

Impact Summary: Domestic transport services supplied as part of the international transport of goods

Section 1: General information

Purpose

Inland Revenue is solely responsible for the analysis and advice set out in this Impact Summary, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing policy decisions to be made by Cabinet.

Key Limitations or Constraints on Analysis

Number of affected parties and potential future fiscal risks are unknown

The potential fiscal risks that affected GST-registered taxpayers are choosing not to follow the existing rules is unknown. While officials have undertaken public consultation on this issue and members of the tax community have indicated that there is limited voluntary compliance, affected taxpayers have not indicated the level of voluntary compliance. Therefore, it is not possible to accurately estimate the level of non-compliance and the level of fiscal risk.

The options considered in this Impact Summary are limited to those which would be suitable for inclusion in the next omnibus tax bill. Accordingly, the analysis is limited to options which have already been identified and discussed during consultation with stakeholders.

Responsible Manager (signature and date):

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Quality Assurance Reviewing Agency:

Inland Revenue

Quality Assurance Assessment:

The Quality Assurance reviewer at Inland Revenue has reviewed the *Domestic transport services supplied as part of the international transport of goods* Regulatory Impact Assessment prepared by Inland Revenue, and considers that the information and analysis summarised in the Regulatory Impact Assessment **meets** the quality assurance criteria.

Reviewer Comments and Recommendations:

The reviewer's comments on earlier versions of this regulatory impact assessment have been incorporated into this version.

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The GST Act allows for GST to be charged at 0% (known as zero-rated) for services provided to transport goods to and from New Zealand (NZ) and, in certain circumstances, the transport of goods within NZ (the domestic leg) as part of the international transport of goods may also be zero-rated. This is because exported goods are zero-rated, and the value of transport services is already included in the cost of imported goods which are subject to 15% GST.

For the domestic leg of transport services to be zero-rated, the primary transport supplier must also supply the domestic portion of the international transport of goods. This means that if an NZ based courier is subcontracted by the international transporter to provide the domestic transport services as part of the international transport of goods, the NZ-based courier should charge GST on the supply. This applies even if they are associated with or owned by the international supplier.

The problem is that under current practice, most international transporters do not undertake the domestic leg of the transportation, and instead subcontract to an NZ-based courier. The current rules have led to a lot of non-compliance in the industry, as many goods transporters within NZ are incorrectly zero-rating their domestic services. A lot of this is due to lack of understanding of the requirement that for the domestic leg to be zero-rated it must be supplied by the same supplier as the international transportation. There is also commercial pressure for suppliers of domestic transport services to zero-rate, especially when the recipient of the supply of the domestic transport (being an international supplier) is not registered for NZ GST.

2.2 Who is affected and how?

Final consumer: The current rules may create tax cascades¹ whereby a business that is not registered for GST (off-shore supplier) is charged GST by a domestic courier undertaking the domestic leg of transportation. The GST charged to a non-registered business by the supplier cannot be refunded by Inland Revenue (if you are not registered for GST you cannot claim any inputs) thereby leading to the GST being embedded in the price charged for the international transportation, and thus passed on to the final consumer.²

Domestic couriers: The current rules create a bias towards the international transport supplier of the international transport services also supplying the domestic transport services (as it would be zero-rated). This theoretically lowers demand for the domestic couriers service. Secondly, in the event the domestic courier is chosen, there is a lot of pressure on them to incorrectly zero-rate the domestic leg services (anecdotally this is what officials understand happens in practice but could potentially open the domestic leg supplier up to liability).

International couriers: Creates inefficiencies as international transporters are required to either register for NZ GST (to claim inputs on the GST cost charged by domestic

¹ Whereby a business absorbs the GST cost that is otherwise irrecoverable and passes this additional cost on to its customers as part of the sales price.

² This tax cascade could be avoided if the non-resident business chose to register for NZ GST (either under section 51 of the GST Act if they have a taxable activity in NZ or under section 54B if they do not make taxable supplies in NZ but do incur GST). However, this solution is not always pragmatic.

couriers for the domestic leg) or carry out the domestic leg of transportation themselves, despite it not necessarily making best business sense to do so. As the current rules incentivise international couriers to undertake the transportation themselves, this also affects competition. There is also an incentive for the transporters to deliver goods through the postal service, as the full value of international postal services is always zero-rated (whereas for courier services the domestic leg is currently subject to GST).

2.3 What are the objectives sought in relation to the identified problem?

- That the tax settings do not bias business decisions by favouring the use of certain courier companies over others.
- To avoid tax cascades and other additional costs being passed on to the final consumer (it is appropriate for the final consumer to bear the GST cost).
- To ensure ease of compliance: to ensure that the rules in this area are clear and easy for transporters to follow and apply.

Section 3: Options identification

3.1 What options have been considered?

The following criteria were used to assess the options:

- **Certainty:** It should be clear how the tax rules operate so that affected parties can plan their affairs accordingly.
- **Fairness:** It is appropriate under fundamental GST principles that the final consumer bears the GST cost. However, we want to avoid tax cascades that occur when, by virtue of not being registered for GST, a taxpayer is unable to claim input tax deductions for goods/services that are used in their taxable activity. This results in additional GST costs, which would otherwise be recoverable by the GST registered party, being imbedded in the final price paid by the consumer.
- **Tax considerations should not bias business decisions:** The GST treatment of transport services should not bias investment decisions.
- **Consistency with other jurisdictions:** It is important for these rules to be consistent with other jurisdictions, so NZ will remain a competitive market for the buying and selling of goods which are required to be transported overseas (for example Australia have provisions that allow for zero-rating of the domestic leg).

Option one: Status Quo

Under the status quo the domestic leg of the international transportation of goods can only be zero-rated where the domestic leg of the transportation is supplied by the same supplier as the international leg of the transportation, excluding subcontract arrangements widely used in New Zealand.

Option two: Zero-rating domestic transport services if the primary transport supplier contracted to transport goods to or from NZ is non-resident

Under this option, domestic transport services supplied to the primary transport supplier contracted to transport goods to or from NZ will be zero-rated if the primary transport supplier is a non-resident. For the sake of clarity, this policy setting would apply where an international transport supplier is contracted to deliver goods from point A outside NZ to point B inside NZ, and, point B *inside* NZ to point A *outside* NZ.

Pros:

- Provides certainty and reduces compliance costs by aligning with existing business practices of zero-rating all transport on international courier items (to the extent the primary transport supplier is non-resident).
- Removes the tax incentive for the primary transporter to also undertake the domestic leg.
- By reducing the compliance costs associated with sub-contracting, the proposal may improve competition and increase efficiency.
- This approach is similar to Australia and Singapore. Alignment with other countries may make compliance easier for international transporters if they are already familiar with the rules in those countries.
- Domestic providers will be able to provide more competitive pricing without having to account for the GST component of the transaction.

- Solves tax cascades and commercial pressure put on domestic transporters: The rationale for allowing zero-rating of domestic transport services only if the primary transport supplier is non-resident is because non-residents are much less likely to be registered for NZ GST. The issues of tax cascades and commercial pressure to zero-rate only arise when the recipients of the transport services are not registered for GST. In cases where the transporter for the international leg of transportation is NZ resident (and thus highly likely to be registered for GST), this transporter can claim an input tax credit and there is no GST cost of transportation being absorbed in the cost borne by the end consumer.

Cons:

- Some GST revenue is foregone by virtue of the wider scope for zero-rating (up to \$200k pa fiscal cost, but slightly less than option three).
- There still may be some lack of certainty as it may be difficult for the domestic leg transporter to always determine whether the primary transporter is non-resident.
- There may be theoretical gaps in cases where a NZ-resident international transporter is not GST registered (highly unlikely). In these cases GST would be charged and there would be no ability to claim inputs (tax cascade issue therefore remains).

Option three: Zero-rating all domestic transport services supplied to a primary transport supplier contracted to transport goods to and from NZ, regardless of the residency of that primary transport supplier

Under this option, all domestic transport services supplied to the primary transport supplier contracted to transport goods to or from New Zealand will be zero-rated.

Pros:

- Lower compliance costs on domestic transporter: The domestic transporter would only be required to determine whether the goods delivery service they are undertaking relates to an international transport service. They would not be required to verify the residency of the primary transport supplier (which is an additional compliance step required under option two).
- Also has the following pros similar to option two:
 - removes tax incentive for the primary transporter to also undertake the domestic leg
 - solves the problem of tax cascades
 - reduces compliance costs of sub-contracting which improves competition and efficiency
 - similar to law in Australia/Singapore
 - allows the domestic leg transporter to offer more competitive pricing
- This option accords with current commercial practice of simply zero-rating the domestic leg of transportation (although this commercial practice is currently non-compliant, it does not require the domestic leg transporter to consider whether international transporter is non-resident).

Cons:

- As with option two, some GST revenue will be foregone (\$200k pa)³ on the domestic leg of transportation due to zero-rating (or in the case of NZ registered transporters, the GST impost would be removed by claiming an input tax deduction).

Option four: Encourage non-resident businesses to register for NZ GST

Under this option, non-resident businesses will be encouraged to register for New Zealand GST so they can claim their GST input deductions, removing the possibility of the GST becoming irrecoverable and embedded in the price of the service.

Pros:

- If non-resident businesses were GST registered then they would be able to claim their GST inputs, and thus the issue of tax cascades would not apply.
- Does not require legislative amendment, only guidance.
- No fiscal cost (although being GST registered means the transporters could claim inputs they would also pay output tax as well as GST would still be charged on the domestic leg).

Cons:

- Any success of this proposal is contingent on non-resident businesses registering for NZ GST. This is considered unlikely.
- Increases compliance costs as transporters would have to enquire as to the GST registration status of the primary transporter (therefore also a lack of certainty).
- Does not increase competition – non-resident business is disincentivised from choosing another transport supplier, even if it makes good commercial sense to do so, due to tax considerations.

3.2 Which of these options is the proposed approach?

Option three is the preferred option – to zero-rate all domestic transport services supplied to a primary transport supplier contracted to transport goods to and from NZ, regardless of the residency of the primary transport supplier.

This option is preferable because it results in lower compliance costs on transporters, as they will not suffer the compliance costs of trying to determine whether the primary transport supplier is non-resident (as they would under option 1). It also increases efficiency as tax considerations would no longer drive business decisions (i.e. this option completely removes the tax incentive for the primary transporter to also undertake the domestic leg).

It is noted that option three would also not have any measurable increase in fiscal costs when compared to option two. Our understanding of current business practices is that in nearly all cases, the primary transport supplier is registered for GST and/or the subcontracted courier treats their domestic leg services as zero-rated. In either of these cases, the proposed change will not change the total amount of GST collected, but will reduce compliance costs.

³ This is slightly higher than option 2 due to its broader scope but differences should be nominal.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties	Comment:	Impact
Additional costs of proposed approach, compared to taking no action		
Regulated parties (transporters of goods)	No cost.	None
Regulators (Inland Revenue)	<p>Zero-rating domestic transport services will result in a lower tax take for the Government. It is noted that this fiscal cost would be nominal as in nearly all cases the primary transported is either registered for GST and/or the subcontracted courier treats their domestic leg services as zero-rated.</p> <p>In terms of non-monetised costs, these changes will bring a very small administrative cost to Inland Revenue in terms of providing guidance to transporters on what the new rules are in order to aid taxpayer understanding and promote compliance.</p>	\$200k pa approx. GST foregone
Wider government	No expected costs	None
Other parties	Not applicable.	Not applicable
Total Monetised Cost		\$200k pa
Non-monetised costs		Low
Expected benefits of proposed approach, compared to taking no action		
Regulated parties (transporters of goods)	Transporters undertaking the domestic leg of transportation may see an uplift in their business. This is because the proposals remove the tax incentive for international transporters to also undertake the domestic leg of transportation. This will reduce compliance costs associated with sub-contracting which may improve competition and increase efficiency. There would also be no commercial pressure placed on domestic transporters to incorrectly zero-rate (as zero-rating would be permissible under the law).	Low

Regulators	Creates certainty in the law (as current law is misunderstood).	Low
Wider government	Not applicable.	Not applicable.
Other parties (end consumer)	The end consumer should pay a lower overall cost for goods. This is because the proposed policy solution will reduce the compliance costs associated with sub-contracting. This will lead to improved competition, increased efficiency and potentially lower prices. In circumstances where GST was previously charged, the proposals will eliminate tax cascades (GST charged on the domestic leg will not be imbedded in the final cost of the goods).	Low
Total Monetised Benefit	None.	Not applicable.
Non-monetised benefits	As above, the proposals would remove the tax incentive for the international transporter to also undertake the domestic leg. This could result in an uplift in business for domestic carriers.	<i>Medium</i>
4.2 What other impacts is this approach likely to have?		
There are unlikely to be any further material impacts of this approach.		

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

Who has been consulted?

This issue was consulted on as part of the release of the *GST policy issues – an officials’ issues paper*. Inland Revenue received 9 submissions on the domestic leg of the international transport of goods proposals.

What was the nature of their interest?

Submissions were generally positive of the proposed changes, with several submitters noting that it needs to be a clear and easily understood definition of what constitutes the international transport of goods, to ensure the new rules do not inadvertently add another layer of complexity.

Several submitters noted their preference for the zero rating treatment to be on all domestic transport services where they relate to an international transport service, instead of relying on the tax residency of the primary transport supplier. This approach would remove complexity in determining the correct GST treatment of the transport service.

Do they agree with your analysis of the problem and its causes?

Yes. The submissions received on this issue in the GST issues paper outlined similar concerns to what has been discussed in this RIA (see above and in the pros and cons section of the discussion options).

Do they agree with your proposed approach?

Submitters preferred a broad zero-rating rule and this is the approach we are implementing (see option 3).

Has your proposed approach been modified as a result of stakeholder feedback?

Yes. When officials initially consulted on this in the issues paper we proposed allowing domestic transport services to be zero-rated only if supplied to a non-resident. The issues paper posed a question to submitters as to whether this rule should be extended more broadly to all domestic transport services supplied as part of the international transport of goods, regardless of the residency of the primary transport supplier.

Submitters supported the broader approach. Having considered this issue in greater detail officials have now opted to recommend the broader solution.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

An amendment will be required to the Goods and Services Tax Act 1985 to give effect to this proposal. This could be included in the next available omnibus tax bill (expected to be introduced in August 2021).

Guidance materials to explain how the amendments would operate will be published when the bill is introduced, in response to submissions raised with Select Committee and after the bill is enacted (by way of inclusion in a Tax Information Bulletin).

The proposals have been subject to consultation via a GST issues paper and would be subject to the standard legislative process. It therefore follows that there will be sufficient time for people to react to and understand the changes (which it is noted are simple in nature).

As these changes generally align with existing taxpayer practices there are unlikely to be any significant implementation risks.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

We will continue to engage with submitters and other stakeholders to ensure the rules are operating correctly and to determine whether any remedials or further changes are required. As the proposal is taxpayer friendly, compliance will be voluntary and enforcement/extensive monitoring is not necessary.

7.2 When and how will the new arrangements be reviewed?

There are no plans to review these changes. This is because the changes are taxpayer friendly and therefore compliance will be voluntary. That said, we will continue to engage with submitters to ensure the proposals deliver the desired outcome in terms of improved efficiency and a reduction in compliance costs.

As officials have developed relationships with stakeholders throughout consultation on the issues paper, this engagement channel is open to stakeholders should they wish to provide feedback on the legislation.