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WEEKLY COMMENT: FRIDAY 1 FEBRUARY 2013

1. This week I continue with GST and look at the significant changes proposed in the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill* ("the Bill") that was introduced on 13 September 2012.

2. The changes can broadly be divided into 3 categories:

   (a) The introduction of the mixed-use assets GST rules

   (b) The new rules to allow non-resident businesses to claim input tax deductions

   (c) Other changes.

3. I discussed the proposed new rules to allow non-residents to claim input tax deductions in *Weekly Comment 28 September 2012*.

MIXED-USE ASSETS GST RULES

4. The mixed-use assets GST rules in the Bill need to be read in conjunction with the proposed income tax rules in proposed new subpart DG of the *Income Tax Act 2007*. The details of the rules are set out in the attached PDF *The GST Mixed-Use Assets Rules*. (I looked at the mixed-use assets income tax rules in *Weekly Comment 21 September 2012*.)

What is a mixed-use asset

5. A mixed-use asset is an asset within a defined group that is used partly for deriving income and partly for private use, and that is not in active use for its intended purpose for at least 62 days in the income year (or where normal use occurs only on working days, 62 working days).

6. The defined group of assets is land and improvements to land (whatever the cost), and other assets that cost $50,000 or more. Motor vehicles are excluded, as are assets whose expenditure is apportioned based on space, floor area or on some similar basis (for example, home offices).

Apportionment formula

7. The apportionment formula requires expenditure on a mixed-use asset to be divided into 3 categories:

   (a) Expenditure related solely to the income-earning use of the asset: from which no personal benefit could reasonably be expected, or that is required to meet a regulatory requirement for use in deriving income, and excluding any repairs and maintenance expenditure.

(b) Expenditure related solely to the private use of the asset: by the person or an associated person (regardless of any income derived), or any use if the income derived is less than market value (meaning the arm's length price in the open market, as defined in s. DG 4(2) of the *Income Tax Act 2007*).

(c) Other expenditure, which must include repairs and maintenance expenditure (referred to from here on as "mixed-use expenditure").

8. Input tax on the first two categories of expenditure listed above is not apportioned under the specific GST formula applying to mixed-use assets in proposed new s. 20G(1).

9. It may not be an easy task to apportion expenditure into these three categories.

10. The input tax on mixed-use expenditure must then be apportioned based on the total active use of the asset for its intended purpose. The proportion of total active use that corresponds to income-earning use – i.e. the supply of the asset for a consideration at or above market value - is the deductible proportion of the input tax. (Income-earning use includes use by the person or an associate if specialist knowledge is required for the use of the asset, and the person's services are paid for, and the income is a market value amount.)

11. The formula refers to "days" as the measurement yardstick but some other unit of measurement, such as hours, or nights, or anything else, can be used if that provides a fair and reasonable result.

What happens on acquisition

12. Upon acquisition of a mixed-use asset, the "standard" apportionment rules apply. Proposed new s. 20(3JB)(a)(i) provides that upon acquisition the intended use of the goods must be determined under s. 20(3G): the person must determine the extent to which the goods or services are used for making taxable supplies by estimating how they intend to use the goods or services, choosing a determination method that provides a fair and reasonable result. The determination must be expressed as a percentage of total use.

13. Proposed new s. 20(3JB)(a)(ii) then states that the input tax deduction on acquisition is based on the formula in s. 20(3H):

[Full input tax deduction] x [percentage intended use]

14. Full input tax deduction is, under s. 20(3I), the total amount of input tax on the supply.

Post-acquisition mixed-use expenditure

15. Post-acquisition, proposed new s. 20(3JB)(b) requires adjustments to be made under proposed new s. 20G(4) and (5).

16. The "standard" post-acquisition adjustments do not apply to mixed-use expenditure. However, the general rules for determining the first and subsequent adjustment periods and the number of adjustment periods will apply.

17. At the end of an adjustment period, a person must ascertain whether an adjustment is required to be made for any difference between the supply of the asset for the period and the actual use of the asset for making taxable supplies.

18. If an adjustment is required:

    (a) The person must calculate the percentage actual use under the apportionment formula in s. 20G(1) as set out in paragraphs 7 to 11 above;

    (b) Compare the percentage actual use with the percentage intended use or previous actual use, as applicable; and

    (c) Make an adjustment for any percentage difference under s. 21D(3):

        (i) If the percentage difference is positive – i.e. the actual use exceeds the intended use or previous actual use, claim an additional deduction under s. 20(3)(e); or

        (ii) If the percentage difference is negative – i.e. the actual use is less than the intended use or previous actual use, pay output tax equal to the difference under s. 21A.

19. Note especially, that for the purpose of the adjustment calculation under s. 20G(5), all expenditure on the mixed-use asset is aggregated and included in the adjustment. The de minimis rules in s. 21(2)(c) and (d) – under which differences of less than 10% are ignored if the adjustment would not exceed $1,000 - apply to the aggregated amount: not to individual items of expenditure.

Disposal of a mixed-use asset

20. When a mixed-use asset is disposed of, s. 20G(7) states that s. 8 and 21F apply to the disposal of the asset, treating the disposal as in the course or furtherance of a taxable activity.

21. Refer to the separate PDF attachment *The GST Apportionment Rules*, **pages 19 – 20** for the details. In summary:

    (a) If the goods or services were not acquired as part of a supply that was zero-rated under s. 11(1)(mb), a final input tax adjustment is made to compensate for the proportion of the output tax on disposal that corresponds to the input tax not claimed as a deduction; and

    (b) If the goods or services were acquired as part of a supply that was zero-rated under s. 11(1)(mb), a final input tax adjustment is made to compensate for the proportion of the output tax on disposal that corresponds to the input tax not claimed based on the previous actual use of the asset in the adjustment period before the period in which the disposal occurs.

Pre-registration acquisitions

22. The rules on pre-registration acquisitions are to be amended to accommodate the mixed-use assets rules. A proposed amendment to s. 21B(2) will require the post-registration adjustment to be made under the rules in s. 20G, with the first adjustment period starting on the date of acquisition and ending on the first balance date after use of the goods or services to make taxable supplies.

Application of the GST apportionment rules depends on a number of variables

23. The application of the GST apportionment rules to mixed-use assets will depend on a number of variables, including:

    (a) Whether the asset was acquired pre- or post-1 April 2011 (to determine the application of the transitional rules in s. 21H – refer to the PDF attachment *The GST Apportionment Rules*, **page 31**).

    (b) Whether the asset was previously exempt but is now taxable due to changes to the definitions of "dwelling" and "commercial dwelling" (to determine if s. 21HB applies – refer to the PDF attachment *GST Land Transactions Rules*, **page 16**).

    (c) Whether the supply of the asset was zero-rated under s. 11(1)(mb) (refer to the PDF attachment *GST Land Transactions Rules*, **pages 4-5**).

    (d) Precisely what expenditure corresponds to mixed-use of the asset.

    (e) The details of the mixed-use assets rules themselves.

OTHER CHANGES

24. There are a few other proposed changes, including making prize competitions subject to GST and allowing a principal and agent to opt out of the agency rules.

Participation in a prize competition is a supply of services

25. Section 5(10) is being amended so that it clearly includes the provision of prize competitions as a supply of services for GST purposes. Proposed replacement s. 5(10) provides that an amount of money paid by a person to participate in gambling (including a New Zealand lottery) or in a prize competition is treated as a payment for the supply of services by the person who conducts the gambling or the prize competition.

26. The consideration under proposed replacement s. 10(14) is the amounts in money received by the person who conducts the gambling or prize competition, less the amount of prizes paid or payable in money. The consideration for organisers of prize competitions is, therefore, the money received less the prizes paid or payable in money.

27. There is a proposed new definition of "prize competition" in s. 2, which is a competition for which consideration is paid and the prizes are money, and the result is determined by requiring the participant to perform an activity requiring some knowledge or skill and possible some level of chance (regardless of whether the activity could be correctly performed by chance alone).

28. The time of supply for a prize competition under proposed replacement s. 9(2)(e) is being aligned with the current rule for gambling, and is the date on which the first drawing or determination, of the prize competition commences.

29. The amendments are to apply from the date of enactment.

Opt-out provision to the agency rules

30. Proposed new s. 60(1B) will allow a principal and an agent who are both registered persons to agree in writing that s. 60(1B) applies to a supply that is then treated as two separate supplies: a supply from the principal to the agent, and a separate supply from the agent to the recipient.

31. Proposed new s. 60(1C) requires the principal to account for the tax on the supply to the agent under s. 60(1B) on an invoice basis, so that there is no loss of revenue if the agent defaults on payment.

32. Proposed new s. 26(3) denies the principal a bad debt deduction if the agent has been paid for the supply.

33. The amendments are to apply from the date of enactment.

GST records kept offshore by an Inland Revenue-approved data storage provider

34. Proposed new sections 75(3BA), (6) & (7) will allow an Inland Revenue-approved data storage provider to hold a registered person's records at places outside New Zealand.

35. This amendment aligns the GST provisions with the corresponding provisions for income tax and certain other records covered by amendments to the *Tax Administration Act 1994* contained in the *Annual Rates Tax Act*.

36. The amendments are to apply from 2 November 2012, the date of assent of the *Annual Rates Tax Act*.

Change of accounting basis for certain local authorities

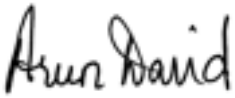
37. Under proposed new s. 87, from 1 July 2013, a local authority referred to in the *Goods and Services Tax (Local Authorities Accounting on Payments Basis) Order 2009* must account for tax payable on an invoice basis.

38. The tax payable on the change of accounting basis can be spread evenly over a period of 72 months commencing on 1 July 2013.

39. The amendment is to come into force on 1 April 2013.

Input tax deductions limited to non-profit bodies resident in New Zealand

40. Effective from 1 April 2014, the input tax deduction available to non-profit bodies for GST paid on goods and services used other than for making exempt supplies will be limited to non-profit bodies that are resident in New Zealand. This amendment is because non-residents will be able to register and recover GST based on taxable activities outside New Zealand as from that date.



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