Hon David Parker, Minister of Revenue

Information Release

GST apportionment: release of officials' issues paper

March 2022

Availability

This information release is available on Inland Revenue's tax policy website at https://taxpolicy.ird.govt.nz/publications/2022/2022-ir-cab-dev-22-sub-0017

Documents in this information release

#	Reference	Type	Title	Date
1	IR2021/510	Tax policy report	Public release of an officials' issues paper on the GST apportionment and adjustment rules	2 December 2021
2	DEV-22-SUB-0017	Cabinet paper	GST apportionment: an officials' issues paper	2 March 2022
3	DEV-22-MIN-0017	Minute	GST apportionment: release of officials' issues paper	2 March 2022

Additional information

The Cabinet paper was considered by the Cabinet Economic Development Committee on 2 March 2022 and confirmed by Cabinet on 7 March 2022.

One attachment to the Cabinet paper is not included in this information release as it is publicly available:

- GST apportionment and adjustment rules – an officials' issues paper (March 2022)[1]

Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

9(2)(a)	to protect the privacy of natural persons, including deceased people
9(2)(f)(iv)	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[1] Available at https://taxpolicy.ird.govt.nz/publications/2022/2022-ip-gst-apportionment-rules

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POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Public release of an officials' issues paper on the GST apportionment and adjustment rules

Date:	2 December 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/510

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendation	20 December 2021
Minister of Revenue	**Agree** to recommendation **Approve and lodge** the attached Cabinet paper and draft officials' issues paper	20 December 2021 10am Thursday 3 February 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Graeme Morrison	Policy Lead, Inland Revenue	s 9(2)(a)
Gordon Witte	Principal Policy Advisor, Inland Revenue	

2 December 2021

Minister of Finance
Minister of Revenue

Public release of an officials' issues paper on the GST apportionment and adjustment rules

Executive summary

1. This report seeks your approval to release the *GST apportionment and adjustment rules* officials' issues paper, for public consultation. These rules apply when a GST registered business purchases an asset which is used for both business and for private or exempt use. A draft officials' issues paper and draft cabinet paper are attached to this report, for your consideration.

2. As outlined in our earlier report to you in February 2021 (*IR2021/060* refers), the GST apportionment and adjustment rules have been an issue of high priority for stakeholders for some time, with reform of the apportionment rules being ranked the highest priority in the recent GST stewardship review, as well as in submissions received in the February 2020 GST issues paper.

3. In recent months, we have been engaging with external stakeholders (including private sector GST advisors) in developing several policy proposals and technical amendments, with a view of making the rules simpler and easier for taxpayers to comply with, that now should be subject to public consultation.

4. We seek your approval to publicly consult on these proposals.

5. The draft officials' issues paper seeks submissions on:

   5.1 Allowing GST-registered persons to elect capital assets not to be subject to GST.

   5.2 Introducing a principal purpose test for assets worth less than $5,000, whereby an asset purchased for predominant business use will receive full input deduction.

   5.3 Establishing a 20% margin rule for assets worth more than $5,000, whereby businesses would not be required to make annual apportionment adjustments unless their business use of the asset has significantly changed.

   5.4 Introducing new rounding-based rules for assets that have less than 20% or more than 80% of taxable use, so they are effectively not subject to the apportionment rules.

   5.5 Proposing technical changes to the definitions of residential and commercial accommodation services, to provide more certainty to various commercial situations.

   5.6 Exploring potentially treating houses as fully private assets and GST exempt on sale.

   5.7 Simplifying the rules for residential property developers, while encouraging land to be developed within a reasonable timeframe.

   5.8 A number of other technical improvements that will reduce compliance costs.

6. If you agree to the recommendations in this report, the next step is to obtain Cabinet's approval to release the officials' issues paper for public consultation. A draft Cabinet paper is attached for lodgement with the Cabinet Office by 10.00am Thursday 3 February 2022, for consideration by the Economic Development Committee the following Wednesday 9 February 2022.

s 9(2)(f)(iv)

10. The Treasury has been consulted in the preparation of this report.

Recommended action

We recommend that you:

Recommendations		Minister of Finance	Minister of Revenue
(a)	**note** the contents of the attached draft Cabinet paper and draft GST apportionment and adjustment rules officials' issues paper	Noted	Noted
(b)	**note** the draft officials' issues paper is subject to minor technical and editorial changes	Noted	Noted
(c)	s 9(2)(f)(iv) [redacted]		
(d)			
(e)	**approve and lodge** the attached Cabinet paper and draft officials' issues paper to the Cabinet Office, for consideration by the Cabinet Economic Development Committee	N/A	Approved and lodged

s 9(2)(a) [redacted]

Graeme Morrison
Policy Lead, Indirect Tax
Policy and Regulatory Stewardship

Hon Grant Robertson
Minister of Finance
/ /2021

Hon David Parker
Minister of Revenue
/ /2021

Background

11. The Goods and Services Tax (GST) is a 15% tax on the consumption of most goods and services supplied to New Zealand consumers. To prevent businesses bearing the burden of GST, GST-registered businesses can claim back GST paid on their purchases (known as an input tax deduction), provided these goods and services are used in their business.

12. However, some businesses purchase goods and services that are used in both their business, known as taxable use, such as a delivery van supplying courier services during the week, and for private use[1], such as recreational use of the van in the weekend. Where the good or service has been used both for taxable use and non-taxable use, then the business must apportion the input tax deduction based on the estimated percentage of taxable use. This is known as apportionment.

13. Once the business has apportioned their input tax deduction based on their estimated taxable use, they are required to monitor their actual use of the asset over time (often several years). If their estimated use is inaccurate, then this must be accounted for in their GST return. This is known as adjustment or change in use.

14. The goal of the apportionment rules is to ensure that GST is collected on the portion of the good or service's use that is not for making taxable supplies, as would be the outcome if the asset was bought outright for non-taxable use.

Calls to reform the apportionment and adjustment rules

15. As outlined in our earlier report (*IR2021/060* refers), public submissions received on proposed technical amendments to the apportionment rules in the 2020 *GST Policy Issues: an officials' issues paper* were that in many situations, the existing rules are complex and impose unreasonable compliance costs, and that more substantial reform was required.

16. Submissions received on the 2020 GST Policy Issues: an officials' issues paper made it clear that substantial reform of the apportionment and adjustment rules is a priority. Submitters said the focus needs to be creating rules that are simpler and practical to apply, especially for small and medium-sized businesses.

17. Importantly, reform to the apportionment and adjustment rules was the number one issue identified by private sector stakeholders in the recent GST system stewardship review. A redesign of the existing rules is required to ensure they support emerging commercial practices, such as the gig and sharing economy.

18. Since our earlier report we have been regularly engaging with key stakeholders, such as private sector GST advisors, to discuss what reform options are available. This has included removing assets from the apportionment rules and reducing the need for annual monitoring by businesses.

19. The four significant proposals are further explained in this report.

The election method

20. It is proposed that a GST-registered business can elect whether to exclude certain capital assets[2] from GST. An election to exclude the asset would have the same GST outcome as the scenario where an asset was purchased by an unregistered person - no GST input claimed, no GST charged on sale or disposal. The proposal

[1] Or for making GST-exempt supplies.
[2] Such as private homes, holiday homes and other mainly private and appreciating assets.

would apply to capital improvements and would exclude certain assets such as trading stock.

21. It is anticipated that historically, many affected taxpayers have not claimed input tax deductions on predominantly private assets, and so potentially this method could be applied retrospectively (where no inputs have been claimed on existing assets).

22. This proposal seeks to resolve a current concern of Chartered Accountants Australia and New Zealand and private sector tax advisors known as the "farmhouse or home-office issue" whereby predominately private properties have been used to support a taxable activity (including where some have only claimed GST input deductions on the property's operating expenses) but can unexpectedly result in the whole property being subject to GST on sale (including any capital gain). The current rules are complex and unfair, with stakeholders seeking a policy solution to this issue with some urgency.

23. The effectiveness of the election method will ultimately depend on the extent to which taxpayers choose to use it. If take-up is high, then the election method would remove GST liabilities from mainly private assets and reduce compliance costs; however, if take-up is low, then the benefits are not likely to be realised.

24. It is expected that stakeholders will be supportive of this proposal, as it will allow predominantly private capital assets to be kept outside the GST base.

Principal purpose test for low-value assets

25. It is proposed that a principal purpose test would apply for assets that cost less than $5,000 (excluding GST). For example, if the asset was purchased for the principal purpose of making taxable supplies, then a full input tax deduction could be claimed, and the asset would effectively not be subject to the apportionment rules[3]. A $5,000 limit means the maximum GST adjustment would be $750 per asset.

26. It is expected that stakeholders will be supportive of this proposal, as it will reduce compliance costs as well as aligning the law to reflect current commercial practices.

20 percent margin rule and rounding rules for near exclusive business or private use

27. It is proposed that a +/-20% margin (or buffer) is applied to a chosen apportionment percentage, for assets that are not subject to the principal purpose test. Essentially, the mix of taxable use and non-taxable use can move freely within this range without consequence. The GST-registered person would only make an adjustment if the change in use was greater than 20%.

28. For example, if an asset had an initial apportionment of 66% business use, then an adjustment would only be made if the business use dropped below 46% (-20%) or increased above 86% (+20%).

29. Additionally, it is proposed that rounding rules apply to assets not subject to the principal purpose test, that have an overwhelming taxable or non-taxable use. Where an asset has a taxable use of 80% or more, then the asset's taxable use would be rounded up to 100%. This rounding-up rule would be taxpayer-friendly

[3] Unless the asset then became no longer principally used to make taxable supplies – then the input would be repaid.

because businesses would receive full input tax deductions; whilst allowing a limited amount of private use (such as most work-related vehicles).

30. Likewise, where an asset has a taxable use of 20% or less, then the asset's taxable use would be rounded down to 0%, meaning the GST-registered person would treat the asset like a private asset. It is anticipated that this rule would remove most residential property that has limited taxable use (such as a home office or farmhouse). If a dwelling has higher than 20 percent taxable use, but still has mainly private use (such as a holiday home rented to guests and used privately) it could be removed from GST on sale by using the election method discussed above.

31. It is expected that stakeholders will be supportive of the proposal, as it will effectively remove assets that are 80% or more taxable or private from the apportionment rules.

Rules for residential property developers

32. Currently, GST apportionment rules are complex to apply if land that is being developed by a residential property developer also has some non-taxable use (such as owner-occupier or an on-going residential tenancy) before the improved property is sold.

33. The issues paper proposes to simplify the rules, whereby GST-registered property developers would no longer apply the apportionment rules and instead claim a full input tax deduction for the purchase of the land and for other capital development costs once their development activity had commenced. This simplification proposal is expected to be supported by stakeholders.

34. Another issue is that currently, Inland Revenue can have difficulty distinguishing between GST-registered persons who are *bona fide* property developers and those who intend to develop land. Both groups claim input tax deductions when purchasing the land but some ultimately don't commence the development or don't sell the developed property. This represents a fiscal risk as large GST deductions / refunds are paid on purchase, but no subsequent GST is collected as the land is ultimately not improved and sold.

35. The issues paper proposes potential timing and information changes which could reduce this risk, whilst also encouraging land to be developed and sold in a reasonable timeframe (such as 36 months with an ability to apply to Inland Revenue for an extension).

36. Where the developer has an established property development business, they would continue to receive their input deduction at the time of purchase, however the issues paper proposes that other first-time or small-scale developers could have to wait until their development activity has commenced (rather than claiming deductions at the time the land is purchased as per current rules).

37. This delay may negatively impact their cash flow. Stakeholders are likely to raise concerns about this proposal because developers use the input tax deduction to partly fund the purchase and/or initial development costs.

38. Stakeholders may also raise concerns with the proposed deadline for developing and selling the land, given some property developers prefer to hold land until it is commercially suitable to undertake the development activity. The consultation process will allow us to better refine the proposals towards areas of concern, while mitigating unintended consequences.

Other proposed changes

39. The officials' issues paper also includes several proposed changes that seek to reduce compliance costs for businesses. These issues are listed below, under the same headings and in the same order as in the officials' issues paper. These are:

    39.1 Accommodation services supplied in dwellings and commercial dwellings.

    39.2 Sale of a dwelling an exempt or separate supply.

    39.3 Reduce the required number of adjustment periods.

    39.4 Expand the wash-up rule eligibility.

    39.5 Repeal the mixed-use asset rules in section 20G; Repeal the concurrent use of land rules in section 21E.

    39.6 Allowing a wider range of apportionment methods to be approved by Inland Revenue.

Consultation

40. The Treasury has been consulted in the preparation of this report.

41. The Ministry of Housing and Urban Development has been consulted on the proposals and has not raised any concerns. We will continue to work with the Ministry of Housing and Urban Development before seeking final policy decisions.

42. We have also had preliminary discussions with several private sector GST advisors and the Chartered Accountants of Australia and New Zealand, where they have provided feedback and advice on various policy issues and proposals. We intend to continue to meet with stakeholders after the officials' issues paper has been released for public consultation, as part of developing final policy decisions.

s 9(2)(f)(iv)

s 9(2)(f)(iv)

[redacted]

Timing of the officials' issues paper

48. Subject to your approval, the next step is to obtain Cabinet's approval to release the officials' issues paper for public consultation.

49. Subject to Cabinet approval, the preferred date to release the officials' issues paper is February 2022, with public submissions closing in April 2022. This will allow sufficient time to undertake further policy development.

50. Below is an indicative timetable, based on a release date in February 2022.

Milestone	**Date**
Cabinet Economic Development Committee	9 February 2022
Cabinet	14 February 2022
Release of officials' issues paper	February 2022
Submissions close	April 2022
Seek final policy decisions from Ministers and Cabinet	June / July 2022
Introduction of the next omnibus tax bill	August 2022
Legislation enacted	March 2023

Next steps

51. If you agree to the inclusion of the proposals outlined above, the next step is to obtain Cabinet approval to release the officials' issues paper for consultation. For the paper to be considered by the Cabinet Economic Development Committee on Wednesday 9 February 2022, it would need to be lodged with the Cabinet Office by 10.00am Thursday 3 February 2022.

52. If Cabinet approval is obtained, you will have the delegated authority to prescribe the date for officials to release the officials' issues paper for public consultation.

53. We propose to proactively release the cabinet paper, cabinet minute and key advice papers when the officials' issues paper is released.

54. We will report back to you on public submissions received. The feedback will support the development of final policy decisions, with a view of obtaining Cabinet approval in time for their inclusion in the next available tax bill.

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

GST APPORTIONMENT: AN OFFICIALS' ISSUES PAPER

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to the release of an officials' issues paper *GST apportionment and adjustment rules*, which is attached. The consultation document discusses policy issues with the existing goods and services tax (GST) apportionment and adjustment rules and suggests potential solutions.

2. I seek Cabinet's approval for the officials' issues paper to be finalised and publicly released for consultation. Subject to Cabinet's approval, I plan to direct officials as to when the officials' issues paper should be released for consultation.

Relation to Government Priorities

3. This proposal supports the Government's Fiscal Strategy[1] and the following workstream in the Government's 2021–22 tax policy work programme: Maintaining the tax system: tax legislation needs to be regularly maintained and updated in response to changing technology and business practices. It is important that the tax legislation reflects the principles of fairness and certainty.

4. The attached officials' issues paper supports this workstream as the proposed policy options it consults on seek to update the existing GST rules to improve fairness, reduce compliance costs and better reflect commercial practices.

Executive Summary

5. Goods and Services Tax is a consumption tax on most goods and services which are supplied by registered persons (such as businesses), at a single rate of 15%, under the Goods and Services Act 1985 ("GST Act"). A GST registered taxpayer can claim GST input tax deductions on purchases of assets (such as buildings and vehicles) that they intend to use in their business.

6. Where the asset is used both for business use and for private use (or making exempt supplies), then the taxpayer can only deduct a percentage of the total deduction, based on their estimate of the percentage of business use. This is known as apportionment.

7. Once the taxpayer has apportioned their input tax deduction based on their estimated business use, they are required to monitor their actual use of the asset

[1] See https://treasury.govt.nz/publications/wellbeing-budget/wellbeing-budget-2019-html#section-13

over time, and if their estimate is inaccurate, then the taxpayer must account for this difference in their GST return, annually. This is known as an adjustment or change in use.

8. The current GST apportionment and adjustment rules are complex and have high compliance costs. Submissions on the February 2020 *GST policy issues paper* suggested the current apportionment rules should be replaced with simpler rules. Additionally, the recent stewardship review of the GST system identified the apportionment and adjustment rules as the number one issue that needed revision.

9. In recent months, my officials have met with key stakeholders such as private sector GST advisors to discuss what practical reform options are available, for inclusion into an officials' issues paper.

10. The attached officials' issues paper consults on options for simplifying the rules. To address some of the gaps and weaknesses of each option, it is likely that a combination of potential solutions will be required, as a reform package. The policy options in the officials' issues paper include:

    10.1 Allowing GST registered businesses to elect that their capital assets not be subject to GST on sale, by not claiming input tax deductions when the asset is purchased (**the election method**).

    10.2 Introducing a simple **principal purpose test** for assets purchased for less than $5,000 (GST exclusive), where for assets which are principally acquired for business purposes the business would claim a full GST input tax deduction (rather than applying the apportionment rules).

    10.3 A **20% margin rule**, whereby GST registered businesses would no longer be required to make annual adjustments unless their business use of the asset has significantly changed (by more than 20 percent).

    10.4 Introducing **rounding-based rules** for assets purchased for $5,000 or more (GST exclusive), that seek to remove most assets from the apportionment and adjustment rules:

        10.4.1 Assets with 80% or more of business use would be deemed to have 100% business use, allowing the taxpayer to claim full input tax deductions while having a small amount of private or exempt use.

        10.4.2 Likewise, assets with 20% or less of business use would be deemed to have 0% business use and consequently the asset is treated like a private asset.

    10.5 Several potential, technical changes to the **definitions of residential and commercial accommodation services**, which are more certain and easier to apply to various commercial situations, than the existing definitions.

    10.6 **Discussing if special GST rules should apply to the sale of houses** (and other types of dwellings), whereby these could be treated as fully private assets and GST exempt on sale, unless the house has been built or developed by a property developer for sale.

10.7 Several proposals aimed at simplifying the **rules for residential property developers**, whilst also encouraging land to be developed and sold sooner (generally within 36 months).

10.8 As well, the paper also contains **several minor changes to the apportionment and adjustment rules** that seek to reduce compliance costs for GST registered businesses.

11. The estimated overall fiscal impact of the potential solutions is uncertain as it depends on which options are progressed and how they compare to current taxpayer practices.

12. Subject to Cabinet's approval, officials will release the issues paper to seek feedback on these potential solutions. Following public consultation, I will report back to Cabinet with recommended policy decisions and their estimated fiscal implications. These decisions could apply from the 2022/23 fiscal year onwards.

Background

13. Goods and Services Tax is a 15% consumption tax on most goods and services supplied to New Zealand consumers by registered persons (such as businesses). To ensure GST is not a cost on business production, businesses can claim back GST input tax deductions on purchases of goods and services they use in their business.

14. However, where the asset is used both for business use (known as taxable use), such as a van delivering packages during the week, and for private use, such as recreational use of the van in the weekend (or making exempt supplies), then the taxpayer must apportion (by way of a percentage) the total deduction, based on their estimate of the percentage of taxable use. This is to ensure GST is collected on the portion of the asset's private use, as would be the outcome if it was bought outright for non-business use.

15. Once the taxpayer has apportioned their input tax deduction based on their estimated business use of the asset, they are required to monitor their actual use over time. If there is a difference in the actual use, then an adjustment to the original apportionment percentage is required and the change included in their GST return.

16. Public submissions received on the February 2020 *GST Policy Issues: an officials' issues paper* explained that in many situations, the current rules are complex and impose unreasonable compliance costs. The recent stewardship review of the GST system identified the apportionment and adjustment rules as the number one issue that needed revision. Stakeholders were clear that the existing apportionment rules needed to change. A redesign of the existing rules is required to ensure they support emerging commercial practices, such as the gig and sharing economy.

17. Last year, my officials met with key stakeholders such as private sector GST advisors to discuss what simpler, practical options could be further explored, for inclusion into an officials' issues paper.

18. Several reform options have been identified and are further explained below. Many of the proposed options seek to remove most assets from the apportionment rules and reduce the need for annual monitoring by GST registered businesses.

19. These policy options have been included in the attached officials' issues paper, *GST apportionment and adjustment rules*. Resolving these issues would reduce compliance costs for taxpayers while ensuring GST is continues to be collected on the private consumption of goods and services.

GST apportionment and adjustment rules: An officials' issues paper

The election method

20. The UK and Singapore's GST rules allow taxpayers to exclude assets from being subject to the apportionment rules, and GST on sale, by choosing not to claim an input tax deduction at the time of purchase. The issues paper proposes a similar election method could be introduced in New Zealand. Taxpayers would be electing to be taxed on the asset as if it only had private use.

21. Officials anticipate the method would mainly be applied to residential land and dwellings which may have some minor business use (e.g. a home office or workshop). This would ensure GST registered sole traders are not disadvantaged compared to other types of ownership structures where houses and other private assets are usually held by a different person to the entity which is GST registered.

22. It is anticipated that historically, many of the affected taxpayers (e.g. GST registered sole traders) have not claimed input tax deductions on assets that are predominantly private (e.g. the family home with a home office), and so this method could be applied retrospectively, that is, where no input tax deductions have been claimed on existing assets, then these assets would not be subject to GST on sale. This should be positively received by taxpayers that could otherwise, under the existing rules, be subject to GST on sale despite not previously claiming input tax deductions.

23. The issues paper also proposes an option whereby taxpayers that have previously claimed input tax deductions on their assets could repay these input tax deductions within 12 months of the reforms taking effect, and in return, their existing assets would not be subject to GST on sale in the future.

Principal purpose test for assets less than $5,000

24. Another proposed option consulted on in the issues paper is that businesses could claim a full GST input tax deduction (rather than apportioning the deduction) for any asset costing less than $5,000 (GST exclusive) which they principally acquired for business purposes.

25. This test would reduce compliance costs for taxpayers by greatly reducing the number of assets subject to the apportionment and adjustment rules. Instead, a GST adjustment would only be made if the principal purpose that the asset was acquired for changed (which would be uncommon).

26. It is anticipated that many GST registered businesses may already be claiming full input tax deductions on low-value business assets (on the basis that these assets

have no or very little private use), rather than applying the existing apportionment and adjustment rules.

20% margin for assets above $5,000

27. For higher value assets it is proposed that rather than being required to make annual GST adjustments if there is any increase or decrease in business use, the taxpayer would only make an adjustment if the change in use of the asset was greater than 20%.

28. For example, if an asset had an initial apportionment of 66% business use, then an adjustment would only be made if the business use dropped below 46% (-20%) or increased above 86% (+20%).

29. A 20% threshold has been proposed as it is understood that for an asset to experience a 20% change in use, then it is likely a deliberate change in use of the asset has occurred, rather than an unintended change. Consequently, a 20% threshold should remove most compliance costs associated with closely monitoring the use of each asset, and from being required to file adjustments each year.

Deeming rules for assets that are almost exclusively taxable or private

30. Another simplification option proposed is that where an asset that cost more $5,000 (GST exclusive) that has at least an 80% taxable use, it could be rounded up and deemed to have 100% taxable use.

31. This would be a taxpayer-friendly rule because businesses could receive full input tax deductions, whilst allowing a limited amount of private use (such as for most work-related vehicles).

32. Likewise, where an asset has 20% or less taxable use, then the asset would be deemed to have no taxable use (0%) and therefore treated like a private asset (GST is collected on purchase, but not when the asset is subsequently sold).

33. Essentially, under both of these rules, qualifying assets would be effectively removed from the GST apportionment and adjustment rules entirely.

Changes to the definition of residential and commercial accommodation services

34. GST apportionment issues can arise when the same premises is used to make both taxable supplies of commercial accommodation (e.g. a hotel) and non-taxable supplies such as private use or exempt supplies (e.g. a live-in hotel manager).

35. The GST treatment in such cases depends on the definitions of “dwelling” and “commercial dwelling” which can overlap and be uncertain.

36. The issues paper outlines several potential, technical-based amendments to the existing definitions, as well as seeking submissions on whether any alternative definitions could be developed which could provide more certainty or be easier to apply than the existing definitions.

Special GST rules for sales of houses

37. The GST system does not tax most private assets such as houses and dwellings. This is because they are not usually used by a GST registered business to conduct their business. However, some GST registered sole traders may use part of their home such as a home office or workshop to conduct their business which can cause the sale of that home to become subject to GST, even though it is mostly used for private purposes.

38. One way that other countries have addressed this is by making the sale of houses (and other types of dwellings) an exempt supply, unless the house has been built or developed by a property developer for sale.

39. The issues paper discusses a potential exemption and notes that the other reform options discussed above may be a simpler way to remove GST compliance costs and liabilities on private houses which have some business use. The feedback received from a small group of tax advisors, was that developing a specific exemption for houses may not be necessary and would require some new definitions to be developed which would add complexity and uncertainty to the GST rules for land.

Land which is developed and sold by property developers

40. Land that is developed and sold by a GST registered property developer would remain subject to GST to ensure the GST system correctly taxes the value-added from this activity. This rule would apply regardless of any of the other proposals discussed in the issues paper.

41. However, the current GST apportionment rules are complex to apply if land that is being developed to be sold by a GST registered residential property developer, also has some non-taxable use (such as owner-occupation of the existing dwelling or an on-going residential tenancy) during the period of the registered person's ownership.

42. The issues paper consults on a proposed simplification, whereby GST registered property developers would claim a full input tax deduction for the purchase the land and for other capital development costs once their development activity had commenced, instead of applying the apportionment rules.

43. This proposal could encourage more efficient use of housing. For example, property developers may currently prefer vacant properties (to get a full input tax deduction and simpler GST compliance) than letting the house to a residential tenant (e.g. by maintaining an existing tenancy or entering a new one) until the house is ready to be developed or sold (as this non-taxable use would mean GST apportionment would apply to the land).

44. Another issue is that under the current GST rules, Inland Revenue can have difficulty distinguishing between registered persons who are *bona fide* property developers and those who intend to develop land. Both groups claim input tax deductions when purchasing the land but some ultimately don't commence the development or don't sell the land. This represents a fiscal risk as large GST deductions / refunds are claimed on purchase, but no subsequent GST is collected as the land is not ultimately developed or sold.

45. The issues paper consults on some potential timing and information changes which could reduce this risk, whilst also encouraging land to be developed and sold in a reasonable timeframe.

46. Currently, a GST registered person can claim an input tax deduction at the time they purchase land. Under the proposed option, if a GST registered person had an existing business of developing land for sale they would still be able to claim an input tax deduction at the time of purchase.

47. However, if they did not have an existing land development business (e.g. a first time developer) they would not initially be able to claim an input tax deduction for the cost of the land. Once they begin developing the property and have an intention to sell the property when they finish this development, they would then be able to claim a full input tax deduction on the purchase price of the property in their next GST return (rather than apportioning the deduction).

48. This proposed change could have negative cashflow implications for some smaller or first-time property developers as it would delay when they are able to claim a GST deduction from the date of purchase to the date development commenced. However, it could also encourage the development to commence sooner (rather than simply holding the land).

49. The issues paper also proposes a time limit could be introduced so if a registered person claims a full input tax deduction for land under the proposed new residential property development rules, they will generally need to sell the land within 36 months of the deduction being claimed. The GST registered developer could apply to Inland Revenue for an extension to this time limit if they can provide evidence that they have actually developed the property (or are continuing to develop it) and intend to sell the property within a certain timeframe.

50. To support compliance with the new rules, the issues paper also proposes that GST registered taxpayers would be required to provide certain information to Inland Revenue when they have claimed input tax deductions on land (as well as luxury yachts or aircraft) as this information will assist Inland Revenue to monitor if these taxpayers account for GST on any subsequent non-taxable use, or when the asset is sold.

51. Stakeholders may raise concerns with some of these proposals. The consultation process will allow officials to better refine the proposals towards areas of concern, while mitigating unintended consequences.

Other potential simplification changes to the existing rules

52. Finally, the issues paper contains several minor and incremental improvements to the existing apportionment rules. These include allowing taxpayers to make an adjustment for a permanent change in use in a wider range of circumstances and 12 months earlier than the current rules; and repealing certain special rules for land and mixed-use assets because the policy solutions contained in the officials' issues paper would supersede them.

Implementation

53. The proposals in the officials' issues paper would require legislative amendments to the Inland Revenue Acts. Several proposals would also require the affected GST registered persons to disclose information to Inland Revenue on certain purchases of land.

54. The purpose of the issues paper is to seek feedback on the proposals, including implementation implications, which will be reported back to Cabinet when final policy decisions are sought.

Financial Implications

55. There are no financial implications associated with releasing the GST apportionment and adjustment rules, officials' issues paper. However, if following public consultation certain policy options are progressed, then their introduction will likely have an impact on forecast Crown revenue. If these options have a net fiscal cost, then consideration will be given to funding the changes through the Tax Policy Scorecard. Any final policy decisions are likely to be effective from the 2022/23 fiscal year onwards at the earliest.

Legislative Implications

56. The decision to consult on the various GST proposals do not give rise to any immediate legislative implications. If, following consultation, Cabinet decides to implement the changes contained in the officials' issues paper, enabling legislation will be required. Proposals could be included in an omnibus tax bill in late 2022.

Impact Analysis

Regulatory Impact Assessment

57. The Regulatory Impact Analysis panel at Inland Revenue has reviewed and confirmed that the *GST apportionment and adjustment rules* officials' issues paper can substitute for an interim Regulatory Impact Statement. It will lead to effective consultation and support the eventual development of a quality Regulatory Impact Statement.

Climate Implications of Policy Assessment

58. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

59. Releasing the issues paper does not have any population implications. Any populations implications resulting from the proposals will be included in final policy advice to Cabinet following consultation.

Human Rights

60. The issues contained in the officials' issues paper and their policy solutions do not give rise to any human rights implications.

Consultation

61. The attached officials' issues paper has been prepared by Inland Revenue.

62. The Treasury and the Ministry of Housing and Urban Development have been consulted about the policy options in this cabinet paper and the attached officials' issues paper.

Communications

63. Subject to Cabinet's approval, I will direct officials as to when the officials' issues paper should be published for consultation on Inland Revenue's website.

Proactive Release

64. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers, with appropriate redactions, within 30 working days of the release of the officials' issues paper.

Recommendations

The Minister of Revenue recommends that the Committee:

1. **Note** that a number of policy issues have been identified with the existing GST apportionment and adjustment rules;

2. **Note** that the attached officials' issues paper, consults on a range of options for simplifying the existing apportionment and adjustment rules, including:

   2.1 Allowing GST registered businesses to elect capital assets not be subject to GST on purchase or sale (**the election method**)

   2.2 Introducing a **principal purpose test** for assets purchased for less than $5,000 (GST exclusive), where an asset that is principally acquired for business purposes would claim a full GST input tax deduction

   2.3 Introducing a **20% margin rule**, whereby GST registered businesses would no longer make annual adjustments unless their business or private use of the asset has significantly changed (by more than 20%)

   2.4 Introducing **rounding-based rules** for assets that are close to being either fully taxable (80% or more taxable use) or fully non-taxable (20% or less taxable use)

   2.5 Potential options for improving the **definitions of residential and commercial accommodation services**

2.6 Discussing if **special rules should apply to the sale of houses** and other types of dwellings, where they are treated as fully private assets and GST exempt on sale by a registered person other than a property developer

2.7 Potential options for **simplifying the GST apportionment rules for residential property developers** whilst also encouraging land to be developed and sold sooner

2.8 Other **minor and incremental improvements** that seek to reduce compliance costs for GST registered businesses and remove rules that are superseded by policy options outlined in the officials' issues paper;

3. **Approve** that, subject to minor editorial changes, the attached officials' issues paper *GST apportionment and adjustment rules*, be approved to be released on Inland Revenue's website for public consultation;

4. **Authorise** the Minister of Revenue to approve minor changes to the officials' issues paper prior to its release;

5. **Authorise** the Minister of Revenue to prescribe the date for when the officials' issues paper will be released.

Authorised for lodgement

Hon David Parker
Minister of Revenue

DEV-22-MIN-0017

Cabinet Economic Development Committee

Minute of Decision

GST Apportionment: Release of Officials' Issues Paper

Portfolio **Revenue**

On 2 March 2022, the Cabinet Economic Development Committee:

1 **noted** that a number of policy issues have been identified with the existing GST apportionment and adjustment rules;

2 **noted** that the officials' issues paper, *GST Apportionment and Adjustment Rules: An Officials' Issues Paper* (the officials' issues paper), attached to the submission under DEV-22-SUB-0017, includes a range of options for simplifying the existing apportionment and adjustment rules, including:

2.1 allowing GST registered businesses to elect that capital assets not be subject to GST on purchase or sale (the election method);

2.2 introducing a principal purpose test for assets purchased for less than $5,000 (GST exclusive), where an asset that is principally acquired for business purposes would claim a full GST input tax deduction;

2.3 introducing a 20 percent margin rule, whereby GST registered businesses would no longer make annual adjustments unless their business or private use of the asset has significantly changed (by more than 20 percent);

2.4 introducing rounding-based rules for assets that are close to being either fully taxable (80 percent or more taxable use) or fully non-taxable (20 percent or less taxable use);

2.5 potential options for improving the definitions of residential and commercial accommodation services;

2.6 discussing if special rules should apply to the sale of houses and other types of dwellings, where they are treated as fully private assets and GST exempt on sale by a registered person other than a property developer;

2.7 potential options for simplifying the GST apportionment rules for residential property developers whilst also encouraging land to be developed and sold sooner;

2.8 other minor and incremental improvements that seek to reduce compliance costs for GST registered businesses and remove rules that are superseded by policy options outlined in the officials' issues paper;

3 **agreed** to the release of the officials' issues paper, subject to any minor, editorial or technical changes that may be authorised by the Minister of Revenue;

4 **authorised** the Minister of Revenue to determine the date of release of the officials' issues paper.

Janine Harvey
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Carmel Sepuloni
Hon David Parker
Hon Poto Williams
Hon Stuart Nash
Hon Kris Faafoi
Hon Willie Jackson
Hon Michael Wood
Hon Dr David Clark
Hon Dr Ayesha Verrall
Hon Meka Whaitiri
Hon Phil Twyford
Dr Deborah Russell MP

Officials present from:
Office of the Prime Minister
Officials Committee for DEV