

GST on assets sold by non-profit bodies

An officials' issues paper

May 2018

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CHAPTER 1

Introduction

- 1.1 The GST treatment of non-profit bodies (NPBs) is more concessionary than for other taxpayers because NPBs may claim back GST on most of their expenses but in many cases not pay much GST meaning that they often receive GST refunds. This issues paper is not focussed on the ability of NPBs to claim back their GST costs but instead to provide certainty about when GST applies to the sale of the assets of an NPB. Importantly, this issues paper aims to reduce a significant revenue base risk arising from an interpretation of what constitutes the “taxable activity” of an NPB.
- 1.2 Following the announcement by the Minister of Revenue about the GST treatment of assets sold by non-profit bodies that is to apply from 15 May 2018, this issues paper outlines proposals to:
- Treat any goods and services for which an NPB has claimed GST costs (input tax) to be subject to GST as part of its “taxable activity” if later sold by the NPB.
 - Apply the same treatment if an event equivalent to a sale such as an insurance pay-out or GST deregistration occurs.
 - For NPBs who may not have expected to have to pay this GST, allow a 12 month period in which GST input tax claimed can be repaid so as to treat the asset in question as never having been part of the NPB’s taxable activity.
 - Include a savings provision that preserves all tax positions taken before 15 May 2018 by NPBs for the scope of their taxable activities.

These proposals are discussed in more detail in chapter 3.

How to make a submission

- 1.3 Officials invite submissions on the suggested changes and points raised in this issues paper.
- 1.4 Send your submission to policy.webmaster@ird.govt.nz with “GST on assets sold by non-profit bodies” in the subject line.
- 1.5 Alternatively, send your submission to:
- GST on assets sold by non-profit bodies
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140
- 1.6 The closing date for submissions is **15 June 2018**.

- 1.7 Submissions should include a brief summary of major points and recommendations. They should also indicate whether it is acceptable for Inland Revenue and Treasury officials to contact submitters to discuss the points raised, if required.
- 1.8 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their release. The withholding of particular submissions, or parts of submissions, on the grounds of privacy, or commercial sensitivity, or for any other reason, will be determined in accordance with that Act. Those making a submission who consider that there is any part of it that should properly be withheld under the Act should clearly indicate this.

CHAPTER 2

Background

- 2.1 The GST treatment of non-profit bodies (NPBs) differs from that of other entities in two areas:
- The supply of donated goods and services by an NPB, for example the sale by a charity shop of donated clothing, is exempt. This means that no GST is paid on the sale of these goods and services, and no input tax deductions are available for GST costs incurred in making those sales.
 - Except for exempt supplies (such as the sale of donated goods), input tax deductions can be claimed by NPBs for all GST incurred for any activity that is not an exempt activity of an NPB. The receipt and payment of donations is outside the scope of GST rather than specifically exempt. Under current legislation, NPBs can therefore claim input tax deductions (often in the form of refunds) for the GST costs involved in fundraising and distributing funds or providing services. As a result, of the 19,000 NPBs registered for GST purposes, 7,000 are registered despite the fact that their annual turnover does not exceed the \$60,000 compulsory registration threshold.
- 2.2 The exemption for donated goods and services by an NPB is clearly legislated for and will not be affected by the proposals in this issues paper. Rather, the issues paper concentrates on the lack of specific guidance in the legislation on the output tax (the GST charged) liabilities of an NPB where goods and services that are not specifically exempt are supplied by an NPB. The question of whether GST is payable in these cases is dependent on whether the goods and services in question are supplied in the course or furtherance of the NPB's "taxable activity", that is any regular activity that involves making supplies for consideration.
- 2.3 The GST treatment of NPBs' outputs has been uncertain since the introduction of GST, so it has likely been assumed by many that the liabilities would be the same as for any GST-registered person apart from the exemption for donated goods and services. In other words, some may have assumed in line with the general expectation under the GST system, that GST is payable on any supply for which input tax deductions have been claimed. This was because it may have been thought that, once an entity registers, all its activities (other than its expressly exempt activities) form part of the entity's taxable activity.

What is a "taxable activity"?

- 2.4 What might constitute an NPB's taxable activity has recently been more closely considered by Inland Revenue. It is suggested that the taxable activity may not include activities undertaken by the NPB that do not have a sufficient connection with the activity of making supplies for a consideration. So when there are two activities, one of which involves making supplies for

consideration and the other of which involves making supplies for no consideration, the question is whether the two activities have a sufficient connection with each other to be treated as one taxable activity or as two activities, one taxable and one not. It may also be possible to have situations where there is more than one taxable activity and other activities that are not taxable.

- 2.5 Figures 1 and 2 illustrate the GST position for an NPB under the earlier alternative interpretation (“old interpretation”) and the “new interpretation” of “taxable activity”. The green box on the left hand column shows the GST payable by the NPB and the red boxes on the right show the GST that can be claimed back by the NPB. The non-coloured boxes show where GST is either not payable or not able to be claimed back.
- 2.6 Note that the only difference between figures 1 and 2 is that the GST payable is reduced because some supplies that were previously considered part of an NPB’s taxable activity are now non-taxable supplies. While they are not exempt supplies under the GST Act, they are still excluded from the “taxable activity” definition as they do not have a sufficient connection with an activity from which money (or other consideration) is derived. Importantly, while described differently, the new interpretation does not change the level of input tax deductions that can be claimed by NPBs.

Example 1: Asset not part of the taxable activity

A charity for the homeless owns two buildings – one a headquarters dedicated to fundraising and one an emergency accommodation facility which charges a fee based on the facility’s costs for its services. The funds raised assist towards researching issues about homelessness and finding local and national solutions.

The charity has claimed input tax deductions for capital, maintenance and overhead costs relating to both buildings. Following Inland Revenue’s recent interpretation, it could be argued that the charity would not be required to pay output tax on a sale of the fundraising headquarters because the sale would not have been made in the course or furtherance of the taxable activity of providing emergency accommodation. This situation arises because:

- Unlike other GST payers, NPBs are entitled to input tax deductions for all GST incurred unless it relates to making exempt supplies – so deductions can be claimed for fundraising activities.
- The fundraising activity does not on balance have a sufficient connection with the activity of providing accommodation to the homeless for a fee.

This example is illustrated in figures 1 and 2.

Figure 1: GST registered NPBs' GST position under "old" interpretation

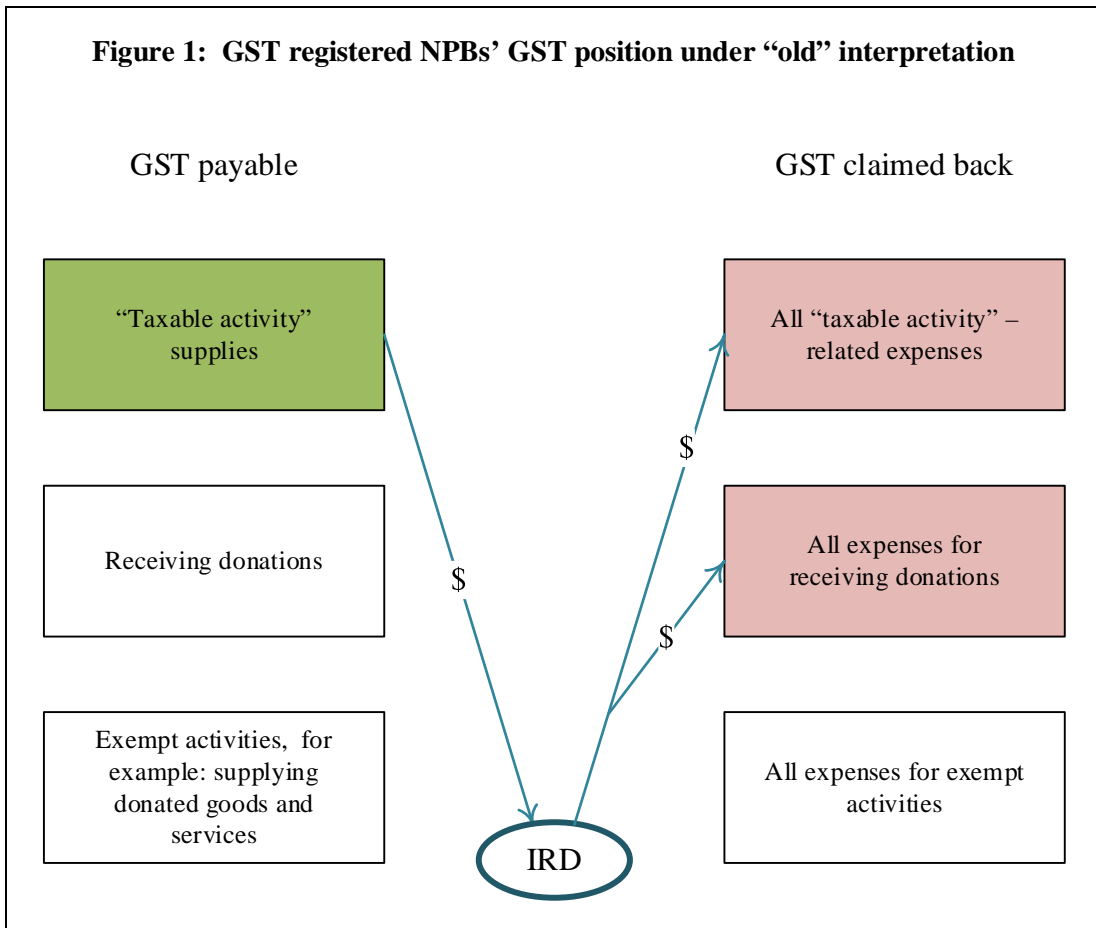
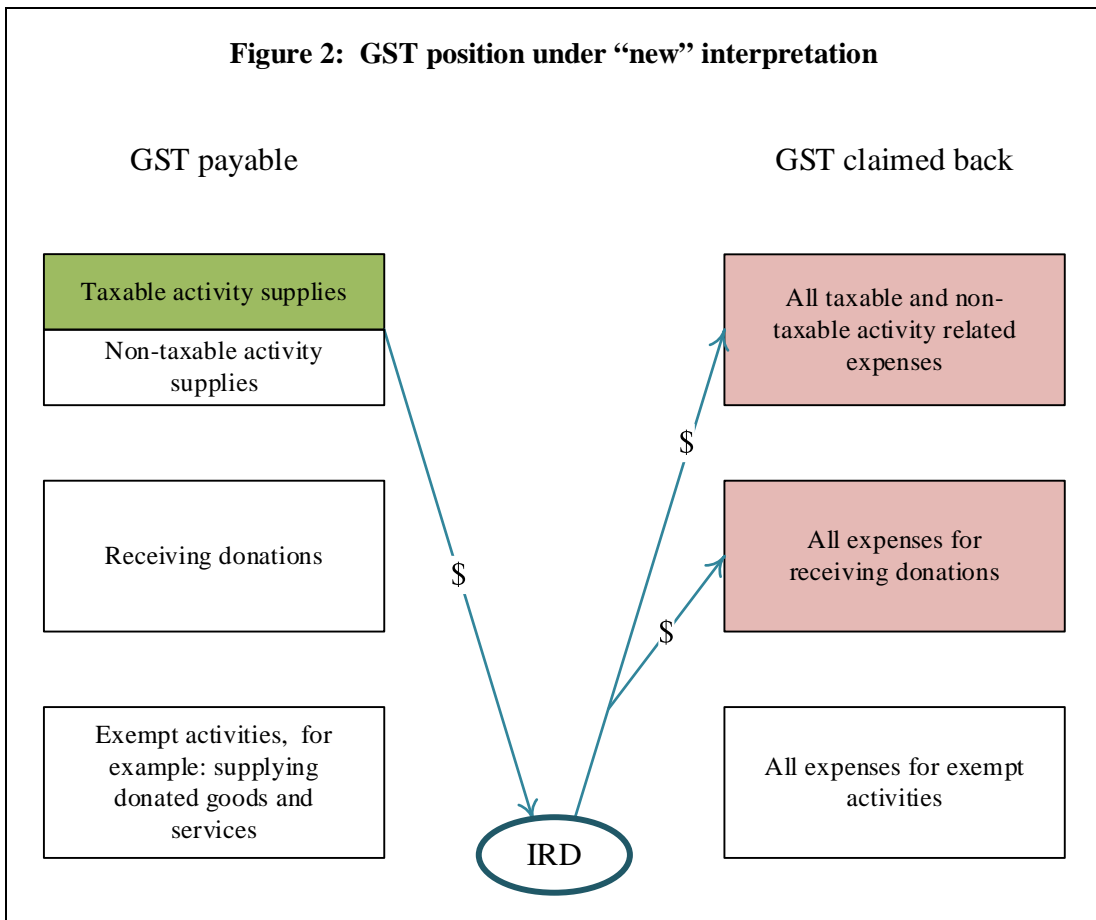


Figure 2: GST position under "new" interpretation



CHAPTER 3

Proposals

It is proposed to:

- Treat any goods and services for which an NPB has claimed GST input to be subject to GST as part of its “taxable activity” if they are later sold by the NPB.
- Apply the same treatment if an event equivalent to a sale such as an insurance pay-out or GST deregistration occurs.
- For NPBs who may not have expected to have to pay this GST, allow a 12 month period in which the GST input tax claimed can be repaid so as to treat the asset in question as never having been part of the NPB’s taxable activity.
- Include a savings provision that preserves all tax positions taken before 15 May 2018 by NPBs for the scope of their taxable activities.

The problem

- 3.1 The current GST treatment of NPBs is concessionary because it can allow almost full input tax deductibility even if very few taxable supplies are made. Therefore, GST-registered NPBs can be advantaged by GST relative to other registered persons. The recent interpretation of “taxable activity” only increases this advantage and, in doing so, causes a significant but unquantifiable fiscal risk.
- 3.2 The revenue risk could arise from certain key events including from the disposal by GST-registered NPBs of any assets to which GST may have been expected to apply but, because of the new interpretation of “taxable activity” by Inland Revenue, will not apply. The risk could also arise for other events which are treated for GST purposes in the same way as if a disposal of assets had occurred such as insurance pay-outs and GST deregistration which we have called “equivalent events” in this issues paper. Another revenue risk could also arise, depending on the circumstances, from the application of the second-hand goods input tax credit. Finally, there is a revenue risk from the possibility of the suggested interpretation applying retrospectively so as to result in refunds of GST previously paid.

The main proposal

- 3.3 The Government intends to amend the GST Act to reduce the input tax/output tax mismatch caused by the interpretation of taxable activity just outlined. The first proposal, therefore, is to amend the input tax deductibility

rule for NPBs, so that, on the sale or equivalent event of goods or services (that is, receipt of an insurance payment or deregistration) they will be subject to GST. The amendment will provide that goods and services that are treated as relating to taxable supplies are also deemed to have been acquired in the course or furtherance of a taxable activity. The rule will apply to sales by NPBs or equivalent events occurring on or after 15 May 2018 whether the affected goods or services were acquired before, during or after that date.

Example 2: Aligning input and output tax

A healthcare NPB is devoted to monitoring the health of children under the age of five in the local community. The NPB is partly funded by the local health board which provides the NPB with the necessary medical staff. The NPB obtains the necessary medical equipment and overhead expenses out of its own fund-raising activities. The NPB also leases out child car seats and baby equipment to the public for a fee.

The NPB has claimed input tax credits for all the GST it has incurred in acquiring the equipment needed for both the health monitoring service and the hiring activity, and for rent and other overheads relating to both activities.

The NPB decides that the hiring activity is detracting from its main activity of providing health checks and therefore decides to sell off the car seats and baby equipment to the highest bidders. It also discovers that there is now better medical equipment available for rent, the cost of which could be met by selling off the existing medical equipment to other health providers.

Under the government's proposal the NPB will be required to pay GST on the proceeds of sale of the car seats, baby equipment and medical equipment. Before the proposal it may have been argued that the sale of the medical equipment was not subject to GST as it was not sufficiently connected with the activity of hiring out car seats and baby equipment for a fee.

- 3.4 There would be no specific rule for goods and services acquired before 1986. Input tax deductions will not have been claimed for the capital cost of acquiring the goods and services but, if input tax deductions for expenses attributable to such goods and services had been claimed, the goods and services will be treated as if they had been brought into the GST base and therefore output tax would apply. Other GST-registered entities with pre-1986 assets are generally required to pay output tax on sale of the assets or equivalent event so the proposed approach aligns the GST treatment with the general treatment.

Unexpected GST cost

- 3.5 It is possible that some NPBs will have claimed input tax credits for goods and services for which it was not expected there would be an output tax liability on sale or equivalent event. This would be where they had already taken a view that it was possible to claim input tax deductions but not pay related output tax if the relevant good or service was not sufficiently connected with supplies made for a consideration. In that case it would seem fair to allow these NPBs to pay back any GST already claimed and remove the relevant goods and services from the GST base so as to put the NPBs in the same position as if that GST had never been claimed.

- 3.6 The idea is that these NPBs could, for a limited time, either notify Inland Revenue or apply to Inland Revenue to pay back any input tax claimed on goods and services affected by the changed interpretation since the date they were registered for GST, rather than pay output tax on the sale of the particular assets or an equivalent event. The main instances in which this is likely to be a better outcome for an NPB is with land or any other asset that appreciates rather than depreciates in value.
- 3.7 The suggested period for allowing input tax deductions to be paid back in this way is 12 months from the date of enactment of the proposals. This would ensure that NPBs using six-monthly GST filing periods have enough time to consider their positions for the next GST filing period.
- 3.8 It is recognised that a good proportion of NPBs will have been registered for many years and also held their relevant assets for many years. On the other hand, tax records are generally only required to be held for seven years. This means that the exact level of relevant input tax deductions over the period since registration may not be known or not known without involving substantial compliance costs. Therefore, for any period where it is difficult to determine the level of input tax deduction claims made (either in total or in relation to a specific asset or assets) a reasonable estimate of the claims will be able to be used. Any output tax paid would be deducted from the calculation.
- 3.9 Further points to consider:
- What form of notification or application should be required to be made by an NPB electing to pay past input tax deductions under this proposal?
 - The level of guidance needed to determine what is a “reasonable estimate” of input tax deductions claimed.
 - Whether there should be a threshold for the affected goods and services so that applications to repay input tax deductions are only available if the deductions related to goods and services that are in aggregate over a certain market value – for example \$50,000.
 - If and how use-of-money interest (UOMI) should be applied to the amount repaid.
- 3.10 The Government is concerned about any compliance cost increase for NPBs resulting from the “taxable activity” interpretation and that the issue could affect more NPBs than just those which decided to remove an asset from the GST base that no longer meet the “taxable activity” requirement since all NPBs will have an interest in ensuring the best tax outcome. Therefore, we are particularly interested in submissions on the idea and whether it is outweighed by compliance cost considerations.
- 3.11 Examples 3 and 4 illustrate how the idea to allow the repayment of input tax deductions from an affected asset and remove it from the GST base would apply in practice.

Example 3

A GST-registered charitable trust owns a historic nineteenth century church in the Bay of Plenty region in which religious services have been regularly held. In 2013 the trust built a hall next to the church for the use of parishioners but also for the use of the general public for a small fee (which has never exceeded the \$60,000 compulsory registration threshold). Input tax deductions have been claimed by the trust for the GST incurred in acquiring the hall, for the maintenance costs of both buildings and for general overhead costs.

Parishioner numbers have been steadily declining while maintenance costs, including earthquake strengthening costs, have risen sharply. The trust therefore decides to wind up and distribute its assets for charitable purposes.

The trust had received an “on balance” view from its tax accountant in 2013 that, if the church was sold or the trust deregistered, output tax would not be payable notwithstanding full input tax deductions could be claimed for expenses related to both the hall and the church. However, the government is now proposing to clarify the legislation so that output tax is in fact payable on the sale of the church or an equivalent event such as deregistration from GST.

Because it is winding up, the trust will need to deregister for GST, meaning that GST would be payable on the market value of the church and the hall as well as any other goods or services held by the trust at that time.

The trust could, however, elect to limit this outcome by returning to Inland Revenue within the proposed twelve-month period its best estimate of all input tax deductions previously claimed for the church. The result would be equivalent to the trust never having included the church as part of its taxable activity.

Example 4

A GST-registered university in Wellington provides a free student counselling service close to its campus in a building that was bequeathed in 1990 by a renowned psychologist and former student subject to the terms of a special purpose trust. At that time the property had a rateable value of \$345,000.

The university has since 1990 claimed a second-hand goods input tax credit of \$45,000 for the property which represents the notional GST on the market value of the property when acquired. It has also been claiming input tax deductions for expenses relating to the counselling service including repairs and maintenance of the building, general overheads and payments to bring in the occasional overseas expert. The sum of deductions claimed since 1990 (including the second-hand goods claim) is \$245,000.

Student demand for the service has been rapidly increasing. As the building is now valued at \$1.5m the university is considering selling the building for the long-term sustainability of the service.

Under the proposals the university would be required to pay output tax on the sale price of the building if it were to sell it. The GST liability would therefore be \$225,000 which would need to be added into the sale price (whether or not zero-rated because the sale is to a GST-registered purchaser).

After considering the recent interpretation of what would constitute a taxable activity for an NPB in the absence of the amendment to section 20(3K), the University is of the view that the property and free counselling service is not part of its taxable activity. It considers whether it is worth paying back all the related GST expenses and decides not to do so because the cost of this is greater than the GST cost of the sale of the building.

Application date and transitional rules

- 3.12 Because of the need to provide early certainty to the sector, coupled with the risk of the interpretation suggested in this chapter potentially giving rise to refund requests relating to past positions, it is proposed that the amendments apply to tax positions taken on or after 15 May 2018.
- 3.13 A savings provision for tax positions taken before 15 May 2018 is also proposed, meaning that NPBs will not be able to change a position for the proposed amendments if such a position has not been taken before that date. This means that if an NPB has taken the tax position before 15 May 2018 that an asset that it has sold before that date (or is the subject of an equivalent event before that date) is not part of its taxable activity, the NPB will not be retrospectively subject to GST on that sale or event. Conversely, if an NPB has taken the position that an asset sold, or equivalent event, before 15 May 2018 is subject to GST, that GST will not be able to be claimed back retrospectively. While it is recognised that there could be some concerns raised in submissions about neutrality of treatment, the approach does ensure that NPBs do not need to revisit the past GST positions taken, thereby reducing the compliance costs of the proposals.
- 3.14 To better ensure that the suggested application date and transitional rules do not themselves give rise to uncertainty, submissions are welcomed on these aspects of the proposals as well as the substantive legislative proposals.