The Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill

Number 93-1

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Regulatory Impact Statement

Information sharing Arrangement with Australia for the recovery of student loan debt

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options to implement an information-sharing mechanism between Australia and New Zealand for the recovery of student loan debt. This analysis follows approval by Cabinet in August of last year to negotiate and progress towards an agreement with Australia for the purpose of exchanging information to assist in the recovery of New Zealand student loan debt held by borrowers currently residing in Australia.

Negotiations with Australian officials included a test data exchange to examine the ability of the Australians to perform the relevant information exchange and the likely benefits to New Zealand for having such an exchange.

In assessing the likely revenue benefits and determining the cost of the exchange, assumptions were made regarding the frequency of exchange and number of borrowers whose details will be matched under the proposed facility. Estimation of the revenue benefits and analysis of the problem also makes assumptions about the extent of the overseas-based borrower population residing in Australia. Because of the lack of quality contact details held for borrowers overseas, particularly for borrowers in default, it is difficult to ascertain what proportion of these borrowers are in Australia.

The information-sharing mechanism requires amendment to both Australian and New Zealand legislation. Further work needs to be undertaken to develop the required legislative changes.

No public consultation was carried out in respect of the proposed Arrangement. Extensive consultation occurred between Inland Revenue officials and the Office of the Privacy Commissioner to ensure that the potential privacy impacts have been identified and properly considered. Additionally, the Ministry of Foreign Affairs and Trade was consulted with regards to the appropriate international instrument to support the proposed exchange of information.

There is no legislation accompanying this Arrangement. However, legislation will be required before exchange of information under this Arrangement can become operational. The required legislation could be included in a student loan scheme bill scheduled for introduction in the second half of this year.

None of the proposed options are expected to impair private property rights, reduce market competition, or override common law principles.

Chris Gillion
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10 February 2015

STATUS QUO AND PROBLEM DEFINITION

Overseas-based-borrower debt

1. There is currently over $683 million owing in overseas student loan default. In 2015 this is likely to increase to $880 million, which will represent well over 90 percent of all student loan default. Approximately 65 percent of overseas-based borrower default is estimated to be held by borrowers residing in Australia.

2. Overall, repayment rates for overseas-based borrowers are very poor. Nearly 80 percent who had a repayment obligation on 31 March 2014 failed to make their payments.

3. The key to collecting overdue repayments is holding up-to-date contact details for defaulters. Inland Revenue holds some form of contact details for only approximately 30 percent of overseas-based borrowers. This lack of contact details makes engaging with overseas-based borrowers difficult, including those borrowers based in Australia.

Previous initiatives

4. In order to address the high levels of non-compliance by overseas-based borrowers, several initiatives have been introduced over the last four years to increase the quality of contact details held by Inland Revenue for overseas-based borrowers.

5. From 2012, borrowers applying for a repayment holiday were required to also provide details for an alternative contact person based in New Zealand. In 2013, legislation was amended to ensure all borrowers have an obligation to notify the Commissioner of Inland Revenue of any change in their contact details.

6. Additionally, Inland Revenue has an information match with the New Zealand Customs Service, which allows Inland Revenue to receive the contact information from the arrival cards of serious defaulters. There is also an information-sharing agreement with the Department of Internal Affairs, which allows Inland Revenue to receive contact details from passport applications and renewals for overseas-based borrowers who are either in default of their repayment obligations or whose contact details appear not to be up-to-date.

7. Inland Revenue also entered into contracts with private debt collection agencies in Australia in 2013, which allowed these agencies to locate borrowers' contact details and pursue debt collection activities on behalf of Inland Revenue when required.

8. The exchange of information underlying the proposed Arrangement follows these initiatives in scaling up the overseas-based borrower compliance initiative which began in 2010 (and initially focused on borrowers based in Australia). The initiative is run by Inland Revenue, which reports on its progress quarterly to the Minister for Tertiary Education, Skills and Employment and the Minister of Revenue.

Status quo

9. There is currently no written understanding in place to facilitate and support an information-sharing mechanism between New Zealand and Australia to assist in the recovery of student loan debt.

10. At the Australia–New Zealand Leaders' meeting held in February 2013, it was agreed that officials from Australia and New Zealand would work together to investigate the possible implementation of a reciprocal student debt recovery scheme on a without-prejudice basis.

11. Following the Australia-New Zealand Leaders' meeting held in February 2014, the Prime Ministers welcomed progress on work to set up a mechanism to share data to assist New Zealand to recoup unpaid student loans in Australia, with the option of New Zealand providing reciprocal assistance should Australia adopt an overseas-based borrower regime in the future.

12. In August 2014, Cabinet agreed that New Zealand officials would enter into formal negotiations with their Australian counterparts in relation to an agreement to exchange information to assist in the recovery of student loan debt [CAB Min (14) 26/22 refers].

13. There is a concern that the status quo is not sufficient, as there is no official political commitment between Australia and New Zealand to assist in the recovery of student loan debt. As mentioned above, Australia has previously signalled an intention to cooperate with New Zealand in the recovery of student loan debt; however, this intention is not currently formalised in any manner. Assistance in recovery of student loan debt in Australia would be beneficial to New Zealand, as there is a high level of student loan default held by borrowers currently residing in Australia.

Problem definition

14. The problem addressed in this RIS is limited to implementation of an agreement following negotiations with Australian officials, as Cabinet approved these negotiations in August 2014. This RIS therefore identifies the implementation options available for an agreement for the assistance in the recovery of student loan debt between Australia and New Zealand.

15. After formal negotiations with Australian officials, which took place in September to December of 2014, it has been decided that the type of agreement that is acceptable to both jurisdictions is an Arrangement. An Arrangement is of less than treaty status and instead embodies a moral and political commitment.

16. In this context, this RIS is concerned with how to progress the exchange of information between Australia and New Zealand to assist with the recovery of New Zealand student loan debt held by borrowers residing in Australia.

17. This RIS does not consider a legally binding agreement (treaty) as an option. Formal negotiations with Australian officials have indicated that their preferred option for an international instrument is an Arrangement.

OBJECTIVES

18. The objectives are to:

(a) Support an information exchange between the Australian Taxation Office (ATO) and Inland Revenue in relation to New Zealand student loan borrowers residing in Australia.

(b) Commit Australia to enter into a mechanism for the exchange of information for information on student loan borrowers. This will require consensus with Australian officials.

(c) Gain access to contact information for New Zealand student loan borrowers in a cost-effective way.

(d) Achieve (c) in a timely manner, recognising that the quicker Inland Revenue can make contact with these borrowers, the more successful the initiative is likely to be.

(e) Maintain flexibility to negotiate debt recovery terms, including information requests from Australia to New Zealand on Australian borrowers living in New Zealand (reciprocity).

19. The primary objective is to advance an information exchange between the ATO and Inland Revenue in relation to New Zealand student loan borrowers residing in Australia (objective (a)). The objectives (b), (c), (d) and (e) concern the specific criteria to be considered when trying to achieve (a).

20. The ability to maintain flexibility, particularly for the purpose of potentially providing reciprocal facilities in the future for sharing information on Australian borrowers residing in New Zealand (objective (e)) is likely to involve more lengthy negotiations. Accordingly there is a trade-off between objectives (d) and (e).

21. For an information exchange to become operational, both Australia and New Zealand will require passing amendments to current legislation to allow for the sharing of information. This means that the earliest any information exchange will be operational is the middle of 2016.

22. Following consultation with the Office of the Privacy Commissioner, and as stated in the proposed Arrangement, any information sharing will be carried out in accordance with applicable privacy laws in both jurisdictions.

REGULATORY IMPACT ANALYSIS

23. This RIS considers the status quo (option one) and one alternative (option two) as options to address the stated problem and achieve the desired objectives.

Status quo (option one)

24. There is currently no written understanding between Australia and New Zealand that allows for assistance in the collection of student loan debt. Accordingly, there is currently no ability or mechanism to share information with Australia for the purpose of obtaining contact details on student loan borrowers.

25. If the status quo is retained, the ability to implement an information exchange with the ATO is substantially reduced.

26. Negotiations between Australian and New Zealand officials have indicated that it is preferable for there to be a high-level written understanding or arrangement in place to facilitate an information-sharing mechanism between tax departments in each jurisdiction.

27. Therefore, if the proposed Arrangement is not made, there is no support for an information exchange mechanism to assist in the recovery of New Zealand student loan debt held in Australia.

28. If the information exchange is still pursued, re-negotiations with Australia officials will be required to ascertain whether it is possible to implement an information-sharing mechanism either without a high-level agreement or with another kind of high-level

agreement (for example, a treaty). This is likely to substantially delay the implementation of an information exchange and the likely benefits.

Enter into an Arrangement (option two)

29. Option two is for the Commissioner of Inland Revenue to enter into an Arrangement with the Commissioner of Taxation (Australia) for the exchange of information on New Zealand student loan borrowers residing in Australia. The information exchange proposed under this Arrangement will require changes to both Australian and New Zealand legislation. In particular, it will require amendment to the tax secrecy provisions in the Tax Administration Act 1994 and further changes to either the Tax Administration Act or the Student Loan Scheme Act 2011.

30. This proposed Arrangement is a high-level document that embodies a moral and political commitment. It allows for the exchange of information between the ATO and Inland Revenue. This information exchange would allow Inland to receive up-to-date contact details for New Zealand student loan borrowers residing in Australia through matching borrower details against the ATO database of Australian taxpayers. Inland Revenue would then be able contact those individuals to keep them engaged with their loan obligations and, where appropriate, recover outstanding student loan amounts.

31. To indicate the potential benefits of the proposed Arrangement, a test information-match occurred in November 2014 between the ATO and Inland Revenue, using a sample of New Zealand student loan borrower data.

32. The high-level data match process involved the following:

- Inland Revenue selected 1,000 active student loan cases.
- The cases were sent securely in two batches to the ATO.
- The ATO performed an information-match.
- A high-level report was provided to Inland Revenue.

33. The results of the test match were as follows:

Confidence	Group 1 (up-to-date contact details)		Group 2 (contact details not up-to-date)		Total	
High confidence of match	483	96.6%	384	76.8%	867	86.7%
Low confidence of match	3	0.6%	22	4.4%	25	2.5%
No match	9	1.8%	58	11.6%	67	6.7%
Inconclusive match	5	1.0%	36	7.2%	41	4.1%
TOTALS	**500**	**100.0%**	**500**	**100.0%**	**1,000**	**100.0%**

34. This table outlines the degree of confidence of the information-match performed by ATO using the data Inland Revenue sent on New Zealand borrowers. This data was separated into two groups of borrowers. Group 1 consisted of borrowers for whom Inland Revenue believed it had up-to-date contact details. Group 2 consisted of borrowers who were not considered to have up-to-date contact details currently registered with Inland Revenue.

35. This test match indicates that an information exchange between the ATO and Inland Revenue is likely to be a good source of contact details for New Zealand borrowers residing in Australia.

36. The results of this test match were used to estimate the likely revenue benefits from an information-exchange mechanism. Additional assumptions were made regarding the frequency of exchange and volume of borrowers' details sent to the ATO for matching. These benefits were estimated to be around $NZ10 million in repayments (additional to the repayments already being received under the overseas-based borrower compliance initiative) for the first year. Subsequent years are estimated to have a similar increase in borrower repayments from new contacts made as well as from those contacted in previous years who have continued to make their repayments.

37. This table summarises our impact assessment of the options.

Options	**Does it meet the objectives (a, b, c , d or e)?**	**Impacts**					
		Fiscal	**Administration**	**Compliance**	**Environmental , social and cultural**	**Risks**	**Net impacts**
Option one - Retain the status quo (No Arrangement with the ATO for exchange of information)	None	Revenue negative. Debt is likely to continue to grow. Relies on previous initiatives to obtain contact details.	Unable to utilise ATO database to obtain contact details for borrowers.	No compliance costs for borrowers. No expected compliance change for borrowers.	Announcements have been made regarding the intention of Australian and New Zealand to work together for student loan debt recovery. Failure to proceed might be perceived negatively.	No formalised political commitment from Australia to assist in student loan debt recovery. Potential loss of goodwill between Australia and New Zealand.	Overall, negative. Does not progress the information-exchange mechanism between Australia and New Zealand.
Option two - Enter into an Arrangement with the ATO for the exchange of information *(Preferred option)*	Yes (a, b, c, d, and e*).	Revenue positive. Estimated revenue benefits around $10 million in additional repayments in the initial year (2016/17). Subsequent years are expected to have a similar increase from new contacts in addition to ongoing compliance from those already contacted.	The indicative administrative cost to implement this initiative is $1,143,600 (AUD) over five years. This service is provided on a cost-recovery basis. Service-level arrangement and implementing legislation need to be developed for information exchange to be operational. An impact assessment has been completed within Inland Revenue. This indicates that the administrative impacts of this proposal are likely to be minimal.	Direct positive impact on compliance – experience shows once contacted a large proportion of borrowers start to comply. Indirect positive impact on compliance – illustrates that Inland Revenue is able to obtain details on borrowers living in Australia.	Change in cultural perception – signals to borrowers in Australia that Inland Revenue is able to obtain contact information from ATO.	An Arrangement between Australia and New Zealand would set a precedent in international cooperation for New Zealand student loan debt recovery – may prompt other countries to pursue similar agreements with New Zealand.	Overall, positive. Will support access to a reliable source of information on student loan borrowers in Australia.

*The Arrangement is able to be easily amended in the future to incorporate reciprocal information sharing. However, there is no explicit provision in the Arrangement to cover information sharing on Australian student loan borrowers in New Zealand.

CONSULTATION

38. Inland Revenue officials have developed the proposed Arrangement in consultation with the Ministry of Foreign Affairs and Trade, the Office of the Privacy Commissioner, the Australian Treasury and the ATO. The New Zealand Treasury and the Ministry of Education have also been consulted on the proposed information exchange and proposed Arrangement.

39. In particular, the Office of the Privacy Commissioner has been consulted with regards to the privacy impacts and relevant information safeguards in the development of the text of the Arrangement. Inland Revenue officials will continue to consult with the Office of the Privacy Commissioner in the drafting and preparation of the legislation required to implement the information exchange.

40. The Australian and legal divisions of the Ministry of Foreign Affairs and Trade have been consulted extensively with regards to the most appropriate international instrument to bring the information exchange into effect.

CONCLUSIONS AND RECOMMENDATIONS

41. Inland Revenue's recommendation is for the Commissioner of Inland Revenue to enter into an Arrangement with the Commissioner of Taxation (Australia). This option meets all of the objectives outlined above.

42. The Arrangement solidifies the intention for Australia to assist New Zealand in the recovery of its student loan debt through an information-exchange facility (objective (b)).

43. The status of the Arrangement allows the exchange of information to become operational pending the enactment of legislation to allow information to be shared between Australia and New Zealand for this purpose. The information-exchange mechanism is expected to become operational in the second half of 2016 (objective (d)).

44. The Arrangement supports a one-way information exchange between Australia and New Zealand to assist New Zealand in the recovery of its student loan debt held in Australia. However, the nature of an Arrangement means that it is able to be amended in the future for the purpose of supporting a reciprocal information exchange (objective (e)).

45. This service is to be provided on a cost-recovery basis. Australian officials have provided Inland Revenue with an indicative cost of $1,143,600 (AUD) over five years. The results of the test match indicate that the ATO is a reliable source of information on New Zealand borrowers based in Australia (objective (c)).

46. Entering into an Arrangement is considered to be preferable to the status quo because it ultimately supports an information exchange with the ATO to assist in the recovery of New Zealand student loan debt (objective (a)), while the status quo does not support this.

IMPLEMENTATION

47. The Arrangement is required to be signed by the Commissioner of Inland Revenue and the Commissioner of the Australian Taxation Office.

48. In order for the exchange of information facility to be operational, legislation will need to be passed in both Australia and New Zealand to allow for the relevant sharing of information. In New Zealand, legislative amendments would need to be made to secrecy provisions in the Tax Administration Act 1994. Further amendments would be required, which could be included in either the Tax Administration Act 1994 or the Student Loan Scheme Act 2011. Those amendments could be included in a student loan scheme bill, scheduled for introduction in the second half of 2015.

49. Following the approval of the Arrangement, a service-level arrangement will be drafted between Australian and New Zealand officials. This document will govern the operational details of how the information exchange will be carried out, and it will be able to be amended where necessary to ensure efficient operation of the information-exchange mechanism.

50. The Arrangement includes guidelines for the use of information. Specific operational details of the handling of information and appropriate safeguards will be included in the service-level arrangement.

51. Broadly, the exchange of information is intended to work as follows: at the request of the New Zealand Central Authority[1], the Australian Central Authority will take all appropriate steps to provide directly to the requesting Central Authority, as promptly as possible, any information it holds on:

- the most recent residential address of a student loan borrower; and
- the contact information for a student loan borrower.

52. Inland Revenue will then use the contact details in normal student loan collection processes for overseas-based borrowers.

53. An impact assessment has been completed within Inland Revenue. This assessment indicates that the administrative impacts of this proposal are likely to be minimal.

MONITORING, EVALUATION AND REVIEW

54. The Arrangement provides that Central Authorities may carry out an annual review of the Arrangement, and additionally may review the whole or part of the Arrangement at the request of either Central Authority. This is outlined in paragraph 10 of the Arrangement.

55. Once this proposal is operational, its results and evaluation will be included as part of quarterly reporting on the overseas-based borrower compliance initiative to the Minister for Tertiary Education, Skills and Employment and the Minister of Revenue.

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[1] The New Zealand Central Authority refers to the Commissioner of Inland Revenue or a person authorised by the Commissioner. The Australian Central Authority refers to the Commissioner of Taxation or a person authorised by the Commissioner.

Regulatory Impact Statement

Charitable organisations for the purposes of the Student Loan Scheme Act 2011

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options to provide student loan borrowers working overseas for a charitable organisation better access to an interest write-off on their loan. This policy ensures that the differing treatment with regards to interest for New Zealand-based and overseas-based borrowers does not affect a borrower's decision to volunteer for a charitable organisation overseas.

To assess the likely administrative and fiscal impacts, assumptions have been made about the numbers of expected applications from charitable organisations and borrowers seeking an interest write-off. These are based on the number of applications received in previous years and further assumptions about the volumes of applications if the preferred option is implemented. The amount of interest foregone is approximate, based on average loan balance and the current interest rate. These assumptions do not materially affect the analysis in this RIS.

Officials consulted on details of the preferred option with other government agencies, in particular with the Ministry of Education, the Treasury, the Department of Internal Affairs' Charities Services, the Ministry of Foreign Affairs and the Ministry of Social Development.

No public consultation was carried out in respect of the preferred option. Due to the difficulty and cost involved in identifying individuals and organisations that might be affected from the change in process, and the expected benefit from consulting widely, it was considered that a full public consultation process and its associated costs would have been disproportionate to the expected benefits and the magnitude of the impact.

The preferred option will require a legislative amendment to the Student Loan Scheme Act 2011 (and a consequential amendment to the Income Tax Act 2007). The required legislation could be included in the student loan scheme bill which is scheduled for introduction in the second half of this year.

None of the proposed options are expected to impair private property rights, reduce market competition, or override common law principles. The preferred option does not involve any additional compliance costs on businesses or charitable organisations.

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23 June 2015

STATUS QUO AND PROBLEM DEFINITION

Background

1. Student loan borrowers who are New Zealand-based do not pay interest on their student loans, while overseas-based borrowers do. There are some circumstances where an overseas-based borrower may be treated as New Zealand-based and therefore eligible for the interest write-off.

2. An overseas-based borrower may apply to be treated as New Zealand-based and receive the interest write-off when they are volunteering or working for token payment for an approved charitable organisation for the purposes of the Student Loan Scheme Act 2011 ("the Act"). This policy aims to ensure that interest does not create a disincentive for borrowers wishing to volunteer overseas.

3. The policy was intended to ensure that only students working for bona fide charitable organisations would benefit from the concessionary treatment. It pre-dated implementation of the Charities Act 2005, and the introduction of Charities Commission register in February 2007 which introduced more rigorous requirements for the registration of charities.

4. To qualify as a charitable organisation for the purposes of the Act, the organisation must be listed in the Student Loan Scheme (Charitable Organisations) Regulations 2011 (the Regulations). If not listed, the organisation must apply for inclusion in the Regulations and provide evidence that it meets criteria established by the Government when the policy was introduced in 2006. To benefit from the interest write-off, each borrower must make an individual application to Inland Revenue with evidence their volunteer work meets requirements specified in Schedule 1 of the Act.[1]

5. The Regulations are also used in defining the eligibility for KiwiSaver member tax credits. Under the Income Tax Act 2007, KiwiSaver members are eligible for member tax credits provided they are working overseas as a volunteer or for token payment for a charitable organisation named in the Regulations.

Status quo – the current process

6. The current process for a charitable organisation to obtain approval for the purposes of the Act involves Inland Revenue's assessment against the criteria set out below in paragraphs 7 - 8. Once assessed, the charities must then be submitted to Cabinet and approved to be added to the Regulations via Order in Council.

7. In March 2006, the Government established the following criteria for listing charitable organisations in the Regulations:

- The organisation must carry on charitable activities[2] and be established for charitable purposes; and
- It must have been established and operating for at least two years.

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[1] A borrower must provide the Commissioner with evidence the work they are doing is for the relief of poverty, hunger, sickness, or the ravages of war or natural disaster, or improving either the economy or educational standards of a country which is on the Organisation for Economic Co-operation and Development's list of countries receiving development assistance.

[2] The borrower must also provide evidence as specified in footnote 1, which limits the borrower to a subset of charitable activities in order to be eligible for the interest write-off.

8. In addition consideration should be given to:

- the credibility of the organisation (with the presence in at least five countries being an indication of the organisation's credibility);
- the not-for-profit status of the organisation;
- whether it has recognised record keeping
- whether it is publicly accountable
- the monitoring and evaluation processes it has in place; and
- whether it has a New Zealand base (but this is not a determinative criterion).

9. The requirement for a charity to be listed in Regulations, combined with the length of time it takes to add a charitable organisation, can mean a borrower who meets the policy intent is denied access to the interest write-off.

10. As noted earlier, for an individual borrower to be entitled to an interest write-off, they must make an application to Inland Revenue with evidence that they are working for an approved charitable organisation and carrying out work that meets criteria specified in Schedule 1 of the Act[3].

Problem definition

11. The current process for approving charitable organisations is inefficient, as it does not always meet the policy intent of providing interest relief for borrowers volunteering overseas for a charitable organisation. There is also a duplication of processes which are already in place for assessing charities for an income tax exemption.

12. One of the five most common reasons a borrower's individual application for an interest write-off is denied is that the charitable organisation is not listed in the Regulations at the time the borrower is volunteering overseas. This can be partially attributed to the slow process involved in adding an organisation to the Regulations.

13. It is helpful to illustrate the steps in the current process and how this may impact on a borrower gaining access to the interest write-off provision. Of particular concern is the situation where an organisation is only prompted to apply to be an approved charitable organisation for the purposes of the Act because one or more of their prospective or current volunteers has a student loan. When an organisation applies to Inland Revenue, it must be assessed against the criteria set out in paragraphs 7 - 8. This often involves correspondence between Inland Revenue and the organisation to gather the appropriate information to support their application. Once Inland Revenue is satisfied the organisation meets the criteria, it is recommended to Ministers, and subsequently Cabinet, for approval. Following Cabinet approval, an Order in Council can take a minimum of 4 weeks to draft, depending on the Parliamentary Counsel Office's availability. The Order in Council must be presented to the Cabinet Legislation Committee before a second approval by Cabinet and signing by the Governor General. An Order in Council cannot come into effect earlier than 28 days after date of publication in the Gazette.

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[3] See footnote 1

OBJECTIVES

14. The objectives are to:

(a) provide an interest write-off to borrowers who are volunteering overseas for charitable purposes

(b) have an efficient and timely process for assessing a charitable organisation's application for charitable status

(c) reduce administration costs for Inland Revenue

(d) reduce compliance costs for charitable organisations

(e) ensure integrity of the process and mitigate abuse of the interest write-off provision.

15. The key objective, objective (a), reflects the original policy intent, which was to ensure student loan interest did not deter borrowers from volunteering with charitable organisations overseas. The remaining objectives concern the efficiency and effectiveness of the process.

REGULATORY IMPACT ANALYSIS

16. Three options were considered to address the problem identified above: retaining the status quo, delegating the authority for approval of organisations to the Commissioner of Inland Revenue, and backdating the effective approval date of the charitable organisations.

Option one - status quo

17. The status quo is to continue the current process, which is set out in paragraphs 6 - 10. The authority to approve charitable organisations would remain with Cabinet. As a consequence, there would continue to be a delay, as outlined in paragraph 13, between when an organisation applies to be a charitable organisation for the purposes of the Act and when the Order in Council comes into effect, adding it to the Regulations.

18. All charities seeking to be included in the Regulations and therefore be a charitable organisation for the purposes of the Act will continue to be required to apply to Inland Revenue and provide information in support of the criteria outlined in paragraphs 7 - 8.

Option two - Delegate the authority for the approval of charitable organisations to the Commissioner of Inland Revenue (Officials' preferred option)

19. Option two would involve the delegation of authority to approve charitable organisations for the purposes of the Act to the Commissioner of Inland Revenue. Once approved, a charity will be added to a list of charitable organisations for the purposes of the Act ("the approved list"). Such a list is already published on Inland Revenue's website.

20. The Commissioner could utilise current process for the assessment of charities for income tax exemptions and therefore reduce the duplication of assessing a charity separately for the purposes of income tax and the student loan scheme. It is proposed that the Commissioner will automatically approve charities that are registered with Charities Services, or already approved by Inland Revenue for an exemption from income tax.

21. Charities that are already registered with Charities Services would not be required to apply to Inland Revenue for inclusion in the list, because their charitable status will have already been established through the Charities Services process. Similarly if a charity has already been assessed and approved by Inland Revenue for an exemption from income tax, the charity will be automatically added to the approved list for the purposes of the Act[4].

22. Under this proposal, when a borrower volunteering for an organisation that already has charitable status with Charities Services, or has been approved by Inland Revenue for an income tax exemption, applies to Inland Revenue for the interest write-off, the organisation will automatically be approved and consequently added to the approved list.

23. Charities that are not registered with Charities Services, or approved by Inland Revenue for an income tax exemption, will still be required to apply to Inland Revenue. However, the process is likely to be quicker, as the charity will be able to be immediately added to the approved list once Inland Revenue has completed the assessment. This is unlike the current process, which requires two Cabinet approvals and the subsequent Order in Council to come into effect before the charitable organisation is added to the approved list.

24. Those charities referred to in paragraph 23, will be assessed against the existing criteria set out in paragraphs 7 - 8 with the exception of the two year rule. To ensure consistency with the criteria used by Charities Services and by Inland Revenue when assessing charities for an income tax exemption, the requirement of a charity having been established and operating for two years could be removed for charities that apply and are assessed on the existing criteria.

25. This option would also decrease compliance costs for applicant organisations, as those that are already registered with Charities Services or approved by Inland Revenue for an exemption from income tax will not be required to provide additional documentation to Inland Revenue to support their application.

26. The application requirements and process for individual borrowers would not change. To qualify for the interest write-off, a borrower will still be required to provide Inland Revenue with evidence that they are volunteering for a charitable organisation and carrying out work specified in Schedule 1 of the Act[5].

27. It is proposed that the Commissioner would also have the authority to remove a charitable organisation from the approved list if she becomes aware that the organisation no longer meets the charitable criteria, such as when the organisation has been de-registered by Charities Services. This will increase the integrity of the approved list by mitigating the risk of borrowers working for charities that no longer meet the criteria.

28. The removal of an organisation from the approved list will not affect the eligibility of borrowers to an interest write-off if they volunteered for the organisation during the time period that the organisation was on the approved list.

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[4] Charities registered with Charities Services are automatically approved for an income tax exemption, and Inland Revenue follows Charities Services criteria when independently assessing an organisation for an income tax exemption.

[5] See footnote 1

Option three - Change rules around effective date

29. Another option considered would be to retain the Cabinet approval process but change the rules around the effective date that an organisation becomes a charitable organisation for the purposes of the Student Loan Scheme Act 2011 and is added to the approved list. This would potentially involve retrospective legislation.

30. This could allow for the approval to be backdated to the beginning of the tax year or to another earlier specified time from which Inland Revenue and Cabinet are satisfied the organisation meets the charitable criteria.

31. This would give more borrowers access to the interest write-off. Charitable organisations would still be required to apply to Inland Revenue and provide information to support their application in line with the criteria set out in paragraphs 7 - 8. The time delay outlined in paragraph 13 would still occur, however this delay would be less likely to restrict a borrower's access to the interest write-off as they could still be able to claim an interest write off dependent on the effective date.

32. To ensure the charitable organisation met the criteria at the earlier point in time, Inland Revenue may need additional information from the organisation, potentially increasing compliance costs. In addition, determining the effective start date and applying a date retrospectively would be more complex to administer.

33. This table summarises our impact assessment of the options.

Options	Does it meet the objectives (a, b, c , d, e)?	Impacts					
		Fiscal	Administration	Compliance	Environmental , social and cultural	Risks	Net impacts
Option one –status quo	a, e	No change.	No change.	No change.	Lack of support for borrowers who are volunteering for an overseas charitable organisation.	Time to process applications undermines policy intent.	Neutral. Does not address the problem definition.
Option two – delegate the authority for the approval of charitable organisations to the Commissioner of Inland Revenue	a, b, c, d, e	Negative. Expected to result in more applications for interest write-off being accepted, with interest foregone of approximately $1,000 per student per year[6]. Estimated to be $30,000 interest forgone per year[7].	Overall expected to decrease. Reduce administration costs for Inland Revenue in processing applications. There will be a small administrative cost for Inland Revenue in moving from a non-disputable to a disputable decision. Reduce administration cost for Cabinet and reduce use of Cabinet time.	Reduction in compliance costs for charitable organisations – those already registered with Charities Services or approved by Inland Revenue for income tax exemption are automatically accepted.	Increase support to borrowers volunteering for an overseas charitable organisation.	Potentially some time delays if organisations that are not automatically approved are slow to provide necessary information.	Overall positive, as allows better access to interest write-off in line with the policy intent. Reduction in administrative costs mitigates, and potentially outweighs, small fiscal cost.

Objectives:

(a) provide an interest write-off to borrowers who are volunteering overseas for charitable purposes
(b) have an efficient and timely process for approving a charitable organisation applying for charitable status
(c) reduce administration costs for Inland Revenue
(d) reduce compliance costs for charitable organisations
(e) ensure integrity of the process and mitigate abuse of the interest write-off provision

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[6] Based on the average loan balance held by Inland Revenue at 30 June 2014 of $19,731 and the current interest rate of 5.3% p.a

[7] This estimate is based on the following assumptions about borrower applications: 25% increase in the number of applications currently approved (one of the top 5 reasons a borrower's application is currently declined is due to the borrower working for a charity that is not currently approved), and an increase in the number of individual applications by 30% (using the year with the highest volume of borrower applications and assuming all new applications are also approved).

Options	Does it meet the objectives (a, b, c , d, e)?	Impacts					
		Fiscal	Administration	Compliance	Environmental , social and cultural	Risks	Net impacts
Option three – backdate effective date of approval	a, partially b, e	Negative. Expected to result in more applications for interest write-off being accepted (but less so than option 2).	Small increase in administration costs for Inland Revenue. Extra decision involved in deciding what effective date should apply for each organisation.	Small increase in compliance costs – may increase the information some organisations are required to provide to Inland Revenue to support application.	Increase support to borrowers volunteering for overseas charitable organisations.	Potentially some time delays if organisations that are not automatically approved are slow to provide necessary information.	Small positive effect; likely to give rise to greater access to interest write-off for borrowers volunteering overseas.

Objectives:

(a) provide an interest write-off to borrowers who are volunteering overseas for charitable purposes
(b) have an efficient and timely process for approving a charitable organisation applying for charitable status
(c) reduce administration costs for Inland Revenue
(d) reduce compliance costs for charitable organisations
(e) ensure integrity of the process and mitigate abuse of the interest write-off provision

CONSULTATION

34. The following agencies were consulted on option two and support the proposal: the Ministry of Education, the Treasury, the Department of Internal Affairs' Charities Services, the Ministry of Foreign Affairs and the Ministry of Social Development.

35. The Ministry of Education raised a concern around organisations which might cease to become charitable remaining on the approved list. To address this concern, officials recommend that the Commissioner is also given the power to remove a charitable organisation from the approved list if she becomes aware that it no longer meets the criteria.

36. There was no public consultation carried out in respect of option two. This decision not to consult was made in consideration of the difficulty and cost involved in identifying individuals and organisations that might be affected from the change in process, and the likely (marginal) benefit from consulting widely.

CONCLUSIONS AND RECOMMENDATIONS

37. Inland Revenue recommends proceeding with option two – delegating authority to approve charitable organisations for the purposes of the Student Loan Scheme Act 2011 to the Commissioner of Inland Revenue.

38. This proposal meets all five objectives. An interest write-off is provided to borrowers who are working for a charitable organisation overseas and who meet specified criteria, which meets the original policy intent as reflected in objective (a).

39. Objective (b) is achieved, as the process removes the requirement for Cabinet to approve each charitable organisation and the subsequent addition to the Regulations by Order in Council.

40. The delegation of authority to the Commissioner also reduces administration costs for Inland Revenue, as there would be automatic approval of charitable organisations that are already registered with Charities Services or approved by Inland Revenue for an income tax exemption (objective (c)). This will decrease the duplication of assessing charities separately for income tax and student loan scheme purposes.

41. The automatic approval and removal of the requirement for charitable organisations to apply if they are already registered with Charities Services also reduces compliance costs for many charitable organisations, achieving objective (d).

42. The integrity of the approved list is maintained (objective (e)) by giving the Commissioner the authority to remove a charity if she becomes aware it no longer meets the criteria. This will apply to any charity on the approved list.

43. Options one and three also achieve objective (a) and (e), as they both continue to provide an interest write-off to borrowers working overseas for volunteer organisations and use the existing criteria for inclusion in the Regulations.

44. Option three allows backdating of the effective date that the organisation is deemed charitable for the purposes of the Act, which makes the process more effective in providing eligible borrowers with access to the interest write-off, and therefore partially meets objective (b). However, option three does not meet objectives (c) or (d) and may increase the administration costs for Inland Revenue and compliance costs of charitable organisations.

IMPLEMENTATION

45. To implement option two, the Commissioner of Inland Revenue could assess charitable organisations that apply to be a charitable organisation for the purposes of the Act in the following way:

i. *Automatic approval:* Charitable organisations that are already registered with Charities Services, or independently approved by Inland Revenue for exemptions from income tax, would be automatically approved for the purposes of the Act.

ii. *Consideration under existing criteria:* Applications from other charitable organisations would be processed by Inland Revenue and considered in accordance with the existing criteria set out in paragraphs 7 - 8 (without the need to be established and operating for two years).

46. To ensure consistency of the criteria used for the organisations automatically approved with those charities individually assessed for the purposes of the Act, the requirement of a charity having been established for two years could be removed for charities that apply and are assessed on the existing criteria.

47. Charitable organisations already listed in the Regulations will automatically be added to the new approved list at the time when the Regulations are revoked. These charities will not need to be re-assessed in order to be included on the approved list which replaces the Regulations. The approved list will continue to be published on Inland Revenue's website.

48. Decisions on registration of resident charitable organisations with Charities Services in accordance with the Charities Act 2005 are made by an independent Charities Registration Board. The Board tests each application against a set of nine criteria, which are intended to provide assurance that the organisation operates in accordance with the Charities Act 2005, meets minimum standards of reporting, and is publicly accountable. Each of the officers in a registered charity must also be qualified as an officer under the Charities Act 2005.

49. Charities Services tests applications for registration of non-resident charitable organisations against the same criteria, but the organisation must also demonstrate a strong connection with New Zealand.

50. The charitable organisations that are registered in accordance with paragraphs 48 and 49 are automatically accepted by Inland Revenue as eligible for an exemption from income tax. However, Inland Revenue also has an internal process for assessing applications for income tax exemptions from non-resident charitable organisations that are unable to be registered by Charities Services because they cannot demonstrate a sufficient connection with New Zealand.

51. An organisation will be able to dispute the Commissioner's decision to decline adding a charity to the approved list. Where possible this will use existing processes in place – for example, the disputes resolution process provided for in the Tax Administration Act 1994.

52. The necessary legislative amendments to bring option two into effect could be included in the Student Loan Scheme Amendment Bill planned for introduction in October of this year. It will be necessary to concurrently revoke the Student Loan Scheme (Charitable Organisations) Regulations 2011.

MONITORING, EVALUATION AND REVIEW

53. In general, Inland Revenue's monitoring, evaluating and reviewing of new legislation takes place takes under the GTPP. The GTPP is a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995. The final stage in the GTPP is the implementation and review stage, which involves post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. In practice, any changes identified as necessary for the new legislation to have its intended effect would be prioritised in the context of the current Tax Policy Work Programme, and any proposals would go through the GTPP.

Regulatory Impact Statement

Options for optimising the effectiveness of the bright-line test

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options for optimising the effectiveness and the integrity of the "bright-line test" proposed in the Taxation (Bright-line Test for Residential Land) Bill.

On 14 May 2015, the Government announced plans to introduce a bright-line test to buttress the "intention test" in the current land sale rules. The proposed bright-line test would require income tax to be paid on any gains from the disposal of residential land that is acquired and disposed of within two years, subject to some exceptions. The Government also announced plans to investigate the introduction of a withholding tax to collect revenue arising under the bright-line test.

The analysis in this RIS was informed by public feedback on proposals contained in the officials' issues paper *Residential land withholding tax*, which was released on 31 August 2015, and further discussions with practitioners involved in the conveyancing process. The issues paper proposed the introduction of a withholding tax to collect revenue on gains from the sale of residential property to improve compliance with the bright-line test.

The preferred option is to introduce a withholding tax, similar to that proposed in the officials' issues paper. It is designed primarily as a collection mechanism for the proposed bright-line test and so is not intended to raise Crown Revenue. As the preferred option would apply to a subset of bright-line sales, it would collect a portion of revenue arising under the bright-line test. The exact fiscal and compliance cost figures for the proposed bright-line test are not available because Inland Revenue does not currently have accurate data on the types and levels of land sales occurring or how much is collected under the current land sale rules.

The data for these areas is expected to improve as new information disclosure requirements for property come into force and Inland Revenue implements a new form to better monitor taxable land sales.

The analysis in this RIS needs to be considered in light of the additional constraint faced by Inland Revenue at the present time, which is its inability to make significant systems changes in advance of the relevant stage of development of its Business Transformation programme.

This proposal has been subject to public consultation and the design features take a number of these comments into account. However, owing to time constraints, the time provided for submissions was slightly shorter than the time ordinarily provided under the Generic Tax Policy Process. Further, the time between receiving submissions and reporting on the final design was compressed. As a result, we cannot be sure that the nature and scale of the

impacts and any potential unintended effects of the proposal have been fully considered in this analysis. We note that the Bill will be subject to a public consultation process as part of consideration by Select Committee.

Carmel Peters
Policy Manager, Policy and Strategy
Inland Revenue

09 November 2015

STATUS QUO AND PROBLEM DEFINITION

1. The Government is concerned with high house prices, particularly in the Auckland area. Other possible causes, both on the supply and demand sides, are being separately considered, but property speculation is seen as one of a number of causes of the current prices. The attractiveness of property speculation, when compared with other forms of investment increases, if the gains are able to be realised untaxed, when gains from other investments are taxed.

2. The main change arising from the Budget 2015 property measures is the proposed introduction of a "bright-line" test that will require income tax to be paid on any gains from the sale of residential property that is bought and sold within two years, with some exceptions.

3. The purpose of the bright-line test is to supplement the "intention test" in the current land sale rules. The intention test makes gains from the sale of real property purchased with an intention of disposal taxable. The intention test can be challenging to enforce due to the difficulty in proving a person's intention upon acquisition, which is a subjective test. The bright-line test is intended to deal with the problem by supplementing the intention test with an objective test.

4. If enacted, the bright-line test will generally apply to property acquired under an agreement for sale and purchase entered into on or after 1 October 2015. Legislation for the proposed bright-line test is included in the Taxation (Bright-line Test for Residential Land) Bill.

5. In addition to these measures, the Government announced that it would investigate the introduction of a withholding tax for non-residents sellers to collect revenue arising under the bright-line test. The Government directed Inland Revenue and Treasury officials to develop a withholding tax that could be implemented by mid-2016 to improve compliance with the bright-line test.

6. This regulatory impact statement deals with the question of how to optimise the effectiveness of the bright-line test and support the integrity of the new rules.

Compliance with tax obligations

7. New Zealand taxes its tax residents on their worldwide income. New Zealand also taxes foreign investors on income that is sourced in New Zealand. When a foreign investor has a branch or controls a subsidiary in New Zealand, tax can be imposed on the New Zealand-sourced income of that branch or subsidiary in the same way as it would be on New Zealanders. However, when the foreign investor does not have a New Zealand presence, it is more difficult for New Zealand to collect tax from them.

8. New Zealand's tax system operates on the principle of voluntary compliance, which relies on taxpayers understanding their tax obligations and how the wider tax system works.

9. Foreign investors may not always have the same level of understanding as taxpayers based in New Zealand, and they do not have the same level of connection to New Zealand that would otherwise create an intrinsic incentive to voluntarily comply with their New Zealand tax obligations.

10. While voluntary compliance is an important feature of New Zealand's tax system, withholding taxes are imposed on many types of income where there is likely to be a tax liability and there is the possibility of unenforceability or evasion. Withholding taxes are important in these situations because they ensure that the relevant tax is paid out of the amount due to the payee before the payee gets control of the funds. Under New Zealand's tax rules, the Commissioner of Inland Revenue (the Commissioner) has the ability to impose penalties on taxpayers who knowingly fail to deduct withholding tax from a payment they have made and on those who have withheld tax for any purpose other than for payment to the Commissioner.

11. Existing withholding taxes in the New Zealand tax system include withholding taxes on:

- employment income;
- interest and dividends;
- payments to certain contractors (including special rules for non-resident contractors, entertainers and insurers); and
- distributions from trusts.

12. In these situations, it is likely that the payee will have a New Zealand tax liability in relation to the income they receive, and in order to ensure the satisfaction of that liability, tax on that income is withheld before the payee receives the income.

13. The Commissioner also has a number of powers to enforce the tax obligations of taxpayers to assist in the collection of taxes.[1] One concern is that these measures are not always administratively practical or effective when the taxpayer has no presence in New Zealand.

14. New Zealand can request help to collect tax from foreign investors from overseas revenue authorities under its various international agreements, including the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, bilateral double tax agreements and tax information exchange agreements. These agreements allow for the exchange of tax-related information and assistance in the collection of taxes. While these are useful tools in enabling the Government to collect tax, they are a backstop and should not be the primary tool.

15. We are not able to quantify the size of the problem. This is because to date, Inland Revenue has not had access to detailed information about compliance with the existing land sale rules. However, information collection measures introduced in the Land Transfer Amendment Act 2015 will provide more useful information to Inland Revenue about land sales in the future. This information will enable Inland Revenue to have better information about compliance with the land sale rules and in particular, the proposed bright-line test.

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[1] The Commissioner may impose a number of monetary penalties, including, for example, late filing, shortfall, and late payment penalties. The Tax Administration Act 1994 sets out when and at what rates such penalties may be charged. This ensures that penalties for breaches of tax obligations are imposed impartially and consistently, at a level that is proportionate to the seriousness of the breach.

In addition, the Commissioner has powers available to recover amounts of unpaid tax. These powers include requiring deductions from payments made to the defaulter by any other person, and court action.

OBJECTIVES

16. The objective is to both optimise the effectiveness and support the integrity of the proposed new bright-line test.

17. Optimising the effectiveness of the bright-line test involves maximising compliance with the new bright-line test, having regard to other factors such as compliance and administrative costs.

18. Supporting the integrity of the new bright-line test (which, if enacted, will form part of the tax system) is important in ensuring that New Zealand's tax system can effectively rely on the principle of voluntary compliance. The "integrity of the tax system" is defined in section 6 of the Tax Administration Act 1994 as including (among other factors) the responsibilities of taxpayers to comply with the law, and taxpayer perceptions of the integrity of the tax system.

19. In addition to the stated objective, the fiscal, economic, administrative, compliance, and fairness impacts of each feasible option will be assessed.

20. The fiscal impact is the likely effect of a given option on Crown Revenue. The bright-line test has been forecasted to raise approximately $5 million per year. As this analysis is targeted at optimising the effectiveness of the bright-line test, none of the feasible options identified and analysed in this statement are intended or expected to raise revenue, but may lend themselves to collecting a portion of the $5 million. The $5 million per annum figure forecasted for the bright-line test is based on a number of behavioural assumptions, which are inherently difficult to quantify, such as the number of sales that would be delayed in order to exceed the two-year holding period. The actual revenue collected under the two-year bright-line test may be significantly more if the behavioural responses are different to those assumed.

21. The economic impact of each feasible option will also be assessed, in particular, whether compliance with New Zealand's tax rules more generally may be affected and whether there may be possible flow-on effects in the residential housing market given that the proposed bright-line test is targeted at short-term churn and speculation in residential housing. The bright-line test has already been identified as creating a "lock-in" effect as people will have an incentive to hold onto property for longer than two years – this is an economic distortion as people may not undergo efficient transactions due to the bright-line test. The economic impact of each option identified in the regulatory impact analysis is over and above that of the proposed bright-line test.

22. An important component of any recommended approach is the administrative impact. Thus, the impact analysis of the feasible options includes whether, and to what extent, a particular option requires changes to systems in order to administer it, for example, whether changes are required to Inland Revenue's computer systems or other processes, and/or whether a particular option requires the use of additional resources to implement a solution or identify and investigate cases of non-compliance.

23. Conversely, the recommended approach should not unduly impose compliance costs, although some compliance costs are to be expected. The regulatory impact statement *Bright-line test for sales of residential property* noted that the bright-line test would increase compliance costs for those whose sales of residential property were not previously taxable under the intention test as they would be required to start accounting for income tax on their property sales. The compliance impacts identified in the impact analysis are over and above those identified for the proposed bright-line test.

24. As noted previously, New Zealand's tax system operates on the principle of voluntary compliance, which relies on taxpayers understanding their tax obligations and how the wider tax system works. Where there is unfairness or a perception of unfairness present in the tax system, people may be less willing to voluntarily comply with their tax obligations, which may undermine the integrity of the New Zealand tax system. Fairness (and the perception of fairness) is accordingly an important part of the principles underpinning the integrity of the tax system. As the New Zealand tax system relies heavily on people voluntarily complying with their tax obligations, we consider that the fairness impacts of any feasible option are significant in determining whether the option meets the stated objective.

REGULATORY IMPACT ANALYSIS

25. We note that the identification and analysis of a full range of practical options to achieve the Government's stated objective has been constrained by a number of factors:

- time available for policy design and consultation; and
- Inland Revenue's need to limit the amount of significant or complex changes within its legacy systems in advance of the relevant stage of development of its Business Transformation programme.

26. Further, the Government directed Treasury and Inland Revenue officials to develop a withholding tax to improve compliance with the bright-line test.

27. However, to assess whether the design of a withholding tax fully meets the stated objective, we have also evaluated the Commissioner's current tools for collection and other possible non-regulatory approaches to determine whether they may also be appropriate for optimising the effectiveness and integrity of the proposed bright-line test.

28. Four options for optimising the effectiveness and integrity of the bright-line test are considered below:

- Option 1: Rely on existing compliance measures (the status quo);
- Option 2: Status quo, but provide more guidance on tax obligations;
- Option 3: Status quo, but review effectiveness of bright-line test in three to four years; and
- Option 4: Introduce a withholding tax on sales of residential property made within the two-year bright-line period that:
    - (a) is restricted to instances where the seller is an offshore person;
    - (b) applies to all sellers.

29. Options 1–3 are non-regulatory responses, while option 4 is a regulatory response that would require both administrative and legislative changes.

30. Option 4 is divided into two possible approaches, with option 4(a) applying in instances where the seller of residential property is an "offshore person", and option 4(b) applying to all sellers regardless of their onshore/offshore status. We consider that these two differences in scope to be significant enough to warrant undertaking a full impact analysis for each approach. The overall effectiveness of both options 4(a) and 4(b) are dependent on a number of key design features. These features are discussed in further detail in the section titled *Further analysis of option 4 – detailed design issues.* Our recommendations regarding these design issues have informed our impact analysis on option 4.

Option 1: Rely on existing compliance measures (the status quo)

31. This option would require no legislative amendment and would instead rely on the Commissioner's existing tools for collection and enforcement, which we have outlined above and have also summarised below. It would also rely on the standard "business-as-usual" response to new legislation outlined in the regulatory impact statement *Bright-line test for sales of residential property* – this will include updating forms and communication material. To assist in the implementation of the bright-line test, Inland Revenue is also developing a new attachment to income tax returns.

32. As discussed in the regulatory impact statement *Bright-line test for sales of residential property*, one of the concerns with the "intention test" in the current land sale rules is that it is difficult for the Commissioner to enforce due to difficulties in establishing intent and the high volume and churn of residential property sales. The proposed bright-line test is designed to be an unambiguous and objective test. This in itself would improve compliance with, and the enforceability of, the land sale rules in the Income Tax Act 2007.

33. The status quo would be problematic from an enforcement perspective. The Commissioner has a number of tools available to assist in the collection of taxes, for example, late filing, late payment and shortfall penalties. In addition, the Commissioner has powers available to recover amounts of unpaid tax. These powers include requiring deductions from payments made to the defaulter by any other person, and court action. However, where the taxpayer has no presence or other assets in New Zealand, these tools and powers are not always administratively practical or effective.

34. Note that in situations where there is the possibility of unenforceability or evasion of a tax liability, withholding taxes are commonly imposed before the payee receives the income. Withholding taxes are important in these situations because they ensure that the relevant tax is paid out of the amount due to the payee before the payee gets control of the funds. This is discussed in further detail in the section titled *Status quo and problem definition*. However, in the case of residential property sales, the Commissioner's current tools for collection and enforcement do not include a withholding tax.

35. New Zealand can request help to collect tax from foreign investors from overseas revenue authorities under its various international agreements, including the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, and bilateral double tax agreements and tax information exchange agreements. These agreements allow for the exchange of tax-related information and assistance in the collection of taxes. While these are useful tools in enabling the Government to collect tax, they should only act as a backstop.

36. Inland Revenue does not have detailed data about the compliance of non-residents with their New Zealand tax obligations on their New Zealand-sourced income. However, there is anecdotal evidence that compliance with the land sale rules to date has been low, particularly in relation to non-residents. New information collection and reporting measures introduced from 1 October 2015 regarding residential land sales should provide better quality information in the future, but using this data to form views about compliance rates and trends regarding the proposed bright-line test will not be possible for several years.

37. Option 1 is not Inland Revenue's preferred option. It would make the tax system less coherent as a whole, given that withholding taxes are required in relation to other forms of income in similar circumstances (that is, where a payee is likely to have a tax liability and where there may be enforceability or evasion concerns). The absence of a withholding tax as part of the Commissioner's current tools for collection and enforcement is not practical where

the taxpayer has limited or no presence in New Zealand, which is where voluntary compliance with New Zealand's tax rules is less likely to occur. There is also a strong risk that this could create a perception that foreign investors are not paying their "fair share of tax" in relation to income derived from residential land, and that their tax obligations are not being sufficiently enforced, thereby undermining the integrity of the tax system.

Option 2: status quo, but provide more information guidance on tax obligations in relation to residential property

38. This option is a non-regulatory response that is similar to option 1, but in addition to the Commissioner's existing powers for collection and the standard "business-as-usual" response to new legislation, it would also involve additional information being provided and education campaigns being run in an effort to boost levels of voluntary compliance in relation to the new bright-line test (and potentially the other land sale rules).

39. Targeted education campaigns have been utilised by Inland Revenue in the past to deliver messages regarding significant changes to the tax system and to ensure those affected understand their obligations, for example in the child support area.

40. A similar strategy could be used for the proposed bright-line test, with the level of detail of the information provided and the medium dependent on the target audience.

41. However, a major limitation with this approach is that it requires in-depth knowledge of the appropriate medium in other jurisdictions to best ensure that the appropriate audiences are covered. As previously mentioned, Inland Revenue does not currently have access to detailed information about land sales in New Zealand. Information collection measures introduced in the Land Transfer Amendment Act 2015 and the Tax Administration Amendment Act 2015 will provide more useful information to Inland Revenue about land sales in the future. However, in order to be able to understand characteristics of and patterns surrounding residential land sales, for example, the country of residence of those involved, the data over the medium term will need to be evaluated to ensure effective targeting.

42. In addition, the success of this option is dependent on another major assumption – that non-compliance with the proposed bright-line test will arise from a lack of information and knowledge about the tax implications of sales of residential land. There will be instances where an improved understanding of the tax rules and one's tax obligations in relation to a particular transaction may lead to higher levels of compliance. However, there will be taxpayers who, regardless of their level of knowledge, will not voluntarily comply with their tax obligations.

43. As noted in option 1, the Commissioner's standard tools for collection and enforcement in relation to general income tax liabilities are not always practical where the taxpayer has limited or no presence in New Zealand. As a result, withholding taxes are commonly imposed in other situations where there is the possibility of unenforceability or evasion of a tax liability, before the payee receives the income. Withholding taxes are important in these situations because they ensure that the relevant tax is paid out of the amount due to the payee before the payee gets control of the funds. This is discussed in further detail in the section titled *Status quo and problem definition*. However, in the case of residential property sales, the Commissioner's current tools for collection and enforcement do not include a withholding tax.

44. Option 2 is not preferred. As noted in option 1, the absence of a withholding tax would make the tax system less coherent as a whole given that withholding taxes are required in relation to other forms of income in similar circumstances (that is, where a payee is likely to have a tax liability and where there may be enforceability or evasion concerns). Further, while option 2 may assist in increasing taxpayers' awareness and understanding of their tax obligations in relation to residential property sales, it will not increase compliance with the proposed bright-line test in instances where voluntary compliance is unlikely to occur regardless of the extent of taxpayer education. It would also require the use of Inland Revenue resources to implement.

Option 3: status quo, but assess levels of compliance with the bright-line test in three to four years

45. This option is also similar to option 1 in that it relies on the Commissioner's existing powers for collection and enforcement and the standard "business-as-usual" response to new legislation, but it also introduces an explicit requirement that the effectiveness of the proposed bright-line test be reviewed in three to four years (when it is expected that those who purchased on 1 October 2015 or shortly after, and sold at or prior to the two-year mark, to file their income tax return).

46. Some submissions on the officials' issues paper *Residential land withholding tax* expressed concern that until Inland Revenue has undergone its Business Transformation Programme, it would be unable implement an effective and efficient withholding tax. These submissions therefore recommended delaying the implementation of a withholding tax on income derived from sales of residential property, and Inland Revenue should first conduct a review of the effectiveness of the proposed bright-line test.

47. The review of the effectiveness of the proposed bright-line test under this option would involve analysing data on land sales collected under the new Land Transfer Amendment Act 2015 and the Tax Administration Amendment Act 2015 and identifying areas of risk and non-compliance. Identification of specific areas of non-compliance would allow for better targeting of Inland Revenue's resources.

48. In addition, the resulting analysis could assist in determining whether a separate regulatory response to optimise the effectiveness of the proposed bright-line test is, in fact, required. It may also provide useful information for shaping the scope of any regulatory response, such as a withholding tax, which has been identified as a feasible option in options 4(a) and 4(b).

49. One advantage of this approach is that it may turn out that the Commissioner's current powers for collection and enforcement are sufficient in ensuring high levels of compliance with the proposed bright-line test. Conversely, if there are low levels of compliance with the proposed bright-line test, the Commissioner will need to rely on her existing tools and powers to remedy the non-compliance in the period prior to the review, and a regulatory response would also need to be subsequently designed.

50. As noted in options 1 and 2, the Commissioner's standard tools for collection and enforcement in relation to general income tax liabilities are not always practical where the taxpayer has limited or no presence in New Zealand. As a result, withholding taxes are commonly imposed in other situations where there is the possibility of unenforceability or evasion of a tax liability, before the payee receives the income. Withholding taxes are important in these situations because they ensure that the relevant tax is paid out of the

amount due to the payee before the payee gets control of the funds. This is discussed in further detail in the section titled *Status quo and problem definition*. However, in the case of residential property sales, the Commissioner's current tools for collection and enforcement do not include a withholding tax.

51. As noted in option 1, the absence of a withholding tax would make the tax system less coherent as a whole given that withholding taxes are required in relation to other forms of income in similar circumstances (that is, where a payee is likely to have a tax liability and where there may be enforceability or evasion concerns). Given the structural inconsistency with other types of income that this would create, and the apparent low levels of compliance with the current land rules to date in relation to residential property, option 3 as a "wait and see" type approach is not Inland Revenue's preferred option. This is because it would likely shift the problem to a later date and require the use of the Commissioner's resources to collect unpaid amounts of tax that arose in the review period.[2] Inland Revenue's preference is to optimise the effectiveness of the proposed bright-line test as soon as the new rules take effect. Like options 1 and 2, the "wait and see" strategy of option 3 may undermine the integrity of the tax system if there is a public perception that foreign investors, particularly in residential property, are not paying their "fair share of tax" in New Zealand.

Option 4: introduce a withholding tax on sales of residential property ("residential land withholding tax" or "RLWT")

52. This option would introduce a withholding tax on sales of residential land ("residential land withholding tax" or "RLWT") where the seller acquires the property on or after 1 October 2015 and has subsequently disposed of the property within two years. The meaning of "residential land" and how the two-year ownership period is calculated would directly follow the proposed bright-line test.

53. As noted in the section titled *Status quo and problem definition*, an important feature of New Zealand's tax system is the existence of withholding taxes on many types of income where there is likely to be a tax liability and the possibility of unenforceability or evasion. In these situations, it is likely that the payee will have a New Zealand tax liability in relation to the income they receive, and tax is accordingly withheld before the payee receives the income.

54. With the proposed introduction of the bright-line test, it highly likely that sellers who sell residential property within two years will have a tax liability in New Zealand in relation to income from that property. As noted, the Commissioner's standard tools for collection and enforcement in relation to general income tax liabilities are not always practical where the taxpayer has limited or no presence in New Zealand. In the case of bright-line sales made by overseas sellers, it would be consistent with New Zealand's broader approach to withholding taxes to withhold tax from the amount received by the seller.

55. As New Zealand currently only taxes the disposal of land in very limited circumstances, there has been no imperative to have a withholding tax on property-related transactions. Further, because under current law tax is generally imposed only when certain intention tests are met, it would be practically difficult to identify situations where tax should be withheld.

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[2] As discussed in option 1, there are likely to be limits to the effectiveness of the Commissioner's abilities to collect these tax debts when the taxpayer has no or very limited presence in New Zealand.

56. In situations when tax is likely to be imposed on income from a disposal (such as where there is a broader capital gains tax), many countries consider withholding taxes on sales of real property to be an effective collection mechanism. Countries with property withholding taxes include Canada, Japan, and the United States. In addition, Australia has recently announced that it is introducing a withholding tax on sales of certain interests in land by foreign investors to support its capital gains tax.

57. The RLWT would require the seller's conveyancer or solicitor involved in the conveyancing process (the withholding agent) to withhold an amount from the proceeds of the sale before the funds are released to the seller. The withholding agent would then be required to pay this amount to Inland Revenue.

58. The RLWT has been designed as a collection mechanism for the bright-line test, which means that RLWT is a non-final withholding tax and the seller would be able to offset the amount of RLWT withheld against their income tax liability arising under the land sale rules. If the amount of RLWT withheld exceeds their final income tax liability, they would be entitled to a refund.

59. Two separate approaches have been identified under option 4. Option 4(a) restricts the application of the RLWT to instances where the seller is an offshore person. Option 4(b) would apply to all sellers regardless of their offshore status. Under both options, there would be an exemption for transfers of inherited property or property transferred under a relationship property agreement.

60. Changes to Inland Revenue's systems would be required to implement options 4(a) and 4(b). These options would impose additional compliance costs on taxpayers selling residential property, and would incur administrative costs. The administrative and compliance costs of 4(b) are likely to be higher than option 4(a), for the reasons discussed below.

61. The extent to which the two approaches under this option meet the objective of supporting the integrity of, and optimising compliance with, the bright-line test is dependent on a number of key design features. These key design issues are considered in further detail in the section titled *Further analysis of option 4 - detailed design issues*.

Option 4(a): applies to sellers who are offshore persons

62. As noted in the discussion on options 1–3, the Commissioner's existing tools are not always practical or effective when the taxpayer has limited or no presence in New Zealand. Other areas of the income tax rules currently recognise this practical concern and use a withholding tax to assist in the collection of taxes where there is likely to be a tax liability and where there may be issues with enforceability or evasion.

63. New Zealand imposes withholding taxes on many types of New Zealand-sourced income derived by non-residents. For example, non-resident withholding tax (NRWT) is imposed on certain types of passive income such as dividends and royalties, and a form of withholding tax called "schedular payments" is imposed on non-residents performing a contract activity. These withholding taxes are imposed on the payer, who is usually resident in New Zealand, which makes enforcement and collection easier.

64. The RLWT proposed under option 4(a) would only apply where the seller is an "offshore person", a concept introduced in the Tax Administration Amendment Act 2015. In response to submitters' concerns relating to the difficulties of establishing whether a person is an offshore person (particularly relating to non-individuals), it is proposed that the definition be modified to be simpler and more prescriptive. In particular, the requirements in relation to trusts have been made clearer.

65. An individual is an offshore person if they are not a New Zealand citizen who has been physically present in New Zealand within the previous three years or a holder of a residence class visa who has been physically present in New Zealand in the previous year. It is proposed that a non-individual will be an offshore person if, in the case of a company, any of its directors are offshore persons, it is constituted outside New Zealand, or 25% or more of shareholders are offshore persons. This is broadly based on definition of "overseas person" in the Overseas Investment Act 2005, which provides for the screening and consent of proposed overseas investment in sensitive New Zealand assets, with modifications. It is also proposed that a partnership will be an offshore person if any of its partners are offshore persons. A trust will be an offshore person if any of its trustees or settlors are offshore persons. In addition, a trust will be an offshore person if all its beneficiaries are offshore persons, or if at least one beneficiary is an offshore person and has received a distribution from the trust within the last six years. For further discussion on this issue refer to paragraphs 103–118.

66. Given the general difficulty faced in collecting tax from foreign investors and other non-residents with limited presence in New Zealand, the introduction of a withholding tax under option 4(a) is Inland Revenue's preferred approach. To minimise some of the potential compliance costs under this option, particularly those borne by withholding agents, some-self certification may be required by sellers regarding whether or not they are an offshore person.

67. This option does not explicitly provide for the main home exception available under the proposed bright-line test. However, the main home exception would not apply to most offshore persons anyway, so withholding under this option where no tax liability exists is unlikely to occur.

68. While we see this option as increasing the effectiveness of the bright-line test by increasing compliance with the new rules and other options may also do the same, we also view this option as *optimising* compliance with the bright-line test, due to its impact on fairness as well as compliance and administrative costs. The compliance costs of the withholding tax under this option would legally fall on the person with the ultimate tax liability, i.e. the seller. As the withholding tax under this option would only apply to offshore persons, it is expected to increase the perception that foreign investors are paying their "fair share of tax" in New Zealand, thereby enhancing the integrity of the tax system.

Option 4(b): applies to all sellers regardless of offshore status

69. We identified option 4(b) as a possible option – a withholding tax as outlined in option 4(a), but applying regardless of the offshore status of the seller.

70. Officials consider that this would be the most effective way of ensuring maximum compliance with the proposed bright-line test. Another advantage of this approach is that it would reduce some compliance costs, as there would be no determination required as to whether a person is an offshore person or not.

71. However, we would expect overall compliance costs and administrative costs to increase relative to option 4(a). This is because there would be a greater number of transactions that require withholding. The number of sales likely to be affected is unknown, because there will be a number of behavioural effects associated with the introduction of the bright-line test, which are inherently difficult to quantify – one of these is the number of sales that would be delayed in order to exceed the two-year holding period.

72. Income from many of these sales will be exempted under the bright-line proposal because they relate to the seller's main home. Accordingly, tax would be more likely to be over-withheld under option 4(b). This would increase compliance costs as such taxpayers would need to apply for refunds. It would also increase administrative costs, because Inland Revenue would need to process these refunds.

73. It may be possible to develop exemptions that relate to the main home to address situations of over-withholding. These exemptions would need to be clear and robust and would take more time to work through than is possible under current timeframes. Any such exemptions would increase the complexity of the rules.

74. While Inland Revenue is able to implement a withholding tax under option 4(a), implementation solutions are restricted by Inland Revenue's ability to make significant systems changes ahead of the appropriate phase of its Business Transformation Programme. This means that it would be very difficult for Inland Revenue to implement and administer a withholding tax on all sales of residential property made within two years of acquisition.

75. Thus, option 4(b) is not recommended at this point in time.

Summary of analysis of options

76. The table below summarises the impact analysis of the identified options.

Option	Meets objective?	Impacts					Net impact
		Fiscal	*Economic*	*Administrative*	*Compliance*	*Fairness*	
Option 1: status quo	Does not optimise effectiveness or support the integrity of the bright-line test.	N/A	Could be perceived as inaction and increase non-compliance with New Zealand's tax rules more generally.	Would require the use of Inland Revenue resources to identify and investigate non-compliance.	This option does not impose additional compliance costs beyond those already experienced.	Could be perceived as being unfair, if there is a view that foreign investors are not paying "their fair share of tax".	Perception of unfairness could undermine the integrity of the New Zealand tax system. Does not impose additional compliance costs, but does not increase the effectiveness of the bright-line test and will require the use of Inland Revenue to investigate non-compliance. **Not recommended**
Option 2: status quo + additional information campaigns	May partially meet objective as it could increase the effectiveness or support the integrity of the bright-line test in some situations. However, the effectiveness of the bright-line test would not be optimised.	N/A	Could be perceived as inaction and increase non-compliance with New Zealand's tax rules more generally.	Would increase administrative costs as it will require the use of additional Inland Revenue resources to engage in information campaigns. Audit resources still required to investigate non-compliance.	Compliance costs may be greater than under option 1, depending on whether third parties would be required to provide information to residential property buyers and sellers about their tax obligations.	Could be perceived as being unfair, if there is a view that foreign investors are not paying "their fair share of tax".	Increases administrative costs without guaranteeing an increase in compliance. Perception of unfairness could undermine the integrity of the New Zealand tax system. **Not recommended**

Option	Meets objective?	Impacts					Net impact
		Fiscal	*Economic*	*Administrative*	*Compliance*	*Fairness*	
Option 3: status quo + review in three to four years	Does not optimise the effectiveness or support the integrity of the bright-line test.	N/A	Could be perceived as inaction and increase non-compliance with New Zealand's tax rules.	Could increase administrative costs as it will require the use of Inland Revenue resources to conduct a full review and would still require use of Inland Revenue resources to investigate non-compliance.	Compliance costs are likely to be the same as option 1.	Could be perceived as being unfair, if there is a view that foreign investors are not paying "their fair share of tax".	Perception of unfairness could undermine the integrity of the New Zealand tax system. Perception of inaction could encourage further non-compliance. **Not recommended**
Option 4(a): withholding tax on sales of residential property made within bright-line period by offshore persons	Meets objective.	The bright-line test is estimated to raise an additional $5 million per annum. As option 4 has been designed as a collection mechanism for the bright-line test, it is expected that it would raise a portion of the $5 million estimated for the bright-line test.	Would reduce instances of non-compliance with the bright-line test. Could prevent some property transactions from being completed, due to, for example, cash-flow issues, or if some sellers would in absence of a withholding tax think that they could evade the bright-line test.	Increases administrative costs because it requires the implementation of a new withholding tax type, but it could decrease required audit resources over the longer term.	Increases compliance costs in determining whether withholding applies and undertaking the withholding. Could decrease compliance costs for some sellers, where the withholding is close to their income tax liability.	Could be perceived as being fairer by New Zealand residents, if there is a view that foreign investors are not complying with their tax obligations.	Increases compliance costs and administrative costs beyond the status quo, but this is offset by reduced administrative costs in other areas and would improve integrity in the tax system, as New Zealand-based taxpayers could perceive the measure as ensuring that foreign investors "pay their fair share of tax". **Recommended**

Option	Meets objective?	Impacts					Net impact
		Fiscal	*Economic*	*Administrative*	*Compliance*	*Fairness*	
Option 4(b): withholding tax on all sales of residential property subject to bright-line test	Maximises compliance with and supports the integrity of the bright-line test, but does not optimise the effectiveness of the rules.	Would collect a greater portion of estimated bright-line revenue than option 4(a) – possibly close to the $5m bright-line estimate	Would significantly reduce instances of non-compliance. Could prevent some property transactions from being completed, due to, for example, cash-flow issues, or if some sellers would in absence of a withholding tax think that they could evade the bright-line test.	Substantially increases administrative costs and may not be possible for Inland Revenue to implement prior to relevant phase of its Business Transformation Programme.	Increases compliance costs as withholding agents will be required to withhold on all bright-line transactions. This will result in over-withholding in a greater number of circumstances, which would result in higher compliance costs.	Likely to be perceived as fair to the extent that it correctly withholds tax. Likely to be perceived as unfair if it withholds tax in situations where there is no underlying tax liability.	Substantially increases administration and compliance costs relative to status quo. While it would maximise compliance with the bright-line test, the additional administrative and compliance costs relative to option 4(a) would not be justified by the expected marginal increase in compliance. **Not recommended**

Further analysis of option 4 - detailed design issues

77. As noted above, the extent to which option 4 meets the objectives depends on a number of detailed design features of the RLWT. These detailed design issues require separate impact analysis and this analysis is summarised below.

78. These key design features were areas we consulted on as part of the submission process for the officials' issues paper and submitters' views have been taken into account in our recommendations as they provided valuable feedback on the compliance burden likely to occur with each feature and option.

The RLWT withholding rate

79. The officials' issues paper proposed a "lower of" approach, whereby the amount of the RLWT to be withheld would be the lower of 10% of the total sales price ("the default rate") and 33% of the seller's gain (i.e. total sales price - seller's acquisition price) ("the standard rate"). In most cases, we would expect the standard rate to apply, but the default rate acts as a back stop to prevent significant over-taxation where the seller's acquisition price is unable to be obtained.

80. We recommend that the "lower of" approach proposed in the issues paper be used as it strikes a balance between creating a collection mechanism that approximates the amount of tax payable under the bright-line test and making the process straightforward for the withholding agent, while also reducing the risk of significant over-taxation.

81. Ideally, the RLWT should neither under nor over tax the seller. However, for the RLWT to retain simplicity and reduce the compliance burden faced by taxpayers, the amount withheld will not be exactly the same as the seller's ultimate income tax liability. As discussed previously, the Commissioner's powers for enforcement and collection can be limited in some situations, and for this reason, we recommend that the RLWT should be more likely to over tax rather than under tax. As a result, the standard rate proposed in the issues paper used the top marginal tax rate of 33% (which is consistent with the default resident withholding tax rate on dividends where no tax rate has been provided) rather than the lowest marginal tax rate of 10.5%, for example.

82. During consultation, it was raised by some submitters that a 33% rate would always result in over-taxation in relation to sellers that are companies; they suggested a 28% rate would be more suitable. Officials agree and recommend that where the seller is a company, the standard rate should be 28% x the seller's gain.

83. To mitigate the risk of over-taxation and potential cash-flow issues for sellers, we recommend that sellers should be able to file an interim income tax return following the payment of RLWT to the Commissioner in order to obtain a refund, rather than having to wait to until the end of the income year. Submitters considered this to be an important factor in making the withholding tax practical and effective.

Options	Advantages	Disadvantages
10% of total sales price	Simple to calculate as the total sales price would be available to both buyer and seller, as well as their respective conveyancing agents thereby reducing	Likely to result in over-taxation relative to the taxpayer's final income tax liability - particularly as the bright-line test (and thus the RLWT) is targeted at short-term speculation. Where the

	compliance costs.	seller has made a loss on the sales price, RLWT would be withheld even though there is no tax liability. Would require more refunds to be issued.
	Recommendation: not recommended.	
33% of seller's gain (total sales price - seller's acquisition price)	The amount withheld would be more in line with the taxpayer's final income tax liability. Relatively simple to calculate - seller's acquisition price generally available from Quotable Value. No RLWT to be withheld when the seller has made a loss on the sales price.	There may be instances where the seller's acquisition price is not available, in which case, 33% x seller's gain becomes 33% x total sales price and there would be over-taxation. Over-taxation would also occur where the seller has a number of deductions available (for example, where the seller has made a number of capital improvements)
	Recommendation: not recommended.	
"Lower of" approach	The amount withheld would be more in line with the taxpayer's final income tax liability, but there is a back stop where the seller's acquisition price cannot be obtained.	There would still be some instances of over-taxation where the seller has a number of deductions available.
	Recommendation: recommended.	

The withholding agent

84. In general, withholding taxes are used to ensure that the relevant tax is paid out of an amount due to a person before the recipient gets control of the funds. The recipient may have an incentive to spend the funds before tax has been paid, which is generally why tax administrations "clip the ticket" before the money reaches the recipient. In finding an appropriate party to clip the ticket, we consider it should be the person with the least to gain from failing to comply with the rules – this is normally the payer of the amount. This is particularly relevant to the problem here, because the RLWT under option 4 is aimed at enforcing the seller's tax liability under the bright-line test, where the seller may not otherwise comply with their tax obligations.

85. The officials' issues paper proposed that the withholding agent should be a solicitor or conveyancer involved in the property conveyancing process ("the conveyancing agent") and not the buyer or seller themselves.[3] This is because they already have professional obligations to discharge in relation to the conveyancing of property and this would more naturally form part of those other obligations. They also have the systems and trust accounts needed to manage the funds involved in the settlement of property, which is important in terms of ensuring the integrity of the withholding process.

86. The majority of submitters agreed that neither the buyer nor seller should be the default withholding agent and proposed that the seller's conveyancing agent should be the withholding agent. This is because they have ready access to the required information to determine whether the seller would be eligible for an exemption from withholding and it would minimise the required interaction between the buyer's and seller's conveyancing agents. This reduces the compliance burden imposed on the conveyancing agents and their clients. In addition, a major advantage identified by submitters was that it would make the

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[3] However, many other countries place the withholding obligation on the buyer, but they expect the buyer to use the services of a solicitor to discharge their withholding obligations.

withholding tax a lot fairer – the compliance costs of the withholding tax would be borne by the seller.

87. Officials do not consider the issue to be as clear cut. There are a number of advantages to requiring the buyer's conveyancing agent to withhold on the buyer's behalf. The first is that it follows other withholding taxes (both in New Zealand and overseas), where the withholding agent is the first payer in the chain. Other advantages include that a secondary obligation can be placed on the seller's conveyancing agent if the buyer's agent fails to withhold, the funds are more likely to flow through a New Zealand bank account, and it would not create a potential conflict between the seller and their conveyancing agent where withholding could go against a client action.

88. Officials consider the advantages and disadvantages of both options to be finely balanced. There are marginal compliance cost benefits to the proposal that the withholding agent be the seller's conveyancing agent. On the other hand, there are marginal revenue integrity benefits to the proposal that the withholding agent be the buyer's conveyancing agent.

89. Officials consider that the better approach, on balance, is the proposal that the withholding agent be the seller's conveyancing agent as long as sufficient other revenue integrity measures can be put in place as part of the overall structure of the proposed RLWT.

90. Where the buyer is the withholding agent, we recommend that they should be required to provide a statutory declaration stating they have fulfilled their withholding obligations. We consider this necessary to protect the integrity of the RLWT. We understand that while it is possible to complete a property transfer without a conveyancing agent, only very few people do. RLWT should not encourage people to undertake their own conveyancing simply in order to circumvent the application of the withholding tax.

Options	Advantages	Disadvantages
Buyer	Legal international norm e.g. US, Canada, Japan (and soon Australia). Allows the buyer to use their solicitor to discharge their withholding obligation if desired.	Would be administratively burdensome for Inland Revenue and compliance-heavy for buyers of residential property.
	Recommendation: not recommended.	
Buyer's conveyancing agent (e.g. solicitor or conveyancer)	Practical international norm e.g. US, Canada, Japan (and soon Australia), where buyers are expected to use a solicitor or other agent to discharge their withholding obligations. Follows other New Zealand withholding taxes which place withholding liability on the payer (e.g. employers with PAYE, banks with RWT and NRWT). There is a "back stop": if the buyer's conveyancing agent fails to withhold correctly, a secondary liability can be placed on the seller's conveyancing agent.	Seen as unfair as the ultimate tax liability belongs to the seller. Requires the buyer's conveyancing agent to obtain information about the seller from the seller's agent, which could lead to delays in settlement. May be seen as increasing the compliance burden on the buyer's agent and adding an additional cost to New Zealand buyers.
	Recommendation: not recommended.	
Seller's conveyancing agent (e.g. solicitor or conveyancer)	Could be seen as being fairer for buyers – the compliance burden and cost are legally borne by the seller (i.e. by the person with the ultimate tax liability). The seller's conveyancing agent may have more immediate access to information about the seller's offshore status. The seller's conveyancing agent deals with other expenses at the time of settlement (e.g. mortgages and	Contrary to international norms and New Zealand's current withholding taxes where the withholding liability on the payer. There is no "back stop" if the agent fails to withhold.

	rates).	
	Recommendation: recommended if a number of safeguards are introduced to protect the integrity of the withholding tax.	

When should the Commissioner be paid before other disbursements?

91. In situations where the buyer's conveyancing agent withholds RLWT, the amount withheld would be paid to Inland Revenue and the remaining funds would then be passed to the seller's conveyancing agent, who would use the funds to pay the seller's mortgages and outstanding local government rates, before paying the remaining amount to the seller.

92. Where the seller's conveyancing agent withholds RLWT, the issue of whether the withholding tax should be paid first (that is, before mortgages on the property) arises.

93. The issues paper proposed that the Commissioner should be paid before other disbursements.

94. If withholding tax is collected first, this would be consistent with the situation where the buyer's conveyancing agent withholds RLWT. It also provides the same result as other withholding taxes such as PAYE, as tax is withheld by the payer before the payee receives the balance.

95. If withholding tax is not collected first, there would be an incentive for an offshore seller to effectively strip out the profits from the sale by increasing their mortgage prior to the sale in order to avoid payment of RLWT. This may be particularly problematic where the mortgagee is an overseas lender, as in those situations, New Zealand Reserve Bank lending ratios will not be relevant.

96. Where there is a resulting unpaid tax liability, this behaviour could be subject to penalties for tax evasion. However, because the offshore person is unlikely to have any presence in New Zealand, the Commissioner would need to rely on the existing rules for collecting tax. Under these rules it is more difficult to collect tax from offshore persons. Accordingly, if RLWT is not collected in these situations then the objective of the RLWT rules is significantly undermined.

97. Therefore Inland Revenue's preferred approach is for the Commissioner to be paid before other disbursements, as it is (in substance) consistent with other withholding taxes and it would be the most effective approach from an integrity perspective.

98. However, submitters on the officials' issues paper considered that the Commissioner should not be paid before the seller's other creditors. Their reasons centred on the fact that it could leave insufficient funds to discharge the seller's mortgage, resulting in delays in settlement, or prevent settlement from occurring in some cases. Submitters also noted that income tax does not usually have priority in circumstances of liquidation. However, officials consider that the better comparison in this context is with other types of withholding taxes, which are paid first.

99. Officials were asked to consider alternative options to address submitters' concerns while still providing an acceptable level of integrity.

100. An option suggested by one submitter was for RLWT to be paid first, but the mortgagee releases title on the basis that when the seller's ultimate tax liability in relation to the sale is calculated, Inland Revenue could repay the amount of overpaid tax directly to the mortgagee.

Under this approach, the mortgagee would effectively step into the shoes of the seller. This could involve relatively high administrative and compliance costs. There would need to be criteria for Inland Revenue to determine whether the refund should be provided to the mortgagee, for example, on the basis that the seller has no ultimate tax liability, or that Inland Revenue has determined that there is no abuse. Further, it may be difficult to implement as the mortgagee may not have sufficient information about the seller in order to claim the refund from Inland Revenue.

101. Officials considered whether specific anti-abuse rules could target avoidance situations, for example, requiring RLWT to be paid before other disbursements where the seller has deliberately geared up prior to the sale or has an arrangement with an associated party. Any anti-abuse rules would need to be applied by the withholding agent rather than by Inland Revenue, so from a practical perspective, the rules would need to be straightforward and able to be easily determined.

102. To address to an extent the concerns raised by submitters in relation to delays in settlement (or non-settlement), it is proposed that the Commissioner should be paid before other disbursements unless the disbursement relates to a mortgage held by a New Zealand-registered bank (or a New Zealand-registered non-bank deposit taker). Officials consider that this rule should provide a reasonable level of integrity as priority would apply in situations where abuse is particularly likely to occur. This rule should also be relatively straightforward for withholding agents to apply.

Definition of offshore person/information requirements

Individuals

103. For individuals, an offshore person (as defined in the recently enacted Tax Administration Amendment Act 2015) is a person who is:

- not a New Zealand citizen or does not hold a New Zealand residence class visa; or
- a New Zealand citizen and has been away from New Zealand for more than three years; or
- a holder of a New Zealand residence class visa and has been away from New Zealand for more than one year.

104. Several submitters on the issues paper asked for further detail around what would be required to satisfy this test. We propose the following criteria.

105. The withholding agent would need to be satisfied that the seller meets the requirements for non-withholding.

106. It is anticipated that in most cases a New Zealand citizen or holder of a residence class visa who is selling within two years could satisfy the proof requirement by meeting with their New Zealand conveyancing agent in person and showing them their passport. The conveyancing agent would be able to take a copy of the documentation and record that they have seen the person in New Zealand (as the person is currently in New Zealand, this means that they will not be an offshore person).

107. If an individual person is selling their property from outside New Zealand, a certified statement or other suitable proof from the seller that they are not an offshore person should be provided to the withholding agent. This could include evidence of flights to New Zealand within the relevant time.

108. The proposed requirements for sellers to provide further information on their offshore status go beyond the recently enacted information requirements for requiring IRD numbers on property transactions as specified in the Land Transfer Amendment Act 2015. However, we consider that, in order to make the proposed withholding tax effective and to minimise compliance costs for agents, this additional information is necessary. In practice, for individuals this information would likely have been captured by conveyancing agents as evidence anyway.

Non-individuals

109. The issues paper proposed that for an entity or an arrangement (e.g. a company or a trust), an offshore person could be a person who is either incorporated overseas or who is owned or controlled (legally or beneficially) 25% or more by offshore persons. This is based on the definition of "offshore person" as defined in the recently enacted Tax Administration Amendment Act 2015.

110. Concerns were raised by submitters around the potential difficulties for withholding agents to determine whether a non-individual is an offshore person. This could be complex and involve high compliance costs if the withholding agent needs to verify the underlying ownership of an entity or trust. We also have some concerns with the 25% threshold in relation to certain arrangements (in particular, partnerships and trusts).

111. Accordingly, we consider that the test for non-individuals (including arrangements) should be modified to be more certain and to ensure revenue integrity.

112. For a company (including a unit trust) to qualify for the non-offshore exemption, the following conditions should be met:

- the company is registered in New Zealand; and
- all directors of the company are non-offshore individuals; and
- not more than 25% of the shareholder decision-making rights of the company are held by offshore persons.

113. This could be satisfied, for example, by proof such as:

- a copy of the company's New Zealand registration; and
- a copy of each director's New Zealand passport or residency visa sighted during a meeting with the conveyancing agent; and
- a statement from each director that, to their knowledge, no more than 25% of the shareholder decision-making rights of the company are held by offshore persons.

114. For partners of a partnership, we propose that if any of the partners is an offshore person, then the RLWT should apply. This will ensure integrity is retained.

115. We propose that discretionary trusts should be considered offshore and subject to RLWT if either a settlor or trustee is an offshore person (as defined above).

116. In addition, the trustees of a discretionary trust have the ability to shift the tax liability to one of the beneficiaries by distributing the income to the beneficiary and treating it as beneficiary income. In order to ensure that the gain does not escape tax by being transferred to an offshore beneficiary, the RLWT should also apply to gains of trusts where:

- all of the beneficiaries of the trust are offshore, or

- one or more of the beneficiaries are offshore, and the offshore beneficiary received a distribution from the trust within the last six years.

117. This should limit instances of abuse. At the same time, it would ensure that most ordinary family trusts that only hold the family home would not be subject to RLWT solely because some of its beneficiaries reside overseas.

118. A corporate trustee would be able to qualify for the non-offshore exemption if it met both the company and trust criteria above.

Certification

119. Pure self-certification is not recommended in this instance, due to the funds potentially at stake – the two outcomes for RLWT are withholding and no withholding, while for the majority of other withholding taxes, the two outcomes both involve withholding, but at different rates. Pure self-certification could create an incentive to fraudulently self-certify as not an offshore person, thus reducing the effectiveness of the withholding tax.

Options	Advantages	Disadvantages
Pure self-certification	From a compliance perspective, it is very simple.	Could create an incentive to fraudulently self-certify as not an offshore person due to the funds at stake. This could substantially reduce the effectiveness of the withholding tax and thus the bright-line test.
	Recommendation: not recommended.	
Provision of information by seller and certification by conveyancing agent	Could be very difficult or impractical to determine in relation to non-individuals. This would increase compliance costs substantially.	Less likely for offshore person non-individuals to be incorrectly classified. This would enhance the effectiveness of the withholding tax and bright-line test.
	Recommendation: not recommended.	
Withholding agent must be satisfied that person is not offshore, with clear guidance on who is offshore and what information is acceptable	Reduces compliance burden placed on withholding agents to determine whether a non-individual is an offshore person. The requirement that the non-offshore person who controls the entity must provide a statement in relation to the offshore status of underlying owners gives the Commissioner someone to impose penalties on if the statement is incorrect.	Would still impose compliance costs on non-individuals in order to be able to correctly state whether they are an offshore person.
	Recommendation: recommended.	

Penalties for failure to withhold

120. Penalties play an important role in ensuring that taxpayers, including withholding agents, do not have an incentive to not comply with their tax obligations. The Tax Administration Act 1994 provides for a number of monetary penalties, for example, late payment penalties and shortfall penalties.

121. To maintain overall coherence of the penalties regime, we recommended as a starting point, the existing penalties that apply to withholding regimes should apply to withholding agents who have not complied with their withholding obligations.

122. In some cases, it is possible for criminal penalties, including "absolute liability offences" to apply. For example, failing to keep documents required to be kept by tax law is an offence punishable by a fine not exceeding $12,000. During consultation, some submitters expressed concern in relation to the potential application of criminal penalties. While they agreed that monetary penalties were appropriate, they were concerned that applying criminal penalties in relatively "low level" cases could have overly severe consequences for conveyancing agents. We note that potential criminal penalties are relatively few in number, but are critical to the integrity of the tax system. They apply to all persons with tax obligations.

123. However, unlike other withholding regimes, we do not recommend also making the conveyancing agent responsible for the underlying amount that should have been withheld. This is because they are an intermediary in the process and neither the purchase amount nor sales proceeds belongs them. To do so would likely increase the cost of professional indemnity insurance, potentially substantially.

124. Other countries which place the withholding obligation on the buyer are able to hold the buyer liable for the amount that should have been withheld. However, since we are recommending a departure from that approach, we do not consider it appropriate to hold the buyer liable for the underlying amount of withholding tax that should have been withheld. A buyer would have limited ability to ensure that the seller's conveyancing agent does the right thing.

125. In addition, we consider that Inland Revenue should be able to inform the relevant professional body of the withholding agent about a failure to withhold where the failure appears to be negligent or fraudulent.

126. We also consider that the buyer should be held liable for the amount of RLWT that should have been withheld, if the buyer and seller are associated persons.

Options	Advantages	Disadvantages
Withholding agent is liable for amount that should have been withheld	There is someone in New Zealand from whom Inland Revenue can collect the amount that should have been withheld and paid to Inland Revenue.	The funds never belonged to the withholding agent – they are simply an intermediary. This may lead to increases in the cost of professional indemnity insurance, which could substantially increase the cost of conveyancing.
	Recommendation: not recommended.	
No further action	Simple to administer. Provides certainty to withholding agent that they would not be held liable for the amount that should have been withheld, if they had no reason to not believe the seller's statement.	Aside from monetary penalties there will be no incentive for withholding agents to comply with withholding tax obligations. This would undermine the integrity of the withholding tax and the bright-line test, as well as the integrity of the tax system.
	Recommendation: not recommended.	
Referral to relevant professional body after failure to withhold due to negligence or fraudulence	Similar to system in place for Landonline. Provides withholding agents with additional incentive to comply with withholding obligations, otherwise they could lose the ability to practise. Still provides withholding agents with certainty that they would not be held liable for the amount that should have	Action taken by relevant professional may not deter repeat offenders and may not affect overseas solicitors. There may still be an incentive to not comply with withholding tax obligations – particularly if the withholding agent is not a New Zealand-registered solicitor.

	been withheld if the seller misled them.	
	Recommendation: recommended.	

CONSULTATION

127. Treasury and Inland Revenue officials released an officials' issues paper titled *Residential land withholding tax* on 31 August 2015. Submissions closed on 2 October 2015 and a total of 16 submissions were received, including from those in the conveyancing industry.

128. In addition to this, a workshop was held on 10 September 2015 with representatives from the Auckland District Law Society, New Zealand Law Society, and the New Zealand Society of Conveyancers to discuss the proposals in the issues paper. The intent of the workshop was to inform submitters in compiling their written submissions and to provide officials with an indication of submitters' views prior to the receipt of written submissions.

129. Support for the proposal was mixed. While some submitters supported the proposal, other submitters submitted that the measure should not proceed if the revenue that would be directly collected by the measure is less than the potential compliance and administrative costs. Officials note that while revenue directly raised from the measure is important, a key objective of the proposed measure is to support the integrity of the bright-line test as part of the wider tax system.

130. Submissions generally focused on whether the buyer's conveyancing agent or seller's conveyancing agent should be the withholding agent and the likely compliance impacts associated with both approaches, as was requested in the issues paper. The majority of submitters expressed their preference for the seller's conveyancing agent to be the withholding agent. This is due to a number of reasons, including the fact that the seller's conveyancing agent is likely to have more detailed information about their client and that the seller's conveyancing agent deals with other disbursements at the time of settlement. Submitters raised a number of points as to why the withholding agent should not be the buyer's conveyancing agent – in particular, it would not be fair to require buyers to bear the compliance cost of withholding when it is the seller who has the ultimate tax liability and sellers may not want to disclose private information (for example, personal details about all beneficiaries of a family trust). While officials note that imposing the obligation on the buyer's conveyancing agent would not necessarily mean that the compliance costs are borne by the buyer, the points raised in the submissions have informed our analysis on who should be the withholding agent under option 4.

131. The issues paper proposed to give the Commissioner priority over other disbursements made at the time of settlement - that is, for RLWT to be paid before the seller's other disbursements. This is Inland Revenue's preferred approach, as it is (in substance) consistent with other withholding taxes and it would be the most effective approach from an integrity perspective. However, submitters did not believe that the Commissioner should be paid before other disbursements made at the time of settlement, as it could prevent some sales from being completed.

132. To address the concerns raised by submitters to an extent, it is proposed that the Commissioner should be paid before other disbursements unless the disbursement relates to a mortgage held by a New Zealand-registered bank or non-bank deposit taker. Officials consider that this rule is likely to prevent situations that are particularly problematic from an

integrity perspective, and should be relatively straightforward for withholding agents to comply with.

133. Many submitters expressed concern about the difficulty of identifying who is an "offshore person", particularly in the case of non-individuals. This may be impractical and difficult when there are many levels in the structure of a company and it is not immediately clear who the underlying owner is. This concern has been taken into account in the design of the RLWT under option 4(a). In addition, option 4(b) has also been identified and analysed as an alternative approach by subjecting all bright-line sales to the withholding tax.

134. A few submitters also raised concerns about whether Inland Revenue is able to implement a new withholding tax, given the age of Inland Revenue's current computer system and the limited ability to make changes to it before the completion of Inland Revenue's Business Transformation Programme. Some submitters proposed that the implementation of a withholding tax should be delayed until the relevant part of the Business Transformation Programme has been completed and detailed data is available on compliance with the bright-line test. Inland Revenue is able to make the appropriate systems changes to implement the withholding tax, but to address submitters' other points, we have identified as a feasible option and analysed whether a review in three to four years would meet the objective of optimising the effectiveness of the bright-line test (option 3).

135. Submitters also made comments about detailed design features of a withholding tax under option 4. We have taken these comments into consideration in our design of the policy details.

CONCLUSIONS AND RECOMMENDATIONS

136. Inland Revenue supports option 4(a). We consider that option 4(a) would optimise the effectiveness and support the integrity of the bright-line test. With the proposed introduction of the bright-line test, it highly likely that overseas sellers who sell residential property within two years will have a tax liability in New Zealand in relation to income from that property. It would be consistent with New Zealand's broader approach to withholding taxes to withhold tax on the payment received by the seller.

137. Given the general difficulty faced in collecting tax from foreign investors with no physical presence in New Zealand, we consider that options 1–3 would not improve compliance with the bright-line test and could undermine the integrity of the tax system if there is a perception that foreign investors, particularly in the area of residential property, are not paying their "fair share of tax" in New Zealand. Option 4(b) would not optimise the effectiveness of the bright-line test due to the significant additional compliance and administrative costs relative to option 4(a).

138. While option 4(a) involves greater up-front administration costs, compliance costs and is not expected to raise Crown Revenue (as it is simply a collection mechanism), we consider that it would meet the objective of optimising the effectiveness, and supporting the integrity of, the bright-line test. However, the extent to which a withholding tax would meet the objectives is dependent on the key design features we have outlined in this regulatory impact statement.

IMPLEMENTATION

139. Legislative change to the Income Tax Act 2007 and Tax Administration Act 1994 would be required to implement option 4. Any legislative amendments required to implement option 4 could be included in a bill introduced before the end of 2015.

140. The Government has indicated that a withholding tax under option 4 should be effective from 1 July 2016. To ensure that Inland Revenue has the appropriate systems changes in place and that practitioners involved in the withholding process are well informed of their obligations, any legislative amendments should be enacted by the end of March 2016.

141. In addition, Inland Revenue would be required to update forms and communication material that can be distributed to withholding agents and other parties potentially impacted by the withholding tax. One possibility would be to distribute information forms to real estate agents to distribute to their clients.

142. The withholding tax under option 4 would be administered by Inland Revenue.

143. Whilst Inland Revenue has mechanisms in place to collect various taxes, it does not have existing administrative arrangements to collect the proposed RLWT.

144. Where a withholding agent has failed to withhold when required, penalties would apply and where there has been a negligent or fraudulent failure to withhold, Inland Revenue would work closely with the relevant professional body to ensure that appropriate action is taken.

145. In designing option 4, officials sought feedback from representatives on the compliance costs associated with administering a withholding tax. This feedback informed the key design features preferred by officials as set out in the regulatory impact analysis section of this statement.

MONITORING, EVALUATION AND REVIEW

146. Inland Revenue is putting in place new systems for administering the bright-line test including a new form to monitor property sales subject to the bright-line test. In addition, further measures have been introduced to provide more useful information to Inland Revenue about land sales. These measures will enable Inland Revenue to have better information about cases where withholding tax should be withheld and whether or not it has actually been withheld.

147. If any detailed concerns are raised in relation to these changes, Inland Revenue will determine whether there are substantive grounds for review under the Generic Tax Policy Process (GTTP).

148. Inland Revenue monitors, evaluates and reviews new legislation under the GTTP. The GTTP is a multi-stage tax policy process that has been used for tax policy in New Zealand since 1995. The implementation and review stage of the GTTP involves reviewing the legislation after implementation and identifying any issues.

149. Inland Revenue officials will continue to make themselves available for discussion with affected parties in the design of a RLWT under option 4(a).

Regulatory Impact Statement

GST on cross-border services and intangibles

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options to apply Goods and Services Tax (GST) to cross-border services and intangibles consumed in New Zealand (including e-books, music, videos, and software purchased from offshore websites). Currently, GST is not usually collected on cross-border services and intangibles, which results in competition and fairness concerns by New Zealand businesses, as well as a revenue gap in New Zealand's GST system.

This analysis follows submissions received on the discussion document *GST: Cross-border services, intangibles and goods* released on 18 August 2015, which sought public feedback on a proposal to require offshore suppliers of services and intangibles to New Zealand resident consumers to register and return the GST. The analysis also considered international developments to address this issue, including the OECD guidelines on GST and cross-border services and intangibles which are connected with the work on "base erosion and profit shifting" (BEPS). In addition, consideration has been given to approaches adopted in the European Union, and a number of countries including Australia, Norway, Switzerland, South Africa, Japan and South Korea.

There are three key constraints / caveats on the analysis:

1. Because of data limitations it is not possible to accurately determine how many offshore suppliers could be required to register and return GST under the preferred option. Experience in similar countries suggests that around 100 offshore suppliers may register if the preferred approach is adopted.

2. Again owing to data limitations it is not possible to determine exactly how much is spent on services and intangibles purchased offshore and consumed in New Zealand. Officials' best estimate that around $270 million per annum is spent on services and intangibles from offshore suppliers. This estimate means that around $40 million of GST is forgone on these purchases. This amount could be growing at a rate of 10% per annum.

3. The extent to which the GST treatment of services and intangibles purchased from offshore influences consumers' purchasing decisions is uncertain. Other factors such as product range, availability and price (exclusive of GST) may have a greater impact on consumers' decision to purchase from an offshore supplier as opposed to a domestic supplier.

A range of options has been considered and measured against the objectives of providing certainty, consistency and fairness of GST treatment whilst minimising compliance costs and disruption to current practices. There are no environmental or cultural impacts from these recommended changes.

There are no other significant constraints, caveats or uncertainties concerning this regulatory impact analysis other than those noted above.

The proposals could impact on the level of competition by discouraging offshore suppliers from entering or continuing to supply to the New Zealand market. However, this impact may depend on the extent to which compliance costs are imposed on offshore suppliers and the extent to which consumers alter their purchasing behaviour in response to the change.

The preferred option would likely impose some compliance costs on offshore suppliers as they would be required to register and return GST. These compliance costs are likely to be comparable to (if not lower than) the compliance costs already imposed on domestic businesses associated with registering and returning GST on domestic supplies. The preferred option also contains a number of compliance savings measures to ensure compliance costs imposed on offshore suppliers are minimised.

The application of GST on services and intangibles purchased from offshore suppliers may also impact New Zealand consumers' purchasing decisions. As noted above, the impact is likely to be limited as other factors such as product range, availability and price (exclusive of GST) may have a greater impact on consumers' decisions than the application of GST on these services and intangibles.

None of the policy options identified is expected to unduly impair private property rights or override fundamental common law principles.

Note that this RIS only considers the application of GST to cross-border services and intangibles. The application of GST to low-value imported goods will be considered at a later time following separate public consultation.

Marie Pallot
Policy Manager, Policy and Strategy
Inland Revenue

21 October 2015

STATUS QUO AND PROBLEM DEFINITION

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

3. 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.

4. Many domestic providers feel the existing tax settings place them at an unfair disadvantage when compared with offshore businesses supplying products with no GST added to the price. There are a number of reasons why New Zealand consumers may purchase services offshore, such as overall cheaper prices, product availability, and convenience. However, ideally, the tax treatment should not be a factor in consumers' purchasing decisions.

5. It is likely that up to $40 million of GST is forgone on cross-border services and intangibles per year. The growth of imported 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 per year.

International considerations

6. The 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 is in the process of developing guidelines which focus on establishing an international set of principles for determining when countries should have the right to tax such supplies.

7. The guidelines were publicly released on 5 October 2015. The guidelines suggest that, for remotely supplied 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.

8. The offshore supplier registration model has been adopted in the European Union for cross-border services and intangibles as well as a number of countries, including Norway, South Korea, Switzerland, Japan and South Africa. The countries that have implemented such a system report some success in collecting GST or VAT.

9. Australia also announced plans to introduce the model as part of their 2015 Federal Government Budget. While some of the detail is still subject to consultation, the broad framework of the proposed rules is consistent with the OECD guidelines and the system that operates in Europe. Australia intends to implement its proposed rules on 1 July 2017.

Establishing New Zealand's right to tax

10. Before considering the various options, it is first important to determine which cross-border services and intangibles New Zealand should tax. New Zealand and other countries' GST systems seek to tax domestic consumption. This is done taxing imports (as well as other goods and services supplied domestically), and not taxing exports.

11. In the case of cross-border goods, the place of consumption will be clear – the consumption occurs in the country of import. There is less certainty when applying GST to cross-border services and intangibles. In many cases it is not clear where the consumption occurs and therefore which country has the taxing right. A number of proxies could be used to determine place of consumption, such as the location of the consumer, location of the supplier, or the residence of the consumer.

12. Without international consensus on taxing rights, it is possible that services could be taxed in multiple jurisdictions or not at all. The OECD has been developing 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.

13. The OECD draft guidelines and growing international practice suggest that New Zealand should apply GST to "remote" services and intangibles supplied to New Zealand-residents. Remote services are services where it is not necessary for the supplier and customer to be in the same location when the services are supplied – such as if, for example, a person downloads a song from a website. These services can be distinguished from "on-the-spot" services, where the supplier and the customer are usually required to be in the same location as the supplier in order for the services to be physically performed – for example, the services provided by a hairdresser.

14. In relation to remote services, residence is internationally regarded as a reasonable proxy for determining where a cross-border service or intangible will be consumed. It is recommended that New Zealand follow international consensus to avoid double taxation or double non-taxation in international trade. Therefore, the options considered seek to apply GST to remotely supplied services and intangibles received by New Zealand residents.

OBJECTIVES

The options outlined in this RIS seek to achieve two main objectives:

(a) Address the non-taxation of cross-border services and intangibles

15. 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".

16. Conversely, goods and services that are exported, and therefore consumed offshore, are generally untaxed – that is, 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.

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

largely be averted. Services and intangibles that are exported are zero-rated in most jurisdictions so if jurisdictions do not tax incoming services and intangibles this can lead to double non-taxation. This result is inconsistent with New Zealand's broad-based GST system which seeks to tax virtually all New Zealand based consumption.

18. Therefore, the options discussed in this RIS seek to address the issue of the non-taxation of cross-border services consumed in New Zealand. As discussed above, around $40 million of GST is forgone on cross-border services and intangibles per year growing at a rate of 10 percent per year.

(b) Reduce competitive distortions

19. 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. When GST does not apply evenly it has the potential to distort consumer behaviour. Domestic businesses argue that the fact that no GST is charged on services purchased from offshore businesses but, is charged when services are purchased from domestic businesses, is distorting consumers' purchasing decisions in favour of offshore businesses.

20. Therefore, the second objective is to reduce any distortive effects that GST may have on consumers' purchasing decisions. However, any option discussed must also ensure that domestic businesses are not advantaged as compared to offshore businesses as a result of any proposal.

Objectives against which the options are to be assessed

21. The objectives against which the options are to be assessed are:

- **Certainty and simplicity:** The GST rules should be clear and simple to understand, so that taxpayers are aware of the GST treatment of a particular supply and their GST obligations.

- **Efficiency of compliance and administration**: Compliance costs for taxpayers and administrative costs for Inland Revenue should be minimised as far as possible.

- **Neutrality:** Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

- **Effectiveness and fairness**: The option must have the ability to meet the objectives of collects the forgone revenue and reducing the distortions the current treatment brings about.

REGULATORY IMPACT ANALYSIS

22. Three policy options and the status quo were considered for addressing the policy problem and meeting the objectives. These were:

Option 1: Require non-resident suppliers to register and return GST on services and intangibles supplied to New Zealand resident customers.

Option 2: Require the New Zealand resident customer to return the GST on services and intangibles supplied by non-residents (known as a reverse charge mechanism).

Option 3: Require financial institutions to return the GST on credit/debit card transactions involving services and intangibles purchased from non-resident suppliers.

Option 4: Retain the current GST treatment where no GST is collected on services and intangibles supplied by non-residents. This is the status quo option to which the other options are being assessed against.

23. All of the options (apart from option 4) impact New Zealand resident consumers as they will likely bear the cost of the application of GST on purchases of services and intangibles received from offshore suppliers. The extent to which the resident consumer will bear the cost will depend on the effectiveness and rate of compliance of each option.

24. With regard to option 1, the extent to which New Zealand resident consumers will bear the GST will also depend on whether the offshore supplier passes the cost on to the consumer. This may be industry or firm specific and depend on factors such as business practices and the elasticity of demand for products.

Option 1: Offshore supplier registration (officials' preferred option)

25. Option one involves offshore suppliers or offshore electronic market places registering and returning GST on services and intangibles consumed in New Zealand. This option therefore primarily impacts offshore suppliers and offshore electronic market places.

26. Under this option offshore suppliers and marketplaces would be required to register and return GST if their supplies of services to New Zealand-resident customers exceed a certain registration threshold in a 12-month period. This option is consistent with how GST is collected on domestic supplies of goods and services.

27. The offshore supplier registration model is endorsed by the draft OECD guidelines – *Guidelines on place of taxation for business-to-consumer supplies of services and intangibles* – which were released December 2014 and are expected to be finalised later this year.

28. This option has been adopted in other countries, for example members of the European Union, and other countries such as Norway, South Korea, Switzerland, Japan and South Africa have also recently adopted this option. Australia has recently proposed to apply GST to cross-border services and intangibles from 1 July 2017 using an offshore supplier registration system.

Certainty and simplicity

29. Adopting a system that is widely used internationally and is, therefore, familiar to international suppliers should make this option relatively simple to apply in practice. For example, the European Union has collected VAT on services and intangibles using this option since 2003. Given the European Union is the largest VAT market, many international suppliers will be familiar with this system and already be registered and returning VAT in Europe.

30. In addition, given New Zealand's GST system is broad-based, with a single rate and few exemptions, it is expected to be relatively simple for offshore suppliers to comply with as compared to countries with multiple VAT/GST rates and exemptions.

Efficiency of compliance and administration

31. This option is relatively efficient to administer given systems are already in place to register domestic suppliers. Since New Zealand's GST system is relatively simple, compliance costs should be minimal and consistent with (if not lower than) the compliance cost imposed on domestic businesses in registering and returning GST.

32. Implementing simplified registration processes that are tailored to offshore suppliers will assist in reducing the compliance costs associated with the new rules (see the implementation section for more information on the simplified registration system).

33. As a further compliance cost reduction measure, offshore suppliers would not be required to register in New Zealand unless their supplies exceeded a certain registration threshold. This means that offshore suppliers that supply a minimal level of services to New Zealand residents would not have to register.

The rules contain other features that are designed to reduce compliance costs for offshore suppliers. A discussion of these features is included in further analysis on option 1: Offshore supplier registration model.

Neutrality

34. This option is neutral because offshore suppliers will be subject to the same rules as those applying to domestic businesses. Consequently, for tax purposes consumers should be indifferent as to whether they purchase a remote service from a domestic or offshore supplier as both suppliers would be required to return GST on that service.

Effectiveness and fairness

35. The effectiveness and fairness of this option may depend on the extent to which liable offshore suppliers comply with the rules. Since New Zealand's tax system is based on voluntary compliance, the system relies on the fact 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, albeit there will be some differences in the enforcement mechanisms adopted.

36. 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. For many of these suppliers, failure to comply with their obligations would pose a significant risk to their reputation. Furthermore, to generate a similar level of compliance for New Zealand, the option adopts similar and consistent rules with the rules that apply in those other countries.

37. There are a number of detailed design issues with this option. These design issues have a significant impact on the degree to which this option meets the objectives. These detailed design issues are considered in the section "further analysis of option 1".

Option 2: Reverse charge

38. Under this option, when a New Zealand consumer purchases services or intangibles from an offshore supplier, they would be required to return GST by making a separate payment to Inland Revenue or pay the GST as part of a end of year tax return (as opposed to the GST being included in the price paid). This is known as a 'reverse charge'. This option therefore primarily impacts New Zealand resident consumers that purchases services and intangibles from offshore suppliers.

39. New Zealand already has a limited reverse charge rule for services purchased by New Zealand businesses from non-residents. It applies to the extent the services relate to 5% or more to non-taxable activities, such as those of a financial institution.

40. Under this option the existing reverse charge would be expanded to apply to individual consumers that purchase services and intangibles from offshore suppliers.

41. Like New Zealand, other countries (particularly in the EU) apply reverse charges as the primary collection method in relation to business-to-business offshore supplies of services and digital goods. Canada also uses this approach to collect GST on offshore supplies of services to non-registered individuals. The tax is due by the end of the month following the calendar month in which the amount for the services was paid or became payable.

Certainty and simplicity

42. The main disadvantage with this option is that a large number of taxpayers will be required to return GST, as compared to options 1 and 3 where a comparably small number of offshore suppliers or financial institutions would be required to return the GST. The amount of GST paid by each consumer is likely to be relatively small.

43. Given this option has the potential to impact a large number of consumers that are unfamiliar with returning GST there is likely to be less certainty as to how the GST rules apply. Consumers would also be required to identify whether or not they are purchasing the service from a New Zealand resident supplier and only return GST on services received by non-resident suppliers.

Efficiency of compliance and administration

44. As discussed above, this option would impose compliance costs on a relatively large group of consumers that purchase services from offshore suppliers for relatively small amounts of GST. Given that a large proportion of individual taxpayers are currently not required to file tax returns this option has the potential to require a large number of taxpayers to file returns.

45. Administrative costs are also likely to be significant as this option would involve the development of a new system of receiving GST payments. Either a new tax form would need to be developed or existing end of year tax returns would need to be amended. Resources would also need to be allocated to ensuring consumers complied with their tax obligations, by promoting awareness, providing guidance materials and dealing with enquiries, errors and refunds.

Neutrality

46. If applied consistently and successfully, GST would be returned on both services provided domestically and from offshore. However, the method of collection would differ significantly depending upon whether the supplier was offshore or onshore.

Effectiveness and fairness

47. When this option has been applied in other jurisdictions its success has been limited. This is likely due to a number of factors such as lack of awareness of the requirement to return GST given that consumers are accustomed to GST being included in the purchase price, and the difficulty of enforcing a reverse charge on such a large taxpayer base.

48. In many cases, the New Zealand purchaser may not realise they are buying from an non-resident supplier. For example, an offshore supplier could have a New Zealand domain name (.co.nz) or a separate chain of New Zealand retail stores.

Option 3: Financial institutions return the GST

49. Option 3 would impact financial institutions (e.g. New Zealand banks) and other payment intermediaries that would be required to add GST to New Zealand issued credit/debit cards at the time that services are purchased from an offshore supplier.

50. How this collection option would apply in practice would need to be determined through consultation with financial institutions. However, one possible approach would be for the financial institution to add GST to the consumers' credit or debit card when the following conditions are met:

- The card is not physically present when the transaction occurs (e.g. instead of swiping the card, the customer supplies the credit card number).
- The supplier of the service is not in New Zealand.
- The billing address for the card is a New Zealand address.

Certainty and simplicity

51. The development of an automated system to apply GST to purchases of remotely supplied services could be complex. The system would need to identify purchases that would not be subject to GST, such as 'on-the-spot' services consumed outside of New Zealand (for example, overseas accommodation) and international travel[1]. It is unclear as to whether financial institutions have the necessary information and therefore there would be a risk that GST would be applied to services consumed outside of New Zealand.

52. Consumers' use of online intermediary payment systems would have to be considered. Although a credit/debit card is still used, from the perspective of the financial institution it may be difficult to determine who the ultimate supplier of the service is, and therefore, whether GST should be charged. For example, it would be difficult to exclude an industry type (such as overseas accommodation providers) if the payment was made through intermediary payment systems. One solution would be to require the intermediary payment

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[1] International travel is currently zero-rated because it is a service that is considered to be consumed outside of New Zealand.

provider (as opposed to the financial institution who issues the credit or debit card) to collect the GST in such cases.

53. Another disadvantage with this option is that it has not been implemented in any other country. There is no international experience on how well this option will work, what practical difficulties could arise and what compliance costs would be involved. The success of this option would also depend on financial institutions agreeing to develop and implement a system.

Efficiency of compliance and administration

54. While there would be some costs involved in setting up the collection system, the collection of GST from credit and debit cards would be an automated process. Automated processes for collection have the potential to significantly lower the cost of collection and the compliance costs.

55. There are only a relatively small number of New Zealand credit and debit card issuers. This should make it easier for the Government to work with those involved to develop practical and realistic processes to address any implementation issues which may arise.

Neutrality

56. This collection system would only collect GST on services purchased with a New Zealand issued credit or debit card. Consequently, payment by other means would not be captured under this system. For example, services paid for using overseas bank accounts including overseas domiciled credit/debit cards and consumers could also use online banking to make payments to overseas suppliers.

Effectiveness and fairness

57. This option is limited to collecting GST on New Zealand issued credit and debit cards and therefore may not easily respond to future developments in the way consumers pay for services online. Therefore, the longevity of this system could be an issue.

58. As discussed above, if the collection system cannot accurately distinguish between services consumed in New Zealand and services consumed outside of New Zealand, there is a risk that some services will be over taxed or subject to double tax as the overseas jurisdiction may also seek to apply GST/VAT to the services. This would negatively impact the fairness of this option.

Option 4: Status quo

59. Under the status quo, GST would not be collected on supplies of cross-border remote services and intangibles received by New Zealand residents. As a result the competitive distortions between domestic and offshore suppliers would continue and the Government would not collect $40 million on services and intangibles that are consumed in New Zealand.

Certainty and simplicity

60. As GST is not collected on cross-border supplies of services and intangibles, this option is associated with greater certainty and simplicity when compared to the other options.

Efficiency of compliance and administration

61. As offshore suppliers are not required to return GST on supplies of services and intangibles to New Zealand resident consumers, there are fewer compliance and administration costs associated with this option.

Neutrality

62. This option is the least neutral of those considered, as the tax treatment of a remote service consumed in New Zealand will depend on whether the service is purchased from a domestic or offshore supplier. These differences in tax treatment may distort consumers' decision making, as purchases of remote services from an offshore supplier are not subject to GST, while those from domestic suppliers are generally taxed.

Effectiveness and fairness

63. Many domestic suppliers feel that the current tax settings place them at an unfair disadvantage when compared with offshore suppliers who are not required to return GST on supplies of services and intangibles to the same customers. The perception that the GST rules are ineffective in evenly taxing consumption in New Zealand may undermine compliance with tax rules more generally.

64. Domestic suppliers may also restructure their affairs in order to take advantage of the non-collection of GST on services supplied from offshore. This may further exacerbate the risk to the GST base and the competitive unfairness.

Summary of the analysis of the options

65. The table below summarises the impact analysis of the options.

Impacts					
Option	**Objectives met or partly met**	**Economic impact**	**Compliance cost & administrative impact**	**Fiscal impact**	**Fairness impacts**
Option 1: Require non-resident suppliers to register and return GST on services and intangibles supplied to New Zealand resident customers.	Best meets objective (a) Best meets objective (b)	This option would reduce distortions on consumers' purchasing decisions that arise from the differences in tax treatment between domestic and offshore suppliers.	This option would result in some additional compliance costs for offshore suppliers. However, this impact is mitigated by several features of the rules that are designed to reduce compliance costs.	Estimated net gain in revenue of up to $40m per year.	Improves fairness as offshore suppliers will largely be subject to the same rules that apply to domestic businesses.

Option 2: Require the New Zealand resident customer to return the GST on services and intangibles supplied by non-residents (known as a reverse charge mechanism).	Partly meets objective (a) Partly meets objective (b)	This option would reduce distortions on consumers' purchasing decisions that arise from the differences in tax treatment between domestic and offshore suppliers. However, the extent to which this occurs may depend on the extent to which there is widespread compliance with the rules.	This option would impose significant compliance on New Zealand resident consumers and would result in additional administrative costs.	No estimate of the fiscal impact of this option is available, though it would be expected to result in lower revenue gains than option 1 as a result of non-compliance with the rules.	This option would improve fairness in the system to the extent that neutrality between domestic and offshore suppliers can be achieved.
Option 3: Require financial institutions to return the GST on credit/debit card transactions involving services and intangibles purchased from non-resident suppliers.	Partly meets objective (a) Partly meets objective (b)	This option would reduce distortions on consumers' purchasing decisions that arise from the differences in tax treatment between domestic and offshore suppliers. However, the extent to which this occurs may depend on the effectiveness of the system in identifying transactions that should be subject to GST.	This option could result in lower compliance costs than option 1, as there are likely to be fewer entities required to return GST and this could be achieved through automated processes. However, significant challenges in implementing the option have been identified, and it has not been adopted in other countries.	The revenue impact is likely to be similar to option 1 if the system was effective at identifying transactions that should be subject to GST.	This option would improve fairness in the system to the extent that neutrality between domestic and offshore suppliers can be achieved.
Option 4: Retain the current GST treatment where no GST is collected on services and intangibles supplied by non-residents.	Does not meet objective (a) Does not meet objective (b)	This option results in distortions on consumers' purchasing decisions due to differences in the tax treatment between domestic and offshore suppliers.	This option is not associated with significant compliance or administration costs.	The revenue impact will be neutral, however, the Government will not collect $40 million on services and intangibles that are consumed in New Zealand.	This option is perceived to result in significant unfairness, which may undermine compliance more generally.

Further analysis on option 1: Offshore supplier registration model

66. Option 1 involves requiring non-resident suppliers to register and return GST on services and intangibles supplied to New Zealand resident customers. There are a number of design issues for the offshore supplier registration model which require separate impact analysis. The detail design aspects of option 1 are as follows:

- zero-rating the supply of remote services and intangibles to New Zealand GST-registered businesses;
- adopting a broad definition of remote services and intangibles (including digital services and more traditional services);
- requiring offshore suppliers to register and return GST if their total supplies of remote services and intangibles to New Zealand residents exceed $60,000 in a 12-month period. However, offshore suppliers would not be required to register if they

predominantly made supplies to GST-registered businesses and their supplies to New Zealand resident consumers were less than $10,000 in a 12-month period;

- requiring offshore suppliers to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of evidence, and an alternative method may be prescribed by the Commissioner of Inland Revenue if the offshore supplier does not have the necessary information;
- implementing a simplified registration and return process to reduce compliance costs for registered offshore suppliers;
- In some situations, requiring an electronic marketplace or intermediary to register instead of the principal offshore supplier.

67. The analysis of these design issues are summarised in the tables below.

Zero-rating supplies of services and intangibles to GST-registered New Zealand businesses from the rules

68. One key design issue is whether offshore suppliers should be required to return GST on supplies of remote services and intangibles to New Zealand GST-registered businesses, or whether GST should apply only to supplies to New Zealand-resident final consumers.

Issue	Options	Advantages	Disadvantages	Recommendations
Should the rules zero-rate supplies to New Zealand GST-registered businesses?	*Exclude supplies to New Zealand GST-registered businesses unless the offshore supplier and GST-registered recipient agree to zero-rate the supply.*	This option allows the rules requiring tax invoices to be relaxed, as unregistered recipients will not have the ability to claim back GST charged on the services they receive. This would result in lower compliance costs for offshore suppliers. This option is consistent with the approach taken in most other jurisdictions that have adopted an offshore supplier registration model for services and intangibles, and is more consistent with the draft OECD guidelines. The option to zero-rate these supplies will allow non-resident businesses to claim back any New Zealand GST incurred in making these supplies which ensures GST is neutral for these businesses.	This option requires offshore suppliers to determine whether they are supplying to a registered business or an individual customer, which could require the collection of additional information in some cases. However, as other countries have adopted offshore supplier registration systems that do not require offshore suppliers to return GST on business-to-business supplies, it is likely that many suppliers have implemented systems to operate in this environment. Offshore suppliers will also be able to rely on businesses customers GST number to determine their registration status. Additionally, to further reduce compliance costs, an offshore supplier would also be able to agree with the Commissioner of Inland Revenue on an alternative method of determining whether customers are GST-registered businesses.	Recommended

	Require offshore suppliers to return GST at a rate of 15% on all supplies to New Zealand resident consumers and businesses.	This option would mean offshore suppliers would not have to determine whether they were supplying to a business or an individual customer, which may reduce compliance costs for some.	This option would have little value from a revenue perspective as GST-registered businesses would be in a position to claim back GST charged. This option would pose a fiscal risk if an offshore supplier charged GST to a New Zealand business but did not pay the GST to Inland Revenue as the New Zealand business would be entitled to an input tax deduction.	Not recommended

69. It is proposed that if a GST-registered business is inadvertently charged GST they would need to seek a refund from the offshore supplier. However, if the value of the supply is less than $1,000, the offshore supplier could provide a tax invoice which would allow the GST-registered business the ability to claim back the GST in their normal GST return. This would reduce the compliance costs imposed on offshore suppliers associated with returning inadvertently charged GST on low-value transactions. At the same time a threshold set at $1,000 reduces the fiscal risks associated with GST-registered businesses claiming back high value amounts of GST charged by offshore suppliers.

Scope of the cross-border services and intangibles that are subject to the rules

70. In designing the rules, a broad scope could be adopted that applies GST to all cross-border supplies of remote services and intangibles. Alternatively, the rules could apply only to certain supplies of digital services and intangibles.

Issue	**Options**	**Advantages**	**Disadvantages**	**Recommendations**
What services and intangibles should the rules apply to?	*Apply the rules to a wide range of remote services and intangibles*	This option is more consistent with the broad-based GST system in New Zealand, which tends to avoid issues with classifying services into particular categories for fairness and efficiency reasons. Using a broad definition may 'future-proof' the rules, as more prescriptive legislation may need to be frequently updated to reflect changes in the types of services that become available.	This option has not been implemented in other countries, though it has been announced to apply in Australia. Therefore unintended consequences could arise from a broad definition of remote services that encompasses traditional cross-border services that are supplied remotely, such as consultancy, accounting or legal services. However, these impacts may be reduced if business-to-business supplies are excluded from the rules, and if the registration threshold is set $60,000.	Recommended

	Apply the rules only to digital supplies of services and intangibles	This option would apply GST only to digital services that are electronically delivered. Offshore suppliers may be more familiar with this approach as it is consistent with the approach taken in European Union and other countries such as South Africa.	This option could distort consumers' decisions on whether to purchase services through digital or non-digital channels. It would make the rules more complex with the potential for boundary issues to arise around what would be regarded as a "digital service" and could require the rules to be frequently updated to reflect new types of services that should be captured by the rules (as is experienced in the EU).	Not recommended

71. An exception to the broad definition of services is the supply of telecommunication services to New Zealand residents, specifically the supply of international mobile roaming services. Currently, if these services are supplied by a domestic telecommunication provider to a New Zealand resident customer abroad the services are zero-rated. At the time these rules were introduced it was considered that these services were consumed outside of New Zealand, and therefore, should not be subject to GST.

72. Under the proposed framework, where residence is used as a proxy for consumption, these services should be subject to GST as they are considered to be consumed in New Zealand. This would be consistent with the treatment of international mobile roaming services in majority of OECD countries (excluding Australia and Japan).

73. Ministers preference is to retain the current zero-rated treatment of international mobile roaming services, which is consistent with the treatment in Australia, and to keep a watching brief on any further developments in Australia.

Registration threshold

74. Establishing a registration threshold for offshore suppliers of services and intangibles is intended to reduce compliance costs for small suppliers and suppliers that do not make many supplies to New Zealand residents. A lower threshold (such as NZD $10,000 of supplies to New Zealand residents over a 12 month period) or a threshold based on the domestic threshold (NZD $60,000 of supplies to New Zealand residents over a 12 month period) could be adopted.

Issue	Options	Advantages	Disadvantages	Recommendations
What registration threshold should apply to offshore suppliers of remote services?	*A registration threshold equal to the domestic registration threshold (NZD $60,000)*	This option is consistent with the registration threshold that applies to domestic suppliers. This will result in competitive neutrality as offshore suppliers and domestic suppliers will be subject to the same registration requiremnts. This option would also result in lower compliance costs for suppliers that make a relatively small volume of supplies to the New Zealand market. Evidence from other countries suggests that a small number of large suppliers account for a significant proportion of the total revenue collected from offshore registrants.	A higher threshold may increase the incentive for some offshore suppliers to break up their supplies into different entities in order to stay under the registration threshold. A higher registration threshold may be associated with less revenue being collected, as fewer suppliers would be required to register and return GST on their supplies.	Recommended
	A registration threshold that is lower than the domestic registration threshold (for example, NZD $10,000)	A lower registration threshold would increase the revenue collected, though this may be outweighed by additional compliance costs for offshore suppliers. A lower threshold would be more consistent with the European Union that has no threshold, and other countries that tend to have low thresholds.	A registration threshold that is lower than the domestic registration threshold may reduce the competitive neutrality between domestic and offshore suppliers.	Not recommended

Determining whether a customer is a New Zealand resident

75. The discussion document compared the EU approach, where an offshore supplier is required to determine where a customer has their residence based on two non-conflicting pieces of evidence (for example, payment information, customer address, and Internet Protocol (IP) address), with the proposed Australian rules, which would require them to take 'reasonable steps' to determine the residency status of the consumer.

Issue	Options	Advantages	Disadvantages	Recommendations
How should an offshore supplier determine whether a customer is a New Zealand resident?	A requirement to determine whether a customer is a New Zealand resident based on two non-conflicting pieces of evidence.	This option has greater certainty and simplicity for offshore suppliers to apply. This option is also consistent with the rules that apply in the European Union and therefore offshore suppliers are likely to have already developed systems to apply this option.	Some offshore suppliers may not have access to two non-conflicting pieces of evidence. To address this issue it is proposed that the Commissioner of Inland Revenue be able to prescribe an alternative method to determine whether a customer is a New Zealand resident.	Recommended

	A requirement to take reasonable steps to determine whether a customer is a New Zealand resident	This option allows more discretion for offshore suppliers to determine the residence of their customers.	The option creates uncertainty about what would be acceptable as a "reasonable step" to determine a customer's residence. This could increase offshore suppliers' compliance costs.	Not recommended

Simplified registration and return process

76. The discussion document proposed that offshore suppliers could be required to register under the domestic system or have the option of registering under a simplified "pay only" system.

77. "Pay-only" registration systems are tailored for offshore suppliers that have no GST 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.

Issue	Options	Advantages	Disadvantages	Recommendations
What registration system should offshore suppliers be required to use.	Simplified 'pay only' registration system.	A 'pay only' registration system may lower compliance costs for suppliers that are in a pay only position. This should encourage compliance with the rules.	Administrative systems would be required to be developed. However, the development of a 'pay only' system can be incorporated into the Inland Revenue business transformation process.	Recommended
	Domestic registration system.	Using the domestic registration system would not require any new administrative systems. New Zealand's domestic registration system is already, by international standards, very simple to comply with. Offshore suppliers are treated in the same way as domestic suppliers.	Offshore suppliers who are only required to return GST will be subject to the same requirements and processes that are in place for suppliers who return and claim GST. This may increase the compliance costs imposed on 'pay only' offshore suppliers.	The domestic registration system will initially be available until a 'pay only' system is developed as part of the Business Transformation Programme. Still available for offshore suppliers that want to return and claim GST.

Electronic market places

78. To further reduce compliance costs offshore suppliers who supply services via an electronic marketplace would not be required to register and return GST. The marketplace (such as an app store) would instead be treated as the supplier and be required to register. 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 therefore may reduce compliance costs as a large number of smaller suppliers may not be required to register.

CONSULTATION

79. The discussion document *GST: Cross-border services, intangibles and goods* was released on 18 August 2015, and sought public feedback on the proposal to require offshore suppliers of services and intangibles to register and return the GST along with a number of key design features.

80. A number of telephone conferences were held with members of the Business and Industry Advisory Committee to the OECD and the Tax Executives Institute (Indirect Tax chapter). This included a number of representatives of offshore suppliers that supply to the global marketplace, and therefore have experience with the offshore supplier registration systems that have been adopted in other countries.

81. A total of 76 submissions were received in response to the discussion document. The proposals in the discussion document were received well, with most submissions supporting the proposed approach for taxing cross-border services and intangibles. A strong theme was the importance of minimising compliance costs for offshore suppliers, to maximise compliance and reduce the risk the rules could restrict the supply of services and intangibles to New Zealand.

82. Of the 76 submissions, 23 were from individuals (30%), 8 were from offshore businesses and professional associations (11%), and 25 were from New Zealand businesses and professional associations (40%). An additional 15 submissions followed a standard form provided by a domestic industry representative.

83. The table below outlines the some of the initial proposals contained in the discussion document, the submissions received on the proposal and the recommend action following consideration of the submissions:

Initial proposal	Submissions	Preferred approach
Basic framework of the rules		
The discussion document proposed that supplies of remote services and intangibles by an offshore supplier to New Zealand-resident consumers will be subject to GST. A broad definition of "services" was proposed, which includes both digital services and more	78% of submissions agreed with the proposal for services and intangibles, with 92% of submissions on the point supporting a distinction between "remote" and "on-the-spot" services. 81% of submissions agreed with a broad definition of services.	The proposal in the discussion document should be retained.

traditional services.		
Supplies to New Zealand registered businesses		
Submissions were sought on whether offshore suppliers should be required to return GST when they supply services and intangibles remotely to New Zealand GST-registered businesses.	90% of submissions supported excluding supplies to GST-registered businesses.	Supplies of remote services and intangibles to GST-registered businesses should not be subject to GST, unless the supplier and recipient agree that the supply is zero-rated.
Registration threshold		
The discussion document sought submissions on the level of the registration threshold, specifically whether a lower threshold (such as $10,000) or a threshold based on the domestic registration threshold ($60,000) is preferred.	19 submissions preferred a nil threshold, 1 submission preferred a $10,000 threshold and 20 submissions preferred the domestic registration threshold of $60,000 or higher. 9 submissions considered that the threshold should not count supplies to GST-registered businesses.	Offshore suppliers should be required to register when their total supplies of remote services and intangibles to New Zealand residents exceed $60,000.
Identifying whether a customer is resident in New Zealand		
The discussion document compared the European Union (EU) rules, where an offshore supplier is required to determine place of residence based on two non-conflicting pieces of evidence, with the proposed Australia rules, which require ‘reasonable steps’ to be taken.	Offshore suppliers expressed a preference for rules that provide certainty and use commercially available information, including the EU rules. Submissions requested extra flexibility where two non-conflicting pieces of information are not available.	It is proposed that offshore suppliers be able to determine whether a customer is a New Zealand resident based on two non-conflicting pieces of evidence. The Commissioner of Inland Revenue would also be able to prescribe an alternative method, in cases where two pieces of non-conflicting evidence are not commercially available.
New Zealand GST-registered businesses inadvertently charged GST		
If a GST-registered business is inadvertently charged GST, the business would be required to seek a refund from them, rather than claim a deduction in their GST return.	4 submissions supported this proposal, 6 submissions argued that if a registered business is incorrectly charged GST, they should be entitled to claim an input tax deduction in their GST return.	If a GST-registered business is inadvertently charged GST, they should seek a refund from the supplier. If the value of the supply is less than $1,000, the offshore supplier could instead provide a tax invoice which would allow the GST-registered purchaser to claim back the GST in their normal GST return.

84. A strong theme was the importance of minimising compliance costs for offshore suppliers, to maximise compliance and reduce the risk that the rules could restrict the supply

of services and intangibles to New Zealand. This risk has been mitigated by designing the rules to make it as easy as possible for offshore suppliers to comply, which will be complemented by simplified registration and return processes. In addition, the registration threshold would prevent many small suppliers from being required to register under the rules.

85. In response to submissions, several legislative requirements would be relaxed to further reduce compliance costs for offshore suppliers, who would:

- not be required to issue tax invoices, as supplies of GST-registered businesses would not be subject to GST at the 15% rate;
- generally be able to make adjustments in their GST return to take into account refunds of inadvertently charged GST to GST-registered business customers, within two years of the original supply; and
- have an automatic exception from the requirement to keep records in New Zealand and to keep records in English.

86. Recent amendments require an offshore supplier to have a fully functional New Zealand bank account in order to obtain an IRD number, in order to ensure that an offshore person is first subjected to New Zealand's anti-money laundering and Countering Financing of Terrorism rules. Offshore suppliers should be excluded from this requirement in order to reduce the compliance costs associated with registering for GST.

87. Currently, registered businesses are required to express amounts in New Zealand dollars at the time of supply. As offshore suppliers often charge customers in a foreign currency, this would involve significant compliance and transaction costs. Therefore, this requirement would be relaxed, allowing offshore suppliers to elect to convert amounts into NZD at the time of filing their return. A two year 'lock-in' rule would ensure that an offshore supplier could not gain an advantage from switching between these methods.

CONCLUSIONS AND RECOMMENDATIONS

88. The recommended option is to implement option one as outlined in this RIS, specifically offshore suppliers or an offshore electronic marketplace would be required to register and return GST on remote services and intangibles supplied to New Zealand resident consumers. Offshore suppliers would only be required to register if their total supplies of remote services and intangibles to New Zealand residents exceeded $60,000 in a 12-month period, unless the offshore supplier is only making supplies to New Zealand GST-registered businesses.

89. A broad definition of services would be adopted that would apply GST to all cross-border supplies of remote services and intangibles (this would include digital services and more traditional services, such as legal and accounting services). This approach is consistent with New Zealand's broad-based GST system. Offshore suppliers would be required to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of evidence, or to agree with the Commissioner of Inland Revenue on an alternative method.

90. Supplies of remote services and intangibles to GST-registered businesses should not be subject to GST, unless the offshore supplier and GST-registered recipient agree to zero-rate the supply. The option to zero-rate these supplies will allow non-resident businesses to claim back any New Zealand GST incurred in making these supplies, which ensures GST is neutral for these businesses.

91. Out of the options considered, option one best achieves the objectives and is consistent with draft OECD guidelines on taxing cross-border services and intangibles, as well as being consistent with international practice. When similar rules have been applied in other countries anecdotal evidence is that they have been relatively successful at collecting the forgone GST. To generate a similar level of compliance for New Zealand the recommended option aims to adopt similar and consistent rules with the rules that apply in other countries.

92. Given the simplicity of the New Zealand GST system, the rules should be relatively simply to comply with compared with other countries that have different GST/VAT rates and multiple exemptions. This should further promote compliance with the rules.

IMPLEMENTATION

93. Minsters' preference is to implement the rules on 1 October 2016. Considering legislation is expected to be introduced in November 2015 (and if that legislation is enacted in the first half of 2016), this timeframe should give offshore supplies around 6 months to adapt their systems to comply with the new rules. This timeframe is consistent with submissions that suggested that offshore suppliers would need at least 6 months to adapt their systems depending upon the complexity of the rules. If there is a delay in the enactment of the legislation there is a risk that some offshore suppliers may not have enough time to adapt their system to comply with the new rules.

94. To implement the proposals, Inland Revenue is developing a simplified registration system that will be tailored to the requirements of offshore suppliers, informed by best practice in other countries and the recommendations in the draft OECD guidelines.

95. A simplified 'pay only' GST return will be developed as part of Inland Revenue's Business Transformation Programme. The system for processing GST returns is scheduled to be replaced with a new system during the first quarter of 2017. Therefore, it is proposed that offshore suppliers could initially begin with a default six-monthly taxable period, running from 1 October 2016 to 31 March 2017. This would mean the first return offshore suppliers will file will use the simplified 'pay only' GST return.

96. A default six-monthly taxable period would also provide a 'soft start' to the new rules, for example, if an offshore supplier is late to register for GST, they would be able to backdate their registration to 1 October 2016 for up to six months without interest or penalties. During this interim period, two-monthly filing could also be allowed as an option as otherwise offshore suppliers may face foreign exchange risk during the longer 6-month period.

97. From 1 April 2017, offshore suppliers would file quarterly. This is intended to reduce compliance costs for offshore suppliers as quarterly filing periods align with filing requirements for equivalent rules in other jurisdictions.

98. Compliance costs can be further minimised by releasing clear and helpful guidance as to the operation of the new rules. Inland Revenue resources will be allocated to develop and provide tailored educational material that will be easily accessible to offshore suppliers.

MONITORING, EVALUATION AND REVIEW

99. Inland Revenue will monitor the outcomes pursuant to the Generic Tax Policy Process ("GTTP") to confirm that they match the policy objectives. The GTPP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995.

100. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation, and the identification of remedial issues. Post-implementation review is expected to occur around 12 months after implementation. Opportunities for external consultation are built into this stage. Any necessary changes identified as a result of the review would be recommended for addition to the Government's tax policy work programme.