would normally consider the marketplace to be the supplier, and this is reflected in the contractual arrangements between the parties. This is likely to be when the marketplace:
- authorises the charge to the customer;
  - authorises delivery to the customer; or
  - sets the terms and conditions of the transaction.
- 6.14 It would be expected that an offshore supplier simply using a payment service provider to organise the payment from the customer would still be required to register. In this situation, the payment service provider would have a limited role in the supply chain. However, if for example an offshore supplier listed services or intangibles on a third-party website and that website interacted directly with the customer, and organised payment and delivery for any purchases, that website would be required to register, charge and return GST, instead of the principal supplier.
- 6.15 It is important to note however that the underlying suppliers may still be required to register in relation to supplies to New Zealand residents not connected with the electronic marketplace.

### **Questions**

What do you consider is an appropriate registration threshold for offshore suppliers?

Should business-to-business supplies count towards the registration threshold?

Should electronic marketplaces be required to register in certain situations instead of the principal supplier?

What factors do you think are important when determining whether an electronic marketplace should be required to register?

## CHAPTER 7

### Information, compliance and enforcement under the proposed rules

- 7.1 This chapter discusses other key features and the practical application of the proposed new rules, specifically:
- How will offshore suppliers identify New Zealand-resident consumers and, if business-to-business supplies are excluded, how will offshore suppliers identify New Zealand-registered businesses?
  - What if a consumer incorrectly represents themselves as a foreign resident or a New Zealand-registered business?
  - If business-to-business supplies are excluded, when would the existing reverse charge rule apply?
  - If business-to-business supplies are excluded, what if a New Zealand-registered business is inadvertently charged GST?
  - Enforcement of the proposed rules.

#### Identification of New Zealand-resident consumers

- 7.2 Assuming business-to-business suppliers are excluded, the proposed rules would only apply to services supplied to New Zealand tax residents who are not registered for GST. Consequently, before charging GST on a supply, an offshore supplier would be required to determine whether their customer is:
- a New Zealand tax resident; and
  - registered for New Zealand GST.

#### *Tax residence*

- 7.3 One of the main aspects of the proposed rule is that it would apply only to services received by New Zealand tax residents. A New Zealand tax resident is generally a person who is in New Zealand for more than 183 days in any 12-month period or has a “permanent place of abode” in New Zealand.<sup>13</sup>
- 7.4 A company is generally considered to be resident in New Zealand if it meets any one of the following criteria:
- It is incorporated in New Zealand.
  - Control by company directors is exercised in New Zealand.
  - It has its centre of management in New Zealand.
  - It has its head office in New Zealand.<sup>14</sup>

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<sup>13</sup> Section YD 1 of the Income Tax Act 2007.

<sup>14</sup> Section YD 2 of the Income Tax Act 2007.

- 7.5 It would not be expected that offshore suppliers would be required to know precisely the tax residency status of their customers. Instead, offshore suppliers would be able to use proxies as evidence to identify whether a customer is a resident of New Zealand. Examples of the type of proxies recommended by the OECD and used in other countries that have similar rules include:
- the billing address of the customer;
  - the home address of the customer;
  - the Internet Protocol (IP) address of the device used by the customer;
  - the customer's bank details;
  - the location of the originating payment for the service; and
  - the location of the customer's fixed landline through which the service is supplied, if applicable.
- 7.6 The proxies relevant for determining the residency of the customer may depend upon the type of service being supplied. Proxies will be particularly relevant for suppliers of digital services, as the supplier and the customer are unlikely to have a close relationship. However, it is likely that for the more traditional cross-border services, such as professional advice, the supplier and customer will have a closer relationship and therefore the supplier will be better able to determine the residency status of the consumer.
- 7.7 In the European Union, the supplier is required to have two non-conflicting pieces of evidence to determine the residency of the customer. Australia's proposed rules require the supplier to take reasonable steps to obtain information concerning whether the recipient of the supply is an Australian consumer, and after taking these steps, reasonably believe that the recipient is not an Australian consumer.
- 7.8 There is a trade-off between imposing compliance costs on offshore suppliers to accurately determine the residency of their customers, and having proxies which will, in the vast majority of cases, produce the right outcome. Consideration would need to be given to how susceptible to error some proxies may be and therefore whether they should be able to be used by offshore suppliers to determine the customer's residency.
- 7.9 While both models have their merits, we consider the option that imposes the lowest compliance costs on non-resident businesses should be preferred. Allowing non-resident businesses to rely on information they collect as part of their standard business practices appears to meet this objective better than one that requires these businesses to make further enquiries about individual customers. In saying this:
- the rules should focus on the customer residency indicators that are least susceptible to error; and
  - the supplier should not be able to rely on location proxies which provide less accurate outcomes if better information can be relatively simply obtained.



### *New Zealand-registered businesses*

- 7.10 If offshore suppliers are required to return GST in relation to business-to-business supplies, they will not need to identify whether their customer is a GST-registered business.
- 7.11 Assuming that the proposed rules will not require offshore suppliers to return GST in relation to services supplied to GST-registered New Zealand businesses, offshore suppliers, in many instances, would be able to presume the services were being received by individual consumers, given the nature of their supplies.
- 7.12 For services that could be received by either businesses or non-registered consumers, it is proposed that the default position should be that GST is charged. New Zealand GST-registered businesses should be able to provide their Inland Revenue Department (IRD) number to the offshore supplier to prove that they are in fact a registered business. However, registered businesses should not provide their IRD number to the supplier if the services received do not relate to their business activity.
- 7.13 Suppliers would be able to rely on the provision of an IRD number as evidence of GST registration and would not be required to charge GST on these supplies. However, the supplier would also be required to keep sufficient records of the IRD numbers provided by business customers for auditing purposes.

### **Incorrect representations by consumers**

- 7.14 There is a risk that some consumers may incorrectly represent themselves as a registered business customer (if business-to-business supplies are excluded) or a resident consumer of another country and avoid being charged GST.
- 7.15 There are two ways this issue could be addressed:
- First, existing “knowledge offences” could apply if a consumer knowingly supplied incorrect information to a supplier in order to avoid being charged GST.<sup>15</sup>
  - Secondly, it is proposed that the Commissioner of Inland Revenue have the discretion (which is expected to be limited to more egregious cases) to require the consumer to register for GST and treat the consumer as having made the supply from the time the recipient purchased the service.
- 7.16 The knowledge offences apply when a person knowingly provides altered, false, incomplete, or misleading information to any person in respect of a tax law or a matter or thing relating to a tax law. A person convicted of a knowledge offence is liable to a fine up to NZ\$25,000 for a first-time offence, or NZ\$50,000 for repeated offences.

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<sup>15</sup> See section 143A of the Tax Administration Act 1994.

7.17 In relation to requiring the recipient of the service to register, similar rules already exist in relation to land transactions when land was incorrectly zero-rated.<sup>16</sup> In these situations the recipient would be required to return the GST and, since the supply is treated as being made at the date of purchase, the recipient may be subject to use-of-money interest, with any applicable penalties calculated from that date.

### **Reverse charge**

7.18 The consumption of goods and services in New Zealand should be subject to GST. However, GST should not be a tax on businesses. To achieve this, registered businesses are able to claim back GST charged on goods and services they receive to the extent the goods and services are used for, or available for use in, making taxable supplies.<sup>17</sup> In contrast, final consumers are unable to claim back any GST.

7.19 However, registered businesses may purchase goods and services for non-taxable purposes, such as for private or exempt activities. In these situations, the business cannot claim back the GST as the goods and services received do not relate to the making of taxable supplies. In effect, the business is treated like a final consumer.

7.20 In the context of registered businesses purchasing services from an offshore supplier that do not relate to the making of taxable supplies, and assuming that business-to-business supplies are excluded from the proposed rules, New Zealand's existing "reverse charge" rule<sup>18</sup> should apply to tax those services or intangibles. This would ensure that businesses receiving services and intangibles from an offshore supplier, other than for making taxable supplies, are treated in the same way as individual consumers.

7.21 The European Union operates a broad reverse charge which requires registered businesses to return VAT on the total value of the service received regardless of whether the service relates to the making of non-taxable or taxable supplies. Businesses are then able to claim back the VAT that relates to their taxable activities in the usual way. The ability to offset the portion of VAT that relates to their taxable activities means the VAT is only payable on the services that relate to their non-taxable activities.

7.22 While the European Union system has been considered, arguably the same outcome can be achieved with the more limited reverse charge with less compliance costs imposed on domestic businesses.

7.23 If offshore suppliers are required to return GST in relation to business-to-business supplies, consideration would need to be given to whether the existing reverse charge should be repealed or better integrated into the proposed rules.

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<sup>16</sup> See section 5(23) and section 51B(4) of the GST Act.

<sup>17</sup> See section 20(3C) of the GST Act – *Input tax may be deductible*.

<sup>18</sup> See section 8(4B) of the GST Act – *Deemed supply in New Zealand by recipient of imported services*.

### *Application of the reverse charge*

- 7.24 New Zealand's existing reverse charge treats a GST-registered recipient as having made the supply in New Zealand and therefore requires it to return the GST on the supply instead of the offshore supplier. This means that the recipient returns output tax on the full value of the supply (as the deemed supplier), but only claims an input tax deduction to the extent the service is used for making taxable supplies. The net result is that output tax on the non-taxable use is paid by the recipient.
- 7.25 The reverse charge only applies to the extent the services relate to non-taxable activities, such as private activities or exempt supplies, and the current 5 percent de minimis rule would be retained.

#### **Example**

Virginia is a self-employed project manager who is registered for GST. She purchases a software package from an offshore supplier for \$400. Assuming business-to-business supplies are excluded, she identifies herself as a registered business and therefore is not charged GST. She uses the software 50 percent for her taxable project management services and 50 percent for home/recreational use.

Under the reverse charge, Virginia is treated as making a supply to herself of \$400 at the 15 percent rate. She must return output tax of \$60 ( $\$400 \times 15$  percent). However, Virginia can claim an input deduction for the portion of the value of the software package (50 percent) that is attributed to her taxable use. This input deduction is \$30. Her net position in the relevant return (assuming no other supplies) is therefore an output tax liability of \$30 ( $\$60$  output tax minus  $\$30$  input tax).

If Virginia's use of the software package had been 95 percent taxable or more, she would not have been required to apply the reverse charge.

### **New Zealand businesses being inadvertently charged GST**

- 7.26 Assuming that business-to-business supplies are excluded from the proposed new rules, there could be some instances when an offshore supplier may inadvertently charge a registered New Zealand business GST.
- 7.27 In these situations, the business would be required to contact the offshore supplier in order to receive a refund of the incorrectly charged GST. It is not proposed that businesses would be able to claim GST back in their normal GST return. This is because offshore suppliers will not be required to provide a full tax invoice and therefore it would be difficult to verify whether GST had been charged and returned.

- 7.28 Offshore suppliers would be able to adjust their output tax in a GST return, subsequent to the refund being made, to take into account the overpaid GST. Consistent with the general rules for claiming input deductions under section 20 of the GST Act, it is proposed that these adjustments would, subject to existing exceptions, be required to be made within two years of the original supply.

## **Enforcement**

- 7.29 New Zealand's tax system works on the principle that the vast majority of people do the right thing and comply with their tax obligations. This is largely because our tax system is fair and coherent. It is expected that most offshore suppliers would comply with our rules for the same reasons.
- 7.30 When similar rules to those proposed in this document have been applied in other countries, offshore suppliers, particularly large international suppliers that account for the majority of cross-border services and intangibles, have demonstrated a willingness to comply.
- 7.31 To generate a similar level of compliance for New Zealand we have aimed to adopt similar and consistent rules with the rules that apply in other countries.
- 7.32 For offshore suppliers that do not comply, the normal enforcement rules and penalties that apply to New Zealand suppliers are expected to apply. The Commissioner is able to register a supplier who is liable to register from the date the person first became liable to register or a later date as the Commissioner considers equitable,<sup>19</sup> and a supplier is deemed to be registered if it claims that GST is being charged on their supplies but is in fact not registered and not returning the GST.<sup>20</sup>
- 7.33 The OECD also envisages countries cooperating and sharing information to ensure that suppliers comply with registration requirements in different jurisdictions. For example, New Zealand is a signatory to the Convention on Mutual Administrative Assistance in Tax Matters. The Convention is a multilateral instrument available for all forms of tax cooperation to tackle tax evasion and avoidance. The Convention has a very wide scope and covers all forms of compulsory payments, including GST/VAT.
- 7.34 Like many other countries, New Zealand has a large network of double tax agreements. These agreements allow for information-sharing, which normally includes GST/VAT.

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<sup>19</sup> See section 51(4) of the GST Act – *Commissioner to determine registration*.

<sup>20</sup> See section 51B(1) of the GST Act – *Person treated as registered*.

## **Questions**

What proxies do you consider would be appropriate to use in order for offshore suppliers to determine the residency of their customers?

What proxies are likely to be most accessible in practice?

To what extent should offshore suppliers be required to accurately determine the residency of its customers and how much evidence should suppliers be required to obtain?

If business-to-business supplies are excluded, will offshore suppliers be able to easily distinguish between individuals and GST-registered businesses in practice and what compliance costs would this impose on them?

Do you agree with the sanctions proposed for incorrect representations by consumers?

If business-to-business supplies are excluded, do you agree with the application of the reverse charge as suggested?

If business-to-business supplies are excluded, New Zealand businesses will be required to recover any inadvertently charged GST from the offshore supplier. Do you agree with this approach?

## CHAPTER 8

### Registration and return filing

- 8.1 This chapter considers the registration system and filing periods that offshore suppliers would use if they are required to register for New Zealand GST. There are three different registration options that could be adopted:
- the domestic registration system;
  - a “pay only” registration system; or
  - a regional “one-stop-shop” registration system.
- 8.2 This chapter does not recommend any specific option but the option chosen will be made clear in advance of the implementation date of any new rules.

#### Domestic registration system

- 8.3 New Zealand’s current registration system applies to domestic businesses and some non-resident businesses. In order to register, businesses will need to obtain a New Zealand IRD number and then either fill out a registration application form or register online through a system called myIR. Once registered, the business is required to file GST returns every month, two months, or six months depending upon the business’s turnover.<sup>21</sup> Returns can be either filed manually or online through myIR. In addition to accounting for GST on taxable supplies, domestic businesses can also claim back any GST they incur on costs if those costs relate to the making of taxable supplies.
- 8.4 One option for registering offshore suppliers is simply to use the existing registration system. Since New Zealand’s GST system is broad-based with few exemptions, it is relatively simple and easy to comply with and this is reflected in the simplicity of the return itself. Offshore suppliers would be able to return GST on their supplies of services to New Zealand-resident customers and also claim back any New Zealand GST they may incur in the making of taxable supplies.
- 8.5 Using the existing registration system would also keep administrative costs to a minimum since administrative processes have already been developed. However, ideally, if input tax deductions were being claimed, any system that adopted existing systems may need to include elements of the existing registration system for non-residents introduced in 2014. These rules reflect the unique revenue risk associated with allowing non-residents to claim input deductions, and include measures such as allowing the Commissioner of Inland Revenue longer to process any refund claims.

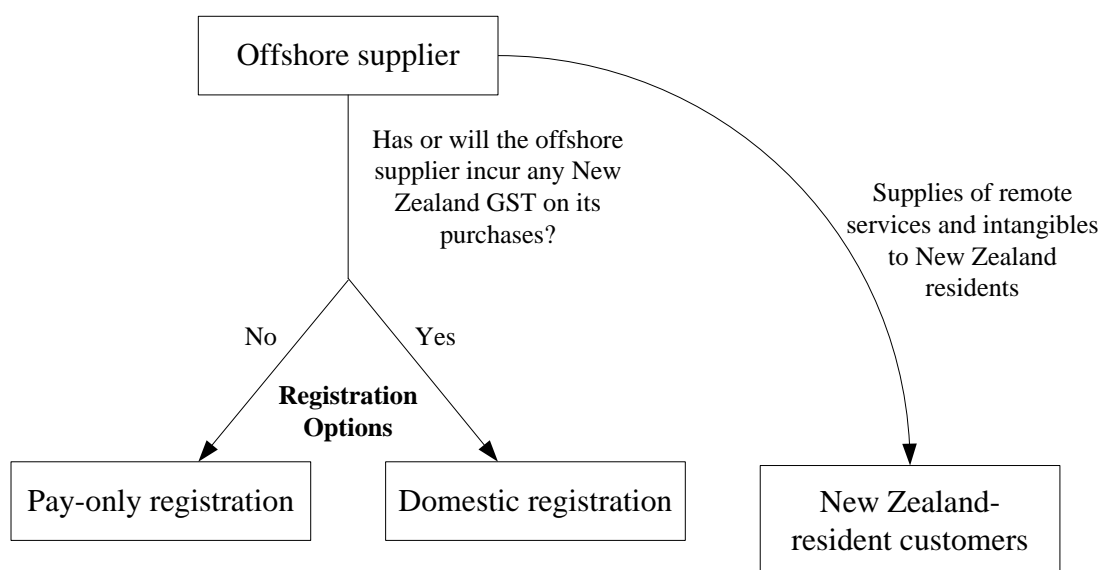
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<sup>21</sup> A person must file returns monthly if taxable supplies in a 12- month period are more, or likely to be more than \$24,000,000. If turnover is less than \$500,000 in a 12-month period a person is able to file every six months.

- 8.6 One disadvantage to using the domestic registration system is the fact that the domestic system is not tailored to the specific needs of offshore suppliers. The majority of offshore suppliers are unlikely to incur any New Zealand expenses and therefore will not need to claim back any GST. Consequently, much of the current GST return that is focused on GST claims may not be relevant for those suppliers that are in a pay-only position.
- 8.7 This system could, however, be implemented relatively quickly and could potentially be used in the first instance until a more tailored system was developed.

**“Pay only” registration system**

- 8.8 “Pay-only” registration systems are tailored for offshore suppliers that have no GST/VAT to claim and make payments only. The main benefit of a pay-only system is that the system can be very simple. Since these offshore suppliers are not claiming any GST they are relatively low-risk from a revenue perspective. The usual checks and balances focussed on ensuring that input tax deductions/refund claims are correct can be relaxed. The processes and information requirements around registering for GST could also be simplified.
- 8.9 It is likely that the majority of offshore suppliers would only need to register under a pay-only system as they will not normally incur any New Zealand GST on their purchases. However, some offshore suppliers will incur New Zealand GST (for example, a non-resident may visit New Zealand to conduct market research and may incur GST in the process) and so should have the opportunity to register under the domestic system and claim the GST back. Therefore, the system would need to accommodate two potential types of registration, as shown in the diagram below:



- 8.10 Some countries have adopted pay-only registration systems, most notably Norway. Australia has suggested that it may seek to develop a similar system. The OECD draft guidelines recommend that, as far as possible, countries develop simplified registration systems for offshore suppliers, such as a pay-only registration system.

### **Regional registration system**

- 8.11 The European Union operates a “one-stop-shop” for suppliers that supply to multiple European Member States. Under the one-stop-shop suppliers are able to register in a single Member State. This is an alternative to registering in every Member State to which they make supplies.
- 8.12 All VAT collected by the offshore supplier is returned to that single Member State, which is responsible for redistributing the VAT revenue to the Member States where the consumption took place. The Member State is, in part, responsible for auditing offshore suppliers that register with that State.
- 8.13 The intention of developing such a system was to lower the compliance costs imposed on offshore suppliers and to enhance voluntary compliance with the system as a whole. Registering and filing a single return with one Member State is considered to be easier than registering and filing in multiple Member States.
- 8.14 New Zealand is not part of a common market, but, similar benefits could be achieved through a comparable “one-stop-shop”. For example, if an offshore supplier supplied services or intangibles to both Australia and New Zealand, a “one-stop-shop” registration system would allow the supplier to register and file returns in a single country, instead of both countries.
- 8.15 There are however some drawbacks to this approach. Countries would need to agree to develop “one-stop-shops” and rely on another country to be responsible for collecting and distributing the GST. It would also be preferable that similar rules be adopted in each country that signs up to such a scheme. Countries can individually be expected to have very different tax bases and tax rates. However, administrative rules like registration thresholds and filing periods may need to be consistent for the system to operate easily in practice and ensure compliance costs imposed on offshore suppliers are kept to a minimum.

### **Taxable periods**

- 8.16 It will be necessary to establish the GST filing frequency of registered non-residents. At present, the default taxable period for a registered person is two months. Larger businesses, with an annual turnover of \$24 million or more, are required to file monthly, whereas smaller businesses can elect to file on a six-monthly basis. For non-residents, there are effectively two options:



- mandating a taxable period that will apply to all registrations; or
- allowing the normal rules to apply, so filing frequency will depend on the size of the business concerned.

8.17 On balance, it is proposed for now that there be a set period for non-resident registrations and that period should be two-monthly. In reaching this view it is important to note that, if the preferred registration option uses existing Inland Revenue systems, any mandated taxable period must be a period that is already specified in legislation: monthly, two-monthly or six-monthly.

8.18 A set period would provide certainty for affected businesses. It would also make any tailored pay-only registration system easier to design and to use, because the same rules would apply to everyone required to use it.

8.19 By contrast, applying the standard rules would require registered persons to work out which filing period applied to them. Rules would need to clarify, for the purposes of the one and six-monthly options, what supplies were counted towards the relevant thresholds. In that case it could be assumed that, whenever possible, a non-resident would apply for a six-monthly period to maximise any timing advantages. This would affect revenue collection and increase administration costs because applications would have to be manually processed in order to determine whether the requirements for six-monthly filing were met in each case.

### **Questions**

Of the three options discussed, which registration system do you prefer?

What compliance costs would be imposed on offshore suppliers if they were required to register under the domestic registration system?

Do you consider there would be significant benefits in developing a “pay-only” registration system?

Do you consider there would be significant benefits in pursuing a regional “one-stop-shop” registration system?

Do you prefer a fixed filing time for offshore suppliers or variable filing times that depend upon the offshore supplier’s turnover?

## **APPENDIX**

### **International adoption of the offshore supplier registration model**

The offshore supplier registration model is being used to collect GST on imported services by the European Union and in some other countries, including Norway, Switzerland, South Korea, South Africa, and soon Japan and Australia. The countries that have implemented these regimes report some success in collecting the GST on cross-border services. Some parallels can also be drawn with recent sales tax proposals in the United States.

The following summary details how other countries have approached the issue.

#### **European Union**

Since 1 July 2003, the European Union has required offshore suppliers to register and return VAT for supplies of services to European Union consumers (business-to-consumer supplies).

To lower the compliance costs on offshore suppliers, a simplified registration system is available (known as the “one-stop-shop”), where offshore suppliers are able to register in a single Member State. This is an alternative to registering in every Member State to which they make supplies.

All VAT collected by the offshore supplier is returned to that single Member State, with VAT amounts for each Member State reported, and the Member State of registration is responsible for redistributing the VAT revenue to the Member States where the consumption took place. The Member State is in part responsible for auditing offshore suppliers that register with that State.

In terms of supplies of services and intangible goods between Member States, before 1 January 2015, suppliers returned VAT on an origin basis (returning VAT to the Member State in which they made the supply as opposed to where the consumption took place). This resulted in suppliers (foreign and domestic) locating branches in Member States with low VAT rates. The supplier would then be able to contract with the EU consumers from that branch and return a lower rate of VAT to the Member State in which the branch was located.

However, since 1 January 2015, this type of tax planning is less attractive as European Union suppliers are required to return VAT based on the rate that applies in the Member State where the consumption takes place (on a destination basis, which is consistent with supplies from offshore). The rules apply to telecommunications, broadcasting and electronic services. In order to lower compliance costs, European Union suppliers will also be able to use the one-stop-shop scheme.

In regard to offshore supplies of services and intangibles to business customers (business-to-business supplies), the business customer is liable to account for VAT through a reverse charge. That is, the business customer itself will account for the VAT in the business customer's jurisdiction.

## **Norway**

Since July 2011, the Norwegian Tax Administration has required offshore suppliers of e-services (including digital goods) to register and return VAT on supplies to Norwegian consumers. Like the European Union, VAT on business-to-business supplies is accounted for by the business receiving the services under a reverse charge mechanism.

Norway operates a simplified registration and filing system for non-residents in a "pay-only" position. Norway also allows non-residents to register under the ordinary domestic system if, for example, the non-resident wishes to claim back any Norwegian VAT that they may have incurred.

## **Switzerland**

Since 2010, Switzerland has required offshore suppliers who supply more than CHF100,000 (around NZD\$150,000) of telecommunications or electronic services to Swiss consumers to register for VAT. When measuring the threshold, offshore suppliers only count their supplies to Swiss customers who are not registered for VAT (for example, non-business customers), but once the offshore supplier is registered for VAT they are required to charge VAT on all their supplies in Switzerland (including supplies to business customers). A reverse charge applies to business consumers when the offshore supplier is not registered.

"Electronic services" is broadly defined and includes providing web-hosting, text and images, databases, software, music, movie, games and gambling electronically over the internet.

## **South Africa**

One of the most recent examples of a country adopting the offshore supplier registration model is South Africa. From 1 June 2014, non-resident suppliers of certain electronic services to South African residents are required to register and account for VAT if the total value of taxable supplies exceeds R50,000 (almost NZD\$6,000). Electronic services include online gambling, subscriptions and most downloads. The registration threshold is the same as the domestic threshold for voluntary registration. Once registered, the offshore supplier is required to return GST in respect of both suppliers to businesses and consumers.

Offshore suppliers can use the customer's address, or the location of the customer's bank account (where the payment originates from), to determine the customer's residency.

## **Australia**

On 12 May 2015, as part of its Budget, the Australian Government announced that it will apply GST to digital products and other services imported by Australian consumers from 1 July 2017. A draft Bill and explanatory material have been released for consultation until 7 July 2015.

The rules are broadly modelled on similar rules currently in operation in the European Union and Norway, and follow OECD guidance. Below is a short summary of the proposed rules:

- The proposed rules apply broadly to all services to Australian residents. This will mean supplies of digital products, such as streaming or downloading of movies, music, apps, games, e-books as well as other services such as consultancy and professional services will be subject to GST. Goods and real property are excluded.
- The proposed rules only apply to supplies to Australian consumers. An Australian consumer is broadly an Australian resident other than a business. This means GST will only apply to business-to-consumer supplies. The explanatory material notes that the Australian Taxation Office will work with taxpayers to agree what steps need to be taken to determine whether a customer is an Australian consumer.
- The explanatory material notes that the existing reverse charge (where registered business customers return the GST) will broadly apply to tax the supply in situations when a business receives the services for non-taxable purposes.
- In some circumstances, responsibility for the GST liability may be shifted from the supplier to the operator of an electronic distribution service. This will occur where the operator controls any of the key elements of the supply such as delivery, charging or terms and conditions. Shifting responsibility for the GST liability to operators is intended to minimise compliance costs as operators are generally better placed to comply.
- The proposed rules permit the making of regulations to provide for simplified GST registration for offshore suppliers. These amendments appear to be aimed at simplifying the administrative burden for offshore suppliers caught by the proposed rules to promote compliance.
- The proposed rules allow offshore suppliers to elect for a “limited registration” which prevents offshore suppliers from claiming input tax credits. This will further simplify the registration and remittance process.

## **South Korea**

From 1 July 2015, offshore suppliers are required to charge and return VAT on electronically supplied services (for example, applications, MP3, music, films) to Korean recipients. The affected digital services include streaming services, program updates, remote service provision (such as news, traffic information), software and electronic documents.

South Korea has a simplified registration system in order to encourage compliance. The new rules apply to both business-to-business and business-to-customer supplies, and offshore service providers will be exempt from the requirement to issue VAT invoices to Korean customers.

## **Japan**

From 1 October 2015, Japan is likely to enact legislation that will require offshore non-residents that provide services to Japanese consumers to register for Japanese consumption tax.

## **The United States**

The United States does not operate a national VAT/GST; instead, individual states apply sales taxes and use taxes to most goods and some services at rates that vary from state to state. Currently, retailers are only required to collect sales and use taxes for states where they have a physical presence.

The Marketplace Fairness Act is proposed legislation pending in the United States Congress that would enable states to collect sales taxes and use taxes from remote retailers with no physical presence in their state. However, to address compliance cost concerns, states would only be granted this authority after they have simplified their sales tax regimes.

States can simplify their sales tax regimes in a number of ways. Many states have signed up to the Streamlined Sales and Use Tax Agreement which, among other simplification measures, allows the state to use a centralised, electronic registration system.