Regulatory Impact Statement

Local authorities' change of accounting basis

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

The question in this statement is how eight local authorities can be supported in their transition from a cash basis to an invoice basis of accounting for goods and services tax.

Officials have consulted with the tax agent for the affected local authorities since 2001, and three temporary exemptions have been provided by way of Order in Council, which have delayed the date on which the authorities are required to change to an invoice basis. These were aimed at supporting the transition to an invoice basis by allowing time for the authorities to reduce their rates debt. We have had frequent consultations with the tax agent over the last year and the preferred option was suggested by the tax agent in that consultation period.

The requirement to change to an invoice basis has minor short-term compliance costs for the affected local authorities. However, the recommended option mitigates the negative impact on cash flow which the local authorities would otherwise incur. The Treasury agrees with the recommended option.

Changing to an invoice basis will reduce compliance costs for the local authorities over the longer term as it means they will no longer have to maintain two accounting bases.

The proposed option does not impair private property rights, reduce market competition, nor provide disincentives to innovate and invest, or override common law principles.

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STATUS QUO AND PROBLEM DEFINITION

1. This RIS provides an analysis of options of potential transitional measures to assist eight local authorities who will soon be required to move to an invoice basis of accounting for goods and services tax (GST).

2. Taxpayers with an annual turnover of more than $2 million are generally required to account for GST on an invoice (or accrual) basis as opposed to a payments (or cash) basis. Accounting for GST on a payments basis means that GST is accounted for in the period when payments are made or received, whereas accounting on an invoice basis means that GST is paid or claimed in the period when obligations or benefits accrue, for example when an invoice is issued.

3. The Goods and Services Tax Act 1985 was amended in 2001 to remove local authorities as a class of registered persons which the Commissioner could allow to account for GST on a payments basis. This eliminated the need for local authorities to maintain a dual system of accounting (ie. an invoice system for financial reports and a payments system for GST purposes).

4. While most local authorities changed to an invoice basis in 2001, nine authorities with high levels of ratepayer debt were granted a temporary exemption from the requirement to change by an Order in Council (the *Goods and Services Tax (Local Authorities Accounting for GST on Payments Basis) Order 2001*).

5. A second Order in Council was made in 2005 which allowed eight of the original nine local authorities to continue to account for GST on a payments basis, and a third and final order was made in 2009 which covered the same eight local authorities. This Order expires on 30 June 2013.

6. When the third Order in Council was made in 2009, Cabinet noted (LEG Min (09) 13/3 refers) that an amendment to the GST Act would be recommended to remove the ability to make further Orders.

Question

7. The question in this statement is how the local authorities can be supported in their transition from a cash basis to an invoice basis of accounting for GST.

OBJECTIVES

8. The key objective is to ensure that the local authorities move to an invoice basis of accounting for GST taking into account the impact on their cash flow.

9. The impact on cash flow results when a registered person changes from a payments basis to an invoice basis and is required to perform a wash-up calculation based on their outstanding debtors and creditors. This would cause significant cash flow implications for local authorities with high levels of ratepayer debt because they would have been liable to pay output tax in respect of that amount.

REGULATORY IMPACT ANALYSIS

10. The total amount of GST payable for the eight local authorities is estimated to be approximately $11 million in total. Officials therefore considered the following four potential transitional measures to support the local authorities in their transition from a cash basis to an invoice basis of accounting for GST.

Option 1 – Permit the local authorities to make the payment of the one-off amount in instalments of equal amounts spread over 72 months **(RECOMMENDED OPTION)**

11. The suggested spreading period of 72 months relates to the six year period before local authorities are able to write off unpaid rates as bad debts. If spreading was allowed over a period of 72 months this would mean that each of the instalments was offset against deductions for bad debts of equivalent amounts from earlier periods. This would minimise the size of the negative impact on cash flow for the local authorities.

12. This option would not have an impact on Government revenue forecasts, as these are prepared on an accruals basis and the liability to pay the full amount would not change. There would, however, be an impact on cash flow due to the timing of the payments.

13. For the first six years following the change to an invoice basis, the local authorities would pay annual amounts equal to one-sixth of the one-off amount (but this would be offset (in part) by deductions relating to bad debts of periods before the 72 months).

14. While 72 months is an unusually long time over which to permit spreading of a tax liability, option 1 is the recommended option since it provides significant mitigation of the negative impact on cash flows for the local authorities.

Option 2 – Permit the local authorities to make the payment of the one-off amount in instalments of equal amounts spread over 24 months

15. A shorter spreading period would mean that the Government would receive the one-off amount sooner, and the required ongoing adjustments to returns would be shortened. This would also mitigate the negative impact on cash flows for the local authorities (like Option 1), albeit to a lesser extent than the longer spreading period.

16. For the first two years following their change to an invoice basis the local authorities would have to pay an amount approximately equal to one half of the one-off amount.

Option 3 – No transitional measures

17. By not providing any transitional measures, this would ensure that the local authorities were subject to the same rules as most other taxpayers who change from a payments basis to an invoice basis. It would not, however, take into account the unusual commercial situation of local authorities holding high portions of ratepayer debt.

18. In their first GST return following the change to an invoice basis, the local authorities would have to pay the entire one-off amount.

Option 4 – Deem the debts of the local authorities as at the close of business on 30 June 2013 to have been written off on 30 June 2013 for the purposes of section 26 of the GST Act

19. This would mean that the local authorities would not have to include their outstanding debts in their wash-up calculation. As the debts would be written off before the local authorities began operating on an invoice basis, the GST component of those debts would never be paid to Inland Revenue, and would not be subsequently returned to the local authorities.

20. For the first six years following their change to an invoice basis, the local authorities would have to pay an amount approximately equal to one-sixth of the one-off amount. This option, while giving rise to a similar result to option 1, would be inconsistent with the GST treatment of debts applied to other taxpayers.

CONSULTATION

21. Officials have been in consultation with the tax agent for the affected local authorities since 2001. This has resulted in three consecutive Orders in Council being made, the cumulative effect of which has been to allow the local authorities until 30 June 2013 to prepare for the transition to an invoice basis.

22. The Orders in Council were aimed at supporting the transition to an invoice basis by allowing time for the authorities to reduce their rates debt. However, the authorities have not been able to reduce their rates debt as they had expected and Ministers decided in 2009 against making a further Order in Council. Officials have been in consultation with the tax agent frequently over the last year to discuss how the local authorities could be supported in their transition to an invoice basis.

23. The tax agent named option 4 as its preferred approach. Given the inconsistent treatment of Option 4, the tax agent proposed Option 1, stating that there was very little preference between those two options. Other Options were not preferred.

24. The Treasury agrees with the recommended option.

CONCLUSIONS AND RECOMMENDATIONS

25. Option 1 is recommended, namely permitting the local authorities to spread the resultant output tax liability equally over their returns for the 72 months from 1 July 2013. This is viewed as the best option as it both ensures that the local authorities are able to move to an invoice basis, and mitigates the significant negative impact on cash flow which would arise if a shorter period of spreading or no spreading was recommended.

IMPLEMENTATION

26. The recommended option would be included in the next available tax bill.

27. Although compliance costs arise for the local authorities in moving to an invoice basis, the recommended option reduces the negative impact on cash flow relative to options 2 and 3. Changing to an invoice basis for GST will reduce compliance costs for the affected local authorities overall as it will mean that the authorities will no longer need to maintain dual accounting bases.

MONITORING, EVALUATION AND REVIEW

28. There are no plans to monitor, evaluate and review the changes following this amendment. This is because the reforms remove existing grand-parenting and are transitional rules only. If any specific concerns are raised, officials will determine whether there are substantive grounds for review under the Generic Tax Policy Process. Also, the GST Act is subject to regular review by officials.