

# Draft GST guidelines for recipients of imported services

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August 2004

*Prepared by the Policy Advice Division of the Inland Revenue Department  
for consultation with affected taxpayers*

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Draft GST guidelines for recipients of imported services.  
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## Foreword

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These draft guidelines on the operation of the new legislation have been prepared for purposes of consultation with affected taxpayers. Comments on the general application and practicality of the guidelines are particularly welcome.

Final guidelines are expected to be available in October 2004.

Submissions should be made by 3 September 2004 and should contain a brief summary of the main points and recommendations. Submissions received by the due date will be acknowledged.

Submissions may be made in electronic form to:

[policy.webmaster@ird.govt.nz](mailto:policy.webmaster@ird.govt.nz)

Please put "GST guidelines" in the subject line for electronic submissions.

Alternatively, submissions may be addressed to:

GST guidelines  
C/- General Manager  
Policy Advice Division  
Inland Revenue Department  
PO Box 2198  
WELLINGTON

Please note that submissions may be the subject of a request under the Official Information Act 1982. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. If you consider that there is any part of your submission that could be properly withheld under the Act, please indicate this clearly in your submission.

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## **Purpose of the guidelines**

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1. The Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003 amended the Goods and Services Tax Act 1985 (the GST Act) to introduce a “reverse charge” mechanism to tax certain imports of services – for example, management, legal and accounting services, a new software installation (and after sales service) or products downloaded via the internet.
2. From 1 January 2005 GST-registered recipients of supplies of imported services are required to add GST to the price of the services and include the tax in the normal GST return and pay it to Inland Revenue if:
  - the services would be subject to GST if supplied in New Zealand; and
  - the recipient makes more than a minimal level of exempt or other non-taxable supplies.
3. The purpose of these guidelines is to explain how the reverse charge affects these supplies of imported services.

## **New definitions**

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4. The following definitions have been included in the Act as part of the introduction of the reverse charge:
  - “Goods” means all kinds of personal or real property, but does not include choses in action, money or a product that is transmitted by a non-resident to a resident by means of a wire, cable, radio, optical or other electromagnetic system or by means of a similar technical system.
  - “Non-resident” means a person to the extent that the person is not resident in New Zealand.

## **Application**

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5. These guidelines apply to a deemed supplier required to self-assess GST on the value of a supply of imported services. For the purposes of GST, a service is anything which is not goods or money. Any business which receives a supply of imported services, or any other person who receives a substantial supply of imported services, is potentially liable to pay GST on the supply.

## Supply of imported services

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6. There is a supply of imported services in New Zealand if:
- the services are supplied by a non-resident supplier to a recipient who is a New Zealand resident;
  - the services are acquired by a person who:
    - has not, in the 12-month period that ends with the month in which the supply is made, made supplies of which at least 95 percent in total are taxable supplies; and
    - does not, at the time of the supply, have reasonable grounds for believing that they will, in the 12-month period that begins with the month in which the supply is made, make supplies of which at least 95 percent in total are taxable supplies.
  - the supply of the services would be a taxable supply if it were made in New Zealand by a registered person in the course or furtherance of their taxable activity;<sup>1</sup>

The 95 percent threshold is consistent with the 5 percent threshold over which change-in-use adjustments are required. Therefore any person who is not currently required to make change-in-use adjustments is not affected by the reverse charge.

7. Therefore supplies of services that would be exempt supplies if made in New Zealand, such as certain financial services, are not subject to the reverse charge. Also, services that would otherwise be subject to GST at 12.5% under the reverse charge can generally be zero-rated under section 11A if they would have been zero-rated had they been supplied in New Zealand.

8. A person required to pay GST under the reverse charge is treated as the supplier of the services for the following purposes:

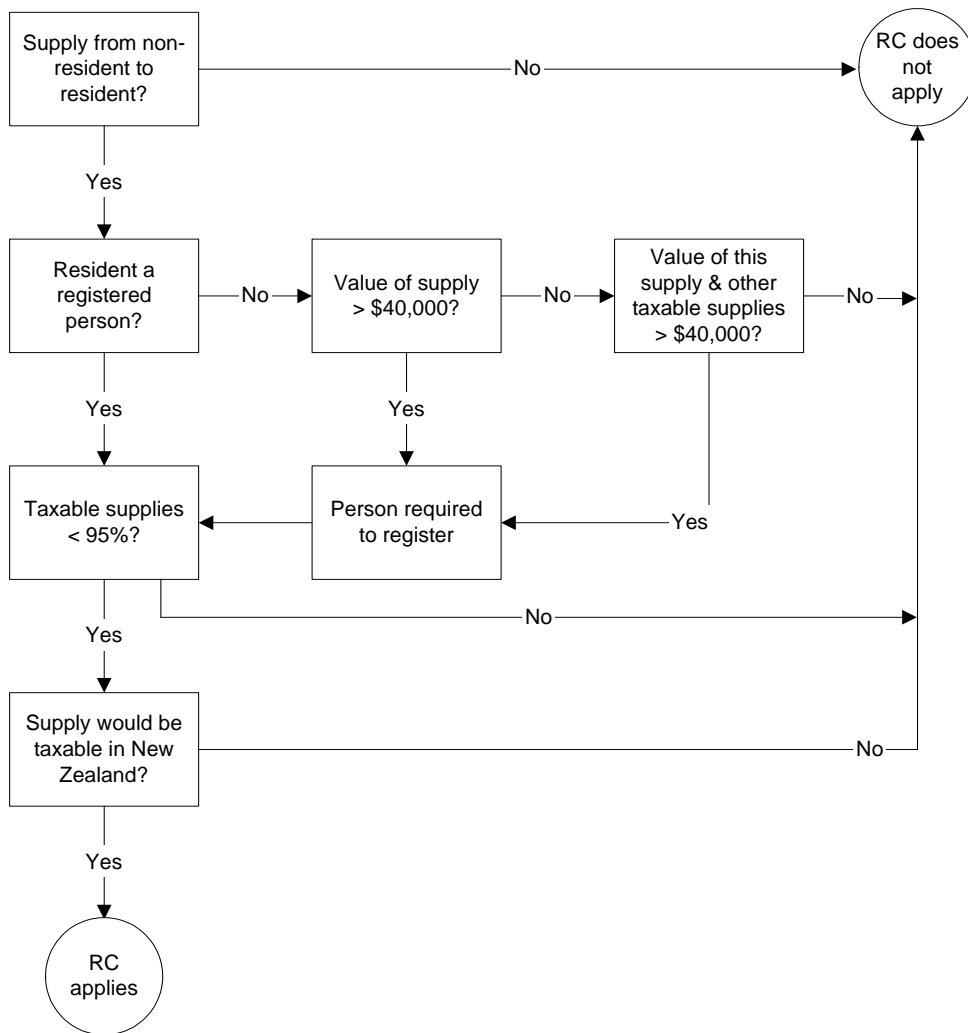
- registration;
- payment of output tax;
- record keeping; and
- avoidance.

9. For all other GST purposes the person is the recipient of services.

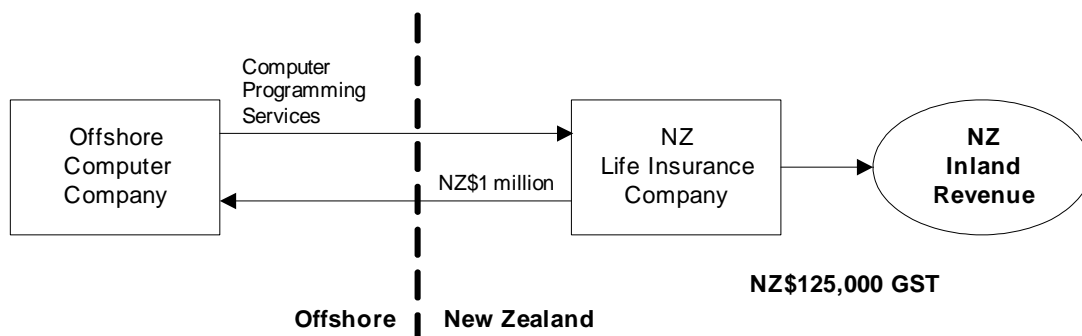
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<sup>1</sup> See section 8(4B) of the Act.

**FIGURE 1:  
Application of the reverse charge**



**FIGURE 2:  
Example of the operation of the reverse charge**



### Example 1: The operation of the reverse charge

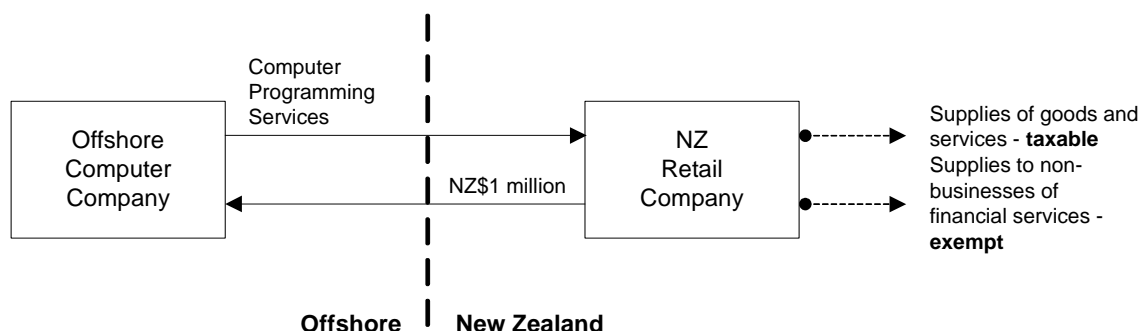
An offshore computer company makes a supply of programming services to a New Zealand life insurance company (see figure 1). The life insurance company makes solely exempt supplies of services. It is charged \$1 million for the programming services, which it pays on receipt of the services. An invoice is provided after payment is made. The two companies are not associated persons.

In this situation:

- The services are supplied by a non-resident supplier to a resident recipient.
- The services are acquired by a person who has not in the last 12 months made (and does not expect in the next 12 months to make) supplies of which at least 95 percent in total are taxable supplies.
- The supply of the services would be a taxable supply if it were made in New Zealand by a registered person in the course or furtherance of their taxable activity.

The New Zealand insurer is required to register for GST, if it is not already registered. The New Zealand life insurer is required to account for GST on the value of the supply. The value of the supply is \$1 million (the consideration for the supply), so the output tax is \$125,000.

**FIGURE 3:**  
**Example of when the reverse charge does not apply**



### Example 2: When the reverse charge does not apply

An offshore computer company makes a supply of programming services to a GST-registered New Zealand retail company (see figure 2). The retail company makes a mix of 98 percent taxable supplies of goods and services and 2 percent exempt supplies of financial services, such as hire purchase, to non-registered consumers. It is charged \$1 million for the programming services, which it pays on receipt of the services. An invoice is provided after payment is made. The two companies are not associated persons.

In this situation:

- The services are supplied by a non-resident supplier to a resident recipient.
- The services are acquired by a person who **has**, in the last 12 months made (and **does** expect in the next 12 months to make) supplies of which at least 95 percent in total are taxable supplies.

Therefore the supply is not subject to the reverse charge because the New Zealand retailer makes taxable supplies in excess of the 95 percent threshold.



## Registration requirements

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10. Because imported services are treated as having been supplied by the recipient in the course or furtherance of a taxable activity carried on by the recipient, the value of imported services supplied to that person is included in the total value of supplies made by that person for the purposes of determining liability to register for GST under section 51. Although many businesses making supplies in New Zealand are currently registered for GST, the reverse charge may require others to register – in particular, any person importing services as a private consumer.

11. A person must register for GST if:

- the total value of supplies made in any month and the 11 preceding months exceeds \$40,000, or
- the total value of supplies made in any month and the 11 following months exceeds \$40,000.

12. Therefore a person who makes no other taxable supplies in New Zealand may be required to register as a result of importing in excess of \$40,000 of services in any 12-month period. Persons who do make other taxable supplies but fall below the \$40,000 threshold may be required to register if they import services which, together with other taxable supplies, exceed the threshold.

### **Example 3: Requirement to register for GST – importing significant amount of services**

A wealthy retired businesswoman has commissioned the building of a substantial property on the outskirts of Auckland. She contracts Italian architects, designers and landscapers for the project. Plans and drawings are sent to her electronically. She is required to register for GST and pay output tax on the value of those services if they exceed \$40,000.

### **Example 4: Requirement to register for GST – registration threshold exceeded**

An unregistered business makes \$39,000 of supplies that would be taxable if the business were GST-registered. It purchases an international franchise licence for \$10,000. As the value of the supplies made by the business is now \$49,000 the business is required to register for GST.

13. Further details on registration requirements are in the Inland Revenue booklet “GST – do you need to register” (IR 365), which can be obtained by phoning 0800 377 776.

# Related party transactions

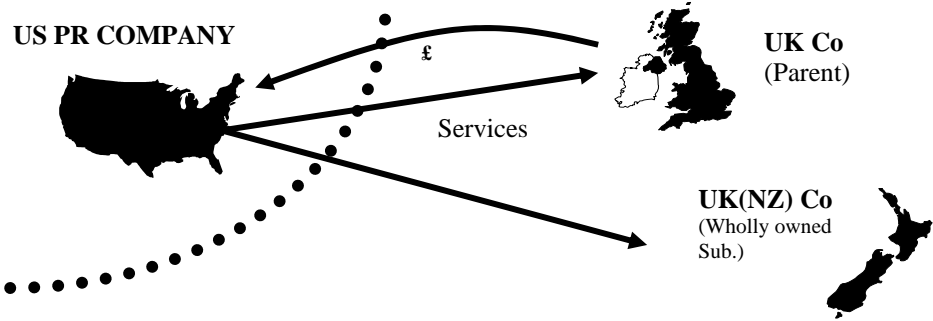
14. Charges for services from an associated overseas business can relate to a specific service or be incorporated into a larger sum. This may be the case, for example, within a group of companies or single multi-national company, when the parent company or head office may allocate a proportion of its costs to the various parts of the enterprise or charge a management fee (referred to as “internal charges”).

15. The reverse charge applies to internal charges by treating them in the first instance as consideration for the supply of services.<sup>2</sup> However, the reverse charge does not apply to any part of an internal charge that relates to salary or wages, interest<sup>3</sup> and other exempt supplies.<sup>4</sup> For the purposes of the reverse charge, the ordinary meaning of salary applies. In the Concise Oxford Dictionary “salary” means a “fixed regular payment made ... by an employer to an employee”.

16. For the purposes of the reverse charge a New Zealand entity or presence must be treated as separate from its offshore presence in relation to the “imported services”. This means that: a New Zealand branch of a non-resident company must be treated as a separate entity; and supplies within a group of companies cannot be disregarded by applying the grouping rules.

### Example 5: Separate entities

UK Co, a manufacturer/wholesale company, engages in an international advertising campaign. The campaign is developed and produced in the USA by a third party. The campaign, including advertising time around the world, costs \$72 million. Nine million dollars of the cost is allocated and charged to New Zealand.



The subsidiary in New Zealand records the cost allocation as an imported service in its GST return and pays GST of \$1.125 million to Inland Revenue.

<sup>2</sup> See section 8(4C).  
<sup>3</sup> See section 10(15C).  
<sup>4</sup> See section 8(4B)(c).

### Example 6: Intra-group supplies

Aus Co, a large retail operation with outlets throughout Australia and New Zealand, maintains a branch in New Zealand (in respect of the consumer finance operations of Aus Co's operations in New Zealand). To reflect accurately the costs incurred in Australia in respect of providing backroom support, including the overall management of Aus Co's financial division, to the New Zealand branch, Aus Co imposes an annual charge of \$6 million on the New Zealand branch.

Previously, this charge had been ignored for GST purposes. However, the New Zealand division is now required to record the amount of the annual charge as an imported service in its GST return. The GST that the New Zealand branch is required to pay to Inland Revenue is \$75,000.

## Taxable value of related party services

17. The value of related party services subject to the reverse charge is reduced by the value of any salary or interest charges from any member of a non-resident company's wholly owned group,<sup>5</sup> or separate branches or divisions of the same company, that form part of an internal charge.

### Example 7: Related party transaction

E is the offshore head office of a multinational company. F is the New Zealand branch of the multinational company. The companies supply financial services. E provides administrative, accounting and management services to F and to other branches in other countries. E recovers the cost of providing these services by making a cost allocation to each branch every year.

F is debited with a cost allocation of \$10 million. This covers administrative and management costs but, owing to the minor nature of the accounting costs for the New Zealand branch, F is not allocated any accounting costs, even though it is provided accounting services. Within the \$10 million of administrative and management costs, there are the following cost components:

Staff salaries:	\$5 million
Financing (interest) costs:	\$1 million
Administration costs:	\$1.5 million
Management costs:	\$2.5 million
<b>Total cost allocation</b>	<b>\$10 million</b>

A cost allocation is treated as a supply of services by a non-resident to a resident that would be taxable in New Zealand. F acquired the services other than for the sole purpose of making taxable supplies. E and F are treated as separate entities carrying on activities. Components of a cost allocation that are attributable to salaries and interest incurred by E are excluded from the value of the cost allocation subject to the reverse charge. Therefore only \$4 million of the cost allocation is subject to the reverse charge.

The accounting services provided to F at no cost are a taxable supply acquired for non-taxable purposes. However, there is no uplift to market value, as the cost of the accounting services would have been allowed as a deduction for F under the Income Tax Act 1994 if it was a separate legal entity for the purposes of that Act. (See discussion of value of supply and example 13.)

<sup>5</sup> See section IG 1 of the Income Tax Act 1994.

Therefore the amount subject to the reverse charge is:

Staff salaries:	0 excluded
Financing (interest) costs:	0 excluded
Administration costs:	\$1.5 million
Management costs:	\$2.5 million
Accounting:	0 no market value uplift required
<b>Total subject to reverse charge:</b>	<b>\$4 million</b>
<b>GST at 12.5%</b>	
<b>Total GST to be returned:</b>	<b>\$500,000</b>

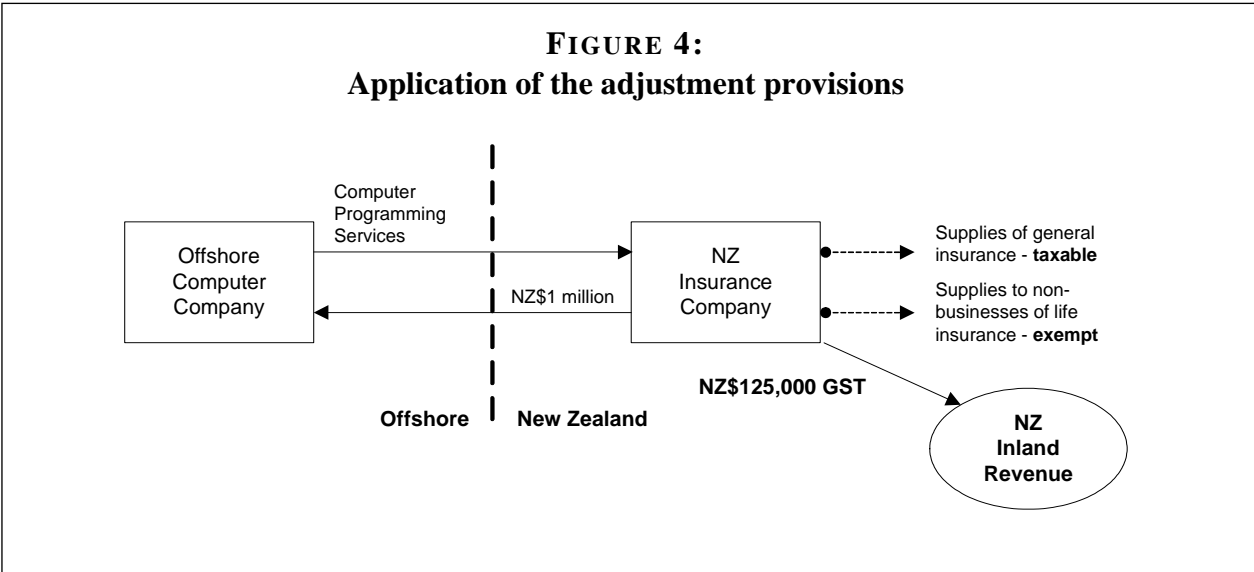
## Mixed-use acquisitions

18. A recipient of services subject to the reverse charge may be able to claim under the general change-in-use adjustment rules either an input tax credit or change-in-use adjustments<sup>6</sup> to reflect any taxable use of the imported services.

19. A person who has acquired imported services for the principal purpose of making taxable supplies is entitled to claim an input tax credit for the GST paid under the reverse charge. That person, however, is required to make a change-in-use adjustment and return additional output tax to the extent that the services were not acquired for the purpose of making taxable supplies.

20. A person who has not acquired imported services for the principal purpose of making taxable supplies is not entitled to an input tax credit for the GST paid under the reverse charge. That person may, however, under the change-in-use adjustment provisions, claim back the GST paid to the extent that the services were acquired for the purpose of making taxable supplies.

21. In either instance when input tax credits are available, a tax invoice is not required if the output tax on the relevant supply has been accounted for.



<sup>6</sup> Either one off or on-going.

**Example 8: Mixed-use acquisition – principally exempt**

An offshore computer company provides computer programming services to a GST-registered New Zealand life insurance company for \$1 million (see figure 3). Using a turnover approach, the services are used 70 percent for making exempt supplies of life insurance, and 30 percent for making taxable supplies of general insurance. Under the reverse charge, the life insurance company is required, therefore, to add GST to the \$1 million, giving a figure of \$1.125 million, and include the GST of \$125,000 imposed under the reverse charge in its GST return.

The life insurance company is not entitled to an input tax credit in relation to the supply of the computer programming services because it has not acquired the services for the principal purpose of making taxable supplies.

Because the life insurance company uses the services 30 percent for making taxable supplies, it is entitled to a change-in-use adjustment, and is able to make a period-by-period deduction during the term of the asset from its output tax liability.

The life insurance company does not, however, include the \$1.125 million as a supply it has made for the purposes of making the adjustment based on turnover.

**Example 9: Mixed-use acquisition – principally (but not 95 percent) taxable**

An offshore computer company provides computer programming services to a GST-registered New Zealand life insurance company for \$1 million (see figure 3). Using a turnover approach, the services are used 70 percent for making taxable supplies and 30 percent for making exempt supplies. The reverse charge applies, as the services are acquired by a company which makes taxable supplies of less than 95 percent of total supplies.

Under the reverse charge, the life insurance company is required to add GST to the \$1 million, giving a figure of \$1.125 million, and include the GST of \$125,000 in its GST return.

The company is, however, entitled to an input tax credit of \$125,000 on the importation of the services, as they are acquired for the principal purpose of making taxable supplies. It is then required to make an adjustment on a period-by-period basis for exempt supplies made using the services.

**Example 10: Mixed-use acquisition – principally (but not 95 percent) taxable**

A multinational company supplies a software package to its GST-registered New Zealand subsidiary for \$1 million. Using a turnover approach, the services are used 70 percent for making taxable supplies and 30 percent for making exempt supplies. The reverse charge applies, as the services are acquired by a company which makes taxable supplies of less than 95 percent of total supplies.

Under the reverse charge, the subsidiary is required to add GST to the \$1 million, giving a figure of \$1.125 million, and include the GST of \$125,000 in its GST return.

The subsidiary is, however, entitled to an input tax credit of \$125,000, as the software was acquired for the principal purpose of making taxable supplies. It has the option to make a one-off or period-by-period adjustment to reflect the extent of the exempt use of the software.

## Zero-rating services consumed wholly outside New Zealand

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22. The reverse charge applies only to services that cannot be regarded as being wholly consumed outside New Zealand. Services can be zero-rated if they are physically performed outside New Zealand and they can be physically received only at the time and place at which they are physically performed. However, services which are intangible in nature, such as the provision of a legal opinion or feasibility study offshore, cannot be zero-rated because such services cannot be regarded as necessarily wholly consumed offshore.

### **Example 11: Zero-rating under the reverse charge**

A GST-registered New Zealand life insurance company sends an employee to Sydney to obtain a legal opinion from an Australian law firm in relation to a proposed transaction and pays for the employee's accommodation in a Sydney hotel. The life insurance company makes predominantly exempt supplies of services.

The life insurance company is charged \$1 million for the legal services, which it pays on receipt of the services. An invoice is provided after payment is made. The life insurance company is charged \$500 for the accommodation services, which the employee pays for using a business credit card. The life insurance company is not an associated person of either the law firm or hotel.

In this situation:

- The legal and the hotel services are supplied by a non-resident supplier to a resident recipient.
- The legal and hotel services are acquired by a person who makes predominantly (more than 95 percent) exempt supplies.
- The supply of the legal and hotel services would be a taxable supply if it were made in New Zealand by a registered person in the course or furtherance of the person's taxable activity.

The supplies are subject to the reverse charge. However, the supply of imported services may be zero-rated if the services are physically performed outside New Zealand and the nature of those services is such that they can be physically received only at the time and place at which the services are physically performed.

Although it is arguable whether the supply of legal services is "physically received" when the employee receives the opinion, the nature of the legal services means that they could be physically received other than at the time and place at which they are physically performed. The New Zealand life insurer can receive the opinion at any time and place (including New Zealand). The supply of legal services cannot, therefore, be zero-rated and is subject to GST at 12.5% under the reverse charge, requiring the New Zealand life insurer to return \$125,000.

The hotel accommodation services, on the other hand, can only ever be physically received where they are performed. Therefore these services can be zero-rated and the New Zealand life insurer is not required to return GST on the supply.

## Time of supply rules

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23. The normal time of supply rules generally apply for the purposes of the reverse charge. This means that the time of supply for the reverse charge is the earlier of when an invoice is issued or payment is made in respect of the supply. If the supply is between associated persons, there may be supplies for which no invoice is issued, or payment is made only at, say, year end (for example, head office charges). To cater for these circumstances, the time of supply test for supplies between associated persons has been amended to allow the test not to be applied until the end of the taxable period that includes the date which is two months after the recipient's balance date for the year in which the services were performed.

24. The time of supply for a supply of services between associated parties subject to the reverse charge is, therefore, the earliest of:

- when an invoice is issued;
- when payment is made in respect of the supply; or
- the end of the taxable period that includes the date which is two months after the recipient's balance date for the year in which the services were performed.

25. In the case of services supplied under an agreement which provides for periodic payments, the services are treated as being successively supplied, with each supply taking place when a payment becomes due or is received, whichever is the earlier.

### **Example 12: Time of supply**

A (offshore parent company) and B (New Zealand subsidiary) are parts of a multinational group. Throughout a year (monthly) A supplies B with administrative and accounting services. B is registered for GST, accounts for GST on a two-monthly taxable period basis and makes solely exempt supplies. B is not charged for these services until after the end of each year, when a lump sum is charged for administrative and accounting services provided by the parent company to all members of the multinational group.

The supply of services is subject to the reverse charge as it is a supply that would be taxable in New Zealand and it is acquired by a business which makes taxable supplies amounting to less than 95 percent of total supplies. B's balance date is 30 June, and the end of the taxable period that includes the date that is two months after B's balance date is 31 August.

The time of supply for the services is either:

**Invoice:** If A provides B with invoices/an invoice for the services provided before either payment is made or 31 August, the time of supply for the service/services is when the invoice is issued.

**Payment:** If B makes payment for the services before either the issue of invoices/an invoice for the supply/supplies or 31 August, the time of supply is when the payment/payments are made.

**Taxable period following balance date:** If neither an invoice is issued, nor payment made, before 31 August, then the time of supply is 31 August. The supply is therefore required to be included in B's GST return, due on 30 September.

## **Transitional provisions**

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26. Special time of supply rules<sup>7</sup> apply when a supply of imported services spans the introduction of the reverse charge. They are based on the transitional provision which applied on the introduction of GST to address situations when tax would be either chargeable on supplies received before the introduction date of GST, or would not be chargeable on supplies received after the introduction date of GST.

27. The new rules provide that a supply of services occurs at the time the services are performed and they are treated as being performed continuously and uniformly during the whole of that period or those periods over which the services are performed.

28. To the extent that services are treated as being supplied before the reverse charge came into effect, the services are not subject to GST. To the extent that services are treated as being supplied on or after the reverse charge came into effect, they are subject to GST, even if they were invoiced or paid for before the reverse charge came into effect.

## **Value of supply**

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29. The value of a supply subject to the reverse charge is equal to the consideration for the supply. This ensures that the supply is GST-exclusive in the same way as for imported goods.

30. Applying the normal rules for supplies between associated persons would mean that the value of the supply would be either the actual consideration or the open market value of the supply.

31. To minimise compliance costs, however, the cost basis for valuing supplies between associated parties applies in the following circumstances:

- if the payment for those services is allowed as a deduction to the recipient; or
- if the supply is between separate branches or divisions of the same company and the payment for those services would be an allowable deduction to the recipient if it was a separate entity for income tax purposes.

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<sup>7</sup> See section 84B.



### **Example 13: Value of supply of services**

As part of an international advertising campaign for a multinational group C (an offshore parent company) supplies D (a GST-registered New Zealand subsidiary that makes predominantly exempt supplies) with advertising services. As the advertising services are for a multinational group and most of the costs are absorbed and incurred in other countries in which the company operates, the New Zealand branch is not charged for the services, either explicitly or by way of a cost allocation from the head office.

The supply of services is subject to the reverse charge as it is a supply that would be taxable in New Zealand and it is acquired other than for solely taxable purposes. Prima facie, as C and D are associated persons, D would have to calculate the market value of the services it has received. However, an uplift in the value of supply to market value is not required, as the cost of the advertising services would have been a deduction for company D under the Income Tax Act 1994. The value of the supply is therefore zero, and GST at 12.5% on this results in a zero amount.

### **Example 14: Value of supply of intangible property**

C electronically supplies a software licence to D for \$200,000. The licence is treated as a supply of services, and the supply is subject to the reverse charge as it would be taxable in New Zealand and is acquired other than for solely taxable purposes. Prima facie, as C and D are associated persons, D would have to calculate the market value of the services it has received. However, an uplift in the value of supply to market value is not required, as the cost of the software licence would have been allowed as a depreciation deduction for D under the Income Tax Act 1994. The value of the supply is therefore \$200,000, and GST at 12.5% on this is \$25,000.

## **Documentation requirements**

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32. A recipient of a supply of imported services subject to the reverse charge is required to maintain sufficient records to establish the correct value on which GST should be charged. The following information is required for this purpose:

- the name and address of the supplier;
- the date on which, or the period during which, the supply was received;
- a description of the services supplied;
- the consideration for the supply;
- the time by which payment of the consideration for the supply is due; and
- the amount of the consideration for a supply that the taxpayer has treated as not affecting the value of the supply under section 10(15C)(a) and (b) (that is, salary and interest).<sup>8</sup>

33. An invoice or other supporting documentation, such as a supply contract or record of payments made, may substantiate the valuations adopted for the purposes of the reverse charge.

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<sup>8</sup> See section 24B.

34. An invoice is not required in order to claim input tax credits for output tax paid on the supply of imported services.<sup>9</sup>

35. Specific information from the related head office or related entity is needed to ascertain the correct value of staff salaries and interest to be excluded from internal charges subject to the reverse charge.

### **Internal charges between associated persons**

36. Charges for services supplied between associated persons are valued at cost if payment is allowed as a deduction. In other circumstances, the value of the supply is its market value. In determining market value, the Commissioner will accept charges calculated and evaluated in accordance with the income tax transfer pricing guidelines.

37. There is no explicit statutory requirement to prepare and maintain transfer pricing documentation, but it should be adequate to ensure that a person is able to demonstrate readily to Inland Revenue that its transfer prices are consistent with the arm's length principle in section GD 13 of the Income Tax Act. The arm's length charge is one that is consistent with what would have been charged and accepted in a transaction between independent enterprises in comparable circumstances.

38. Even so, taxpayers are not expected to prepare levels of documentation that are disproportionate to the amount of tax revenue at risk in their transfer pricing transactions. The cost of preparing documentation should be weighed against the risk that Inland Revenue will make a transfer pricing adjustment.

39. Inland Revenue would expect to see, at a minimum, the following documentation:

- an identification of the cross-border transactions for which the taxpayer has a transfer pricing exposure;
- a broad functional analysis of the taxpayer's operations, to identify the critical functions being performed;
- an estimation of the business risk of not undertaking and documenting a more detailed transfer pricing analysis;
- an estimation of the costs of complying with the transfer pricing rules.

40. A taxpayer should also, as far as practicable, seek to collect and retain documentation that is:

- existing at the time the taxpayer was developing or implementing any arrangement that might raise transfer pricing issues, or
- brought into existence close to the time the transaction occurs.

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<sup>9</sup> See section 20(2)(d).

41. Such documentation might include books, records, studies, analyses, conclusions and any other written or electronic material recording information that may be relevant in the determination of transfer prices.

42. The transfer pricing guidelines are appended to *Tax Information Bulletin* Vol 12, No 10 (October 2000). This document is also available on the internet. Visit Inland Revenue's website at [www.ird.govt.nz](http://www.ird.govt.nz) and choose the *Tax Information Bulletin* section.