

# **Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill**

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*Commentary on the Bill*

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Minister of Revenue

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# GST on low-value imported goods

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## OVERVIEW

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In principle, Goods and Services Tax (GST) should apply to all consumption that occurs in New Zealand, as this ensures that the system is fair, efficient and simple. Under the current rules, however, GST is not typically collected on imported goods below the customs *de minimis* of \$60 of duty owing (this typically equates to a parcel with a value of \$400 if GST is the only duty).

When GST was introduced in 1986, few New Zealand consumers purchased goods from offshore suppliers, and online shopping did not exist. At that time, the compliance and administrative costs that would have been involved in taxing imported goods under the *de minimis* outweighed the benefits of taxation.

The growth of e-commerce means the volume of imported goods on which GST is not collected is becoming increasingly significant. Many are concerned that the current tax settings place New Zealand suppliers of low-value goods at a competitive disadvantage relative to offshore suppliers. The non-collection of GST on low-value imported goods has also resulted in a growing gap in New Zealand's GST revenue base (estimated to be around \$130 million in 2017–18).

The amendments proposed in the Bill apply GST to imported goods valued at or below \$1,000 that are imported from offshore suppliers by consumers in New Zealand. They would require the offshore supplier to register for and return GST on these supplies. Offshore suppliers may have the option to also charge GST on their supplies of goods over \$1,000 to consumers in New Zealand. The New Zealand Customs Service (Customs) will cease to collect any form of duty on consignments valued at \$1,000 or less, except for tobacco products or alcoholic beverages. Customs will however continue to collect GST on imported parcels valued above \$1,000. The proposed amendments contain rules to prevent double taxation by requiring Customs to not collect GST on goods that have already had GST collected on them at the point of sale by the offshore supplier.

Offshore suppliers would not be required to return GST on supplies to New Zealand GST-registered businesses, nor would they be required to provide tax invoices. Furthermore, as with domestic suppliers and offshore suppliers of remote services, offshore suppliers would only be required to register for and return GST when their taxable supplies to New Zealand consumers exceed \$60,000 in a 12-month period.

A range of other amendments are also proposed focusing on implementation. The overall package of amendments is intended to maintain the broad base of New Zealand's GST system and to create a level playing field between domestic and offshore suppliers of low-value goods.

Non-collection of GST on low-value imported goods is an international challenge faced by countries that have a GST or Value Added Tax (VAT) system. On 1 July 2018 Australia introduced rules requiring offshore suppliers to register and return GST on their supplies of low-value imported goods to Australian consumers. The proposed amendments broadly follow Australia's recently introduced rules.

The European Union (EU) has also announced that from 1 January 2021 non-EU suppliers will be required to register and return VAT on supplies of low-value imported goods to consumers in the EU.

Other features of the proposed rules include:

- Supplies of low-value imported goods by non-resident suppliers to New Zealand GST-registered businesses would not be subject to GST unless the supplier decides that the supply will be zero-rated (taxed at a rate of zero percent). The supplier would then be able to claim back any New Zealand GST costs incurred in making the zero-rated supplies.
- Offshore suppliers would be required to determine whether a customer is in New Zealand on the basis of the address the goods are to be delivered to.
- Offshore suppliers would be required to presume that a New Zealand-resident customer is not a GST-registered business unless the customer has provided their GST registration number, New Zealand Business Number or notified their status as a registered business. The Commissioner of Inland Revenue (the Commissioner) is also able to agree to an alternative method of determining whether the supply is made to a GST-registered person.
- If a GST-registered business is inadvertently charged GST, it should seek a refund from the non-resident supplier. However, if the payment for the supply excluding the amount of GST is \$1,000 or less, a non-resident supplier would have the option to provide a tax invoice to the purchaser to allow them to claim a deduction, rather than refund the GST charged.
- When certain conditions are satisfied, an operator of an electronic marketplace would be required to register for and return GST on supplies made through the marketplace instead of the underlying supplier.
- Redeliverers would be required to register and return GST on low-value imported goods they deliver to New Zealand consumers.
- The Commissioner would have the discretion to require a person to register for and pay the GST in cases when a person provides false or misleading information about themselves in order to avoid GST, if the GST amount involved is substantial or the behaviour is repeated.
- A simplified “pay-only” registration system would be made available to offshore suppliers that are only required to return GST and who do not have any New Zealand GST costs to claim back.
- For the period from 1 October 2019 to 31 March 2020, non-resident suppliers of low-value goods would have a taxable period of six months (or the option of having a quarterly taxable period right from the start of the rules). After this transitional period, these suppliers would be required to have quarterly taxable periods.

The proposed amendments follow proposals outlined in the discussion document, *GST on low-value imported goods— an offshore supplier registration system*, released in May 2018. The new rules will apply to supplies made on or after 1 October 2019. All references are to the Goods and Services Tax Act 1985 (GST Act) unless otherwise specified. All monetary values in this Commentary are denominated in New Zealand dollars unless otherwise stated.

The following items detail how this measure would work in practice.



## SUPPLIES OF LOW-VALUE IMPORTED GOODS TO CONSUMERS IN NEW ZEALAND

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*(Clauses 5(2), 6, 9(1), 12(2), 13 and 31)*

### **Summary of proposed amendment**

The Bill proposes amendments to the GST Act that will apply GST to imported goods valued at or below \$1,000 supplied to New Zealand-resident consumers, by requiring offshore suppliers (as well as marketplaces and redeliverers) to register and return GST on these supplies. Customs will continue to collect GST on imported consignments valued above \$1,000.

### **Key features**

#### ***Distantly taxable goods***

The Bill proposes a definition of “distantly taxable goods” be inserted into the GST Act. A distantly taxable good would generally be defined as a good valued up to \$1,000 that is outside New Zealand at the time of supply, supplied by a non-resident and delivered to New Zealand.

In addition, proposed new section 10C would allow suppliers to elect to treat goods that they supply which are individually valued above \$1,000 as distantly taxable goods if certain requirements are met. This means that a good with a value above \$1,000 may be a distantly taxable good if it is outside New Zealand at the time of supply, supplied by a non-resident and delivered to a place in New Zealand, and the supplier has elected to treat such goods as distantly taxable goods.

Goods that are deemed to be supplied by a marketplace operator or a redeliverer would also be distantly taxable goods, regardless of the residency of the deemed supplier or where the goods are geographically situated at the time of supply.

Alcoholic beverages, tobacco, and tobacco products cannot be distantly taxable goods. Instead, these goods will have GST and other duties collected on them at the border by Customs regardless of their value.

To determine whether a good exceeds the \$1,000 threshold, the good’s value would be determined in accordance with proposed new section 10B. If a good’s value under section 10B does not exceed \$1,000 it would be a distantly taxable good. If a good’s value under section 10B exceeds \$1,000, it would not be a distantly taxable good unless the supplier (or deemed supplier) has elected to treat its supplies of high-value imported goods as distantly taxable goods.

### ***Change to the place of supply rules***

Proposed new section 8(3)(ab) is inserted into the place of supply rules. This would treat “distantly taxable goods” (as defined) supplied by a non-resident to a person providing a delivery address in New Zealand as supplied in New Zealand, and therefore subject to GST. Goods deemed to be supplied by a resident marketplace operator or redeliverer would be treated as supplied in New Zealand by existing section 8(2).

### ***Determining the value of a supply of distantly taxable goods***

The value of a supply of distantly taxable goods for determining the amount of GST payable would generally be determined under existing section 10(2) and proposed new section 10(7E). Under section 10(2)(a), the value of a supply of distantly taxable goods (with the addition of GST) would generally be the amount of consideration in money for the supply.

Proposed section 10(7E) would ensure the amount of consideration for a supply of distantly taxable goods includes any additional amounts for services provided in connection with the distantly taxable goods (such as delivery and associated insurance), in all situations where the supplier of the goods supplies, or arranges or facilitates the supply, of these services.

### ***Registration threshold***

As a consequence of proposed section 8(3)(ab), non-resident suppliers (including non-resident marketplaces and redeliverers) would be required to register and return GST when their total supplies treated as being made in New Zealand, including supplies of distantly taxable goods to consumers, exceed \$60,000 in a 12-month period. Supplies of distantly taxable goods to New Zealand GST-registered businesses would only count towards this threshold if the supplier decides to zero-rate the supply (discussed in the next item of this Commentary).

## **Background**

New Zealand’s GST is a broad-based consumption tax that should apply to all consumption in New Zealand, including imported goods. The New Zealand Customs Service is responsible for collecting GST on imported goods. However, GST is not collected on imported consignments of goods for which less than \$60 of duty (including GST) is payable. This \$60 threshold (referred to as the “*de minimis*”) typically means GST is not collected on imported parcels valued under \$400 if GST is the only duty payable.

When GST was introduced in 1986, few final consumers purchased goods from non-residents for delivery in New Zealand. Instead, most imported goods were purchased by GST-registered businesses so the non-collection of GST on imported goods below the customs *de minimis* was not a significant issue. However, the growth of online shopping means it is now common for consumers to purchase goods from non-resident suppliers. The non-collection of GST on imported goods below the *de minimis* is therefore becoming an increasingly significant gap in the GST base.

### ***International developments***

Non-taxation of low-value imported goods is an international issue faced by countries that have a GST or VAT system. Since 1 July 2018, legislation in Australia now requires suppliers, electronic distribution platforms (electronic marketplaces) and redeliverers to collect and return GST on imported goods valued at or below A\$1,000 that they supply or are deemed to supply to consumers in Australia. Switzerland will also introduce an offshore supplier registration system for collecting VAT on low-value imported goods from 1 January 2019. The European Union (EU) has also announced that it will extend its existing VAT rules for cross-border supplies of goods within the EU to also tax low-value imported goods from non-EU suppliers, starting from 1 January 2021.

### ***Current place of supply rules***

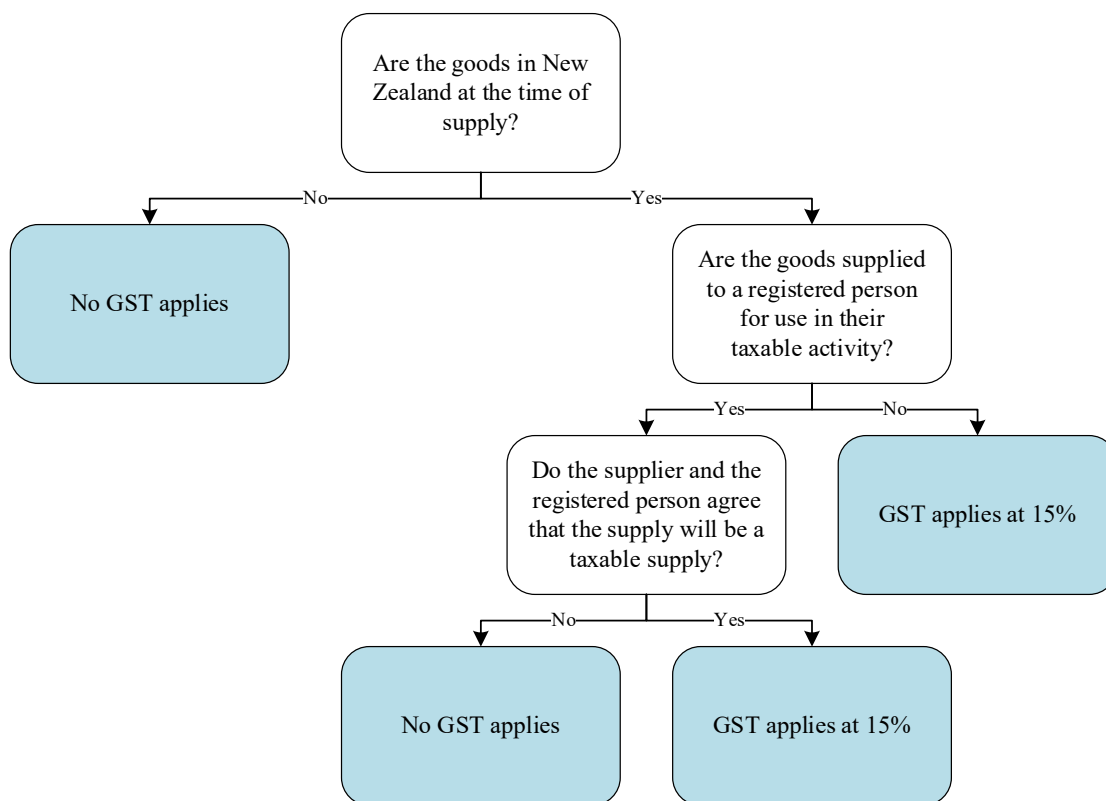
The GST Act adopts an iterative approach to determining whether a good or service is treated as supplied in New Zealand, and therefore whether GST applies to the supply. The place of supply rules in section 8 of the Act are then followed by a range of exclusions that determine whether the supply is zero-rated or exempt.

In the specific case of supplies of goods by non-residents, the current place of supply rules apply GST on the basis of where goods are at the time of supply. Goods that are outside New Zealand at the time of supply are not subject to GST under section 8 if supplied by a non-resident, regardless of whether the goods are subsequently imported into New Zealand.

Under section 8(2) of the Act, when a New Zealand-resident person supplies goods or services, the supply is deemed to be in New Zealand and is therefore subject to GST. However, if the goods are exported, the supply will be zero-rated under section 11.

If a non-resident person supplies goods, the starting point is the supply will be deemed to be outside New Zealand, and therefore not subject to GST. However, under section 8(3)(a), goods are deemed to be supplied in New Zealand if the goods are in New Zealand at the time of supply. Conversely, section 8(4) provides that if a supply is made to a GST-registered business for the purpose of carrying on its taxable activity, the goods are deemed to be supplied outside New Zealand (and therefore are not subject to GST) unless the parties agree that GST will apply.

## Summary of the current place of supply rules for goods supplied by a non-resident



### Detailed analysis

#### *Definition of “distantly taxable goods”*

Under the GST Act, “goods” are defined to mean all kinds of real or personal property; but do not include choses in action, money or a product that is transmitted by means of a wire, cable, radio, optical or other electromagnetic system or by means of a similar technical system.

Proposed new section 4B sets out that “distantly taxable goods” would generally be defined as goods that:

- are supplied by a non-resident;
- are outside New Zealand at the time of supply;
- are delivered to a place in New Zealand by the supplier, or the supplier arranges or assists the delivery of the goods to a place in New Zealand; and
- individually have an entry value of \$1,000 or less.

As discussed in later sections of this Commentary, the proposed definition of distantly taxable goods also includes goods treated by section 60C, 60D or 60E as being supplied by a marketplace operator or redeliverer, regardless of the residency of the marketplace operator or redeliverer.

Alcoholic beverages, tobacco and tobacco products that are exempted from regulations made under section 406(1) of the Customs and Excise Act 2018 would not be distantly taxable goods. At present, Customs collects GST and excise taxes on these goods, which will not change under the proposals.

#### *Goods outside New Zealand at the time of supply*

A non-resident person who is the actual supplier of goods that are delivered to an address in New Zealand (that is, someone who is not merely treated as the supplier of the goods for GST purposes) would be considered to have made a supply of distantly taxable goods if the goods are outside New Zealand at the time of supply. This is subject to the other requirements of a supply of distantly taxable goods being met.

Existing section 9(1) sets out that the time of supply is generally the earlier of any payment being received or an invoice being issued. In the case of goods purchased online by consumers, this will generally be the same as the time the consumer purchases the goods.

If either a redeliverer or an operator of a marketplace is treated by section 60C, 60D or 60E as the supplier of the goods, the location of the goods at the time of supply would not be relevant for determining if the goods are distantly taxable goods. In other words, any supply of goods that is deemed under those sections to be made by a marketplace operator or a redeliverer would be a supply of distantly taxable goods, regardless of where the goods are physically located at the time of supply.

#### *Goods individually having entry values of \$1,000 or less*

In order to determine if a good is a distantly taxable good, suppliers would be required to determine the good's entry value in accordance with proposed section 10B. However, existing section 10(2) and proposed new section 10(7E) would generally apply for determining the value of a supply of distantly taxable goods in order to calculate the amount of GST payable.

Under section 10B(2), a good's entry value would be the amount of consideration it is sold for, less any amounts included in the consideration for:

- duty payable under the Customs and Excise Act 2018; and
- any amounts included in the consideration for the cost of transport and insurance for the good between leaving its country of export and being delivered in New Zealand.

This is consistent with the valuation that Customs would use for determining if a consignment is above or below the *de minimis*.

Under proposed section 10B(3), suppliers would be able to use information available to them at the time of supply to determine a reasonable estimate of a good's entry value under subsection (2).

If a good has an entry value of \$1,000 or less then it would be a distantly taxable good. If a good has an entry value exceeding \$1,000, that good would not be a distantly taxable good unless, as discussed below, the supplier has made an election under proposed new section 10C to treat its high-value goods as distantly taxable goods that is effective at the time of supply.

It is worthwhile noting that currency conversion to New Zealand dollars for the purpose of establishing whether GST applies would only be necessary if:

- it is unclear whether a good that is sold in another currency has an entry value exceeding \$1,000 or not; and
- the supplier has not elected to treat its high-value goods as distantly taxable goods.

As the entry value is worked out by using a reasonable estimate at the time of supply, the date or time of supply would be the date or time of the currency conversion (if required).

The Bill does not propose any restrictions on the type of exchange rate that suppliers may use for converting foreign currency amounts. This means that suppliers would have a choice of using a sell NZD rate, a buy NZD rate or a midpoint rate for the purpose of establishing whether GST applies (as well as for the purpose of determining the amount of output tax to be returned in New Zealand dollars when filing their GST returns, as discussed later in this Commentary).

*Which goods would be included in a supply of distantly taxable goods?*

In some cases, a single transaction will involve one or more goods that each have an entry value of \$1,000 or less and, at the same time, one or more other goods that each have an entry value exceeding \$1,000. If the supplier has not made an election to treat goods with entry values above \$1,000 as distantly taxable goods, proposed section 4B(2) would split such transactions into two separate supplies:

- a supply of distantly taxable goods, consisting of all the goods that are low-value goods (that is, have individual entry values of \$1,000 or less), except for alcoholic beverages, tobacco and tobacco products; and
- a second supply consisting of the remaining goods supplied in the transaction.

However, if the supplier has elected to treat its supplies of high-value goods as distantly taxable goods, proposed section 4B(2) would only apply to split a single supply of goods into two separate supplies if some of the goods supplied do not meet the definition of “distantly taxable goods” because they are in New Zealand at the time of supply, or because they are alcoholic beverages, tobacco or tobacco products.

Further explanation of the proposed rules that would allow suppliers to treat their supplies of high-value goods as distantly taxable goods is provided in a later section of this Commentary.

### ***Changes to the place of supply rules***

The amendments propose changes to the place of supply rules, so that GST applies to supplies of distantly taxable goods where the goods are delivered to an address in New Zealand.

Proposed section 8(3)(ab) provides that distantly taxable goods supplied (or deemed to be supplied) by a non-resident would be treated as supplied in New Zealand (subject to GST).

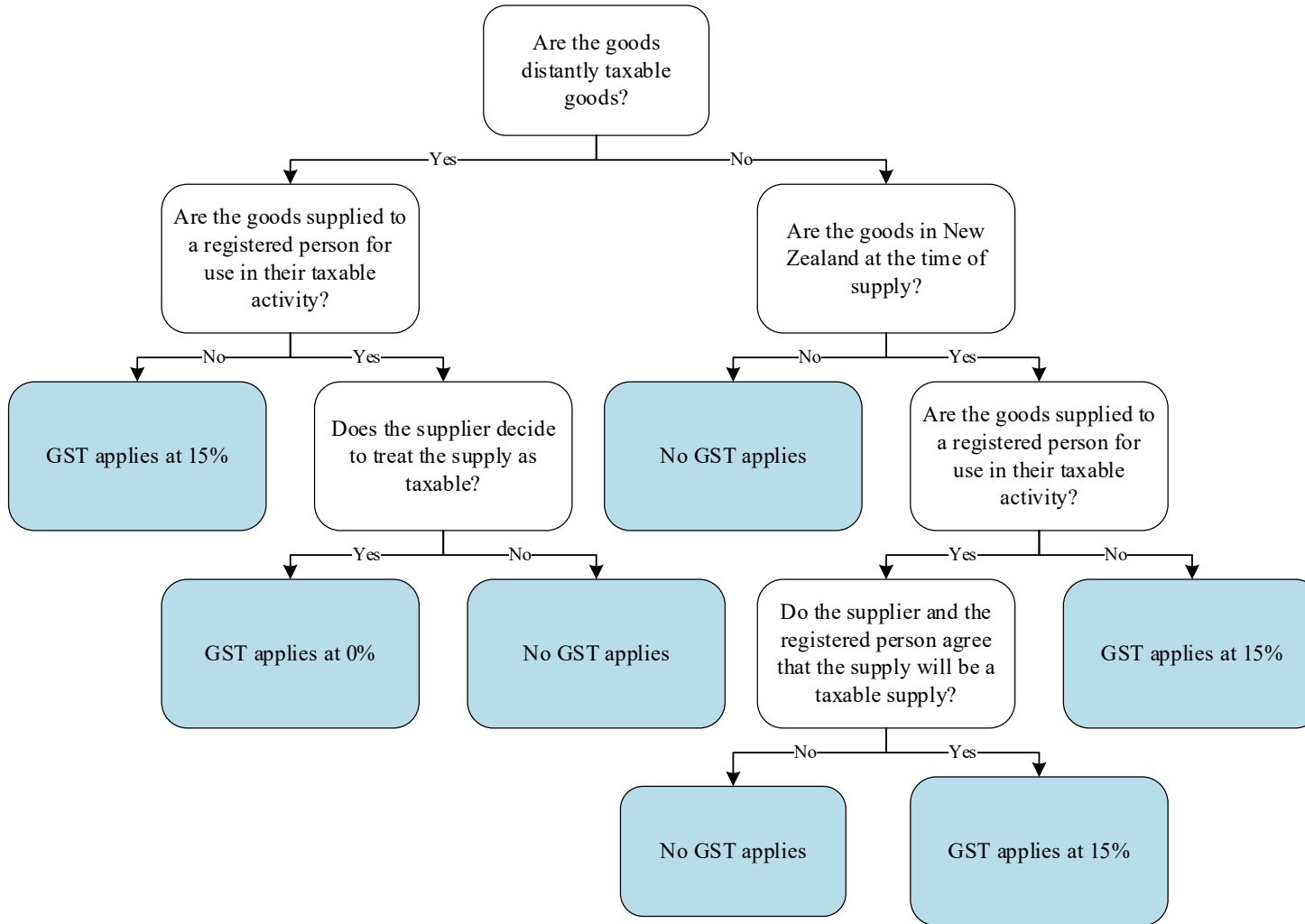
Existing section 8(2) provides that supplies of goods and services by New Zealand residents are treated as supplied in New Zealand. Section 8(2) would therefore treat distantly taxable goods that are deemed to be supplied by resident marketplace operators and redeliverers as supplied in New Zealand (and hence also subject to GST).

Proposed new section 8(4E) sets out that distantly taxable goods that are supplied by a non-resident to a GST-registered business for the purpose of carrying on its taxable activity would be treated as supplied outside New Zealand (not subject to GST), unless the non-resident supplier decides to treat the supply as made in New Zealand. Where the supplier decides to treat the supply as made in New Zealand, the goods would be zero-rated under proposed section 11(1)(fb). (For more information on business-to-business supplies of distantly taxable goods, see the following section of this Commentary item.)

Goods that are already exempt (such as supplies of fine metal) or zero-rated under a specific rule, would retain that character under the proposed amendments.

A further amendment is proposed to exclude supplies of distantly taxable goods that are subject to new section 8(3)(ab) from the scope of existing paragraph (a) (being the provision that applies GST to supplies by non-residents of goods that are in New Zealand at the time of supply). This is because it is possible that some of the distantly taxable goods a marketplace or redeliverer is deemed to supply may be in New Zealand at the time of supply, and therefore could be subject to both section 8(3)(a) and (ab) without the proposed amendment to (a).

**Summary of the new place of supply rules for non-resident suppliers of goods**





### ***Determining the value of a supply of distantly taxable goods***

The amount of GST payable (output tax) on the value of a supply of distantly taxable goods would be determined in accordance with existing section 10(2) and proposed section 10(7E).

The value of a supply of distantly taxable goods would typically be determined by the amount of consideration in money for the supply. Existing section 10(2)(a) provides that, to the extent the consideration for a supply of goods and services is in money, the value of the supply with the addition of GST is equal to the amount of consideration in money.<sup>1</sup>

This means that, for supplies of goods that are priced inclusive of GST, the amount of output tax that should be returned on the supply would be equal to the total amount of consideration multiplied by the tax fraction of 3/23. An example of how this applies is provided below.

#### *Treatment of amounts paid by the recipient for delivery and other related services*

Under ordinary GST principles, the amount of consideration for a supply of distantly taxable goods may include amounts paid by the recipient relating to services such as delivery, insurance or giftwrapping of the goods in the supply, even if an explicit fee is charged for these services. This is because these services may be ancillary, integral or incidental to the supply of the goods (or otherwise would be a means of better enjoying the dominant element of the supply, being the goods). Where this is the case, such services may form part of the supply of distantly taxable goods. This may be the case even though services such as international transportation of goods (including ancillary activities such as handling) and insurance associated with the international transportation are zero-rated.<sup>2</sup>

However, it is possible that there may be a separate zero-rated supply if the recipient contracts separately for the supply of these services. For example, an operator of an electronic marketplace may facilitate the delivery of goods that a consumer has purchased on its marketplace by allowing the consumer to also purchase international transportation services from a transport company through the marketplace.

To avoid doubt and ensure consistent treatment in situations where there may or may not be a separate zero-rated supply, proposed section 10(7E) provides that the value of a supply of distantly taxable goods would include the amount of consideration for a supply of related services to the recipient of the distantly taxable goods, where the supply of the related services:

- is made, arranged or facilitated by the supplier (or by the underlying supplier, if the supplier for GST purposes is a marketplace operator);
- is directly in connection with the distantly taxable goods or is insurance of the goods;

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<sup>1</sup> To the extent that the consideration for a supply of distantly taxable goods is not in money, existing section 10(2)(b) would provide that the value of the supply with the addition of GST is equal to the open market value of the consideration.

<sup>2</sup> For more information on when multiple goods and services supplied in a single transaction will form a single supply or multiple supplies, see the Interpretation Statement, *IS 18/04 Goods and Services Tax – Single supply or multiple supplies*, available at <https://www.ird.govt.nz/resources/2/2/229901d1-77a8-410e-a005-933a9904455e/is1804.pdf>.

- would be zero-rated in the absence of this rule; and
- does not form a single supply with the distantly taxable goods.

This would mean that amounts paid by the recipient for related services (such as international transportation that is contractually supplied to the recipient by a third party) may still be included as part of the consideration for a supply of distantly taxable goods, provided all of the above conditions are met.

This would ensure that GST effectively applies at the rate of 15% to any amounts paid to the supplier or marketplace operator for services that are sufficiently connected with the distantly taxable goods (in terms of being the transportation of the goods or associated with the transportation, or having some other direct physical intervention with the goods) such that the consumption of these services ought to be treated as consumption in New Zealand. This would also provide neutrality with the situation where GST would, under ordinary principles, apply to an amount charged by the supplier for these services because the amount forms part of the consideration for the supply.

However, for practical reasons, paragraph (a) of proposed section 10(7E) requires that the consideration for the services supplied in connection with the distantly taxable goods is a charge solely related to the distantly taxable goods and the associated services. This means that a subscription where a consumer is paying for the transport of many supplies of goods, for example, would be excluded from the scope of the rule.

**Example – calculating amount of output tax based on GST-inclusive price**

Wendy, a consumer in New Zealand, purchases a fascinator from Wild Hats, an e-commerce business based in Australia that ships novelty party hats from its warehouse in Melbourne. Wild Hats is registered for GST in New Zealand.

The full amount paid by Wendy for the fascinator, including GST and an explicit charge for shipping to New Zealand of \$11.50 (also inclusive of GST), is \$34.50.

The amount of output tax returned on the supply by Wild Hats is \$4.50 ( $\$34.50 \times 3/23 = \$4.50$ ). This includes the \$1.50 of GST included in the shipping fee.

The entry value of the good is \$20, being the full amount of consideration for the supply of \$34.50, less the total amount of GST (\$4.50) and the amount of the shipping fee excluding GST (\$10).

*Special rule for calculating GST payable by a redeliverer*

Neither the ordinary rule in section 10(2)(a) nor the proposed new rule in section 10(7E) would apply for determining the value of a supply of distantly taxable goods that a redeliverer is deemed to make under section 60E. Instead, proposed new section 10(7C) contains a special rule for determining the amount of GST payable on a supply of distantly taxable goods that section 60E would treat as being made by a redeliverer. The special rule is explained in a later section on the proposed rules for redeliverers in this Commentary item.

### *Discounts provided by marketplaces*

The Bill also proposes a special valuation rule to deal with the situation where an operator of a marketplace provides discounts for remote services or distantly taxable goods that it is deemed to be the supplier of. This rule is discussed in a later section of this Commentary on the proposed rules for marketplaces.

### ***GST registration threshold***

Non-resident suppliers of distantly taxable goods to New Zealand customers would be required to register for GST if their total value of supplies made to New Zealand consumers exceeds \$60,000 in a 12-month period, which is equivalent to the existing registration threshold for non-resident suppliers of remote services and resident suppliers of goods and services. Non-resident suppliers would be able to use a fair and reasonable method of converting foreign currency amounts to New Zealand dollars to determine whether the registration threshold has been exceeded.

As these suppliers would be subject to the rules contained in section 51 of the GST Act, non-resident suppliers would be required to register if:

- the total value of their supplies made in New Zealand in the past 12 months exceeded \$60,000 (unless the Commissioner is satisfied that their supplies in the next 12 months will not exceed this threshold); or
- the total value of their supplies made in New Zealand in the next 12 months is expected to exceed \$60,000.

As distantly taxable goods supplied by a non-resident to New Zealand GST-registered businesses are generally treated as not being supplied in New Zealand (and therefore not subject to GST), these supplies will not count towards the registration threshold. However, if the supplier decides that these supplies will be zero-rated, these supplies would count towards the threshold.

Where a non-resident supplier of distantly taxable goods is carrying on a taxable activity in New Zealand, and their supplies fall below the \$60,000 threshold, they would be able to voluntarily register for GST.

The existing rules that allow non-resident businesses to register for GST, which are contained in section 54B of the GST Act, will continue to apply. These rules allow a non-resident business that has been charged GST on goods or services received in New Zealand, but that does not carry on a taxable activity in New Zealand, to register and claim refunds of the GST paid, provided certain conditions are met.

**Example – non-resident supplier below the registration threshold**

Jersey Co., a non-resident company based in the United States, sells clothing to customers across the world. Jersey Co. also makes and supplies businesses with staff uniforms.

Each year, Jersey Co. makes supplies valued at \$50,000 to New Zealand customers who are not GST-registered. It makes supplies valued at \$20,000 to New Zealand GST-registered customers.

Unless Jersey Co. chooses to treat its supplies to GST-registered businesses as zero-rated, Jersey Co. will not be required to register and return GST on any of its supplies in New Zealand, as it has not exceeded the \$60,000 registration threshold.

***Effect on suppliers' residency and income tax obligations***

Although these amendments treat certain goods provided by non-residents as “supplied in New Zealand”, there is no intention that this will have a broader impact on whether a supplier is a resident of New Zealand for GST or income tax purposes, or whether a supplier has a “permanent establishment” in New Zealand.

The definition of “resident” in the GST Act includes a resident as defined in the Income Tax Act 2007. For GST purposes, a person is also considered to be a resident of New Zealand to the extent that the person carries on a taxable activity or other activity in New Zealand, and has a fixed or permanent place in New Zealand relating to that activity. The proposed amendments will not affect the extent to which a person carries on an activity in New Zealand, despite making certain supplies taxable for GST purposes.

Double tax agreements (DTAs) primarily deal with whether a resident of one country is subject to income tax on income derived in another country. The concept of “permanent establishment” is used in DTAs between New Zealand and other countries. Under DTAs, a company that does not have a “permanent establishment” in New Zealand will have no New Zealand income tax. The fact that a supplier is registered for New Zealand GST under the proposed rules should not affect whether or not they have a “permanent establishment” in New Zealand for DTA purposes, or the application of the definition of resident used for GST purposes.

## **SUPPLIES TO NEW ZEALAND GST-REGISTERED BUSINESSES**

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*(Clauses 8, 9(2) to (6), 11, 14(1), (4), 19(1), (3) to (9), 23, 25, 26(1) to (3), (5) and 27)*

### **Summary of proposed amendment**

The Bill proposes that supplies of distantly taxable goods by non-residents to New Zealand GST-registered businesses (business-to-business supplies) will not be subject to GST unless the supplier decides to zero-rate the supply. Zero-rating the supply would allow the non-resident supplier to deduct any New Zealand GST costs incurred in making the supply.

Special rules are proposed to deal with the situation where GST is inadvertently charged on a supply of distantly taxable goods to a GST-registered person and the registered person uses (or intends to use) the goods for non-taxable purposes. These rules mirror existing rules applying to business-to-business supplies of remote services.

### **Key features**

Under the proposed rules, supplies of distantly taxable goods by non-residents to New Zealand GST-registered businesses will not be subject to GST unless the supplier decides to zero-rate the supply. Proposed section 11(1)(fb) would apply to business-to-business supplies of distantly taxable goods that the supplier has chosen to zero-rate. This allows the supplier to deduct any New Zealand GST costs incurred in relation to the supply.

As a consequence of these rules, non-resident suppliers may be required to identify whether a New Zealand recipient of the supply is GST-registered. The existing rules for identifying GST-registered recipients of remote services would also apply for identifying a GST-registered recipient of distantly taxable goods. Under these rules, the supplier would be required to treat the recipient as not being a registered person unless the recipient:

- notifies the supplier that they are a registered person; or
- provides the supplier with their GST registration number or New Zealand business number.

GST-registered recipients of distantly taxable goods should not identify themselves as a GST-registered person or provide their GST registration number, or a New Zealand business number, if they intend to use the goods for one hundred percent non-taxable purposes.

As with the rules for remote services, the Commissioner can agree with a supplier on the use of another method to determine whether the supply is made to a registered person for the purpose of carrying on the registered person's taxable activity.

### ***Tax invoices***

A non-resident supplier would not be required to provide a tax invoice in relation to supplies of distantly taxable goods (see proposed new section 24(5)(c) in clause 23(1) of the Bill). However, under existing section 24(5B), a non-resident supplier of remote services can choose to provide a full tax invoice if the recipient has been inadvertently charged GST and the consideration for the supply is \$1,000 or less (inclusive of GST). The Bill proposes to extend this rule to include supplies of distantly taxable goods. The Bill also proposes to amend section 24(5B)(b) to refer to the GST-exclusive value of the supply, rather than consideration (being a GST-inclusive concept).

### ***Input tax deductions***

Under the proposed amendment to section 20(4C), a recipient cannot claim an input tax deduction for a supply of distantly taxable goods unless the recipient has obtained a tax invoice under section 24(5B), resulting from the recipient being inadvertently charged GST, and the value of the supply is \$1,000 or less.

The recipient would not be denied an input tax deduction when, as discussed later in this section, the supply is treated as made in New Zealand by the recipient of the supply (under section 8(4B)) and the recipient has applied the reverse charge under section 5B.

### ***GST-registered business inadvertently charged GST***

When a GST-registered recipient is inadvertently charged GST on a supply of distantly taxable goods, a non-resident supplier may make an output tax adjustment in the return when it is apparent that a mistake has been made, under amendments proposed to section 25(1). These amendments apply when:

- the supply was standard-rated when it should not have been treated as a taxable supply (see the proposed amendment to subsection 25(1)(aab) in clause 26 of the Bill); or
- the supply was standard-rated when it should have been zero-rated (see the proposed amendment to subsection 25(1)(abb)).

A non-resident supplier would have the option to issue a tax invoice when the recipient has been inadvertently charged GST at the standard rate of 15% on a supply of distantly taxable goods when it should not have been taxed or should have been taxed at the rate of zero percent (see the proposed amendments to section 24(5B)(a)(i) and (ii)). However, the non-resident supplier may only provide a tax invoice when the value of the supply is \$1,000 or less, and the recipient notifies the supplier that they are a registered person (see the proposed amendments to section 24(5B)).

When a business-to-business supply has been incorrectly taxed at the standard rate, and the supplier opts to issue a tax invoice, the invoice must contain all the particulars specified in existing section 24(3). The provision of a tax invoice allows the GST-registered recipient to make a deduction for the inadvertently charged GST to the extent to which the recipient uses the goods, or the goods are available for use in, making taxable supplies.

When a non-resident supplier opts to provide a tax invoice under section 24(5B):

- the supplier must not make an adjustment under section 25 to correct the amount of GST shown on the invoice;
- the supplier and recipient would be deemed to have agreed that the supply is subject to GST; and
- the proposed zero-rating provision under section 11(1)(fb) would not apply (see the exception to the zero-rating provision in proposed new section 11(8E)).

### ***Reverse charge***

A proposed amendment to section 8(4B) extends the existing reverse charge to distantly taxable goods that would be treated by section 8(4E) as not being supplied in New Zealand. It also extends the reverse charge in section 8(4B) to goods treated by section 8(4) as not being supplied in New Zealand.

Currently, the reverse charge applies to services acquired by a GST-registered business from a non-resident supplier if the percentage of intended taxable use (or percentage of actual taxable use) of the services is less than 95 percent of the total use. The reverse charge treats the services as being supplied in New Zealand by the recipient in the course or furtherance of a taxable activity carried on by the recipient (see section 5B).

Section 20(3JC), which applies a reverse charge to zero-rated supplies of remote services, would be amended to also require the recipient of a supply of distantly taxable goods that is zero-rated under 11(1)(fb) to return output tax on the nominal GST component for any non-taxable use of the goods. Consistent with section 8(4B), this section only applies when at the time of acquisition, or at the end of an adjustment period, the taxable use of the good is less than 95 percent.

### **Background**

A key feature of the proposals is the exclusion for business-to-business supplies. From a revenue perspective, there is little value in applying GST to business-to-business supplies of low-value imported goods as the GST-registered recipient would, in most cases, be able to claim back the GST in their GST return, resulting in no net GST revenue. Other advantages of excluding business-to-business supplies include the following:

- Tax invoice requirements can be relaxed because no New Zealand consumers charged with GST would be in a position to claim back the GST.
- There are some revenue risks associated with applying GST to business-to-business supplies by non-residents, which would arise if a non-resident supplier purported to charge GST but did not return the GST to Inland Revenue. Registered New Zealand businesses would then seek to claim the GST back in the normal manner.
- Excluding business-to-business supplies is consistent with New Zealand's existing rules for remote services and how similar rules for imported goods have been applied in Australia.

Because business-to-business supplies are proposed to be excluded, special rules are required for when a GST-registered recipient acquires goods from a non-resident supplier for non-taxable purposes (such as private purposes or use in making exempt supplies). In these situations, a GST-registered recipient should be treated in a similar way to a final consumer, as otherwise the supply may be under-taxed. It is therefore proposed that the existing reverse charge provisions (sections 8(4B) and 20(3JC)) would apply to ensure GST is returned by the GST-registered recipient on the portion of non-taxable use of the goods.

This would ensure that businesses acquiring distantly taxable goods from a non-resident supplier for purposes other than for making taxable supplies are treated in the same way as individual consumers.

### **Detailed analysis**

Proposed section 8(4E) would apply to supplies of distantly taxable goods to GST-registered businesses, so that these supplies would be treated as being supplied outside New Zealand unless the supplier decides to treat the supply as a taxable supply. Where the supplier has decided to treat the supply as a taxable supply, the supply would be zero-rated under proposed new section 11(1)(fb).

#### **Example – business-to-business exclusion for distantly taxable goods supplied by non-residents**

Electronics Co. is a non-resident company that supplies phones, computers and other electronic goods to customers around the world. The goods sold by Electronics Co. are not situated in New Zealand at the time of supply. Therefore, the goods Electronic Co. supplies to customers in New Zealand will be distantly taxable goods if they have individual entry values of \$1,000 or less.

Electronics Co.'s supplies of distantly taxable goods to customers in New Zealand that are not registered for GST would be subject to GST under section 8(3)(ab). However, its supplies of distantly taxable goods to customers in New Zealand that are GST registered would be treated as being supplied outside New Zealand unless Electronics Co. decides to zero-rate the supply.

If Electronics Co. incurs New Zealand GST costs, it may wish to zero-rate its supplies of distantly taxable goods to GST-registered customers as this would allow it to deduct the costs incurred in New Zealand in making the supplies.

As a consequence of these rules for business-to-business supplies, non-resident suppliers would need to differentiate between individual consumers and GST-registered businesses. The proposed rules require the supplier to treat the supply as being to a consumer, unless the recipient notifies the supplier that they are registered or provides their GST registration number or a New Zealand business number. GST-registered recipients of distantly taxable goods should not identify themselves as a GST-registered person, or provide their GST registration number or a New Zealand business number, if they intend to use the service for one hundred percent non-taxable purposes (for example, private purposes or use in making exempt supplies).



It is recognised that it may not be practical for all suppliers to ask for evidence that a customer is GST-registered. Therefore, to provide additional flexibility, the proposed rules allow the Commissioner to prescribe or agree alternative methods for determining whether the supply is made to a GST-registered person. This discretion would apply in situations where a supplier can reasonably distinguish between supplies to businesses and individual consumers on the basis of the nature of the goods they supply, and can provide evidence that the goods targeted at businesses are supplied to GST-registered businesses.

The proposed approach for determining whether a recipient of a supply of distantly taxable goods is GST-registered mirrors the rules already applying to supplies of remote services. These rules are contained in proposed new section 8BB, which would replace existing section 8B(6), (7) and (8).

### ***GST inadvertently charged to a GST-registered recipient***

There may be instances when a non-resident supplier accidentally treats a GST-registered business as an individual consumer and therefore charges the business GST. In this situation, the GST-registered recipient should seek a refund from the non-resident supplier and not claim an input tax deduction for the inadvertently charged GST (see the proposed amendment to section 20(4C)). There is, however, a proposed exception to the deduction prohibition in section 20(4C) for supplies under \$1,000, as discussed below.

Proposed amendments to section 25(1) would allow a supplier to make adjustments to the payment of output tax in the return in which it is apparent that the mistake has been made. This will apply when the supply was standard-rated when it should not have been treated as a taxable supply (see the proposed amendment to subsection 25(1)(aab)), or the supply was standard-rated when it should have been zero-rated (see the proposed amendment to subsection 25(1)(abb) in clause 26 of the Bill).

An adjustment would only be required if the non-resident supplier has already filed a return and has accounted for an incorrect amount of output tax as a result of the mistake (see existing section 25(1)(e)).

Since non-resident suppliers would not be required to provide a tax invoice under the proposed amendment to section 24(5), they would not be required to issue a credit note under section 25(4).

### ***Supplies of \$1,000 or less***

An exception to the above rules would apply when the payment for the supply (excluding GST) is \$1,000 or less. In this situation, if the supplier inadvertently charges a GST-registered recipient GST, the supplier could choose to provide a full tax invoice to the GST-registered recipient (see the proposed amendment to section 24(5B)). This option is intended to be a compliance cost-saving measure for non-resident suppliers in relation to low-value supplies, when the cost of issuing a refund relative to the amount of the refund may exceed the cost of issuing a tax invoice.

If the supplier chooses to provide a tax invoice, the supplier would be required to provide a full tax invoice, even if the payment for the supply (including GST) is less than \$50 (see the proposed amendments to section 24(5)).

Existing section 24(3) sets out that a full tax invoice must contain the following particulars:

- the words “tax invoice” in a prominent place;
- the name and registration number of the supplier;
- the name and address of the recipient;
- the date upon which the tax invoice is issued;
- a description of the goods supplied;
- the quantity of the goods supplied;

and either—

- the total amount of the tax charged, the consideration, excluding tax, and the consideration, inclusive of tax for the supply; or
- where the amount of tax charged is the tax fraction of the consideration, the consideration for the supply and a statement that it includes a charge in respect of the tax.

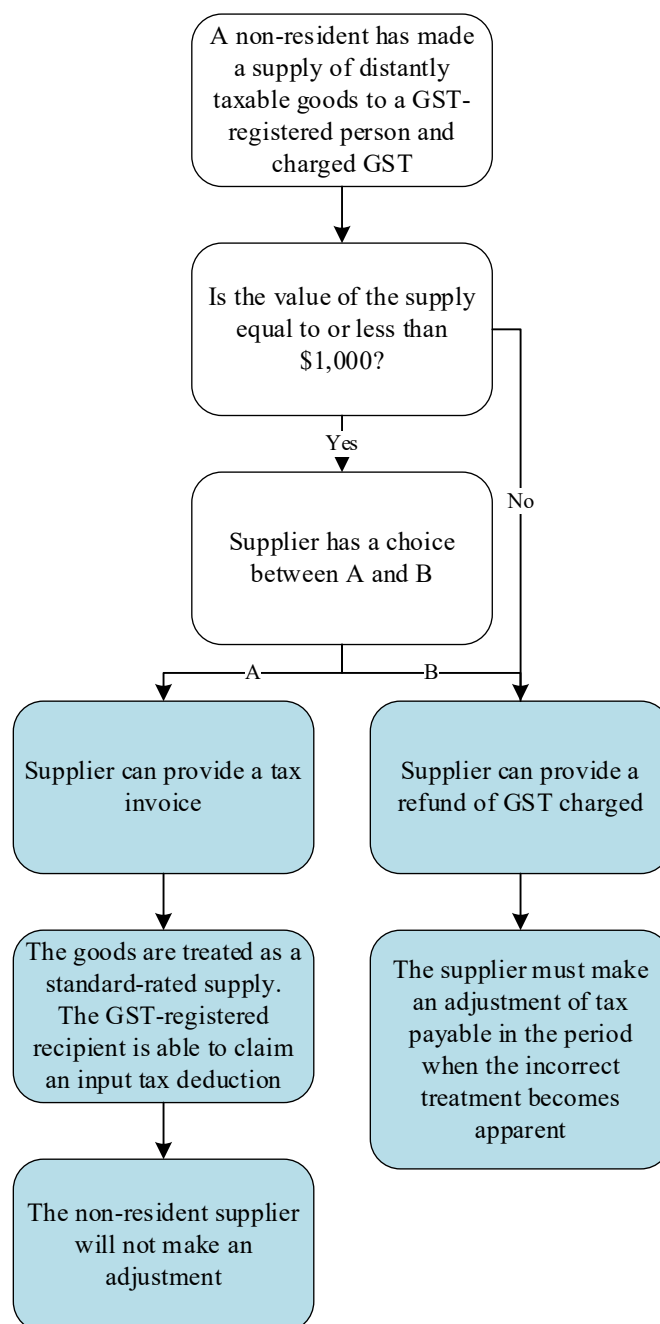
An existing exception to the deduction prohibition in section 20(4C) allows a GST-registered recipient of remote services (for which the non-resident supplier has issued a tax invoice under section 24(5B)) to claim an input tax deduction under the normal deduction provisions, to the extent that the services are used for, or are available for use in, making taxable supplies. An amendment is proposed to section 20(4C), so that this exception would also apply in the situation where a non-resident supplier provides the recipient of a supply of distantly taxable goods not exceeding \$1,000 in value with a full tax invoice.

If the supplier chooses to provide a tax invoice:

- the supplier would not be required to make an adjustment under section 25 to correct the amount of GST shown on the invoice (see section 25(1)(aab)(ii) and the exception to section 25(1)(abb)); and
- the proposed zero-rating provision under section 11(1)(fb) would not apply (see the exception to section 11(1)(fb) in proposed new section 11(8E)).

These provisions are intended to turn a supply that should not have been taxed (or should have been taxed at zero percent), into a supply that is taxed at the standard rate of 15%. In this situation, the correct amount of GST is returned by the supplier, and therefore an adjustment to the supplier’s GST return, under section 25, is not required.

The diagram summarises how these rules would apply.



### ***Reverse charge (GST-registered recipient of goods)***

An amendment to the existing reverse charge under section 8(4B) would require GST-registered recipients of supplies of distantly taxable goods (that are treated by section 8(4E) as not being supplies in New Zealand) to return output tax on the supply if the percentage intended or actual use of the goods is less than 95 percent of the total use. The amendment would also extend the reverse charge to business-to-business supplies of goods that are in New Zealand at the time of supply (that are treated by existing section 8(4) as not being supplies in New Zealand).

An exception (proposed amendment to section 20(4D)) to the prohibition on input tax deductions in section 20(4C) would allow a recipient of distantly taxable goods, that is required to return output tax under the reverse charge, to make an input tax deduction to the extent that the goods are used for, or available for use in, making taxable supplies.

**Example – reverse charge**

Melissa is a self-employed project manager who is registered for GST. She purchases a phone from a non-resident supplier for \$400. At the time of purchase, she identifies herself as a GST-registered person and therefore is not charged GST. She uses the phone fifty percent for her taxable project management services and fifty percent for private use.

Under the reverse charge, Melissa is treated as making a taxable supply to herself of \$400 at the 15% rate. She must return output tax of \$60 ( $\$400 \times 15\%$ ). However, Melissa can claim an input tax deduction for the portion of her total use of the phone that is for taxable purposes (fifty percent). The amount of the input tax deduction is \$30 ( $\$60 \times$  fifty percent). Her net position in the relevant return (assuming no other supplies) is therefore an output tax liability of \$30 ( $\$60$  output tax minus  $\$30$  input tax).

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

The existing reverse charge would only apply when the supply of distantly taxable goods is not treated as a supply in New Zealand. Therefore, the reverse charge under section 8(4B) would not apply when the non-resident supplier decides to zero-rate the supply under section 11(1)(fb) by treating it as being a supply in New Zealand under section 8(4E).

In this situation, amended section 20(3JC) would require the recipient of a distantly taxable goods that are zero-rated under proposed section 11(1)(fb), to return output tax on the nominal GST component for any non-taxable use of the goods. The nominal GST component is the tax that would be chargeable on the value of the supply, as if the value (that is, before the addition of GST) were equal to the consideration for the supply.

Section 20(3JC) would only apply when at the time of acquisition, or at the end of an adjustment period, the taxable use of the goods is less than 95 percent. This is consistent with the proposed application of the reverse charge under section 8(4B).

**Example – output tax adjustment under section 20(3JC)**

Consider the same example as above, however, this time the supplier decides to treat the phone as a supply in New Zealand, in which case the supply of the phone is zero-rated under section 11(1)(fb). Because the supply is zero-rated, Melissa will be required to return output tax on the nominal GST component for any non-taxable use of the phone under section 20(3JC).

Since the value of the phone is \$400, the nominal GST component is \$60 ( $\$400 \times 15\%$ ). The amount of output tax Melissa is required to return is \$30; this is calculated by multiplying the nominal GST component (\$60) by the non-taxable use of the phone (fifty percent).

Note that an equivalent amount of tax is paid on the phone as with the application of section 8(4B).

### ***Reverse charge for supplies of \$1,000 or less***

There may be instances when a GST-registered recipient applies the reverse charge and the non-resident supplier also inadvertently charges the recipient GST. In this situation, GST would be returned twice on a single supply (by the non-resident supplier and the GST-registered recipient). This issue will likely be resolved if the non-resident supplier subsequently refunds the GST charged to the GST-registered recipient and makes an adjustment under section 25 as described previously (note that an adjustment may still be necessary under section 25AA(1)(a)(iii) to ensure the correct amount of tax is accounted for under the reverse charge in section 8(4B)).

To ensure the correct amount of tax is paid in the alternative scenario where the supplier provides a tax invoice under section 24(5B), existing section 25AA would allow the GST-registered recipient to correct the amount of output tax returned and input tax deductions claimed. The recipient would then be able to claim, in the normal manner, a deduction for the portion of the GST that was charged by the non-resident supplier, to the extent that the goods are used for, or available for use in, making taxable supplies.

#### **Example – supplier inadvertently charges GST on supply to a registered person and recipient applies the reverse charge**

Consider the earlier example again, where Melissa has applied the reverse charge under section 8(4B). However, she subsequently finds out that the price for the phone included GST at the standard rate of 15% ( $3/23 \times \$400 = \$52.17$ ).

Melissa contacts the non-resident supplier and requests a refund for the incorrectly charged GST. Instead of providing a refund, the supplier issues Melissa with a full tax invoice, since the value of the supply is \$1,000 or less.

The tax invoice enables Melissa to claim an input tax deduction to the extent the phone is used for, or available for use, in making taxable supplies, which means she can deduct \$26.09. The non-resident supplier is also not required to make any adjustments under section 25.

Under section 25AA(1)(a)(v), Melissa makes an adjustment in the return for the taxable period in which it is discovered that a mistake has been made to correct the amount of output tax and input tax deductions claimed as a result of applying the reverse charge in section 8(4B). Melissa claims a deduction under section 20(3) for the output tax that she accounted for (\$60 – section 25AA(2)) and returns output tax for the input tax deduction she claimed earlier (\$30 – section 25AA(3)).

## PREVENTING DOUBLE TAXATION

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*(Clauses 16, 17, 19(2), 24 and 26(4))*

### **Summary of proposed amendment**

Under the proposed offshore supplier registration system, Customs would continue to collect GST on imported consignments valued over \$1,000. However, a consignment valued over \$1,000 may contain distantly taxable goods, on which GST has already been collected by the supplier.

The Bill therefore proposes that, for consignments over \$1,000, Customs would not collect GST on the distantly taxable goods in the consignment if documentation is provided to Customs showing that GST has already been collected by the supplier.

The Bill also proposes a non-double taxation rule to deal with the situation where a supplier of distantly taxable goods is required by legislation in another jurisdiction to charge that jurisdiction's consumption tax on the supply at a rate of more than zero. In this situation, the supplier would be entitled to make a deduction that offsets the amount of New Zealand GST payable on the supply, to the extent that the supply is subject to a consumption tax in another jurisdiction.

### **Key features**

#### ***Changes to the customs de minimis***

As part of the proposed offshore supplier registration system, the customs *de minimis* would be changed to \$1,000 based on the total value of the goods in a consignment. The effect of this is that Customs would not collect GST or any other duty on consignments valued at \$1,000 or less. This change would occur through an amendment to the Customs and Excise regulations and, as such, is not proposed in this Bill.

#### ***Exception to the collection of GST on importation***

Proposed section 12(1B) sets out that GST would not be collected by Customs on consignments over \$1,000, to the extent that GST has already been collected at the time of supply on goods in the consignment, provided that Customs is notified that GST has already been collected. Customs would still collect GST on goods in a consignment over \$1,000 if it has not received a notification that GST was collected by the supplier.

#### ***Information requirements***

To prevent double taxation, the Bill proposes a range of information requirements for suppliers. These information requirements will help to ensure Customs is notified in the approved manner that GST has already been collected on some or all of the goods in a consignment.

Under proposed section 24BAC, suppliers of distantly taxable goods would be required to take reasonable steps to ensure tax information is included on relevant customs documents when those goods are imported. The information suppliers would need to take reasonable steps to include on customs documents consists of:

- the registration number of the supplier;
- which particular goods in the consignment GST has already been collected on; and
- which particular goods in the consignment GST has not been collected on.

Under proposed section 24BAB, suppliers of distantly taxable goods would need to provide a receipt to consumers if they have charged the consumer GST on some or all of the goods in the transaction. The receipt would be required to show a number of particulars, including the registration number of the supplier and which goods in the transaction GST has been charged on.

### ***Refunds when double taxation occurs***

The Bill proposes that if GST has been collected on the same good by both Customs and the supplier, the supplier would be required to refund the GST they collected to the consumer, but only if the consumer requests a refund and provides a declaration or other confirmation that GST was collected by Customs on the importation of the item. A supplier that has provided a GST refund in this situation would be entitled to make an adjustment in its GST return to correct its net GST position (provided that it has reimbursed the recipient for the GST charged and has received a declaration from the recipient or other confirmation that GST was paid to Customs on the importation of the goods).

These rules would also apply in the situation where a supplier has incorrectly charged GST on an imported good valued over \$1,000.

### ***Non-double taxation rule***

Double taxation could potentially also arise in the situation where a supplier of distantly taxable goods is required by legislation in another jurisdiction to charge that jurisdiction's consumption tax on the supply at a rate of more than zero. To prevent double taxation from occurring, the Bill proposes that a supplier in this situation would be entitled to make a deduction that offsets the amount of New Zealand GST payable on the supply, to the extent that the supply is subject to a consumption tax in another jurisdiction.

## **Background**

Requiring non-resident suppliers, marketplaces and redeliverers to collect GST on imported goods with entry values not exceeding \$1,000, while Customs is also collecting GST on consignments valued over \$1,000, creates the potential for double taxation to occur in some situations. For example, a single consignment could be valued over \$1,000 but contain an item or items that, individually, are valued at \$1,000 or less.

Double taxation could also potentially arise if goods are sold in a foreign currency and exchange rate fluctuations occur between the time of supply and the time of importation, resulting in the supplier valuing the good at or below \$1,000 and Customs valuing the good above \$1,000.

Under the proposed amendments, the supplier would be required to collect GST on the distantly taxable goods included in the consignment. However, without the proposed mechanisms to prevent double taxation, Customs would collect GST on the value of the entire consignment, including any goods in the consignment which already had GST collected on them at the point of sale.

Double taxation may also arise when a supplier that is registered for a consumption tax in another jurisdiction is required to charge that jurisdiction's consumption tax on a supply of distantly taxable goods to a consumer in New Zealand at a rate of more than zero, despite the fact that the goods are exported from that other jurisdiction. This may occur when, for example, tax legislation in that jurisdiction requires the goods to be exported within a specified timeframe in order for the supply to be zero-rated, and the supplier fails to meet this requirement for zero-rating.

## **Detailed analysis**

### ***Change to the customs de minimis***

As part of implementing the proposed offshore supplier registration system, the customs *de minimis* would be changed from \$60 of duty owing, to \$1,000 based on the entry value of the consignment. Customs would therefore collect GST and other duties on imported consignments valued above \$1,000, but would not collect GST on consignments valued at or below \$1,000. Consignments containing alcohol and tobacco products would not be subject to the *de minimis*, with Customs continuing to collect GST and excise taxes on these products, regardless of their value.

As the customs *de minimis* is contained in section 70 of the Customs and Excise Regulations 1996, the proposed change to the *de minimis* would be made using an Order in Council (and for this reason is not proposed in this Bill).

### ***Exception to the collection of GST on importation***

Under proposed section 12(1B), GST would not be collected by Customs on the importation of goods, to the extent that the importation consists of distantly taxable goods on which GST was charged by the supplier at the standard rate of 15%. For this section to apply, the information available to Customs at the time the goods are imported would need to sufficiently identify the items in the consignment on which tax has been charged, the rate at which tax was charged on these items, and the registered person who charged GST on the distantly taxable goods in the consignment.

However, Customs would still collect GST on the full value of an imported consignment valued above \$1,000 if they are not notified before the time at which GST would be collected at the border that tax was already charged at the rate of 15% on the supply.



**Example – consignment of distantly taxable goods with total value above \$1,000**

Jason purchases a phone for \$900 and noise cancelling headphones for \$200 (excluding GST) from Kim's Phone Warehouse, a GST-registered non-resident supplier. As both goods individually have an entry value below \$1,000, Kim's Phone Warehouse charges Jason GST on both the phone and the headphones.

The phone and headphones are sent to Jason in a single package with a value of \$1,100. As the consignment is over \$1,000, Customs will stop the consignment for revenue collection. However, provided that evidence is made available to Customs that GST was already collected by Kim's Phone Warehouse on both the phone and the headphones, Customs would not collect GST on either good in the consignment.

***Information requirements***

To help prevent double taxation, the Bill proposes a range of information requirements for offshore suppliers, marketplaces and redeliverers. These requirements will help to ensure that, when GST has been charged at the point of sale, Customs is notified of this in the approved form and does not also collect GST.

***Receipts***

Proposed section 24BAB would require a supplier to issue a receipt to a recipient of a supply of distantly taxable goods if the supplier has charged GST at the rate of 15% on the supply. The receipt would need to contain the following particulars:

- the name of the supplier;
- the registration number of the supplier;
- the date of the supply;
- the date of issue of the receipt (if different from the date of the supply);
- a description of the goods supplied;
- the consideration for the supply and the amount of GST included;
- information indicating the items for which GST has been charged at the rate of 15%; and
- information indicating the items for which the amount of GST charged is zero.

The amounts shown on the receipt would not be required to be in New Zealand dollars.

Section 24BAB proposes that the supplier would be required to issue the receipt at the time of supply. However, if they have not issued a receipt at the time of supply and the recipient requests a receipt, the supplier would be required to issue one within 10 business days after the request.

Under proposed section 143A(1)(fb) of the Tax Administration Act 1994, a supplier that knowingly fails to issue this receipt within ten business days would have committed a knowledge offence.

*Requirement to take reasonable steps to ensure tax information is included on relevant customs documents*

In addition to the requirement to issue receipts, proposed section 24BAC would require suppliers of distantly taxable goods to take reasonable steps to ensure that the relevant GST information is available to Customs at the time of importation of the goods. This requirement would apply to all supplies of distantly taxable goods where GST has been charged at 15% on some or all of the goods in the transaction.

The tax information that suppliers would need to take reasonable steps to include on customs documents is the following:

- the registration number of the supplier (or deemed supplier);
- which goods in the supply have had GST charged at the rate of 15%; and
- which goods have not had GST charged (or have had GST charged at the rate of zero).

If GST is not charged at the rate of 15% on some items in the transaction, these items must be identified to meet this requirement. This would allow the rule in proposed section 12(1B) that prevents double taxation to operate correctly, as GST on importation will only be switched off to the extent that GST at the rate of 15% has been collected on the item at the point of sale.

For goods transported by express freight, the supplier would fulfil the requirement to take reasonable steps by providing the GST information (included on the receipt or tax invoice for the goods) in the commercial documentation provided to the freight forwarder or customs broker, for use in completing the customs documents on behalf of the importer. Customs brokers and transporters would only need to include this information on customs documents if it is provided to them. If this information is not provided, they would not need to take extra steps to source this information.

An operator of an electronic marketplace would meet the requirement to take reasonable steps if it includes GST information on commercial documentation which they require an underlying supplier to pass through the logistics chain on their behalf.

In relation to goods transported by international post, the transmission of this information may not be accommodated under current systems. Therefore, for goods transported by post, providing a receipt to the customer may currently be sufficient to meet the reasonable steps requirement. The customer would be able to provide the receipt to Customs to prevent Customs from collecting GST again on items that had GST collected by the supplier. What may constitute reasonable steps in relation to goods sent by post may change in the future, as the systems and practices of international postal operators change owing to the increased availability of electronic advance data in the international postal system.

Under proposed new section 143A(1)(fc) of the Tax Administration Act 1994, a supplier would commit a knowledge offence if they knowingly fail to take reasonable steps to ensure that tax information is included on customs documents.

### ***Refunds when double taxation occurs***

Where the relevant tax information is not available to Customs, GST would be collected on importation by Customs on the entire value of a consignment over \$1,000. If some or all of the goods in the consignment had already had GST collected on them by the supplier, the consumer would need to request a refund of the GST from the supplier.

Proposed new section 12B provides that if a consumer requests a refund of the GST charged by the supplier, and the supplier has received a declaration from the recipient or some other confirmation that GST was paid on importation, the supplier would be required to issue a refund of the GST they charged. If the supplier complies with the requirement under section 12B to issue a GST refund, proposed new section 25(1)(bb) would allow the supplier to make a subtraction from its output tax in its GST return for the amount refunded.

### ***Mistakes where GST has been incorrectly charged on a supply***

Proposed sections 12B and 25(1)(bb) would apply in the situation where a supplier has incorrectly charged GST at the rate of 15% on a supply of imported goods that is not a supply of distantly taxable goods (for example, because the goods individually have entry values above \$1,000, and the supplier has not made an effective election to treat its high-value goods as distantly taxable goods). This means that a supplier in this situation would be required to provide a refund of the GST they have charged if the above requirements that the recipient has requested a GST refund, and the supplier has received a declaration from the recipient or some other confirmation that GST was paid on the importation of the goods, are both met. As above, the supplier would only be entitled to make the adjustment under section 25(1)(bb) if:

- they have reimbursed the recipient for the GST charged; and
- the supplier has received a declaration from the recipient or other confirmation that GST was paid on importation to Customs.

This exception from the ability to make an adjustment is necessary to prevent a potential tax advantage from arising, where a supplier incorrectly charging GST on a supply of high-value goods and making the adjustment results in non-taxation (that is, because GST was not collected by Customs on the importation of the goods).

### ***Non-double taxation rule***

Proposed new section 20(3)(dd) would prevent double taxation from arising on supplies of distantly taxable goods to consumers in New Zealand by allowing a deduction that offsets the supplier's liability for GST in New Zealand, to the extent that the supply is subject to consumption tax in another jurisdiction.

Proposed section 20(3)(dd) would provide an input tax deduction for the New Zealand GST charged when:

- there is a supply of distantly taxable goods to a person in New Zealand who is not a GST-registered person; and
- the supplier has, in relation to the supply, incurred liability for, returned and paid a consumption tax in another jurisdiction.

The deduction would be limited to the GST paid on the supply in New Zealand (15%) and to the extent tax is paid and returned in the other country.

**Example – non-double taxation rule in section 20(3)(dd)**

Mike, a consumer in New Zealand imports some shirts from a supplier based in Country A, who ships the goods from its warehouse in Country A. The supplier is registered for VAT in Country A and is also registered for GST in New Zealand.

In order for the supplier to charge Country A's VAT at a rate of zero percent on the supply to Mike, VAT legislation in Country A requires the supplier to export the goods within 21 days of the date of the supply. The supplier does not manage to export the goods within this timeframe, and is therefore required to charge Country A's VAT at the rate of 20%. In addition, the goods are all distantly taxable goods, so the supplier is also required to charge New Zealand GST at the rate of 15% on the supply.

The non-double taxation rule in section 20(3)(dd) allows the supplier to make an input tax deduction up to the amount of New Zealand GST returned on the supply (15%) if the supplier has returned and paid VAT to Country A.

If Country A's VAT rate was instead 10%, the supplier would only be entitled to an input tax deduction of 10%.

## OPTION TO CHARGE GST ON SUPPLIES OF HIGH-VALUE GOODS

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*(Clause 13)*

### **Summary of proposed amendment**

The Bill proposes that suppliers (including redeliverers and operators of marketplaces) could also charge GST at the rate of 15% on their supplies of high-value imported goods to consumers, provided that at least 95 percent of the total value of goods that they supply in a specified 12-month period to New Zealand customers are low-value goods.

Alternatively, a supplier could choose to charge GST on its supplies of high-value goods to consumers if the Commissioner of Inland Revenue is satisfied that the potential revenue risk associated with allowing the supplier to charge GST at the rate of 15% is minimal and agrees to allow the supplier to elect to account for GST on these supplies.

### **Key features**

#### ***Self-assessed 95 percent test for electing suppliers***

The Bill proposes a self-assessed test for suppliers to determine their eligibility to charge GST on supplies of high-value goods to New Zealand consumers. Under the self-assessed test, suppliers of distantly taxable goods could elect to treat imported goods (other than tobacco and alcohol) valued above \$1,000 as distantly taxable goods if it is reasonable to believe that at least 95 percent of the total value of distantly taxable goods that would be supplied to New Zealand consumers in the next 12 months will consist of goods that are individually valued at \$1,000 or less.

A supplier would need to check annually whether at least 95 percent of the total value of distantly taxable goods that it supplied in the previous 12 months to New Zealand consumers consisted of goods individually valued at \$1,000 or less. As long as this test is met, the supplier could continue to charge GST on its supplies of high-value imported goods to New Zealand consumers.

If this historical test is not met, the Bill proposes that the supplier would have two options:

- The supplier may ask the Commissioner to allow it to continue to treat its supplies of high-value imported goods as distantly taxable goods subject to GST at the rate of 15% (discussed below); or
- The supplier must stop treating its high-value imported goods as distantly taxable goods within six months and notify the Commissioner within that timeframe that it will no longer be applying the election.

### ***Commissioner discretion to allow suppliers to charge GST on high-value goods***

It is proposed that the Commissioner would have discretion to allow a supplier to treat its supplies of high-value goods to New Zealand consumers as distantly taxable goods in situations where the self-assessed test is not met. In applying this discretion, the Commissioner would primarily consider any risk to the integrity of the tax system or to the Crown revenue in allowing the supplier to charge GST on its supplies of high-value imported goods.

### ***Commissioner's ability to cancel an election by a supplier***

In cases of non-compliance, or where a supplier no longer wishes to apply the election, the Bill also proposes to give the Commissioner the power to cancel an election made by a supplier, provided that certain procedures are followed.

## **Background**

Under the proposed rules, the starting point is that a supply by a non-resident to a consumer in New Zealand of goods having individual entry values exceeding \$1,000 and that are outside New Zealand at the time of supply, is not subject to GST. Unless suppliers are somehow allowed to standard-rate such supplies, this default rule means that a non-resident supplier would be required to distinguish between individual goods having entry values of \$1,000 or less versus those valued above \$1,000, and only return GST on the low-value goods.

This need to distinguish between low-value and high-value goods may also create complexity for redeliverers and operators of marketplaces who, in the absence of a rule allowing them to elect to be the deemed suppliers of high-value goods and charge GST on these supplies, would only be treated as being the suppliers of goods (that are actually supplied by third parties) to the extent that these goods are low-value goods.

Allowing all these types of suppliers to simply account for GST on all their supplies (or deemed supplies) of goods to consumers with delivery addresses in New Zealand, regardless of the value of the individual items, may therefore reduce compliance costs for these suppliers.

However, there are some risks involved in allowing suppliers of distantly taxable goods to standard-rate their supplies of high-value imported goods:

- Taxing the supply of high-value imported goods while also maintaining the collection of GST at the border on consignments valued above \$1,000 increases the potential for double taxation to occur. Suppliers opting to standard-rate their supplies of high-value imported goods would therefore need to ensure they follow processes for preventing double taxation for these goods, so that collection of GST on these items by Customs is effectively replaced by the supplier collecting GST at the point of sale.

- On the other hand, reliance on processes for preventing double taxation may involve some revenue risks for the Crown if suppliers are permitted to standard-rate their supplies of high-value imported goods. This risk would arise in situations where a supplier has collected GST (or has purported to have collected GST, so that Customs does not collect GST on the importation of the goods), but fails to return the GST to Inland Revenue.

Both the proposed 95 percent test for determining a supplier's eligibility to treat its supplies of high-value imported goods to consumers as distantly taxable goods, and the associated Commissioner discretion, are intended to balance the potential compliance cost savings to suppliers from being able to charge GST on all of their supplies to consumers against the potential risks involved.

In the situation where only a very small proportion of the supplier's total sales of imported goods to consumers in New Zealand are of goods with entry values above \$1,000, the proposed 95 percent test would ensure suppliers are not required to make further systems changes to distinguish between low and high-value goods at the point of sale. The proposed Commissioner discretion is intended to provide some flexibility in other situations where the cost of a further systems upgrade to distinguish between low and high-value goods is likely to be disproportionate to the potential revenue risk (for instance, because the supplier has a good tax compliance history).

## **Detailed analysis**

### ***Self-assessed 95 percent test for electing suppliers***

Proposed new section 10C(1) provides that a registered person (referred to as the "electing supplier") may elect to treat goods with individual entry values exceeding \$1,000 as distantly taxable goods if all the following conditions are met:

- at the time of the election, the electing supplier has reasonable grounds to believe that 95 percent or more of the total value of distantly taxable goods that it will supply in the initial year (being the 12-month period starting on the first day that the electing supplier intends the election to be effective for) will consist of items having an entry value of \$1,000 or less; and
- the electing supplier notifies the Commissioner of the election before the start of the first taxable period that it would be effective for; and
- the Commissioner has not before the date the election is made by the electing supplier, unilaterally cancelled a previous election by the supplier.

Proposed new section 10C(2)(a) provides that an election made under section 10C(1) is effective for the initial year (provided that the self-assessed 95 percent test is met).

### *95 percent test – reasonable grounds requirement*

The proposed 95 percent test discussed above implicitly requires an electing supplier to firstly assume that it will have made an effective election for the initial year – meaning that for the purposes of determining whether the 95 percent test is met, the electing supplier would include its supplies of high-value imported goods in the “total value of distantly taxable goods supplied by the electing supplier to places in New Zealand” (referred to in proposed section 10C(1)(b)).

Having made the above starting assumption, the test then requires the electing supplier to determine whether it is reasonable to believe that the total value of its low-value goods supplied in the initial year will be at least 95 percent of the total value of the distantly taxable goods that it will supply in the initial year.

For an electing supplier who is a redeliverer that is treated by proposed section 60E as the supplier, or an electing supplier who is a merchant (that is, a person who is the actual supplier of distantly taxable goods, and is not merely treated by section 60C, 60D or 60E as the supplier), the reasonable grounds requirement above essentially means the following:

- The electing supplier has a reasonable belief that 95 percent or more of the total value of goods that it will bring (or assist in bringing) into New Zealand in the initial year of the election will consist of goods having individual entry values of \$1,000 or less.
- The electing supplier would not include alcohol or tobacco products for the purposes of assessing whether this test is met.

For an electing supplier who is an operator of a marketplace (and who would be treated by either of proposed sections 60C or 60D as the supplier of goods sold through its marketplace by non-resident underlying suppliers), the reasonable grounds requirement above means the following:

- The marketplace operator has a reasonable belief that 95 percent or more of the total value of goods that would be purchased on or through the marketplace in the initial year of the election, and supplied by non-resident underlying suppliers to customers providing delivery addresses in New Zealand, will consist of goods having individual entry values of \$1,000 or less.
- As above, the marketplace operator should not include sales of alcohol and tobacco products for the purposes of assessing whether this test is met.



**Example – supplier making initial election under self-assessed 95 percent test**

Big Ben’s Bikes, an online British bike, bike parts and bike accessories store, sells and ships goods from its warehouse in London to customers around the world.

Big Ben’s Bikes sold \$97,000 worth of low-value imported goods to customers in New Zealand in the year 1 July 2018 to 30 June 2019. Big Ben’s Bikes also sold \$3,000 worth of high-value imported goods to New Zealand customers in that year. Therefore, 97 percent of the total value of Big Ben’s Bikes’ supplies of goods to customers in New Zealand that year were of goods individually valued at or below \$1,000, which is typical of its annual sales to New Zealand customers (in previous years, Big Ben’s Bikes’ sales of goods valued at or below \$1,000 as a proportion of its total sales to New Zealand customers have been within the range of 95 percent to 98 percent). Based on this historical information, it seems reasonable to assume that the 95 percent test will continue to be met in future years.

Big Ben’s Bikes wishes to elect under section 10C to charge GST at the rate of 15% on its supplies of high-value goods to customers in New Zealand, and intends that the election be effective from the start of its first taxable period, being 1 October 2019. Big Ben’s Bikes has no reason to expect that it will fail to meet the 95 percent test for the year 1 October 2019 to 30 September 2020, so Big Ben’s Bikes self-assesses that it is eligible to make the election.

*Backward-looking test (proposed section 10C(2)(b) and (c))*

Where a supplier has elected to treat its high-value goods as distantly taxable goods under proposed section 10C(1), proposed new section 10C(2)(b), (c) and (d) would apply to determine whether the election is still effective for later years beginning after the initial year covered by the election.

Unless the Commissioner has exercised her discretion in proposed section 10C(4) to allow the supplier to continue to apply the election for such taxable periods (discussed later), the supplier would be required under proposed section 10C(2)(b) to continuously meet a similar 95 percent test to that described above if it wishes to continue to apply the election. However, this second self-assessed 95 percent test would be backward-looking (solely based on historical results) instead of forward-looking (based on future expectations).

*Requirements of the backward-looking test*

Proposed new section 10C(2)(b) provides that a supplier who has elected to treat its high-value goods as distantly taxable goods for an initial year may continue to apply this election in later years. This would be the case if at least 95 percent of the total value of distantly taxable goods that the electing supplier supplied to New Zealand customers in the most recent year comprised sales of low-value goods.

This means that the election would remain effective for subsequent taxable periods beginning after the initial year that the election is made for, provided that the backward-looking 95 percent test is met on an annual basis, beginning after the initial year has ended.

### *High-value goods supplied after election is effective are distantly taxable goods*

Proposed section 10C(3) provides that, for supplies of goods made in the period during which the election is effective, high-value goods supplied by the electing supplier would be distantly taxable goods (provided that the goods meet the definition of “distantly taxable goods” in proposed section 4B, meaning that they are not alcoholic beverages or tobacco products and that they are delivered at a place in New Zealand).

### *When the backward-looking 95 percent test is not met*

Proposed section 10C(2)(c) and (d) sets out that if a supplier fails to meet the backward-looking 95 percent test for a 12-month period (referred to as the failing year), the supplier may be able to continue to apply the election for a maximum of six months after the end of the failing year. However, this would be subject to the condition that the supplier notifies the Commissioner within this six-month timeframe of the date on which the effect of the election would end. If the supplier fails to meet this requirement, it would be required to stop treating its high-value goods as distantly taxable goods immediately after the end of the failing year.

If an electing supplier wishes to continue to use the election beyond the six-month extension period, the supplier may (as discussed below) apply to the Commissioner for an exercise of her discretion under proposed new section 10C(4). The Commissioner would be able to grant this discretion for an indefinite period if she is satisfied that this is appropriate.

Alternatively, if the supplier intends to stop charging GST on its supplies of high-value goods to consumers but needs more time beyond the six-month extension period to make these changes, the Commissioner may grant the discretion for a given period. In this situation, the Commissioner may be satisfied that it is appropriate to grant an extension (by way of exercising her discretion) if such an extension is needed other than as a consequence of avoidable delay by the electing supplier.

### ***Commissioner discretion to allow suppliers to charge GST on high-value goods***

Proposed section 10C(4) provides that the Commissioner may allow a supplier to make an election to treat its high-value goods as distantly taxable goods, even if the self-assessed 95 percent test in proposed section 10C(1)(b) or (2)(b) (whichever is relevant) is not met. In doing so, the Commissioner may agree with the electing supplier on requirements that are an alternative to the self-assessed 95 percent test.

When deciding whether to exercise her discretion under proposed section 10C(4), the Commissioner must be satisfied that the exercise of the discretion appropriately balances the potential fiscal risk against the compliance costs of the requirements for the supplier. In determining whether it is appropriate to allow the electing supplier to apply or continue to apply the election, the Commissioner would take the following factors into account:

- Whether the registered person and any associated persons have a good history of previous compliance with New Zealand tax legislation and the tax laws of countries and territories outside New Zealand.
- The total value of high-value goods supplied by the electing supplier to New Zealand consumers.
- Any other relevant factors.

As mentioned above, the Commissioner would be able to apply the discretion indefinitely or for a given period.

#### *Situations where the Commissioner may exercise the proposed discretion*

The Commissioner's proposed discretion to allow suppliers to elect to treat their high-value goods as distantly taxable goods recognises that there may be some instances where it is difficult for an electing supplier to determine if it is eligible to make the election (or, potentially, if it is eligible to continue to apply the election) under the proposed self-assessed 95 percent test.

In this situation, the Commissioner may be satisfied that it is appropriate to allow the supplier to charge GST on its supplies of high-value goods to consumers if the supplier has a good tax compliance history. Alternatively, if the supplier does not have a tax compliance history that the Commissioner is aware of, the Commissioner may be satisfied that it is appropriate to exercise this discretion if the supplier can show that it is likely that it will meet the 95 percent test, or if the value of the supplier's sales of high-value imported goods to consumers in New Zealand is not significant.

There may also be instances where it is clear the supplier's sales of low-value goods as a proportion of its total sales of goods to New Zealand consumers do not meet the 95 percent test, but the Commissioner is nevertheless satisfied that the supplier is a low compliance risk. The Commissioner may determine that it is appropriate to exercise the proposed discretion in this situation.

#### **Example – exercise of Commissioner's discretion**

Consider Big Ben's Bikes in the previous example. Big Ben's Bikes finds that it sold \$95,000 worth of low-value imported goods to New Zealand customers in the 1 October 2019 to 30 September 2020 year. It also sold \$5,000 worth of high-value imported goods to New Zealand customers in that year. Therefore, only five percent of Big Ben's Bikes' supplies of goods in the initial year of the election being effective were over the low-value goods threshold, so Big Ben's Bikes may continue to charge GST on these high-value goods for at least another year.

After a year, Big Ben's Bikes finds it supplied \$94,000 of low-value goods and \$6,000 of high value goods in the year ending 30 September 2021. Big Ben's Bikes applies to the Commissioner to continue being allowed to charge GST on its supplies of high-value goods. As Big Ben's Bikes has a good compliance history, only supplies a small amount of high-value goods and had previously been charging GST on its supplies of high-value goods to consumers, the Commissioner exercises her discretion to allow Big Ben's Bikes to continue charging GST on its high-value supplies.

#### *Requirement for the Commissioner to consider the supplier's compliance history*

A non-resident supplier that would be subject to these proposals may be unlikely to have a compliance history for New Zealand tax purposes. In considering a non-resident supplier's tax compliance history, it is proposed that the Commissioner may consider any information she has about the supplier's compliance with tax laws in other jurisdictions, including that of entities associated with the supplier.

If an electing supplier or an entity associated with the electing supplier is already registered for GST in New Zealand (for example, under the remote services rules), and/or has New Zealand income tax obligations, the Commissioner would also take this compliance history into account.

***Commissioner's ability to cancel an election by a supplier***

If a supplier who has made an election requests that the election be cancelled, proposed new section 10C(5)(a) provides that the Commissioner may cancel the election by notifying the supplier of the date on which the election ends.

In the situation where the Commissioner unilaterally decides to cancel an election by a supplier (in cases of non-compliance by the supplier), proposed section 10C(5)(b) provides that the Commissioner would:

- notify the electing supplier of the date of the proposed cancellation and the reasons for the proposed cancellation;
- consider any arguments against the proposed cancellation that are provided by the electing supplier within 30 days from the date of notification, or within a shorter or longer period if the Commissioner considers that period is appropriate in the circumstances; and
- notify the supplier of the date on which the election is cancelled.

## MARKETPLACES

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*(Clauses 5(1), (3), (6), 12(2), 14(3), 30, 34(2) to (4), 35 and 36)*

### **Summary of proposed amendment**

Special rules are proposed to apply when distantly taxable goods are supplied through an electronic marketplace to a consumer with a delivery address in New Zealand. The proposed rules would require the operator of the marketplace, as opposed to the actual supplier of the goods, to register and return GST.

Rules are also proposed to allow operators of non-electronic marketplaces to register and return GST on supplies of distantly taxable goods sold through their marketplaces, subject to the Commissioner of Inland Revenue's approval.

### **Key features**

#### ***Definitions of “electronic marketplace” and “underlying supplier”***

Section 2 of the GST Act currently defines an electronic marketplace as a marketplace that is operated by electronic means through which a person (the underlying supplier) makes a supply of remote services by electronic means through another person (the operator of the marketplace) to a third person (the recipient). The Bill proposes to amend the definition to include a marketplace operated by electronic means through which an underlying supplier makes a supply of goods to a recipient.

This definition includes a marketplace operated via a website, internet portal, gateway, store, distribution platform or other similar marketplace. It excludes a marketplace that solely processes payments.

The Bill also proposes a definition of “underlying supplier” to be included in section 2. An “underlying supplier” is defined as the person that would be the supplier of the goods or services for GST purposes in the absence of the marketplace rules.

#### ***Electronic marketplace rule***

Section 60C of the GST Act currently applies to supplies of remote services made to a person resident in New Zealand through an electronic marketplace operated by a non-resident. The section treats the operator of the electronic marketplace, as opposed to the underlying supplier, as the supplier for GST purposes.

The Bill proposes to amend section 60C so that it will also apply to supplies of goods made to a person in New Zealand through an electronic marketplace.

Section 60C would not apply when:

- the documentation provided to the recipient identifies the supply as made by the underlying supplier and not the marketplace;
- the underlying supplier and the operator of the marketplace have agreed in a document signed by them that the supplier is liable for the payment of tax; and
- the electronic marketplace does not:
  - authorise the charge to the recipient;
  - make or authorise the delivery to the recipient; or
  - directly or indirectly set a term or condition under which the supply is made.

An amendment is also proposed to extend the existing rule in section 60C(3) for remote services to supplies of distantly taxable goods. Section 60C(3) currently applies when multiple electronic marketplaces may be liable to register and return GST in relation to a supply of remote services. In this situation, the first operator that authorises a charge or receives payment for the supply is treated as making the supply. If no operator exists that meets this requirement, the first operator that authorises delivery of the supply is treated as making the supply.

#### ***Approved marketplace rule***

Similar to the rule that applies to electronic marketplaces, section 60D allows non-electronic marketplaces (such as a syndicate providing insurance services to New Zealand residents) to register as a marketplace, subject to the Commissioner's approval.

The Bill proposes to amend section 60D for approved marketplaces so that this rule would apply to non-electronic marketplaces for goods (in addition to non-electronic marketplaces for remote services). An approved marketplace, and not the underlying supplier of the goods, would then be treated as the supplier for GST purposes.

#### ***Residency of underlying suppliers***

The proposed extension of the marketplace rules in sections 60C and 60D to supplies of goods would only apply when goods are supplied by non-resident underlying suppliers. This means that the person who operates the marketplace through which the supply of goods is made would be treated as the supplier, and would therefore be required to return GST on goods sold through its marketplace by non-resident underlying suppliers. However, a marketplace would not be deemed to be the supplier of (and should not return GST on) goods supplied by residents.

Because the definition of "distantly taxable goods" includes all goods that are treated by section 60C or 60D as having been supplied by a marketplace operator (regardless of where the goods are situated at the time of supply), the location of the goods at the time of supply is not relevant for determining whether the marketplace operator is the supplier of distantly taxable goods under section 60C or 60D.

This residency rule for supplies of distantly taxable goods can be contrasted with the existing marketplace rules for remote services. Under the rules for remote services, the residency of the underlying supplier is not relevant for determining whether the marketplace operator is deemed to be the supplier of the services. This existing rule for remote services is not proposed to change.

### ***Repeal of residency rule for marketplace operators***

The rules for electronic marketplaces and approved marketplaces in sections 60C and 60D currently only apply to non-resident marketplace operators. The Bill proposes to repeal the requirement in these sections for the marketplace to be operated by a non-resident person. This would extend the marketplace rules for both remote services and distantly taxable goods to marketplaces operated by New Zealand residents.

### ***Specific rule for underlying suppliers***

Section 60(1C) is a specific rule that currently applies to New Zealand-resident underlying suppliers supplying remote services through a marketplace. In this situation, the underlying supplier and marketplace operator may treat the supply as two separate supplies:

- a supply of services from the underlying supplier to the operator; and
- a supply of those services from the operator of the marketplace to the recipient.

An amendment is proposed to section 60(1C) so that this rule also applies in the situation where a GST-registered non-resident underlying supplier makes a supply of remote services or distantly taxable goods to a consumer in New Zealand through a marketplace (that is, so that the non-resident underlying supplier is treated as making a supply to the marketplace operator). This would allow the non-resident underlying supplier to claim input tax deductions for New Zealand GST on expenses incurred in making the supply.

### ***Discounts provided by marketplace operators***

The Bill proposes to clarify the amount of GST that a marketplace operator would be required to return on a supply of remote services or distantly taxable goods that it is treated by section 60C or 60D as the supplier of. The proposed amendment would apply in the situation where the operator provides a discount for a product sold on its marketplace by an underlying supplier to a New Zealand consumer.

The amendment would ensure that the marketplace operator is only required to return GST on the amount that the consumer actually paid for the supply of goods or services (and not on the amount of the discount provided by the marketplace).

### ***Bad debt deduction rule***

There may be situations where an operator of a marketplace may not receive the payment for a supply of distantly taxable goods sold on its marketplace by an underlying supplier (as the payment may be made by the recipient directly to the underlying supplier). In this situation, a marketplace operator that is treated by either of sections 60C or 60D as the supplier of the goods would need to collect the amount of GST that it is required to return on the supply from the underlying supplier.

To provide relief in the situation where a marketplace operator is unable to collect from the underlying supplier the GST that it is required to return, the Bill proposes a special bad debt deduction rule that would apply only to marketplace operators. Under the proposed rule, a marketplace operator would only be able to claim a bad debt deduction in its GST return if it wrote off the full amount of money owed by the underlying supplier in relation to the supply, including the marketplace's sales commission or facilitation fee. A marketplace operator that had claimed a bad debt deduction and later recovered all or some of the debt in a subsequent taxable period would be required to return GST to the extent of the recovery.

### ***Exception to electronic marketplace rule for suppliers that are both resident and non-resident***

The Bill proposes that an operator of a marketplace would be able to use a range of objective proxies to determine if an underlying supplier is a New Zealand resident or a non-resident. Explanation of these methods (contained in proposed new section 60G) is provided in a later section of this Commentary.

In the situation where a non-resident underlying supplier has a branch in New Zealand, there is a possibility that an operator of a marketplace using a method in proposed section 60G may conclude that the underlying supplier is a New Zealand resident, and accordingly not return GST on supplies made by the underlying supplier. A limited exception to section 60C is therefore proposed to deal with this potential issue, so that the marketplace operator's treatment of supplies made by the non-resident underlying supplier is validated in this situation. This is intended to ensure that there is clarity about which party (the electronic marketplace operator or the underlying supplier) has the liability to return GST on the supply.

## **Background**

Requiring an electronic marketplace to register instead of its underlying suppliers may reduce overall compliance costs under the offshore supplier registration system, as this would mean that some non-resident suppliers would not be required to register for GST in New Zealand. It may be the case that without the proposed marketplace rules, a relatively large number of smaller suppliers making supplies to New Zealand consumers exceeding \$60,000 annually would be required to register for GST.

Requiring intermediaries to register for GST in this context has been a relatively recent international development. Australian legislation requires an operator of an "electronic distribution platform" to register for and return GST on supplies of imported services, intangibles and low-value goods. An operator of an electronic distribution platform is required to account for GST on a supply made by a third party when the platform controls any of the key elements of the supply such as delivery, charging or terms and conditions. These proposed rules are modelled on similar rules currently in operation in a number of jurisdictions for imported services and intangibles.

It is likely that many of the electronic marketplaces that would be required to register under the proposed rules will already be registered in Australia. Therefore, to avoid confusion and to promote compliance, the rules proposed are intended to be broadly consistent with the rules in Australia.



## **Detailed analysis**

### ***Definitions of “electronic marketplace” and “underlying supplier”***

A marketplace is a medium that allows consumers and suppliers of goods and services to interact in order to facilitate the sale and purchase of the goods and services. “Electronic marketplaces” refers to virtual marketplaces where consumers and suppliers do not physically interact (typically, online marketplaces).

The proposed definition of “electronic marketplace” requires that:

- the marketplace allows underlying suppliers to make supplies of goods or remote services through the marketplace to customers;
- the marketplace is operated by electronic means, including by a website, internet portal, gateway, store, distribution platform or other similar marketplace; and
- supplies of remote services made through the marketplace must be made by electronic means, but this requirement does not apply to supplies of tangible goods made through the marketplace.

As at present, providers that solely process payments will continue to be specifically excluded from the definition of electronic marketplace under the proposed amendments.

Solely for the purpose of the marketplace rules, the Bill defines an “underlying supplier” as the person that would be the supplier of the goods and services in the absence of the marketplace rules in sections 60C and 60D.

### ***Electronic marketplace rule***

Section 60C currently treats the operator of an electronic marketplace as making a supply in the course or furtherance of a taxable activity if the relevant supply is of remote services supplied by an underlying supplier to a recipient who is a New Zealand resident.

In addition to this existing rule for remote services, the proposed amendments to section 60C would treat the operator of an electronic marketplace as making a supply of distantly taxable goods in the course or furtherance of a taxable activity in certain situations. This would apply when:

- the goods are supplied by a non-resident underlying supplier;
- the operator of the electronic marketplace or the underlying supplier makes, arranges or assists the delivery of the goods to a place in New Zealand; and
- the goods have individual entry values of \$1,000 or less.

This rule would also apply in situations where an electronic marketplace operator has elected to charge GST on goods with an entry value above \$1,000 (discussed in an earlier section of this Commentary), meaning that the operator would be deemed to be the supplier of these high-value goods for GST purposes.

Consistent with the existing rules for remote services, the operator of the electronic marketplace would not be considered to have made the supply if it does not control any of the key elements of the supply, and the liability of the underlying supplier is made clear in the documentation relating to the transaction. Accordingly, under the proposed amendments to section 60C, the non-resident operator of an electronic marketplace would not be deemed to be the supplier if all the following conditions are satisfied:

- the electronic marketplace does not authorise the charge to the recipient, or authorise the delivery of the supply, or directly or indirectly set any of the terms or conditions under which the supply is made;
- the documentation provided to the recipient identifies the supply as made by the underlying supplier and not the operator of the marketplace; and
- the underlying supplier and the operator of the marketplace have agreed in writing that the supplier is liable for GST.

As a result of being treated as making the supply, the operator of the electronic marketplace would be responsible for returning GST. The operator would include these supplies in its turnover for the purposes of determining whether the registration threshold is exceeded and, if it is exceeded, would be liable for the GST. The operator would also make any adjustments arising from the supply, for example, when incorrectly charged GST is refunded to a GST-registered business.

Where multiple electronic marketplaces are liable for GST on a single supply of remote services or of distantly taxable goods, an existing priority rule in section 60C(3) provides that the first operator that authorises a charge or receives payment for the supply is treated as the supplier. If none of the marketplaces involved meet this requirement, the first operator that authorises delivery of the supply would be treated as making the supply.

### *Approved marketplace rule*

Similarly to the rule that applies to electronic marketplaces, existing section 60D allows non-electronic marketplaces (such as a syndicate providing insurance services to New Zealand residents) to register as a marketplace subject to the Commissioner's approval. The operator, and not the underlying supplier, is treated as making the supply in the course or furtherance of a taxable activity.

Amendments to section 60D are proposed so that the rules for approved marketplaces may apply for goods supplied by non-residents, as well as supplies of remote services.

New section 60D(2)(c) sets out that an approved marketplace for goods would be treated as making a supply in the course or furtherance of a taxable activity in circumstances where:

- the Commissioner approves an application made by the operator of the marketplace under subsection (2);
- the goods are supplied by a non-resident underlying supplier;
- the operator of the marketplace or the underlying supplier makes, arranges or assists the delivery of the goods to a place in New Zealand; and
- the goods individually have entry values of \$1,000 or less (if the marketplace operator has not elected to charge GST on high-value goods).

When exercising this discretion to approve a marketplace under section 60D, subsection (3) provides that the Commissioner may take the following into account:

- whether the marketplace is best placed to determine whether the recipient of the supply of goods is a registered person; and
- whether the number of underlying suppliers selling through the marketplace means that return requirements are better satisfied by the marketplace rather than the individual underlying suppliers.

***Residency of underlying suppliers***

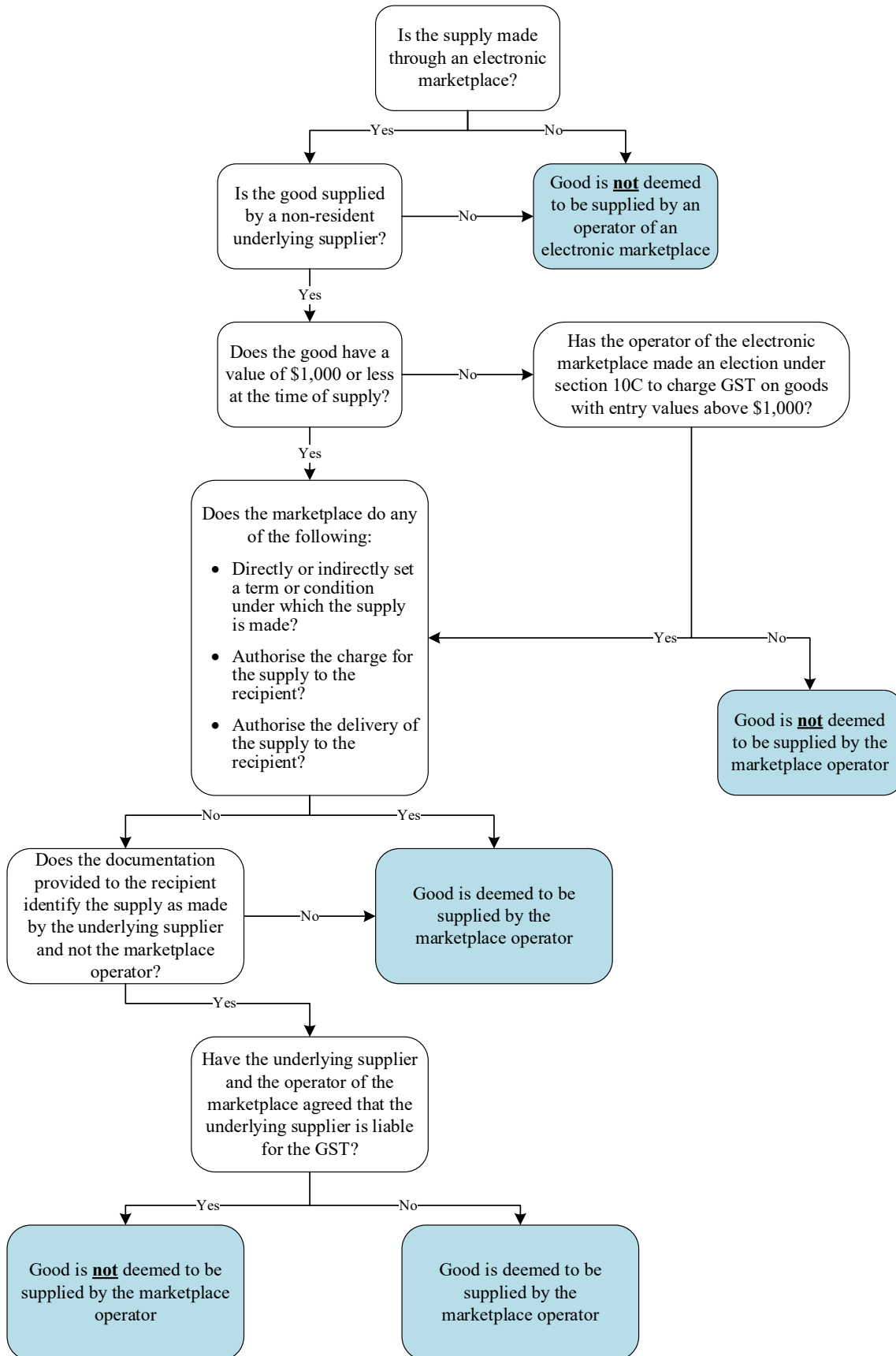
As mentioned above, a marketplace operator would only be treated as making a supply of distantly taxable goods if the underlying supplier of the goods is a non-resident. This is in contrast with the existing marketplace rules for remote services, which (as illustrated in Table 1) apply to supplies made by both resident and non-resident underlying suppliers.

The proposed marketplace rules for goods would not require the marketplace operator to distinguish between goods that are outside New Zealand at the time of supply versus those that are already in New Zealand. This is because all goods that are treated by section 60C or 60D as supplied by a marketplace operator are included in the definition of “distantly taxable goods”, regardless of where the goods are situated at the time of supply.

**Table 1: Existing and proposed application of the marketplace rules to different types of supplies**

		Remote services	Low-value goods in New Zealand at the time of supply	Low-value goods outside New Zealand at the time of supply
<b>Underlying supplier is a non-resident</b>	<i>Existing treatment</i>	Marketplace operator is the supplier for GST purposes.	Underlying supplier is responsible for GST.	Supply not subject to GST.
	<i>Proposed treatment</i>	No change.	Marketplace operator is the supplier for GST purposes.	Marketplace operator is the supplier for GST purposes.
<b>Underlying supplier is a resident</b>	<i>Existing treatment</i>	Marketplace operator is the supplier for GST purposes.	Underlying supplier is responsible for GST.	Underlying supplier is responsible for GST.
	<i>Proposed treatment</i>	No change.	No change.	No change.

**Determining whether the operator of an electronic marketplace is the deemed supplier of  
distantly taxable goods under proposed section 60C**



### ***Repeal of residency rule for marketplace operators***

The Bill proposes to repeal the rule in sections 60C(1)(b) and 60D(1)(b), which restricts the application of the marketplace rules to marketplaces operated by non-residents. This means that the marketplace rules for distantly taxable goods and remote services would apply to marketplaces operated by residents, in addition to those operated by non-residents.

### ***Specific rule for underlying suppliers***

Non-resident suppliers that make supplies of remote services and goods through marketplaces may already be registered for GST under existing rules. It is also possible that some non-residents selling goods through marketplaces may become liable to register in their own right under the proposed rules for distantly taxable goods if they also make non-marketplace supplies (for instance, through their own website or mail order).

Some of these non-resident underlying suppliers may incur New Zealand GST on their inputs for making supplies of remote services and goods. If these suppliers were subject to the general rule under proposed section 60C(2) or proposed section 60D(2), they would not be entitled to make input tax deductions for their expenses in making these supplies, as the operator of the marketplace would have been treated as the supplier for GST purposes. This would mean that GST incurred by the underlying supplier in making these supplies would be unrecoverable.

An amendment to existing section 60(1C) is proposed to treat the supply as two separate supplies – a supply of goods or remote services from the underlying supplier to the operator of the marketplace, and a supply of those same goods or services from the operator to the recipient. The first supply to the marketplace operator would be zero-rated under either existing section 11A(1)(jc) or proposed section 11(1)(jb). This will generally enable the non-resident underlying supplier to recover the GST costs incurred in making the supply.

Another amendment to the wording of section 60(1C) would also mean that the underlying supplier can unilaterally choose to treat the supply as two separate supplies. The current wording of section 60(1C) requires the underlying supplier and the operator of the marketplace to agree to treat the supply as two separate supplies.

#### **Example – remote services**

Games Pty Ltd., an Australian app developer that is registered for GST in New Zealand, contracts with App Store Co., an operator of an app store, to distribute its smartphone games. App Store Co. collects payments from customers and authorises delivery of the app.

App Store Co. is treated as the supplier under proposed section 60C, and therefore is responsible for GST on the supply. If, as a result of proposed section 60C, App Store Co. makes supplies that exceed the registration threshold, it will be required to register and return GST on supplies of remote services that are made through its marketplace to New Zealand-resident consumers.

Even though App Store Co. is treated as the supplier of the app for GST purposes (because of proposed section 60C), under proposed section 60(1C), Games Pty Ltd. can treat its supply of the app as a zero-rated supply to App Store Co. (as a separate supply to the supply that App Store Co. is deemed to make). This will allow Games Pty Ltd. to deduct its GST costs incurred in making supplies of the app through App Store Co.

### **Example – distantly taxable goods**

Page Turners, a US-based book seller that is registered for GST in New Zealand, uses Books Marketplace, an electronic marketplace, to advertise and sell its books to customers in New Zealand. Books Marketplace sets some terms and conditions and collects payments from customers.

Books Marketplace is treated as the supplier under proposed section 60C, and is therefore responsible for GST on the supply. If, as a result of proposed section 60C, Books Marketplace makes supplies that exceed the registration threshold, it will be required to register and return GST on supplies of goods that are made through its marketplace to customers with a delivery address in New Zealand.

Even though Books Marketplace is treated as the supplier, under proposed section 60(1C), Page Turners can treat its supply as a zero-rated supply to Books Marketplace (as a separate supply to the supply that Books Marketplace is deemed to make). This will allow Page Turners to deduct its GST costs incurred in making supplies of books through Books Marketplace.

### ***Discounts provided by marketplace operators***

The Bill also proposes a special valuation rule to deal with the situation where an operator of a marketplace provides discounts for remote services or distantly taxable goods that it is deemed to be the supplier of. The scenario where a marketplace operator provides a discount for a product sold on its marketplace by an underlying supplier is illustrated in the example below.

### **Example – marketplace provides discount for distantly taxable goods sold by underlying supplier**

Trev, a non-resident supplier of sporting goods and accessories based in Australia, sells goods to consumers around the world using the online marketplace A Co.

Mali, a consumer in New Zealand, purchases a rugby league jersey priced at \$50 plus GST if any from Trev on the A Co. platform.

At the online checkout, Mali provides her home address in Auckland for the delivery of the goods. Because the entry value of the jersey is less than \$1,000 (being \$50) and because the delivery address for the supply is in New Zealand, A Co. is deemed to be the supplier of the jersey for GST purposes. This means that the jersey is a distantly taxable good (and therefore the supply of the jersey is subject to GST at the rate of 15%). The GST-inclusive price of the jersey is therefore \$57.50 (\$50 + \$7.50 in GST).

A Co. offers a discount of \$5 on the price of the jersey, which Mali accepts at the checkout before paying for the goods. A Co. pays for the discount, so Trev still receives the GST-exclusive price of \$50 plus \$20 for shipping to New Zealand.

The final price paid by Mali is \$75.50, consisting of:

- \$52.50 for the jersey (\$57.50 less \$5);
- \$20 for shipping to New Zealand; and
- \$3 GST on the shipping charge.

Given that A Co. is treated as the supplier of the jersey for GST purposes, one may expect the total amount of GST that A Co. would be required to return on the supply to be \$9.85 (being  $\frac{3}{23} \times \$52.50 + \$3$ ). However, in the absence of a rule that treats the \$5 discount provided by A Co. as a reduction in the total consideration for the supply, there is a potential argument that A Co. has provided \$5 in third-party consideration for the supply (despite the fact that A Co. is deemed to be the supplier of the goods).

If A Co. is considered to have provided third-party consideration, the amount of GST that A Co. would be required to return on the supply is \$10.50 (\$7.50 + \$3).

To deal with the issue illustrated in the above example, proposed new section 10(7D) provides that where an operator of a marketplace is deemed to make a supply of remote services or distantly taxable goods, the consideration for the supply would not include the amount of a discount that is paid for by the marketplace operator for the recipient of the supply.

This means that the amount of GST that the marketplace operator would be required to return on the supply would be 3/23 of the total GST-inclusive amount paid by the recipient.

### ***Bad debt deduction rule***

An operator of a marketplace may collect GST on a supply it is deemed to make in one of two ways:

- The marketplace operator arranges for the payment from the customer to be split when the payment is processed, with the amount of GST and the marketplace's facilitation fee or commission remitted to the operator and the sale price excluding GST and the amount of the fee or commission on the sale remitted to the underlying supplier of the goods or services.
- Alternatively, the customer may pay the underlying supplier directly, and the marketplace operator collects the GST along with its fee or commission from the underlying supplier.

In the second scenario, the marketplace operator may at times be unable to collect the GST from the underlying supplier. To prevent marketplace operators in this situation from being liable for GST that they are unable to collect, proposed new section 26AA would allow them to claim a bad debt deduction if:

- the underlying supplier fails to pass on the GST paid to them for the supply; and
- the operator of the marketplace has written off as a bad debt all amounts for the supply, including its fee or commission on the sale.

Proposed section 26AA(1) specifies that the rule would apply to a marketplace operator that is treated by section 60C or 60D as making a taxable supply of goods or services if the underlying supplier of the goods is not an associated person, and the marketplace operator:

- charges the underlying supplier a fee for making the supply through the marketplace;
- accounts for output tax on the supply and files a return for the taxable period during which the supply was made;
- has an agreement with the underlying supplier under which the underlying supplier is required to pay, from the consideration the underlying supplier receives from the customer, an amount that includes the GST on the supply that the marketplace operator has accounted for; and
- the marketplace operator writes off as a bad debt the entirety of the amount referred to above (along with the entire amount of the marketplace's fee, if not already included in this amount).

Proposed section 26AA(2) provides that the marketplace operator may make an input tax deduction (or account for a reduction in its output tax, if the marketplace has registered under the simplified “pay only” system, discussed later) equal to the amount of GST charged on the supply.

In the situation where the marketplace operator recovers an amount of the bad debt that was written off in an earlier taxable period, proposed new section 26AA(3) would require the operator to account for an amount of output tax that is a fraction of the amount of the input tax deduction (or output tax reduction) claimed earlier. This fraction would be calculated by dividing the amount recovered by the total amount written off.

**Example – marketplace writes off amount owed by underlying supplier as a bad debt**

Derek, a consumer in New Zealand, purchases a vinyl record listed on the A Co. online marketplace from Retro Audio, a non-resident supplier. The price of the record, including shipping (but excluding GST) is \$40.

At the online checkout, Derek provides an address in New Zealand for the goods to be delivered. Consequently, A Co. is deemed to be the supplier of the vinyl record for GST purposes. The supply of the record is a supply of distantly taxable goods subject to GST at the rate of 15%. The GST-inclusive price of the record is therefore \$46 (\$40 + \$6 in GST).

Instead of paying by a method that would provide A Co. with some control over the processing of the payment (such as by credit card), Derek opts to pay Retro Audio directly by internet banking transfer. A Co. has an agreement with Retro Audio that if a customer pays Retro Audio directly, Retro Audio is required to pay A Co. the amount of GST on the sale, along with A Co.’s commission of five percent on the total sale price. The amount of the debt that Retro Audio owes A Co. is therefore \$8.30 (\$6 in GST, plus commission of  $\$46 \times 5\% = \$2.30$ ).

Retro Audio defaults in paying the debt to A Co, so A Co. writes off the full amount of \$8.30 as a bad debt. A Co. can therefore claim a bad debt deduction of \$6 in its GST return for the amount of the GST on the supply.

If A Co. subsequently recovered any of the debt in a later taxable period, it would be required to return output tax in its GST return for that taxable period, to the extent of the amount of the recovery. For example, if A Co. managed to collect \$4.15 from Retro Audio, the fraction given by section 26AA(3) would be  $4.15 \div 8.30 = \frac{1}{2}$ . A Co. would therefore be required to return \$3 in output tax ( $\frac{1}{2} \times \$6 = \$3$ ).

If, instead of writing off the full amount as a bad debt, A Co. only wrote off a fraction of the amount as a bad debt, A Co. would not be able to claim a bad debt deduction in relation to the supply.

***Exception to electronic marketplace rule for underlying suppliers that are both resident and non-resident***

Applying the proposed marketplace rules for goods to just those supplies of goods made through marketplaces by non-resident underlying suppliers necessitates the inclusion of rules for marketplace operators to determine the residency of their underlying suppliers. Proposed new section 60G (discussed later in this Commentary) sets out a range of objective proxies that marketplace operators would be able to use to determine if an underlying supplier is a New Zealand resident or a non-resident.



The definition of “resident” in section 2(1) of the GST Act treats a person as a resident of New Zealand to the extent that the person carries on a taxable activity or other activity in New Zealand, and has a fixed or permanent place in New Zealand relating to that activity. For example, a non-resident company with a branch in New Zealand that carries on its New Zealand operations through a fixed or permanent place in New Zealand is New Zealand resident for GST purposes, but only to the extent of the activity carried on in New Zealand through its fixed or permanent place.

There are two potential situations that may arise under the proposed marketplace rules in relation to a non-resident company that has a New Zealand branch and which makes supplies of goods to consumers in New Zealand through a marketplace:

- The supply of goods through a marketplace to the customer in New Zealand may be part of the New Zealand branch’s taxable activity (that is, if the New Zealand branch is treated as a separate entity, it would be the person that makes the supplies). In this case there is no problem with the marketplace operator treating the underlying supplier as a resident, because in the context of this sales activity it is in fact a New Zealand resident under the GST Act, and is likely to already be registered for GST in New Zealand.
- The supply of the goods is completely unrelated to the New Zealand branch’s activity (that is, an overseas branch or division of the company makes the supply). Under the proxies set out in proposed new section 60G (which include information that the marketplace operator may have in relation to its underlying suppliers, such as bank details, New Zealand GST registration numbers and physical addresses), it is possible that the marketplace operator may reach the conclusion that the underlying supplier is a New Zealand resident. However, because the underlying supplier in the context of this particular supply is actually a non-resident, section 60C would (in the absence of a specific exception) treat the electronic marketplace operator as the supplier of the goods for GST purposes. This may mean that the underlying supplier of the goods is not the supplier for GST purposes, potentially resulting in zero GST being collected on the supply.

To address the issue in the second scenario, proposed new section 60C(2C) contains a limited exception to the electronic marketplace rule in section 60C. Proposed section 60C(2C) provides that an operator of an electronic marketplace would not be treated as the supplier of goods that are actually supplied by a non-resident underlying supplier if all the following conditions are met:

- the underlying supplier of the goods is a non-resident that has a branch in New Zealand;
- the operator of the marketplace treats the underlying supplier as a New Zealand resident in relation to the supply (meaning that the operator does not return GST on the supply); and
- in treating the underlying supplier as a New Zealand resident, the operator of the marketplace relies on a method for determining the underlying supplier’s residency that is set out in section 60G, or on an alternative method agreed with or prescribed by the Commissioner under section 60G (discussed later).

This would ensure that the liability for the GST would remain with the underlying supplier in this situation, validating the marketplace operator's treatment of the supply if it has determined (based on a section 60G method) that it is not the supplier of the goods for GST purposes.

**Example – non-resident underlying supplier with New Zealand branch treated by marketplace as resident**

Clothes 'N' Stuff Pty Ltd is an Australian-incorporated company that is non-resident for income tax purposes. It carries on activity in New Zealand through a fixed or permanent place, being Clothes 'N' Stuff's retail outlet in Auckland. To the extent of the activity carried on through or related to the Auckland retail outlet, Clothes 'N' Stuff is treated by the GST legislation as a New Zealand resident and accordingly is registered for GST in New Zealand.

Clothes 'N' Stuff also carries on an activity of selling goods to customers in Australia and New Zealand through the A Co. online marketplace. In most cases the goods are shipped directly from a warehouse in Sydney, but in some cases goods sold to a New Zealand customer may instead be sourced from the retail outlet in Auckland in order to provide faster a delivery time.

A Co. has on record a New Zealand GST registration number for Clothes 'N' Stuff, as well as the physical address of the Auckland retail outlet, the fixed landline number for the Auckland retail outlet, and a declaration from Clothes 'N' Stuff that it is a New Zealand resident under the GST Act. On the basis of the information that it holds and in accordance with the requirements in section 60G, A Co. determines that Clothes 'N' Stuff is a New Zealand resident for GST purposes. A Co. therefore does not collect and return GST on Clothes 'N' Stuff's supplies to consumers in New Zealand.

Although Clothes 'N' Stuff is likely to be a non-resident in relation to most of the supplies it makes through the A Co. marketplace (insofar as this sales activity is unrelated to the Auckland retail outlet), the liability for New Zealand GST on any supplies of distantly taxable goods to consumers in New Zealand would remain with Clothes 'N' Stuff. This is because section 60C would not apply to treat A Co. as the supplier of the goods (owing to the exception in section 60C(2C)).

## **REDELIVERERS**

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*(Clauses 5(5), 12(2), 15(2) and 37)*

### **Summary of proposed amendment**

Special rules are proposed to apply when a “redeliverer” brings (or assists in bringing) goods to New Zealand, and neither the actual supplier of the goods nor an operator of a marketplace delivers (or arranges or assists delivery) of the goods to New Zealand. The proposed rules would require the redeliverer to register and return GST on the supply of the goods.

### **Key features**

#### ***Definition of “redeliverer”***

A proposed addition to section 2(1) of the GST Act defines a redeliverer as a person who, under an arrangement with the recipient of the goods, delivers the goods to New Zealand, or arranges or assists the delivery of the goods to New Zealand, and does one or more of the following:

- provides the use of an address outside New Zealand to which the goods are delivered;
- arranges or assists the use of an address outside New Zealand to which the goods are delivered;
- purchases the goods outside New Zealand as an agent of the recipient;
- arranges or assists the purchase of the goods outside New Zealand.

#### ***Redeliverer rule***

Under the proposals, a redeliverer would be treated as making a supply of distantly taxable goods in the course or furtherance of a taxable activity if all the following conditions are satisfied:

- if the redeliverer has not made an election under section 10C to charge GST on goods with entry values above \$1,000, the goods individually have individual entry values of \$1,000 or less;
- no operator of a marketplace is the supplier under section 60C or 60D; and
- the seller or actual supplier of the goods does not deliver, nor arrange or assist the delivery of the goods to New Zealand.

#### ***Priority rule where multiple redeliverers are involved***

The Bill proposes a priority rule to provide certainty about which redeliverer is liable for GST in the situation where multiple redeliverers are involved in bringing distantly taxable goods to New Zealand. The proposed rule sets out that the redeliverer that first enters into an arrangement with the recipient of the goods would be the person that is treated as making the supply. If no such arrangement exists, the first redeliverer to enter into an arrangement with any other person acting on the recipient’s behalf would be treated as the supplier.

### ***Special valuation rule for redeliverers' deemed supplies of goods***

In situations where a redeliverer is deemed to be the supplier of distantly taxable goods, the price paid to the actual supplier will not include New Zealand GST. This means that the redeliverer should return GST on the supply on the basis that the price is GST-exclusive, which requires a special valuation rule for supplies of distantly taxable goods deemed to be made by redeliverers.

Under the proposals, the value of a supply of distantly taxable goods by a redeliverer would be equal to the consideration paid by the recipient for distantly taxable goods, before the addition of GST. This means that the amount of GST to be returned by the redeliverer on the deemed supply of the goods would be 15% of the price paid by the recipient for the goods.

### ***Amendment to zero-rating rules for international transportation services***

The Bill proposes an amendment to ensure that services provided by redeliverers in relation to goods that are deemed to be supplied by the redeliverer will be subject to GST at the rate of 15%, provided that the supply of the goods themselves is also subject to GST at the rate of 15%.

The value of the redeliverer's services would be equal to the consideration for the supply of the services with the addition of GST (meaning that the amount of GST is 3/23 of the GST-inclusive price paid by the recipient).

## **Background**

Redeliverers may be used by consumers when the supplier or marketplace does not offer shipping to New Zealand. Typically, the good is instead shipped to an overseas "hub" or mailbox, from which the redeliverer then ships the good to New Zealand. Since the supplier or marketplace in this situation may not know that the final destination of the good is in New Zealand, it would be unreasonable to require them to charge GST.

Redeliverers would, however, know the final destination of the goods they are "redelivering". They should also know the value of the goods to be redelivered to New Zealand, as the consumer is generally required to provide a value for their parcel as part of the arrangements with the redeliverer for payment and delivery of the goods to New Zealand.

For these reasons, it is proposed that in these situations, redeliverers would be required to register and return GST instead of the actual suppliers or sellers of the goods, if the value of the redeliverer's total supplies in New Zealand (including its deemed supplies under proposed section 60E) exceed the \$60,000 registration threshold. Requiring redeliverers to collect and return GST instead of the actual supplier or a marketplace operator recognises that when consumers engage the services of a redeliverer to "redeliver" their goods to New Zealand, it is the redeliverer who would be best placed to know the location to which the goods are being delivered.

## **Detailed analysis**

### ***Definition of “redeliverer”***

A redeliverer may be a person that provides a “mailbox” service, meaning that they provide the use of an overseas delivery address for consumers purchasing goods from offshore suppliers. These types of redeliverers would receive or collect the goods from the overseas address and deliver the goods to the consumer’s address in New Zealand, or arrange the collection and delivery of the goods to the customer in New Zealand. The proposed definition of “redeliverer” also includes persons that provide personal shopping services to consumers in New Zealand in relation to goods sold by offshore suppliers.

The proposed definition of “redeliverer” requires that the person who is acting as a redeliverer has an arrangement with the recipient of the goods. Under this arrangement, the person either delivers the goods to New Zealand, or arranges or assists the delivery of the goods to New Zealand, and does one or more of the following:

- provides the use of an address outside New Zealand to which the goods are delivered;
- arranges or assists the use of an address outside New Zealand to which the goods are delivered;
- purchases the goods outside New Zealand as an agent of the recipient; or
- arranges or assists the purchase of the goods outside New Zealand.

### ***Redeliverer rule***

Proposed section 60E sets out that a person acting as a redeliverer would be treated as making a supply of distantly taxable goods in the course or furtherance of a taxable activity if all the following conditions are satisfied:

- no operator of an electronic marketplace is the supplier of the goods under section 60C;
- no operator of a non-electronic marketplace is the supplier of the goods under section 60D;
- the actual seller or supplier of the goods does not deliver, nor arrange or assist the delivery of the goods to New Zealand; and
- when the redeliverer is treated as the supplier of the goods, the supply the redeliverer is deemed to make is of distantly taxable goods (meaning that the goods, or some of the goods, have individual entry values of \$1,000 or less, or the redeliverer has made an election under proposed section 10C to charge GST on goods with entry values above \$1,000).

This means that a redeliverer would only be treated as the supplier of the goods for GST purposes if neither the actual supplier, nor an operator of a marketplace, delivers or assists in delivering the goods to New Zealand. If either does deliver or assist in delivering the goods to New Zealand, one of these entities will be responsible for GST on the supply instead of the redeliverer. This is consistent with the policy intent that the redeliverer provisions apply in limited circumstances, where these other entities are unaware that the goods will be sent to New Zealand.

### ***Priority rule where multiple redeliverers are involved***

In some circumstances, more than one person may meet the definition of a redeliverer in relation to a single supply of distantly taxable goods. This would occur when more than one redeliverer is involved in an arrangement to deliver goods to a place in New Zealand. For example, one entity acting as a redeliverer may contract with another entity to purchase the goods as an agent of the consumer.

Proposed new section 60E(2) contains a priority rule to deal with the situation where multiple redeliverers may be liable for GST on a supply of distantly taxable goods to a consumer in New Zealand. The proposed rule sets out that the redeliverer that first enters into an arrangement with the recipient of the goods would be the person that is treated as making the supply. If no such arrangement exists, the first redeliverer to enter into an arrangement with any other person acting on the recipient's behalf would be treated as the supplier and therefore responsible for GST.

### ***Special valuation rule for redeliverers' deemed supplies of goods***

Proposed new section 10(7C) contains a special valuation rule for supplies of goods deemed to be made by redeliverers under section 60E. The rule sets out that the value of a supply of distantly taxable goods by a redeliverer is an amount equal to the consideration paid by the recipient for the goods before the addition of GST.

This rule means that the amount of GST on the supply of goods that the redeliverer would be required to return would be equal to 15% of the price paid by the recipient to the supplier for the goods. This recognises that the price charged by the supplier of the goods did not include GST.

### ***Amendment to zero-rating rules for international transportation services***

Under the existing rules in section 11A(1) of the GST Act, the supply of international transportation and associated insurance services is zero-rated, as are services that are supplied directly in connection with moveable personal property situated outside New Zealand at the time the services are performed. This generally means that services provided by redeliverers (which would largely consist of international transportation and handling, storage and logistics provided in relation to goods that are located offshore, or the arranging or facilitation thereof) are effectively not taxed, as the supply of these services would typically be subject to GST at the rate of 0% under existing rules.

However, proposed new section 11A(1D) sets out that paragraphs (a), (c), (cb), (d) and (f) in section 11A(1) do not apply to a supply of services provided by a GST-registered redeliverer if those services are provided in relation to distantly taxable goods that section 60E deems the redeliverer to be the supplier of. This means that the redeliverer's services would be taxed in the same way as the goods the redeliverer brings or assists in bringing to New Zealand (as any transportation or associated facilitation services provided by the redeliverer in relation to a supply of distantly taxable goods being delivered to an address in New Zealand would also be taxed at the rate of 15%).

The value of a supply of distantly taxable goods and related transport and facilitation services by a redeliverer would therefore be equal to:

- the consideration paid by the recipient for the distantly taxable goods before the addition of GST (meaning that the amount of GST on the deemed supply of the goods is 15% of the price paid by the recipient for the goods); plus
- the consideration for the supply of the redeliverer's services with the addition of GST (meaning that the amount of GST on the supply of the redeliverer's services is 3/23 of the GST-inclusive price paid by the recipient).

#### **Example – redeliverer providing a mailbox service**

Matt, a consumer in New Zealand, contracts a redeliverer called C Co. to pick up a laptop bag from a UK address that C Co. provided to Matt and deliver it to Matt's home address in Wellington. Matt paid \$40 for the bag including the amount charged by the supplier for shipping from its retail store in London to C Co.'s UK address.

When arranging for the goods to be redelivered to Matt's Wellington address, Matt tells C Co. that he paid \$40 for the goods. C Co. charges \$15 plus GST if any for its services as redeliverer in bringing the goods to New Zealand.

As the entry value of the laptop bag is less than \$1,000 (being \$40), the laptop bag is a distantly taxable good. C Co. charges Matt \$23.25, made up of:

- \$6 in GST, which is 15% of the \$40 Matt paid the UK supplier for the goods;
- \$15 for C Co.'s redelivery services; and
- \$2.25 in GST, which is 15% of C Co.'s GST-exclusive fee for its services.

C Co. returns \$8.25 in GST to Inland Revenue when it files its GST return.

#### **Example – redeliverer providing a personal shopping service**

Marie is a redeliverer who regularly purchases clothes as an agent for Carolyn. Marie facilitates the delivery of the goods into New Zealand by arranging for a freight company to deliver the clothes to Carolyn's address in Oamaru. The USA suppliers that sell the clothes have no role in bringing the goods to New Zealand.

Carolyn paid \$720 for a dress that Marie purchased as her agent. This included \$20 for the cost of shipping from the USA stores to Marie's address overseas. Marie charged Carolyn \$40 (exclusive of GST) for her services as a redeliverer in bringing the dress to New Zealand.

As the entry value of the dress is less than \$1,000 (being \$720), the dress is a distantly taxable good. Marie is registered for GST and determines the supply is a taxable supply.

Marie charges Carolyn \$874, made up of:

- \$720 to reimburse Marie for the purchase of the dress (including the \$20 charge for delivery to Marie's USA address);
- \$108 in GST, which is 15% of the \$720 Carolyn paid for the dress;
- \$40 for Marie's facilitation and delivery services; and
- \$6 in GST, which is 15% of Marie's \$40 GST-exclusive fee for her services.

Marie returns \$114 in GST to Inland Revenue when she files her GST return.

## ADMINISTERING THE OFFSHORE SUPPLIER REGISTRATION SYSTEM

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*(Clauses 7(3) to (9), 18, 32, 37, 38(2) and 39)*

### **Summary of proposed amendment**

The proposed amendments contain several features to reduce costs for offshore suppliers, marketplaces and redeliverers in complying with their obligations under the rules. These measures will be complemented by simplified registration and return filing processes that Inland Revenue is developing for these customers. Many of these amendments are extensions of the existing rules applying to supplies of remote services.

An amendment proposes that the Commissioner would have the discretion to require a person who has knowingly provided altered, false or misleading information to register for GST and to repay the GST that should have been charged, when their behaviour is repeated or when a substantial amount of GST is involved.

### **Key features**

#### ***Misrepresentations by recipients of distantly taxable goods***

The Bill proposes amendments to sections 5(27) and 51B(7) that will extend a discretion for the Commissioner to require a person to register and pay GST that should have been charged on a supply of distantly taxable goods. This would apply when the person has knowingly provided incorrect information that leads to GST not being charged on a supply, and this behaviour is repeated or a substantial amount of GST is involved.

#### ***Taxable periods***

Non-resident suppliers of distantly taxable goods would have calendar quarterly taxable periods. Proposed section 15(7) provides that from 1 October 2019 to 31 March 2020, these suppliers would by default have a taxable period of six months, with the option to elect to have quarterly taxable periods right from the start of the rules.

#### ***Simplified GST returns***

Simplified “pay only” GST returns will be available for use by non-resident suppliers of distantly taxable goods. However, non-resident suppliers that claim input tax deductions for any New Zealand GST costs will be required to file full GST returns.

#### ***Expressing amounts in a foreign currency***

Amendments to section 77 are proposed that would allow a supplier of distantly taxable goods that are subject to the new rules to choose to express the amount of consideration for their supplies in a foreign currency at the time of supply, with the amounts being converted into New Zealand currency at a later date.



### ***Holding records outside New Zealand and in a language other than English***

Section 75(3F) would be amended to provide an automatic exception for non-resident suppliers that only supply remote services or distantly taxable goods from the requirement to apply to the Commissioner for authorisation to keep and retain records in a language other than English or at a place outside New Zealand.

### ***Exception from the bank account requirement***

Existing section 24BA(1B) of the Tax Administration Act 1994 would provide an exception for non-resident suppliers of distantly taxable goods to the requirement for an offshore person to have a fully functional New Zealand bank account to obtain an IRD number. No amendments to section 24BA(1B) are required to achieve this.

### ***Methods for marketplace operators and redeliverers to determine GST treatment of supplies***

Proposed sections 60C and 60E would deem operators of electronic marketplaces and redeliverers to be the suppliers of goods that are actually supplied by third parties in certain circumstances. This means electronic marketplace operators and redeliverers would need to rely on information provided by underlying suppliers or by customers to determine the GST treatment of these supplies.

The Bill proposes some default rules (based on objective proxies) that electronic marketplace operators and redeliverers could use to determine how much GST they are required to return on supplies of goods to New Zealand consumers that are actually made by third parties. The Bill also proposes to provide the Commissioner with discretion to prescribe or agree to alternative methods for electronic marketplace operators and redeliverers to make conclusions relevant to whether they are treated as making a supply of goods under section 60C or 60E, and/or the amount of GST payable.

These default rules and the proposed Commissioner discretion (contained in proposed new section 60G) would reduce compliance costs for electronic marketplace operators and redeliverers in situations where they are unable to strictly apply the proposed rules (owing to insufficient commercially available information), by allowing the person to use other relevant information that is commercially available.

### ***Discretion to register underlying supplier or consumer for GST***

Marketplace operators and redeliverers using a default method under proposed new section 60G or an alternative method under a “safe harbour” agreement would be protected from any additional GST liability in situations where they have (in good faith and consistent with the method set out in the legislation or in an agreement with the Commissioner) relied on incorrect or misleading information provided by another party. In these situations, the Commissioner would have discretion to register the person who provided the incorrect or misleading information (the underlying supplier or the consumer) and require them to pay the underpaid GST if the behaviour is repeated or the amount underpaid is substantial.

## Detailed analysis

### *Misrepresentations by recipients of remote services*

Existing sections 5(27) and 51B(7) provide the Commissioner with discretion to require a person to register and pay GST that should have been charged on a supply of remote services, when:

- the person has knowingly provided information that is altered, false or misleading, which leads to a supply being treated as being zero-rated or as not being supplied in New Zealand; and
- the person has repeatedly and knowingly provided altered, false or misleading information, or the amount of GST that was not charged is substantial.

The Bill proposes to extend sections 5(27) and 51B(7) to also apply to supplies of distantly taxable goods.

The existing “knowledge offences” are also expected to apply when a person deliberately supplies incorrect information for the purpose of avoiding GST by misrepresenting themselves as a registered business (section 143A of the Tax Administration Act 1994). A person convicted of a knowledge offence is liable for a fine of up to \$25,000 for a first-time offence, or \$50,000 for repeated offences.

#### **Example – consumer knowingly provides incorrect information**

Luke purchases a number of low-value goods online from an overseas supplier, including electronics and clothing. To avoid paying GST, Luke has provided a false GST registration number.

The Commissioner of Inland Revenue exercises her discretion to register Luke from the time the goods were supplied and requires him to repay the GST that was not charged, plus penalties and interest.

### *Taxable periods*

Non-resident suppliers of distantly taxable goods that would be subject to the proposed rules would have quarterly taxable periods. This is consistent with the existing rules applying to non-resident suppliers of remote services.

Proposed section 15(7) sets out that non-resident suppliers of distantly taxable goods would, by default, have a taxable period of six months from 1 October 2019 to 31 March 2020, unless the supplier elects to file on a quarterly basis for the first six months of the rules. The supplier would be able to make this election by notifying the Commissioner of the election or by filing a return for the 1 October 2019 to 31 December 2019 quarter by the due date for that return.

The six-month taxable period would only apply to non-resident suppliers that are required to register as a result of the new rules. Non-resident suppliers of distantly taxable goods that also supply remote services or other taxable supplies would not be able to elect to have a taxable period of six months.

From 1 April 2020, all non-resident suppliers that only make supplies of distantly taxable goods and/or remote services would be required to have quarterly taxable periods (see the proposed amendment to section 15(6) in clause 18(1) of the Bill).

### ***Simplified GST returns***

Non-resident suppliers of distantly taxable goods would be able to file pay-only GST returns. These returns are simplified and only include fields relevant to returning GST such as the amount of supplies to customers in New Zealand and the GST required to be paid.

Non-resident suppliers of distantly taxable goods that want to claim New Zealand GST on any expenses they have incurred in making taxable supplies would need to file a full GST return.

### ***Expressing amounts in a foreign currency***

Existing section 77(1) requires that all amounts are expressed in New Zealand currency at the time of supply. This means that if a supply is paid for in a foreign currency, the value of the supply must be expressed as the amount of foreign currency converted to New Zealand currency at the exchange rate applying at the time of supply.

However, section 77(2) provides non-resident suppliers of remote services with the option of expressing amounts at the time of supply in a foreign currency. Suppliers of remote services that opt to do this are required under section 77(3) to elect to convert the foreign currency amounts into New Zealand dollars on either:

- the last day of the relevant taxable period;
- the date the supplier files their return for the relevant period (or the due date for filing if the return was filed past the due date); or
- another date agreed between the supplier and the Commissioner.

Once a supplier has made an election under section 77(3), section 77(4) locks them into this election for two years.

The Bill proposes to extend sections 77(2), (3) and (4) to also apply to non-resident suppliers of distantly taxable goods.

### ***Holding records outside New Zealand and in a language other than English***

Section 75(3F) provides an automatic exception to the requirement to keep and retain records in English or at a place in New Zealand for non-resident suppliers of remote services. The Bill proposes an amendment to section 75(3F) so that it also applies to non-resident suppliers of distantly taxable goods. The requirement to keep and retain records in English and at a place in New Zealand would therefore not apply to a non-resident whose only supplies are remote services and/or distantly taxable goods.

### ***Exception from the bank account requirement***

The Tax Administration Act 1994 generally requires an offshore person to have a fully functional New Zealand bank account in order to obtain an IRD number. This is to ensure that an offshore person has first been subjected to New Zealand's anti-money laundering and Countering Financing of Terrorism rules.

However, existing section 24BA(1B) of the Tax Administration Act provides an exception to this requirement for a non-resident supplier who requires an IRD number solely because they are a non-resident supplier of goods and services. No amendments are required to section 24BA(1B) to enable the section to also apply to non-resident suppliers of distantly taxable goods.

### ***Methods for marketplace operators and redeliverers to determine GST treatment of supplies***

Proposed sections 60C and 60E would deem operators of electronic marketplaces and redeliverers to be the suppliers of goods that are actually supplied by third parties, but only if the goods are destined for a delivery address in New Zealand and, in the case of marketplace operators specifically, the underlying supplier of the goods is a non-resident.

In some situations, an electronic marketplace operator or redeliverer may not have the precise information that is required to determine the GST treatment of a supply of goods, as this information may only be available to the underlying supplier and/or the recipient of the supply. In these situations, the electronic marketplace operator or redeliverer would need to rely on information collected from the underlying supplier or the consumer to determine the GST treatment of these supplies.

Proposed new section 60G(2), (3), (4) and (5) sets out a range of objective proxies that redeliverers and operators of electronic marketplaces would be able to use to determine if they are the supplier of distantly taxable goods under section 60C, and/or the amount of GST required to be returned on a supply of distantly taxable goods. These proxies (which are all based on information that may be commercially available to redeliverers or operators of electronic marketplaces) are explained below.

#### *Electronic marketplaces – proxies for determining residency of underlying suppliers*

An operator of an electronic marketplace that does not know the residency of an underlying supplier would be required under proposed section 60G(2)(a) and (5) to treat the underlying supplier as a New Zealand resident if the marketplace operator has any of the following:

- information that the underlying supplier is a company that is incorporated in New Zealand or has its centre of management in New Zealand (see section 60G(2)(a)(i);
- a New Zealand business number for the underlying supplier (see section 60G(2)(a)(ii);  
or
- a declaration from the underlying supplier that it is a New Zealand resident, along with at least two of any of the following items of information that support the conclusion that the underlying supplier is a New Zealand resident (see section 60G(2)(a)(iii) and (5):

- an address of a physical location for the underlying supplier, such as a mailing or billing address;
- a New Zealand GST registration number for the underlying supplier;
- bank details (including the account the underlying supplier uses for making payments, or the billing address held by the bank, or the account to which the marketplace operator makes payments of amounts owed to the underlying supplier);
- the internet protocol (IP) address of the device used by the underlying supplier or another geolocation method;
- the mobile country code of the international mobile subscriber identity stored on the subscriber identity module (SIM) card used by the underlying supplier;
- the location of the underlying supplier’s fixed land line; or
- other commercially relevant information.

Proposed section 60(2)(b) requires the marketplace operator to treat the underlying supplier as a non-resident if a conclusion that the underlying supplier is a New Zealand resident is not supported by any of the three proxies outlined above.

In other words, unless at least one of the three proxies described above supports the conclusion that an underlying supplier is a resident, the operator of the electronic marketplace would be required to presume that the underlying supplier is a non-resident.

*Electronic marketplaces – proxies for determining if delivery address is in New Zealand*

While it is expected that operators of electronic marketplaces would generally have information about the delivery address for a supply of goods, there may be some instances where the recipient of the goods does not provide the delivery address through the marketplace but instead communicates with the underlying supplier through another medium. In this situation, the best that an operator of an electronic marketplace may be able to do is to rely on proxies for the country or territory that the recipient’s delivery address is most likely to be in, based on the information that it does have. An operator of an electronic marketplace in this situation would be able to use objective proxies to determine whether the delivery address is most likely to be in New Zealand.

Under proposed section 60G(3) and (5), an electronic marketplace operator that does not know the address to which the goods are to be delivered would be required to determine whether a supply of goods is made to the recipient at a place in New Zealand on the basis of two non-conflicting pieces of evidence (similar to the rule in proposed section 60G(2)(a)(iii) for determining the residency of an underlying supplier and the existing rule in section 8B(2) for remote services).

Proposed section 60G(5) provides a list of indicators that can be used for these purposes:

- an address of a physical location for the recipient, such as a mailing or billing address;
- bank details (including the account the recipient uses for making payments, or the billing address held by the bank, or the account to which the marketplace operator makes payments of amounts owed to the recipient, if applicable);
- the internet protocol (IP) address of the device used by the recipient or another geolocation method;

- the mobile country code of the international mobile subscriber identity stored on the SIM card used by the recipient;
- the location of the recipient's fixed land line;
- other commercially relevant information.

The marketplace operator would be able to use one or more pieces of other commercially relevant information to determine whether a person is usually located in New Zealand, rather than using the specific indicators listed. This information might include the recipient's trading history (such as a previous billing address) or the product purchased if it is linked to a geographic location (for example, some vouchers may only be used in a particular country). Information provided by a third party, such as by a payment service provider, could also be used if it is commercially relevant.

Under proposed section 60G(3)(a)(ii), if the marketplace operator has more than one set of evidence that meets this test, where one set supports the conclusion that the recipient is usually located in New Zealand and the other supports the opposite conclusion, the marketplace operator is required to choose the more reliable set of evidence. Which specific items of evidence are considered to be more reliable will depend on the circumstances.

#### *Redeliverers – default method for determining entry value of goods*

Proposed section 60G(4) contains a default rule for redeliverers to determine the entry value of goods that they bring or assist in bringing to New Zealand. The proposed default rule would apply to a redeliverer who is not responsible for the purchase of goods that it brings or assists in bringing to New Zealand in its capacity as a redeliverer. This proposed rule would require the redeliverer to:

- prior to the delivery of the goods to a place in New Zealand, obtain a declaration from the recipient of the amount paid for the goods; and
- obtain confirmation of the amount paid by the recipient for the goods from the seller of the goods.

The second requirement above would not require the redeliverer to have any interaction with the seller or actual supplier of the goods. If the actual supplier has included an invoice in the package in which the goods have been shipped to the redeliverer, checking the amount of consideration shown on the invoice against the amount declared by the recipient would be sufficient to satisfy the second requirement.

#### *Commissioner discretion to agree or prescribe alternative methods*

In some instances, a redeliverer or an operator of an electronic marketplace may not have sufficient commercially available information to apply the default methods described above, or another method that is not covered by the default rules may be more reliable. For additional flexibility, proposed new section 60G(6) allows the Commissioner of Inland Revenue to prescribe or agree to methods for marketplace operators and redeliverers to make conclusions relevant to whether they are treated by section 60C or 60E as making a supply of distantly taxable goods in the course or furtherance of a taxable activity, and/or the amount of GST payable.

Proposed section 60G(7) allows the Commissioner to take the following factors into account when exercising the discretion:

- Commercially relevant information that is available to the marketplace operator or redeliverer and the reliability of this information.
- Compliance costs of the marketplace operator or redeliverer in complying with the requirements of the default method.
- The existing mechanisms the marketplace operator or redeliverer has to prevent and address situations where incorrect information is provided.

*Liability for GST if person has relied on a section 60G method*

Under proposed new section 60F, a marketplace operator or redeliverer that has relied on a default method set out in proposed section 60G (or that has a safe harbour agreement with the Commissioner under section 60G(6)), would be prevented from being held liable for GST that should have been returned if they have underpaid GST to Inland Revenue solely as a result of relying on incorrect or misleading information provided by another party.

Proposed section 60F applies when a redeliverer or an operator of an electronic marketplace makes a return of a deficient amount of output tax for a taxable period as a consequence of relying on inaccurate, incomplete or misleading information provided by the recipient of a supply of goods or by the seller or underlying supplier of the goods. In this situation, proposed section 60F(2) provides that the electronic marketplace operator or redeliverer has a reduction in its total output tax allocated to the relevant taxable period that is equal to the amount of the deficiency, provided that the requirements of section 60G are met.

This means that in the situation where the electronic marketplace operator or redeliverer has correctly relied on a method that is prescribed in the legislation or agreed with the Commissioner and discovers there is a shortfall in the amount of output tax returned, the person would not be liable to account for the output tax shortfall.

**Example – agreed method for determining residency of underlying suppliers**

A Co. is a marketplace operator, whose underlying suppliers may be resident in New Zealand or in other countries. A Co. agrees with the Commissioner on the method it will use to determine the residency of underlying suppliers, based on the information that is commercially available to it.

As part of the agreement, A Co. has governance mechanisms to prevent mistakes, which include:

- deploying technology to detect when underlying suppliers provide incorrect information relevant to their residency;
- educating underlying suppliers on the consequences of providing incorrect information (which include tax penalties that may apply);
- taking actions to remove the underlying supplier from its marketplace where incorrect information has been provided, if necessary; and
- in agreed circumstances where a significant amount of tax is at stake, providing information to the Commissioner about underlying suppliers that have provided incorrect information, to allow the Commissioner to use her powers to collect GST from the underlying supplier.

This agreement means that A Co. has certainty that it can rely on certain information to support conclusions that it is not responsible for GST on a supply because the underlying supplier is a New Zealand resident. If it is later discovered that the underlying supplier is not a New Zealand resident, A Co. will not be exposed to additional GST liability (as the amount of the output tax reduction given under section 60F(2) would offset the amount of output tax that should have been returned).

### ***Discretion to register underlying supplier or consumer for GST***

Proposed sections 5(27)(b)(iii), 5(28), 51B(7) and 51B(8) would provide the Commissioner with discretion to register an underlying supplier or consumer and require them to pay the GST shortfall. Similar to existing sections 5(27) and 51B(7), the Commissioner would only be able to exercise the discretion in situations where:

- either the underlying supplier or consumer provides altered, false or misleading information which has resulted in GST being underpaid; and
- the amount of GST is substantial or the behaviour is repeated.

However, unlike section 5(27), proposed new section 5(28) does not require the incorrect information to have been provided for the purposes of avoiding GST applying to the supply in the situation where an underlying supplier has provided altered, false or misleading information to an electronic marketplace operator. This is because the underlying supplier's intention may be difficult to establish in practice.

In cases where the discretion is exercised by the Commissioner, proposed section 5(27)(b)(iii) and (28) set out that the consumer or underlying supplier would be treated as making a supply charged with GST at 15%. Proposed section 51B(7) or (8) treats the person as being registered from the date on which the first supply the discretion is exercised for is made.

This would ensure the Commissioner has the ability to collect unpaid GST in situations where the marketplace operator or redeliverer has correctly relied on a default or prescribed method or is protected by a safe harbour agreement. However, the discretion to require the underlying supplier or consumer to pay the GST shortfall would not apply if the electronic marketplace operator or redeliverer has not used a default method set out in section 60G or a method agreed with or prescribed by the Commissioner. This is intended to ensure there is a clear hierarchy where the marketplace operator or redeliverer is the supplier for GST purposes, and therefore ensure the person has an incentive to take reasonable precautions to prevent an incorrect GST treatment from arising.



## VOUCHERS

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### *(Clause 7(1) and (2))*

#### **Summary of proposed amendment**

An amendment is proposed to provide suppliers of face value vouchers (that may be redeemed for remote services or distantly taxable goods) with the option of treating the supply as arising on the redemption of the voucher. Another proposed amendment clarifies that if GST applies on the redemption of a voucher for goods and services, the party redeeming the voucher for goods and services is the party that is responsible for returning the GST.

#### **Key features**

Paragraph (a) is inserted into section 5(11G) to enable a supplier of a token, stamp or voucher with a face value to treat the supply of goods and services that the token, stamp or voucher is redeemed for as the relevant supply for GST purposes if the goods and services are remote services or distantly taxable goods. This means that the seller of a face value voucher would have the option of treating GST as applying on the redemption of the voucher, if the voucher is (or could be) redeemed for remote services or distantly taxable goods. This option to treat the supply as arising on redemption would apply regardless of whether the issuer or seller of the voucher is a different person to the supplier of the goods and services that the voucher is redeemed for.

Paragraph (b) of the amended section 5(11G) sets out the current rule that when a supply of goods and services that a face value voucher is redeemed for is not of remote services or distantly taxable goods, the seller of the voucher may treat GST as applying on the redemption of the voucher if all of the following conditions apply:

- It is not practical to treat the issue or sale of the voucher as a supply of goods and services.
- The supplier of the goods and services and the issuer or seller of the voucher are, or could be, different persons.
- The issuer and the supplier of the goods and services, or the seller of the voucher and the supplier agree that GST is payable on redemption of the voucher, or are parties to an agreement to that effect.

An amendment to the introductory wording of section 5(11G) clarifies that if GST is payable on the redemption of a voucher, the party redeeming the voucher for goods and services is liable for the GST.

## **Background**

The GST Act contains special rules for vouchers, tokens and stamps. The default rule is that GST applies on the issue of a voucher (the issue basis). However, a significant exception provides the option for GST to apply on the redemption of a voucher (the redemption basis) if the voucher has a face value, and the issuer of the voucher and the supplier of the goods and services that it is redeemed for are separate persons and agree to use the redemption basis.

Since the introduction of the GST rules for remote services, the GST treatment of vouchers in the cross-border context has not been clear. This problem would be exacerbated by extending the current voucher rules to vouchers that can be used for purchasing distantly taxable goods. It is possible that a New Zealand-resident consumer may use this type of voucher to purchase goods for delivery in another country, or in limited cases, goods that are over the \$1,000 threshold, in which case New Zealand GST should not apply under the distantly taxable goods regime.

While the redemption basis can be used when the issuer and redeemer of the voucher is not the same person, the issue basis is the only option if the issuer and redeemer is (or is treated as, such as in the case of an electronic marketplace) the same person. Therefore, the redemption basis ought to be able to be used for vouchers that can be redeemed for any remote services or distantly taxable goods.

Further, in situations involving vouchers that can be redeemed for either domestic or cross-border supplies, where there are more than two parties involved (that is, where the issuer, seller and redeemer of the voucher are different persons), the GST legislation is unclear as to which party has the liability to return the GST. In line with common practice, this should be the party redeeming the voucher.

## AGENCY RULE

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### *(Clause 34(1))*

#### **Summary of proposed amendment**

The bill proposes to extend the scope of an existing agency rule to provide agents acting for non-resident suppliers of distantly taxable goods the ability to agree with the supplier to treat the agent (and not the principal) as making the supply.

#### **Key features**

An existing agency rule in section 60(1A) and (1AB) allows New Zealand-resident agents acting for non-resident suppliers that supply remote services to New Zealand-resident consumers to agree with the supplier to treat the agent (and not the principal) as making the supply in the course and furtherance of a taxable activity carried on by them.

The bill proposes to extend the scope of the existing rule so that New Zealand-resident agents acting for non-resident suppliers of distantly taxable goods may agree with the supplier to treat the agent as making the supply in the course or furtherance of a taxable activity.

If this option is exercised, the agent would be required to register and return GST on the supplies of distantly taxable goods. Since the agent is a New Zealand resident, they would be treated as any other resident supplier of goods and services and, therefore, would be required to return GST on both supplies to New Zealand consumers and GST-registered businesses.



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# Ring-fencing

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## **RING-FENCING RESIDENTIAL PROPERTY DEDUCTIONS**

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*(Clauses 49 and 65)*

### **Summary of proposed amendment**

The proposed rules in the Bill are intended to ensure that investors will no longer be able to deduct expenditure relating to their loss-making residential investment properties from their other income (for example, salary or wages, or business income), to reduce their tax liability. This will be done by allocating deductions for residential land to the next income year, to the extent those deductions exceed income from residential land.

### **Application date**

The rules are proposed to apply in full from the start of the 2019–20 income year.

### **Key features**

The key features of the proposed new rules are as follows:

- The rules are proposed to apply to “residential land”, using the same definition of “residential land” that already exists for the bright-line test. However, the rules would not apply to the taxpayer’s main home; property subject to the mixed-use asset rules; property that will be taxed on sale; property owned by widely-held companies; or certain employee accommodation.
- The default position will be that the rules apply on a portfolio basis, meaning that investors would be able to offset deductions for one residential property against income from other properties – essentially calculating their overall profit or loss across their portfolio. However, taxpayers will be able to elect to apply the rules on a property-by-property basis.
- Ring-fenced residential property deductions will be able to be offset against residential rental income from future years, and income on the sale of residential land, to the extent of reducing the taxable gain (after all other deductions) on the sale to nil. Any remaining unused deductions will generally continue to be ring-fenced. In some situations where residential properties end up being taxed on sale, remaining unused deductions may be released, so they can be offset against other income.
- A rule is proposed to prevent interposed entities being used to circumvent the deduction ring-fencing rules. This rule would apply where someone has borrowed to acquire an interest in an entity, and in a particular income year over fifty percent of the entity’s assets are residential properties.

## **Background**

Under current New Zealand tax settings, tax is applied on a person's net income. Deductions that relate to particular activities or investments are not generally ring-fenced. This means there is generally no restriction on deductions for a loss-making activity or investment reducing a person's net income and therefore tax liability (although there are some exceptions to this general treatment).

While rental housing is not formally tax favoured, there is an argument that it may be under-taxed given that tax-free capital gains are often realised when rental properties are sold. The fact that rental property investments are often persistently loss-making indicates that expected capital gains are an important motivation for many investors purchasing rental property.

While interest and other expenses are fully deductible, not all of the economic income generated from rental housing is subject to tax. There is therefore an argument that, to the extent deductible expenses in the long-term exceed income from rents, those expenses in fact relate to the untaxed gain on sale, so should not be deductible unless the gain is also taxed. Currently investors (particularly highly-g geared investors) have part of the cost of servicing their mortgages subsidised by the reduced tax on their other income sources, helping them to outbid owner-occupiers for properties.

The proposed rules ring-fence deductions from residential properties to the extent they exceed residential property income (including income on disposal). This effectively means that investors will no longer be able to offset residential property losses against their other income (for example, salary or wages, or business income), to reduce their tax liability.

## **Detailed analysis**

### ***Property subject to the rules***

It is proposed that the deduction ring-fencing rules apply to "residential land", using the same definition of "residential land" that already exists for the bright-line test.

"Residential land" means:

- land that has a dwelling on it;
- land for which there is an arrangement to build a dwelling on it; or
- bare land that may have a dwelling built on it under the relevant operative district plan rules.

"Residential land" does not include:

- farmland; or
- land used predominantly as business premises.



However, some land that would otherwise fall within the definition of “residential land” for the purposes of the bright-line test would be excluded from the scope of the deduction ring-fencing rules.

#### *Main home*

The focus of the proposed rules is on loss-making rental properties, so it is proposed that a taxpayer’s main home be specifically excluded from the scope of the rules.

The concept of a “main home” in proposed section DB 18AE is the same as for the purposes of the bright-line test. This would mean that a person can have only one main home, and that to qualify for the exclusion the property has to be used predominantly as the person’s main home. If a person has more than one house, like with the bright-line test, their main home is the property they have the greatest connection with. Under the ring-fencing rules, a property would qualify as a person’s main home for a particular income year if it was used predominantly as their main home for most of that year.

A significant number of family homes in New Zealand are owned by family trusts. The “main home” exclusion therefore ensures that a home owned by a trust can be regarded as a main home. Like with the bright-line rules, it is proposed that a dwelling owned by a trust only be considered a main home (so not subject to the deduction ring-fencing rules) if it is the main home for a beneficiary of the trust, provided that a principal settlor of the trust does not have a different main home. This restriction would ensure that trust ownership cannot be used to claim multiple properties as main homes, and so not subject to the loss ring-fencing rules.

#### *Mixed-use assets*

The existing definition of “residential land” includes holiday houses that are sometimes used privately and sometimes rented out. Many such properties would be subject to the mixed-use asset rules.

The mixed-use asset rules provide for the apportionment of expenditure. Notwithstanding the way expenditure is apportioned under those rules, a mixed-use asset can still be loss-making. This is more likely to occur when the income-earning use of the asset is low. Therefore, the mixed-use assets rules quarantine (or ring-fence) deductions in excess of income from a mixed-use asset where the income-earning use of the asset is low. Under the quarantining rules, a person who makes a loss from a mixed-use asset is not able to offset their excess deductions against other income in the current year, but can take those deductions against any future profits from the asset. However, a person who makes perpetual losses from an asset will never have future profits to offset the excess deductions against, and will therefore not be able to utilise them.

Property subject to the mixed-use asset rules is scoped out of the proposed ring-fencing rules, because the quarantining rules for mixed-use asset rules will cover most (if not all) loss-making mixed-use assets.

### *Overseas property*

The existing definition of “residential land” is not limited to land in New Zealand – it extends to overseas land. It is proposed that the same approach be taken for the ring-fencing rules. This is because it would not be equitable for losses from overseas residential rental investments to be able to be offset against income in New Zealand, but losses from domestic residential rental investments not to be.

### *Property that will be taxed on sale*

The proposed rules will not apply to land that is identified to Inland Revenue as being taxable on sale. This would include land held in dealing, development, subdivision, and building businesses, and land that was bought with the intention of resale.

Where land will be taxed on sale, there is not the same concern about some of the deductible expenses relating to untaxed gains, as all of the economic income from the investment will be taxed.

Section DB 18AF proposes that only land that will definitely be taxed on sale will be excluded, not land that may be taxed on sale if certain contingencies occur (for example, being sold within a particular time period – such as under the bright-line test).

The exclusion for land that will be taxable on sale will be available if either:

- the taxpayer is notifying the Commissioner of their rental income and expenditure for that property on a property-by-property basis; or
- they are notifying the Commissioner of their rental income and expenditure on a portfolio basis and all of the properties within the portfolio are on revenue account.

In both of those situations, the deductible expenses that relate to properties that will be taxed on sale are identified, which would not be the case where someone is applying the rules on a portfolio basis and some of the properties in the portfolio will be taxed on sale but some will not be.

### *Property owned by widely-held companies*

The proposed rules would not apply to land owned by widely-held companies. This will avoid creating compliance costs for companies that hold residential land incidentally to their business (for example, as sites for future development), where there is not the same mischief of offsetting property losses against labour or other income with the expectation of tax-free capital gains.

### *Employee accommodation*

The proposed rules would not apply to accommodation provided to employees or other workers where it is necessary to provide the accommodation due to the nature or remoteness of the business. This would avoid creating compliance costs for businesses where the mischief the ring-fencing rules are seeking to address is not present.

### ***Portfolio basis by default with property-by-property application by election***

The proposed default position is that the loss ring-fencing rules would apply on a portfolio basis, meaning that investors would be able to offset deductions for one rental property against income from other rental properties – essentially calculating their overall profit or loss across their portfolio.

The alternative would be a property-by-property approach, where each property is looked at separately and deductions for one are not able to be offset against income from another. While in theory this would be more effective in reducing tax benefits to investors, in practice, a property-by-property approach could result in de facto portfolio outcomes. Taxpayers could potentially rebalance their debt funding to minimise the extent to which any particular property is loss-making. This taxpayer response would be inefficient, and may also mean that, in terms of the objective, a property-by-property approach may have no real advantage over a portfolio approach – adding complexity and increasing compliance costs for no gain.

However, proposed section DB 18AG would allow taxpayers to elect to apply the rules on a property-by-property basis. This would mean that each property would be looked at separately and deductions for one could not be offset against income from another. If this approach is taken and a particular property ends up being taxed on sale, the net profit or loss for that property would be known, and any ring-fenced deductions in excess of the income from the sale could be released. To apply the rules on a property-by-property basis, the taxpayer would need to notify the Commissioner of their rental income and expenditure for these properties on that basis.

### ***Use of ring-fenced deductions***

If the default portfolio basis is used, ring-fenced residential property deductions could be offset against:

- residential rental income from future years (from any property); and/or
- income on the taxable sale of any residential land, to the extent of reducing the taxable gain (after all other deductions) on the sale to nil.

If the property-by-property basis is used, ring-fenced deductions relating the property could be offset against:

- residential rental income from future years from that property; and/or
- income on the taxable sale of that property, to the extent of reducing the taxable gain (after all other deductions) on the sale to nil.

Generally, any remaining unused deductions would not be released when a property is sold. It is proposed that they continue to be ring-fenced, and carried forward to be used against any future residential rental income or income on other residential land sales (again, to the extent they reduce the taxable gain to nil, after all other deductions).

However, it is proposed that ring-fenced deductions be released if a property ends up being taxed on sale and the taxpayer has:

- applied the rules on a property-by-property basis (proposed section DB 18AG(6)); or
- applied the rules on a portfolio basis and all of the property within the portfolio is sold and was subject to tax on sale (proposed section DB 18AC(5)).

In both of those situations, the deductible expenses that relate to properties subject to tax on sale are identified, so there is not the same concern about some of the deductible expenses relating to untaxed gains. All of the economic income from the property or properties will have been taxed (the rental stream and the capital gain). As such, it is proposed that in those situations, if the ring-fenced deductions exceed what is necessary to reduce the taxable gain on the sale to nil, the remainder of the deductions would be released and able to be offset against other income.

Excess deductions would remain ring-fenced after a non-taxable sale of property, or after divestment of a portfolio where not all the properties that were in the portfolio were taxed on sale. A taxpayer can choose to treat those ring-fenced deductions as relating to another property (proposed sections DB 18AD and DB 18AH). However, if this is done, the deductions would “taint” the property (and any portfolio it is part of), such that any excess deductions on a taxable sale of that property or taxable divestment of the portfolio would not be released (proposed sections DB 18AC(8) and DB 18AG(9)). The excess deductions would still be able to be used to reduce the taxable gain to nil, but if there are excess deductions beyond that they would remain ring-fenced.

Proposed section DB 18AI would allow ring-fenced deductions to be transferred between companies in a wholly-owned group. Often a corporate group will hold rental properties and trading business properties in different entities. It is proposed that the ability to transfer ring-fenced deductions be limited to companies in the same wholly-owned group, as the economic ownership is the same in that situation. Transferred deductions would remain ring-fenced, so they would only be able to be used in the relevant income year to the extent the transferee company has residential rental income or residential land sale income. Any remaining deductions would be carried forward and would remain ring-fenced.

### ***Interposed entities***

#### *The issue*

Without rules to deal with interposed entities, taxpayers (particularly larger and more sophisticated taxpayers) could get around the ring-fencing rules by interposing an entity (for example, a company) to separate a loan (and interest deductions) from the residential rental property, so the interest deductions are not subject to ring-fencing.

For example, a taxpayer could borrow money to buy shares in a company, which uses those funds to buy a residential investment property. Because the interest on the borrowings relates to the individual’s investment in shares in the company, not to the acquisition of a residential rental property, the individual would be able to claim deductions for the interest, and offset those deductions against income from other sources. This would be the case even if the residential rental property held by the company was loss-making, or would be loss-making if the interest expense were taken into account (which would be the case if the person had instead purchased the property directly).

Using an entity in this way to get around the deduction ring-fencing rules would undermine the credibility of the rules, neutrality, and fairness. As such, the Bill proposes specific rules (proposed sections DB 18AJ and DB 18AK) to deal with the interposing of entities, so this mechanism cannot be used to get around the ring-fencing rules.

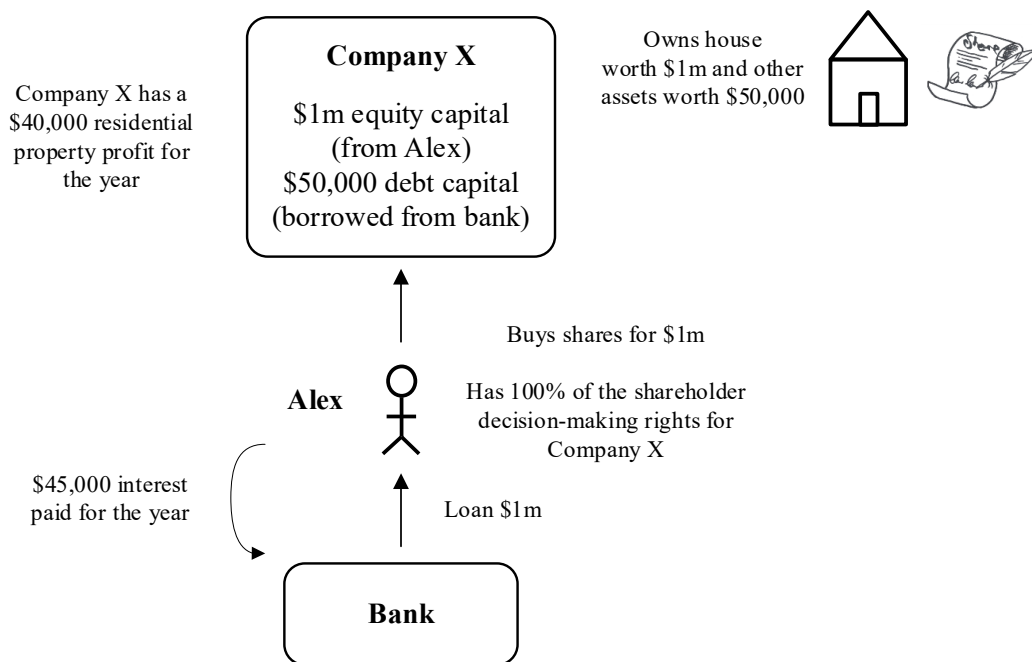
*The proposed solution*

The interposed entity rules would apply for interest on borrowings to acquire an interest in an entity, if for a particular income year the entity is a “residential land-rich entity” – which would be where over fifty percent of the entity’s assets are residential properties.

The fifty percent “residential land-rich entity” threshold would take into account all residential properties, not just those within the scope of the ring-fencing rules. This ensures that the interposed entity rule applies even if, for example, the main home was held in the same entity as a rental property (which would often be worth less than the main home).

Where the land-rich threshold is met, part or all of the interest on the borrowings would be treated as residential rental property expenditure, and deductions would be ring-fenced. Under the proposed rules, the amount of the interest expenditure that would be treated as residential rental property expenditure would be calculated by reference to the level of the entity’s capital that is applied to acquiring residential property. Also, for companies that are not look-through, regard would be had to the person’s interest in the entity, and, for trusts, to the person’s interest in residential rental property that is trust property. This is illustrated in the example.

**Example – proposed rules for interposed entities**



More than fifty percent of Company X’s assets are residential property, so Company X is a “residential land-rich entity”.

95.24% of Company X’s capital ( $\$1,000,000 \div \$1,050,000$ ) was used to acquire residential rental property (this is the “applied capital percentage” in the formula in proposed section DB 18AJ(3)).

The “applied capital percentage” is multiplied by the interest expenditure Alex incurred for the year for the borrowings (\$45,000), under the formula in proposed section DB 18AJ(3). The amount calculated under that formula is therefore **\$42,858** ( $95.24\% \times \$45,000$  interest).

Alex’s voting interest in Company X is one hundred percent, as he has one hundred percent of the shareholder decision-making rights for Company X. That interest is multiplied by Company X’s residential property profit for the year (\$40,000), under the formula in proposed section DB 18AJ(5). The amount calculated under that formula is therefore **\$40,000** ( $100\% \times \$40,000$ ).

To the extent the amount calculated under the formula in proposed section DB 18AJ(3) exceeds the amount calculated under the formula in proposed section DB 18AJ(5), it is treated as an amount of deductions that relate to a residential rental property owned by Alex.

This means that \$2,858 of Alex’s interest expenditure is treated as an amount of deductions that relate to a residential rental property owned by Alex.

Presuming Alex does not own any residential rental property, the result of the interposed entity rule is that Alex can deduct \$42,142 ( $\$45,000 - \$2,858$ ) of the interest expenditure. The remaining \$2,858 is carried forward and allocated to the next year under the proposed ring-fencing rules.

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# Social policy matters

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## **STUDENT LOAN DEDUCTIONS FROM WITHHOLDING INCOME**

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*(Clauses 83, 86, 91 and 92)*

### **Summary of proposed amendment**

Student loan borrowers who receive schedular, election-day, and casual agricultural income will have student loan repayments deducted from their income by their employer.

### **Application date**

The amendment will take effect from 1 April 2020.

### **Key feature**

New Zealand-based student loan borrowers who receive schedular, election-day and casual agricultural income will have student loan repayments deducted from their income by their employer in the same way a salary and wage earner does.

As with salary and wage earners, 12% will be deducted from schedular income over the pay-period repayment threshold each payday. A flat rate of 12% will be deducted from election-day and casual agricultural income.

An end-of-year calculation will still be required for these borrowers to confirm the correct amount has been repaid.

### **Background**

Student loan borrowers who earn salary or wages have student loan repayments deducted from their income. The deductions of 12% are made on each dollar received above the pay-period repayment threshold each payday. If the borrower has other income, the end of the year student loan assessment determines whether additional payments are required.

Some borrowers receive schedular, election-day or casual agricultural income which has a similar tax treatment to other employment income. Employers are required to withhold tax from that income in the same way as for PAYE. However, currently student loan obligations for schedular, election-day or casual agricultural income are calculated at year-end.

It is proposed that borrowers who receive schedular, election-day or casual agricultural income will also have 12% student loan repayment deductions made from that income. Schedular income will be treated as a primary income source and 12% will be deducted for each dollar over the pay period repayment threshold each payday. Election-day income and casual agricultural income will be treated as secondary income where 12% is deducted from each dollar earned each payday.

The amendment is aimed at improving the timeliness of student loan repayments for these borrowers and means end-of-year repayments are smaller or not required. It will also reduce the number of borrowers required to make interim instalments and reduce the number of borrowers getting into debt.

## **INTEREST-FREE STUDENT LOANS**

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*(Clauses 87 to 90)*

### **Summary of proposed amendment**

Student loans will transition to Inland Revenue's new computer system from 1 April 2020. This provides Inland Revenue with an opportunity to stop charging loan interest to New Zealand based borrowers from this date.

### **Application date**

The amendment will apply from 1 April 2020.

### **Key features**

Loan interest will not be charged on student loans for New Zealand based borrowers.

### **Background**

The Student Loan Scheme Amendment Act 2005 introduced interest-free student loans for borrowers living in New Zealand. Under section 134 of the Student Loan Scheme Act 2011, loan interest is charged for all borrowers with a loan balance. Under section 137, the loan interest is reduced to zero for each day that the borrower is New Zealand based. Interest-free student loans were implemented in this manner as this was the best way it could be introduced into Inland Revenue's systems at that time.

The move to Inland Revenue's new computer system from 1 April 2020 provides the opportunity to rectify this anomaly and stop charging loan interest for New Zealand based borrowers.

## **DEFINITION OF INCOME FOR STUDENT LOANS AND WORKING FOR FAMILIES**

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*(Clauses 57 and 93)*

### **Summary of proposed amendment**

The definition of “net adjusted income” that is used for student loan purposes and the definition of “family scheme income” that is used for Working for Families tax credits will be more closely aligned.

### **Application date**

The amendment to the Income Tax Act will apply from Royal assent.

The amendments to the Student Loan Scheme Act will apply from 1 April 2020.

### **Key features**

For the definition of “family scheme income”, a separate legislative provision is proposed which will include non-beneficiary income from a trust as family scheme income when a person is not a settlor.

For the definition of “net adjusted income”, the following are proposed:

- The adjustment for major shareholders in a close company will be amended to take into account the interests of dependent children in the close company.
- Certain contributions to retirement savings schemes will be excluded from net income.

An amount of depreciation loss allowed in the 2002–03 or earlier years will be excluded from net income.

### **Background**

One of the factors that determines social policy entitlements is the relevant definition of “income”. The current approach for social policy products, including the Student Loan Scheme, is to use a common definition of “income”, such as the Income Tax Act definition of “net income”, and to make adjustments to include or exclude other specific types of income as appropriate.

Changes were made to the Working for Families definition of “family scheme income” in 2011. These changes broadened the definition and were intended to improve the fairness and integrity of Working for Families by, for example, countering arrangements that have the effect of inflating entitlements beyond what people’s true economic circumstances justify. In 2014, similar amendments were made to align the definition of income used for student loan purposes with that used for Working for Families.

A number of minor areas have been identified where the definitions are not aligned or where wording changes would improve clarity, reduce misunderstanding and prevent structuring.

For the definition of “family scheme income”, a separate legislative provision is proposed which will include non-beneficiary income from a trust as family scheme income when a person is not a settlor.

In relation to student loans, the following are proposed:

- For the undistributed income from close companies adjustment, alignment of the voting interest percentage with the percentage used for Working for Families tax credits income. This will include an associated persons test to prevent opportunities to structure shareholdings in close companies to reduce student loan repayment obligations.
- For the specific retirement savings contributions adjustment, alignment of the adjustment with the other social policy payments. This brings in a previously approved policy which was not implemented at the time.
- Alignment for depreciation loss allowed on the sale of a building.

## **DAY COUNT TEST AMENDED**

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*(Clauses 84 and 85)*

### **Summary of proposed amendment**

This amendment clarifies the operation of the day count test in sections 22 and 23 of the Student Loan Scheme Act 2011 for determining if a borrower is New Zealand or overseas-based. An unintended change occurred in the rewrite of the Student Loan Scheme Act in 2011, that omitted a tiebreaker provision which made it unclear if borrowers who return to New Zealand after more than five months but less than six months overseas are New Zealand or overseas-based. This amendment ensures that the law continues to operate as intended.

### **Application date**

The proposed amendment will apply from 1 April 2012, the commencement date of the Student Loan Scheme Act 2011. No student loan borrowers will be disadvantaged by this application date.

### **Key features**

The proposed amendment to section 23 of the Student Loan Scheme Act 2011 reinstates a tiebreaker provision to ensure that a borrower cannot be treated as absent from New Zealand for the purpose of the 184 day test for any day on which they are treated as being physically in New Zealand under section 22. That is, borrowers who return to New Zealand after being overseas for less than six months would not become overseas-based borrowers.

Other minor drafting amendments are also made to sections 22 and 23 to incorporate the tiebreaker provision.

### **Background**

Under the Student Loan Scheme Act 2011, borrowers are either overseas-based or New Zealand-based. This status effects their repayment obligations and their eligibility for an interest write off on their student loans. Under section 23 a borrower becomes overseas-based after spending 184 days overseas. Periods in New Zealand of up to 31 days in total over this period are treated as being overseas to prevent borrowers from returning for very short periods to sustain their New Zealand-based borrower status. Section 22 contains equivalent provisions that require overseas-based borrowers to return to New Zealand for 183 days to become New Zealand-based.

The Student Loan Scheme Act 1992 contained a tiebreaker provision that specified that where there were periods that could qualify a borrower as being overseas-based or New Zealand-based, the borrower would be treated as New Zealand-based. This tiebreaker provision had the effect of clarifying that where borrowers returned to New Zealand within 31 days of the end of the 184 day period, they could continue to be New Zealand-based if they subsequently stayed in New Zealand for the 183 day qualifying period. An equivalent tiebreaker provision was inadvertently not included in the rewrite Bill.

## **CHILD SUPPORT (SEX OFFENCE VICTIM EXEMPTION)**

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*(Clauses 76 to 81)*

### **Summary of proposed amendment**

The amendments will give the Commissioner of Inland Revenue the discretion to grant an exemption to the victim of a sex offence in cases when there is not a convicted offender. They will also give the Commissioner of Inland Revenue the discretion to determine the most appropriate start date for the exemption.

### **Application date**

The amendments will apply from the date of Royal assent.

### **Key features**

The following changes are proposed to the Child Support Act 1991:

- Amend section 89Y so that a liable parent who is a victim of a sex offence may apply for the exemption from paying child support when the liable parent believes another person has committed the offence (even if there is no finding that the person has committed the offence) (*clause 76*).
- Amend section 89Z so that the Commissioner of Inland Revenue has discretion to:
  - grant the exemption for child support if in the opinion of the Commissioner, it is likely that another person has committed the sex offence and the liable parent is the victim of that offence (*clause 77(1) and (2)*); and
  - determine the most appropriate start date for any exemption for child support (no earlier than 26 September 2006), provided it does not negatively impact on any parent, child or carer (*clause 77(3)*).
- Amend section 89ZA:
  - so that the exemption for child support should be void from the beginning if the Commissioner of Inland Revenue granted the exemption through the use of discretion, and subsequently becomes aware the exemption should not have been granted (*clause 78(3)*); and
  - to allow that a liable parent may reapply for an exemption for child support payment even when a court has not directed for a retrial, and subsequently convicted an offender (*clause 78(4)*).

## **Background**

Under the Child Support Act 1991, liable parents who have been the victim of a sex offence are eligible to seek an exemption from payment of child support (in relation to a child) if they were the victim of a sex offence, and the child was born as a result of that offence.

For the exemption to be granted, another person must have been convicted of the sex offence. However, very few sex offences are reported and, of those that are, few result in a conviction. In some cases, a conviction is not possible because the offender is never identified.

Often, despite the lack of a convicted offender, there is little doubt that the person was the victim of a sex offence. Giving Inland Revenue the discretion to consider a wider range of factors when deciding whether or not to grant the exemption will better support the intent of the exemption that a person who has been the victim of a sex offence should not be further victimised by having legal obligations conferred upon them as a result.



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## Other policy matters

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## **ANNUAL SETTING OF INCOME TAX RATES**

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*(Clause 3)*

### **Summary of proposed amendment**

The Bill sets the annual income tax rates that will apply for the 2019–20 tax year. The annual rates to be confirmed are the same that applied for the 2018–19 tax year.

### **Application date**

The provision will apply for the 2019–20 tax year.

### **Key features**

The annual income tax rates for the 2019–20 tax year will be set at the rates specified in schedule 1 of the Income Tax Act 2007.

## **SECURITISED PRE-1990 FOREST LAND EMISSIONS UNITS**

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*(Clauses 44, 45, 47, 48, 52 and 53)*

### **Summary of proposed amendment**

The Bill proposes an amendment to the Income Tax Act 2007 to address an issue in relation to the tax treatment of pre-1990 forest land emissions units. The issue arises when the units are securitised through a sale and compulsory buy back transaction, which is effectively a lease of the units in exchange for a loan.

Specifically, the proposed amendment provides the following:

- The sale of the emissions units and the return of the equivalent units would be ignored for both parties. Instead, there would be a loan between the two parties. The interest flows earned/paid by both parties on the borrowed/lent funds would be taxable/deductible.
- The acquirer of the units may wish to on-sell them. If so, any gain or loss on selling the units to a third party would be taxable or deductible according to the ordinary rules that apply to the sales of forest land emissions units.

Ignoring the sale transaction in this instance will also mean that the emissions units would retain their one-off tax-free status on disposal.

Overall, these changes are intended to facilitate the monetisation of assets that might otherwise be locked away, so that the assets can generate income for their owners and the underlying beneficiaries.

More general consideration of other securitised assets is planned as part of a tax policy programme project on financial arrangements.

### **Application date**

The proposed amendment will apply to transactions entered into in the 2018–19 income year, or any subsequent income year, that involve the securitisation of pre-1990 forest land emissions units.

## **Background**

### ***Pre-1990 forest land units***

New Zealand's emissions trading scheme (ETS)<sup>3</sup> places mandatory deforestation obligations on exotic forests that were first established before 1990, referred to as "pre-1990 forests". This means if pre-1990 landowners choose to deforest, for example when converting forest land to a different use, they face "deforestation liabilities" under the ETS and have to report on emissions and surrender an equivalent amount of New Zealand emission units to the Government.

When the ETS was introduced, owners of "pre-1990 forests" were able to apply for a one-off free allocation of New Zealand emissions units. This allocation was intended to recognise the possible impact on land values due to the cost the ETS places on deforesting, and the resulting reduction in land-use flexibility.

A wide variety of owners applied for the pre-1990 forestry allocation of free units, including farmers with small forest holdings, regional councils, owners of large commercial forests, and Māori entities who received forest land as part of treaty settlements. In total, nearly 48 million New Zealand units were allocated in relation to pre-1990 forests, some of which have since been either sold or surrendered.

Although there is a register of unit holders, those records do not allow information on current holders to be publicly identified. However, our expectation is that the current holders will largely be those who take a longer-term view to holding the underlying land, which is consistent with, but not exclusively, the view taken by those who focus on intergenerational sustainability and kaitiakitanga (guardianship).

### ***Tax implications***

The proceeds from the sale of pre-1990 forest land emissions units are generally non-taxable, to reflect the nature of the units. Any subsequent sales of these emissions units are, however, taxable.

It is not appropriate to treat a transaction involving the sale and compulsory buyback of pre-1990 forest land emissions units as a standalone sale as that transaction amounts to a securitisation of an asset in exchange for a loan. The purpose of the securitisation is to turn what would otherwise be a non-income earning asset into cash without losing ultimate control of the asset. The cash can then be invested to earn income, thereby generating income for the original owner and its underlying beneficiaries. The benefit to the other party to the transaction is that they can use the emissions units to offset some of the liability associated with their emissions. Similar tax rules are already in place to enable sales and compulsory buybacks of shares to, in effect, be treated as loans (see the share lending rules enacted in 2006<sup>4</sup>).

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<sup>3</sup> The emissions trading scheme is currently being reviewed.

<sup>4</sup> See Inland Revenue Department *Tax Information Bulletin*, Volume 18, No.5 (June 2006), pages 86–94.

## **Key features**

Various sections of the Income Tax Act are proposed to be amended to ensure a transaction is treated as a loan for income tax purposes. This is achieved by treating the arrangement as a financial arrangement with an attached excepted financial arrangement. The excepted financial arrangement is the assignment of the pre-1990 forest land emissions units by the holder to a person who is not an associated person (the lender) and the later assignment of the same or other New Zealand emissions units by the lender to the holder.

### ***Interest***

The financial arrangement rules will apply to the “interest” component only. For example, the “interest” paid by the original unitholder will be the difference between the amounts they receive from assigning the units and the total amounts they pay the lender under the arrangement.

Under proposed section DB 17B, the lender is denied a deduction for the amount they have lent to the original holder of the units.

### ***Change in value of the collateral***

Because the same amount of units is being returned, changes in the value of the emissions units will be ignored. Under proposed section CX 54B, the amount that relates to the market value of an emissions unit under a transfer of the excepted financial arrangement is excluded income. Moreover, under section EW 52B4(c), the original unit and the returned unit are treated as having a value for the unit holder equal to the cost of the original unit for the unit holder.

### ***Sales to third parties***

Any gain or loss made by the lender from subsequently selling the units to a third party and later purchasing replacement units will be taxable. The lender will be taxed on all the proceeds from the sale of the units to a third party. Their cost base for the units they have sold will be zero (see proposed section EW 52B(4)(d)(ii)). However, the lender will be able to deduct the cost of the replacement units that they acquire in order to meet their obligation to return units to the original holder.

#### **Example**

The lender sells 1,000 units to a third party for \$20 per unit. The lender will be taxed on \$20 per unit as the cost base for the units will be \$0. The taxable income will be \$20,000.

The lender subsequently purchases 1,000 units for \$15 to meet their obligation to return units to the original holder. The lender is allowed a deduction of \$15,000.

Overall, the lender is taxed on the net gain of \$5000 (that is, \$20,000 – \$0 – \$15,000).

This treatment parallels that under the share lending rules.

### ***Preservation of the one-off tax free status of the units***

Provided the requirements of the arrangement are fulfilled, the original owner of the units is considered to hold the units throughout the arrangement (see proposed section EW 52B). This non-recognition of a disposal by the original owner means that the one-off tax free status of the units on disposal is preserved for the purposes of section CX 51B, because the units continue to meet the definition of a “pre-1990 forest land emissions unit”.

### ***When units are not returned by the agreed date***

Parties that have entered into a securitisation arrangement in good faith will be entitled to apply the new provisions on the assumption that the arrangement is fulfilled as agreed. However, if the units are not returned by the date that the parties have agreed, the arrangement is effectively unwound for tax purposes. This means that the original disposal of the units will be treated as an ordinary disposal on the date the arrangement began.

## KEEPING TAX RECORDS IN TE REO MĀORI

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*(Clauses 38(1), (3) to (5) and 68 to 71)*

### **Summary of proposed amendment**

Changes are proposed to the Tax Administration Act 1994 and the Goods and Services Tax Act 1985 (GST Act) to allow tax records to be kept in te reo Māori.

### **Application date**

The proposed changes apply from the date of the Bill's enactment.

### **Key features**

The proposed changes allow taxpayers to hold tax records in te reo Māori for the purposes of the Inland Revenue Acts (the Income Tax Act 2007, the Tax Administration Act and the GST Act) without first having to seek the approval of the Commissioner of Inland Revenue.

The change is directed at internal documents held by taxpayers in compliance with the requirements and obligations of the Tax Administration Act and the GST Act. The proposed changes do not alter or affect taxpayer obligations to use:

- the English phrases in the GST Act, for example, “tax invoice”; or
- donation receipts in English (unless otherwise permitted by Inland Revenue to do so).

The change codifies Inland Revenue operational practice that has been in effect since 1995.

### **Background**

The proposed changes ensure the operation and effect of the Inland Revenue Acts are generally consistent with the spirit and intent of Te Ture mō Te Reo Māori Act 2016 (Māori Language Act 2016).

The proposed changes are not intended to affect, replace, or alter existing taxpayer obligations or disclosures required, for example by section 24 of the GST Act or section 32 of the Tax Administration Act for tax documents that are relied on by third party taxpayers when they take a tax position.



## PAYE AND EMPLOYEE SHARE SCHEMES

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*(Clause 61)*

### **Summary of proposed amendment**

New rules enacted by the Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016 allow employers to choose to withhold tax on employment income an employee receives under an employee share scheme (ESS) on a grant-by-grant basis.

Officials understand that for some employers, the ability to withhold PAYE on a grant-by-grant basis can give rise to undesirable financial reporting consequences. Under *International Financial Reporting Standard 2 Share Based Payments* (IFRS 2), it may mean that the scheme becomes partly “cash settled” from a financial reporting perspective. Some employers prefer from a financial reporting perspective for ESS to be treated as “equity settled” as the scheme cost is fixed and spread on a straight line, whereas the accounting treatment of “cash settled” schemes requires them to be revalued annually. This means the accounting expense can change year to year as the share price changes.

An amendment to section RD 7B is proposed to allow an employer to make an irrevocable election to withhold PAYE in relation to a grant made under an ESS. This election would then create a statutory obligation to withhold and return PAYE on that benefit, and ensure that tax can be withheld without undesirable financial reporting consequences.

### **Application date**

The proposed amendment would apply from the 2019–20 and subsequent income years.

### **Key features**

The proposed amendment would allow employers the flexibility to elect into an irrevocable statutory obligation to withhold PAYE in relation to a benefit provided under an ESS.

The proposed amendment would not disturb employers’ ability to elect to withhold PAYE on a grant-by-grant basis if they wish to do so. The irrevocable election would be available in addition to, not instead of, the elections available in the current section RD 7B.

### **Background**

Section RD 7B(3) currently provides that an “employer *may choose*, in relation to the share purchase agreement, to withhold and pay an amount of tax for the benefit.”

The problem arises when IFRS 2 treats a scheme as being partly “cash settled” for financial reporting purposes. This results in a need to annually account for the PAYE (cash) element of the scheme on a market-to-market basis (meaning the cost of the scheme has to be revalued annually, to that extent). Officials understand that there is a way employers can ensure “equity settled” treatment on the entire benefit provided under an ESS which is subject to PAYE, but that this imposes unnecessary compliance costs on employers and this discourages them from withholding.

IFRS 2 allows a scheme to be treated as wholly “equity settled” if a PAYE payment is made, but only if that payment arises by virtue of an obligation under tax laws or regulations to withhold tax.

Officials understand a contractual undertaking is not sufficient to satisfy the requirements of IFRS 2.

The issue is that section RD 7B does not currently impose a statutory legal obligation to pay PAYE at the time the benefit is granted, but rather it is an election the employer makes at the time the tax obligation arises. Accordingly, the current wording of section RD 7B does not satisfy this requirement.

A tax obligation which arises by virtue of an irrevocable election at the time the offer is made to an employee would mean employers could treat a scheme as entirely equity settled.

The proposed amendments to section RD 7B allow employers to make this irrevocable election and thus meet the requirements of IFRS 2 to treat a benefit provided under an ESS as wholly equity settled.

## **BENEFICIARIES AS SETTLORS**

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*(Clause 56)*

### **Summary of proposed amendment**

When an amount of income is allocated by a trust to a beneficiary but retained in the trust, and no interest is paid by the trust to the beneficiary, such a beneficiary may become a settlor. This is because they meet the definition of “settlor” in section HC 27 of the Income Tax Act, by transferring value to the trust. This could be an overreach in some cases. The proposed change amends the Income Tax Act to ensure that, in certain circumstances, such beneficiaries do not become settlors.

### **Application date**

The proposed application date is the date of the Royal assent.

### **Key features**

The proposed amendment ensures that beneficiaries whose current account balances at the end of the income year are not greater than \$25,000 do not become settlors.

When market rate interest is paid by the trust to the beneficiary, such beneficiaries do not become settlors. For consistency with other legislative provisions, it is proposed that the prescribed interest rate is the same as the rate used to determine whether there is a fringe benefit in relation to a low-interest loan provided to an employee. The current prescribed rate is 5.77%.

A resolution authorising the payment of interest to such beneficiaries should be passed no later than the date the trust files its return, stating that the payment has been backdated to the end of the relevant income year. This is to ensure there is no retrospective action in relation to such amounts.

### **Background**

Under the current law, some beneficiaries of trusts may inadvertently become the settlors of such trusts. This can occur when:

- trustees allocate an amount of money (for example, beneficiary income) to a beneficiary;
- the money is not paid out to the beneficiary but is retained in the beneficiary’s current account with the trust, and is used as working capital of the trust;
- the beneficiary does not receive interest or other return on the money retained by the trust.

Such beneficiaries become settlors in relation to the amount of interest that has not been paid to them, because they “transfer value” to the trust by leaving money in the trust interest-free and, therefore, meet the definition of “settlor” in section HC 27 of the Income Tax Act.

The implications that may arise from treating such beneficiaries as settlors include affecting entitlements for Working for Families, making beneficiaries accountable for tax on the trustee income, and inadvertently increasing the number of persons associated with the trust.

## **COOPERATIVE COMPANIES: NON-DEDUCTIBLE CASH DISTRIBUTIONS**

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*(Clauses 51 and 58 to 60)*

### **Summary of proposed amendment**

The proposed amendments clarify that a co-operative company may elect to make a fully imputed cash distribution of profits attributable to a specific group of shareholders of the company, provided:

- the company's constitution permits distributions to be made to a specific groups of members; and
- the amount paid to each shareholder is determined by the level of trading activity between the members and the company.

### **Application date**

The proposed amendment will apply to non-deductible cash distributions made on or after the date of Royal assent.

### **Key features**

The proposed amendment will permit a co-operative company to choose to distribute to a specific group of its shareholders those profits that are attributable only to that group of shareholders as either:

- an association rebate (tax deductible); or
- a fully imputed cash distribution (non-deductible) which is treated as a dividend.

The proposed amendment will improve the consistency of the imputation rules with co-operative business practices, such as the way in which co-operative companies use pool systems to incentivise a higher quality of supply from members.

### **Detailed analysis**

The amendment seeks to improve consistency of the imputation rules and general tax settings for co-operative companies with both co-operative company law, and commercial practices in the co-operative sector.

Currently, a co-operative company may choose to distribute its profits generated from co-operative activity either as:

- a tax deductible distribution (the association rebate); or

- a non-deductible cash distribution (with imputation credits attached), which is treated as a dividend paid to the shareholder.

This proposed outcome is mostly relevant to co-operative companies that adopt pool systems to incentivise a higher quality of supply from members to the co-operative. Typically, members may elect into such a pool system, and only those participating members can receive distributions of such pool profits.

As tax payable on these pool profits is borne by those participating members, the proposed amendment will ensure that the benefit of the related imputation credits may be allocated proportionately only to those participating members.

## **CLARIFICATION OF THE APPLICATION OF THE COMMON REPORTING STANDARD**

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*(Clauses 73 and 74)*

### **Summary of proposed amendment**

The proposed amendment clarifies that an entity does not have to be remunerated directly for its activities to be considered a financial institution for the purposes of the G20/OECD *Common Reporting Standard* (CRS).

Section 185O of the Tax Administration Act 1994 would be amended, with a Part 2 added to schedule 2, where all such clarifications can be located.

### **Application date**

The clarification will apply from the original date of effect of the CRS rules in New Zealand, that is, from 1 July 2017.

### **Key features**

The clear policy intent is that determination should be based on the nature of the business activities that the entity performs and the remuneration for those activities, irrespective of whether the remuneration is received directly or indirectly through another group entity. This policy intent matches the international consensus on the matter, and is consistent with other references in the Commentary and the applicable Financial Action Task Force (FATF) Recommendations. Additionally, the OECD has issued a draft clarification (FAQ) confirming the policy intent, this will be published sometime in the future.

To give certainty to those administering CRS obligations in New Zealand and to ensure New Zealand complies with its international obligations, it is proposed amending the implementation legislation to clarify this point. At the same time, it is proposed to generally modify section 185O of the Tax Administration Act to insert a new Part 2 to schedule 2, where other clarifications that might be needed in future can all be located.

Both the CRS and the Commentary to the CRS are products of the OECD. The clarification will actually be made to the application of the Commentary to the CRS, to avoid any international perception that New Zealand is modifying the CRS itself.

### **Background**

The CRS is an international standard, and for which New Zealand enacted implementation legislation in 2017, primarily through amendments to Part 11B and schedule 2 of the Tax Administration Act 1994.

That legislation requires financial institutions to collect and report information on non-residents holding financial accounts in New Zealand. The reported information will be exchanged with other countries under tax treaties, to help tax administrations detect and prevent offshore tax evasion. In return, New Zealand will receive reciprocal information from tax treaty partners on New Zealand residents with offshore accounts.

Importantly, the 2017 implementation legislation directly incorporated the CRS into New Zealand law by reference, and provides that it must be applied consistently with the official OECD Commentary. Since 2017, a potential ambiguity has been detected in the wording of the CRS that has created some uncertainty for those determining whether an entity is a financial institution (and therefore whether the entity is subject to CRS due diligence and reporting obligations).

The ambiguity arises from the wording of the definitions of two particular types of financial institution, *Investment Entity and Custodial Institution*. Both definitions refer to “the Entity’s gross income attributable to [the activities/services provided]...”. This reference could be read as requiring the entity to be remunerated directly in order to meet either definition. However, in a common New Zealand group structure, the entity itself may not necessarily be directly remunerated.



## LOSS OF EARNINGS INSURANCE

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*(Clause 42)*

### **Summary of proposed amendment**

The proposed amendment clarifies that loss of earnings insurance proceeds are taxable in all circumstances, including when the rights to receive these proceeds are assigned to another company.

### **Application date**

This amendment would apply retrospectively from the beginning of the 2011–12 income year, subject to a savings provision to protect taxpayers who have taken a tax position on the basis of the existing wording of the law.

### **Key features**

An amendment is proposed to the Income Tax Act 2007 to clarify that a person who has been assigned the right to receive compensation proceeds, from an interruption or impairment of business activities, will be taxed in the same way that the assignor would have been taxed.

### **Background**

Taxpayers manage risk of business interruption by taking out loss of earnings insurance. When a business experiences a period of economic loss due to an adverse event (for example, an earthquake or fire), it can receive a loss of earnings payout as compensation. Since these proceeds are income of the business, they are subject to income tax.

After the Canterbury earthquake in 2011, a question arose about the tax treatment of amounts received from an assignment of the right to receive an insurance claim made under a loss of earnings policy. Due to the facts of the case and the wording of the current rule, the assignee was not taxable. This is contrary to the policy intent, which is to tax loss of earnings compensation, irrespective of whether the right to receive the compensation has been assigned to a third party.

## **TAXATION OF LIFE INSURANCE: REMEDIAL CHANGE TO THE TAX TRANSITIONAL RULES**

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*(Clause 54)*

### **Summary of proposed amendment**

Changes are proposed to the Income Tax Act 2007 to confirm tax transitional entitlements for life insurance policies that are sold as “level premium”.

### **Application date**

The proposed changes apply from 1 July 2010 or the beginning of an income year that includes 1 July 2010.

### **Key features**

Some changes are proposed to the conditions that need to be met for level premium life insurance policies in a low inflation environment.

### **Background**

In 2010, the taxation of life insurance business was substantially reformed. Accompanying the reform was transitional relief for life insurance policies sold before the start of the new rules.

Section EY 30(5)(b) allows life insurers tax transitional relief for life insurance policies that were sold as “level premium” on or before 30 June 2010. Section EY 30(5)(b) allows for increases in the base premium for such policies if the increase is a result of increasing the amount of life cover for movements in the consumer price index (CPI). The base premium is the premium agreed at the time the life insurance policy is sold.

The rule did not deal with situations when, because of a low-inflation environment, premium increases under the formula were higher than CPI increases over the same period.

Most level premium policies allow for an incremental increase in premiums over its contractual duration by a formula to reflect percentage changes in the CPI to maintain the real value of life insurance cover. These increases are typically framed by an increase of three percent or movement in the CPI index – whichever was higher.

The proposed change preserves transitional relief for life insurance policies that provide for an increase in premiums as a direct result of an increase in the amount of life cover that does not exceed three percent or the percentage increase in the CPI (whichever percentage is higher).

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## Remedials and maintenance items

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## TREATMENT OF ARRANGING SERVICES RELATING TO GOODS OFFSHORE

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*(Clause 15(1))*

### **Summary of proposed amendment**

The Bill proposes an amendment to correct an unintended change to the GST treatment of certain arranging services, which resulted from an amendment that was made in 2016 to allow the rules applying GST to supplies of remote services imported by New Zealand consumers to work properly.

### **Application date**

The amendments are proposed to apply on and after 1 October 2016, being the date that the previous law change that inadvertently changed the GST treatment of certain arranging services came into force.

### **Key features**

The proposed amendment concerns the arranging of services that are supplied directly in connection with goods situated outside New Zealand at the time the underlying services are performed. The issue is that the arranging services may not be zero-rated, even though the underlying services that they arrange (such as overseas storage, handling and logistics) will be clearly zero-rated under the rules in section 11A of the Goods and Services Tax Act 1985.

The proposed amendment would ensure that services that consist of the arranging of underlying services supplied directly in connection with moveable personal property located outside New Zealand at the time the underlying services are performed are zero-rated, in line with the policy intent and the previous treatment that applied prior to 1 October 2016.

### **Background**

The Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016 applied GST to supplies of “remote services” from non-residents to New Zealand-resident consumers with effect from 1 October 2016. It was recognised at the time that this policy change necessitated an amendment to the zero-rating rule for services that are physically performed outside New Zealand in order for the new GST rules to work as intended.

“Remote services” are defined in the GST Act as services that, at the time of performance of the services, have no necessary connection between the place where the services are physically performed and the location of the recipient of the services. Section 8(3)(c) provides that a supply of remote services is subject to GST where the services are supplied to a person resident in New Zealand. This however excludes services that are physically performed in New Zealand by a person who is in New Zealand at the time the services are

performed, as those services are already subject to GST under the law existing prior to 1 October 2016.

The types of services which the GST on remote services rules were specifically designed to bring into the GST base are those which are physically performed outside New Zealand. This meant it was necessary to carve out remote services supplied to final consumers from the zero-rating provision for services performed outside New Zealand. The relevant zero-rating provision, section 11A(1)(j), was therefore amended so that services physically performed outside New Zealand, or that arrange services that are physically performed outside New Zealand, are zero-rated, provided that these services are not remote services supplied to a New Zealand resident who is not a registered person.

The issue is that services which are provided in relation to goods located overseas may be remote services under the current definition in the GST Act, even though these services will be clearly zero-rated by section 11A(1)(f) if they are supplied directly in connection with moveable personal property situated outside New Zealand at the time of performance of the services. Hence, while the core underlying services that are supplied directly in connection with moveable personal property situated outside New Zealand (such as overseas storage, handling and logistics) are zero-rated, the arranging of these services may only be zero-rated if the (New Zealand-resident) recipient of the services is a registered person.

### **Detailed analysis**

Proposed new section 11A(1)(jbb) provides that services would be zero-rated if they are the arranging of underlying services that are supplied directly in connection with moveable personal property. This zero-rating treatment would apply if the moveable personal property is situated outside New Zealand at the time the underlying services are performed, and would not be dependent on whether the recipient of the services is a New Zealand resident or a non-resident, nor whether the recipient is registered for GST.

#### **Example – arranging of storage of goods overseas and other associated services**

Sistinas Pty Ltd (Sistinas), an Australian company that is registered for GST in New Zealand, carries on a number of business activities related to e-commerce. One of these activities involves the facilitation of a range of underlying services related to goods stored in third-party warehouses in Australia (such as gift wrapping, handling, logistics and transportation) which are sold as bundled packages to customers resident in New Zealand. These customers are typically GST-registered e-commerce businesses selling goods into Australia, but may also include some non-registered microbusinesses and consumers.

While most of the consideration paid by Sistinas' customers relates to the core underlying services, Sistinas charges its customers a "preparation fee" relating to its facilitation services.

Where one of these service packages is supplied to a person in New Zealand who is not a registered person, the underlying services will be clearly zero-rated under either section 11A(1)(a) or (f) as the supply of overseas transportation, or of services that are supplied directly in connection with moveable personal property situated outside New Zealand.

If the arranging services are treated as supplied in New Zealand, section 11A(1)(jbb) would apply to zero-rate these arranging services. Where this is the case, the preparation fee would be subject to GST at the rate of zero percent.

## CAPITAL RAISING COSTS

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*(Clause 21)*

### **Summary of proposed amendment**

Amendments are proposed to clarify the scope of the rules allowing businesses to deduct GST incurred on costs of raising capital.

### **Application date**

The amendments are proposed to apply on and after 1 April 2017, being the date that the GST rules specifically allowing input tax deductions for capital raising costs came into force. A savings provision is proposed to protect tax positions taken prior to the date of enactment of the Bill in cases where taxpayers did not make a deduction of input tax for capital raising costs on the basis of the existing law.

### **Key features**

The proposed amendments make remedial changes to the rules allowing GST-registered persons to deduct GST incurred on goods and services acquired for use in a capital raising exercise. In particular, the changes:

- clarify that the relevant deduction available under the rules is of input tax on supplies of goods and services made to the registered person that are used for the capital raising transaction;
- provide that a deduction is available for goods and services acquired by the registered person, to the extent that a deduction would be available under the ordinary rules, if the goods and services are used in the person's usual business activity instead of being used in the capital raising activity;
- clarify that GST-registered persons are entitled to claim input tax deductions for capital raising costs in situations where the funds raised are used to refinance a taxable activity of the registered person; and
- ensure that input tax deductions for capital raising costs are also available in situations where the funds are ultimately used in a taxable activity by a different company in the same group of companies as the company that carried out the capital raising transaction.

### **Background**

The Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 inserted new section 20H into the Goods and Services Tax Act 1985 to allow GST-registered businesses to recover GST on their costs of raising capital to fund a taxable activity.

Under the rules that applied prior to 1 April 2017 (being the date that section 20H came into effect), the exempt treatment of financial services posed a problem when businesses that principally made taxable supplies of goods and services incurred costs to raise capital, such as through the issue of bonds or shares. Examples of such capital raising costs include NZX listing fees, legal fees and costs associated with preparing a product disclosure statement. The GST incurred in relation to these costs was potentially unrecoverable because the provision of equity and debt securities is an exempt supply of financial services.

The new rules ensure that businesses which principally make taxable supplies can recover the GST incurred on goods and services used to raise capital for their taxable activities. In line with the policy intent, the rules do not apply when a business principally makes supplies of financial services, or to the extent that they have elected to zero-rate business-to-business supplies of financial services and a deduction is already available as a result of the business-to-business zero-rating rules.

However, there are some minor technical ambiguities and errors in the rules as currently enacted. Amendments are therefore proposed to clarify the scope of the rules to ensure that the policy intent is achieved.

## **Detailed analysis**

### ***Reference to deduction of input tax for the supplies of financial services***

An amendment to section 20H(1) is proposed to rectify an inaccuracy in the introductory wording that a registered person has “a deduction under section 20(3)(hd) of input tax for the supplies of financial services”. The proposed amendment clarifies that the deduction would be for input tax on supplies made to the registered person (for example, legal services) that are used to make the relevant supplies of financial services (being the raising of debt or equity).

### ***Refinancing a taxable activity***

The introductory words to current section 20H(1) refer to an “activity of raising funds that are intended for use by the registered person for expenditure in a taxable activity”. Paragraph (d) of the current section also contains a similar phrase.

In many cases, the funds that are raised through issuing debt or equity securities will be used to repay existing debt that was incurred to finance a registered person’s taxable activity. It is unclear that repayment of debt would be regarded as “expenditure in a taxable activity”. However, there was no policy intention to distinguish between capital-raising where funds are used for that purpose and ones where funds are used for other “taxable activity” purposes, such as acquiring new assets. The proposed amendments to paragraphs (a) and (e) clarify that registered persons are entitled to claim input tax deductions for capital raising costs in situations where it is intended that the funds planned to be raised would be used to refinance the registered person’s taxable activity (provided that the other conditions of section 20H(1) are met).



### ***Capital raising undertaken by different group company to that which uses the funds***

Where a capital raising transaction is carried out by a treasury company or a holding company, it may be another group company (such as the trading company) that ultimately uses the funds in a taxable activity (or to refinance a taxable activity). The wording of proposed paragraphs (a), (c) and (e) ensures that input tax deductions are available to the company that ultimately uses the funds (or to the representative member if the group of companies has group-registered under section 55) in such situations where the capital raising transaction is carried out by another group company.

### ***Apportionment of input tax deductions***

In situations where a registered person carries on both taxable and exempt activities, the intent behind the rules allowing input tax deductions for capital raising costs has always been that the amount of deduction claimed should be apportioned based on the extent to which the registered person makes taxable supplies as a proportion of their total supplies (excluding the capital raising supplies). However, this intended apportionment rule is not explicit in current section 20H.

Proposed section 20H(1B) codifies this apportionment rule to make it explicit that registered persons that have an exempt activity (as well as a taxable activity) and who intend to use the funds raised for both activities are required to apportion input tax deductions for capital raising costs, where the apportionment ratio is based on their taxable supplies as a fraction of their total supplies (excluding the supplies of financial services made to raise capital).

#### **Example**

Pilkinton Properties is a property development company, and makes eighty percent taxable supplies and twenty percent exempt supplies. It issues a bond to raise capital in order to finance the purchase of land. In issuing the bond, it spends \$11,500 in legal fees, including GST of \$1,500. Pilkinton Properties claims a deduction of \$1,200 (eighty percent of \$1,500) based on Pilkinton Properties' usual ratio of taxable to exempt supplies (excluding the bond issue itself).

## APPORTIONING GST FOR MIXED-USE ASSETS

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*(Clause 20)*

### **Summary of proposed amendment**

It is proposed to amend the definition of input tax for the purposes of the formula for apportioning input tax in relation to assets that are used partly for business use and partly for private use, but which are also unused for a period. This will correct the exclusion from the formula for input tax relating solely to private use.

### **Application date**

The amendment is proposed to apply from 1 April 2013, the main application date of the mixed-use asset rules.

### **Key features**

It is proposed to amend section 20G(2)(a)(ii) of the Goods and Services Act 1985 by amending the exclusions from the input tax that needs to be apportioned under the provision for expenditure that is solely related to making taxable or non-taxable supplies. This would be achieved by removing the references in the exclusions to terms and provisions in the Income Tax Act relating to mixed-use assets, and instead using GST Act terminology when describing use.

This means that the exclusion from input tax that can be brought into the mixed-use asset formula for solely private expenditure would be appropriately narrowed so as not to include use by persons associated with the supplier.

### **Background**

Section 20G of the GST Act is a special apportionment method for mixed use assets that aims to apply a similar approach for GST as the approach that is used for income tax purposes under subpart DG of the Income Tax Act. A typical example is that of a family bach or holiday home which is used sometimes for family holidays and sometimes by members of the public for a fee whilst being unoccupied for the remaining period. The aim of subpart DG is to apportion the expenses relating to the unoccupied period according to the relative levels of private and income earning use.

However, because of the way in which “private use” is defined in subpart DG, the exclusion operates more broadly than intended.

## Detailed analysis

Section 20G(1)(a) requires a dual use asset to be apportioned using the formula *input tax for asset*  $\times$  *total income earning days*  $\div$  (*total income-earning days* + *total private days*). Section 20(2)(b) defines “input tax for an asset” as the input tax on expenditure in relation to the relevant asset, excluding expenditure that is “solely related to the income-earning use of the asset” or solely related to the private use of the asset as that term is defined in section DG 4.

The reference to section DG 4 gives rise to a problem in applying the formula to associated persons transactions. This is because section DG 4 treats the use of an asset by an associated person as private use as might be the case if, say the asset is held by a family trust. So, where an associated person uses a mixed-use asset, even if they pay market rent, there will be deemed private use that will not form part of the input tax calculation. Since input tax deductions are not otherwise available for private use, this could significantly limit the input tax deductions that ought to be able to be claimed to give the right economic result under the formula.

It is therefore proposed to amend section 20G(2)(b)(ii) so that dual use by an associated person is not included in the exclusion from “input tax for asset”.

## MAINTENANCE AMENDMENTS

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### Summary of proposed amendments

The following proposed amendments reflect minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

### Application dates

Commencement dates for each proposed amendment are stated in table 2.

### Minor maintenance items

The following amendments relate to minor maintenance items to correct any of the following:

- ambiguities;
- compilation issues;
- cross-references;
- drafting consistency, including readers' aids – for example, the defined terms lists;
- grammar;
- consequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

**Table 2: Maintenance amendments – schedule of clause numbers and changes to text**

Clause	Section	Enactment	Amendment	Application date
22	21HB(4)	Goods and Services Tax Act 1985	Improve clarity of the provision	1 April 2011
43	CV 9	Income Tax Act 2007	Omit redundant section	Enactment date
46	CX 60(2)	Income Tax Act 2007	Correction to cross-reference	1 April 2019
50	DE 4	Income Tax Act 2007	Improve drafting consistency	Enactment date
55	FE 4	Income Tax Act 2007	Improve drafting consistency	1 April 2015
62	RE 21	Income Tax Act 2007	Improve drafting consistency	1 April 2008
63	RF 2B	Income Tax Act 2007	Omit redundant terms	Enactment date
64	RF 2C	Income Tax Act 2007	Omit redundant term	Enactment date
66 and schedule 1	References to NZIAS 39	Income Tax Act 2007	Updating reference to new IFRS standard	Enactment date