DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

WEEKLY COMMENT: FRIDAY 8 FEBRUARY 2013

1. This week I complete looking at recent developments in GST by reviewing the changes proposed in *GST remedial issues - An officials' issues paper*, released in December 2012. The issues covered are:

   (a) Application of the hire-purchase time of supply rule to land transactions;

   (b) Treatment of directors' fees;

   (c) Consequential and remedial amendments following the introduction of the apportionment rules;

   (d) Consequential and remedial amendments following the introduction of the zero-rating for land rules;

   (e) Consequential and remedial amendments following the changes to the definitions of "dwelling" and "commercial dwelling"; and

   (f) Credit notes when GST is mistakenly accounted for.

2. Submissions have been requested by 1 March 2013.

Hire-purchase time of supply rules and land transactions

3. The issue identified is that an agreement for the sale of land on deferred terms could be a hire-purchase agreement for GST purposes. The word "goods" has a broad definition in the GST Act and includes real property.

4. The suggested solution is that the definition of "hire-purchase agreement" in the GST Act should be amended to clarify that, to avoid any doubt, land is specifically excluded from the scope of hire-purchase agreements.

5. The GST Act treats the time of supply for goods and services which are supplied under a hire-purchase agreement to be the time the agreement is entered into. Excluding land from this definition would mean that output tax on a long-term sale and purchase agreement for land would not need to be returned until the date of settlement (although GST will be returned on interim payments made before the date of settlement). However, a full input tax deduction could be claimed on the acquisition of the property.

6. Therefore, the suggested change could result in a GST timing advantage for certain suppliers of long-term sale and purchase agreements for land, such as, for example, a "wrap mortgage provider" who acquires a property and provides it to a purchaser but retains title until

ultimate settlement occurs, which could be up to 30 years after the date of the initial agreement.

7. The suggested solution is to amend s. 19D of the GST Act to require a registered supplier of a transaction involving a deferred settlement of land and periodic payments to account for GST on the supply at the time the agreement is entered into, rather than periodically.

8. Note: s. 19D currently prevents timing advantages involving vendors on the payments basis and purchasers on an invoice accounting basis, and requires the supplier of goods sold for a consideration exceeding $225,000 to account for GST on an invoice basis. The section also contains an anti-avoidance provision to stop suppliers splitting up a supply so that each supply falls below the $225,000 threshold.

9. Officials are also concerned that the present definition of "hire-purchase agreement" in the GST Act arguably does not include an agreement where goods are hired to a person with an option to purchase, and that option is not exercised until a later date. It is arguable that the present definition requires a person's upfront agreement to purchase the goods in order for the arrangement to be a hire-purchase agreement for GST purposes.

10. The suggested solution is that paragraph (a)(i) of the definition of "hire-purchase agreement" explicitly incorporates contracts when the person has an option to purchase, but that option is not exercised until a later date.

11. Officials consider that the amendments should apply from 1 April 2005, but suggest a "savings" provision for taxpayers that have filed returns on a contrary basis.

GST treatment of directors' fees

12. Under s. 6(3)(b) of the GST Act, a director is not carrying on a taxable activity. Unless the activities as a director are performed as part of a broader taxable activity, directors are not required to charge GST for their services.

13. When GST is charged, the paying company will generally be entitled to an input deduction. However, this will not happen in circumstances where an employee of a company acts as a director (of another company) and receives director's fees, which are then passed on to the employer company. In such circumstances, there may be no GST charged on the director's fees paid to the employee.

14. Therefore, the company that pays the director's fees will not be able to claim any input tax, but the company which receives the director's fees from the employee will be required to account for output GST. This outcome for the company receiving the director's fees follows from Inland Revenue Public Ruling BR Pub 05/13 *Directors' fees and GST*.

15. The same problem arises under s. 6(3)(c) when an employee has been engaged as a member of a local authority or statutory board. Such members have never been registered.

16. The suggested solution is to allow the company that pays the directors fees an input tax deduction on the basis that the fees are being paid to the employer company and not to the employee. The rule would extend to situations where the employer is a registered partnership or trust and the employee is a partner/trustee released to act as a director (or a member of a local authority or statutory board).

17. The supply would be treated as having been made for all the relevant 6(3)(c) supplies and when a director was prohibited from registering under section 6(3)(b).

Apportionment rules amendments

18. There are four remedial amendments suggested in relation to the apportionment rules.

(a) Wash-up rule for complete taxable or non-taxable use

19. The issue is the GST treatment of land purchased for both taxable and non-taxable use but later used solely for one purpose. Under existing rules, the land would continue to be subject to ongoing adjustments.

20. The suggested solution, which applies to all assets and not just land, is that there should be a wash-up calculation which would be compulsory if the following criteria are met:

    (a) The taxable use of the asset is 100% or 0% in both the relevant adjustment period and the immediately prior adjustment period; and

    (b) The percentage actual use over the course of ownership of the assets is over 90% or under 10%, as the case may be.

(b) Extending the apportionment rules to apply to supplies by a company to an associated natural person

21. Under the present rules there is an interpretation that would allow a company to claim full input tax on assets that are provided to owners for private use. The supply to the owner is an associated supply, to which the market value rules apply and for which the company would be required to return output tax.

22. The suggested solution is that the definition of "percentage actual use" in s. 21G(1) should be clarified so that associated supplies are excluded from being "taxable supplies" when the recipient of the supply is a natural person. There would be a corresponding output tax amendment to ensure that output tax did not have to be paid on the associated supply. The interaction with the fringe benefit rule in s. 21I would also need to be considered to ensure there is not effective double taxation by denying input tax deductions and charging output tax on the fringe benefit.

23. The suggestion is that the revised rule be retrospective to 1 April 2011, with a savings rule to preserve the position of people who have adopted an alternative interpretation. However, the savings provision would apply only until the new rule is enacted. Views are being requested on whether a grandparenting rule should be allowed.

(c) Output tax and the disposal of land

24. This issue concerns when a person uses land for making taxable supplies and then fully devotes it to a non-taxable purpose before disposal. On disposal the person will arguably not be disposing of the land in the course or furtherance of their taxable activity, and it may be that no output tax is returnable on the sale and the calculation under s. 21F does not have to be performed.

25. The suggested solution, which is targeted to land, is to extend the scope of s. 5(16) so that it applies to all subsequent supplies of land when input tax has been claimed (at present it is

limited to dwellings). The supplier would be required to charge output tax and also perform the existing wash-up calculation in section 21F.

26. If the suggested new wash-up calculation for 100% non-taxable use – see (a) above - has already been made so as to limit the number of adjustment periods, then the disposal would not be treated as being in the course or furtherance of a taxable activity. However, if the disposal is in fact part of a taxable activity, sections 8 and 21F would apply in the usual way.

(d) Non-profit bodies: clarifying that no adjustments are required under the apportionment rules

27. The apportionment rules are to be amended to clarify that the rule in s. 20(3K), which allows non-profit bodies to take advantage of input tax deductions (unless goods or services are used for making exempt supplies) will apply for the purposes of s. 20(3) and 20(3C) and the definitions of "percentage intended use" and "percentage actual use" in section 21G(1). This will confirm that non-profit bodies are not required to make any adjustments. The amendment is to be made retrospective to 1 April 2011.

Zero-rating of land rules

28. There are 3 amendments proposed in relation to the zero-rating of land rules.

(a) Allowing inputs to registered persons where a transaction is incorrectly zero-rated

29. This issue concerns circumstances where a supply that involves land is zero-rated and the supply is later found to in fact consist of 2 supplies, one of which was incorrectly zero-rated. Section 5(23) requires the registered purchaser to treat the incorrectly zero-rated supply as a supply to itself and output tax must be paid. However the present wording of s. 20(4B) will deny the purchaser an input tax credit because the purchaser is already registered, because s. 20(4B) only applies if a person "later becomes a registered person".

30. The suggested solution is that section 20(4B) should apply both to a person who later becomes registered and to a person who is already registered. This would allow input tax to be claimed by a purchaser who is already registered where a supply that includes land has been incorrectly zero-rated and the purchaser has to pay output tax. The proposed change is to have an effective date of 1 April 2011.

(b) Clarifying that an assignment or surrender of an interest in land must only be zero-rated if the requirements for zero-rating are met

31. Under s. 11(8D) a supply that is an assignment or surrender of an interest in land is charged with tax at 0%. However, this is only meant to apply in circumstances where the other requirements for zero-rating have been met.

32. The suggested solution is to change the wording of s. 11(8D) so that an assignment or surrender of an interest in land is "a supply of land", as opposed to "a supply charged with tax at 0%". This will then ensure that the other requirements for zero-rating will need to be met.

33. The wording of s. 11(8D) is to be further amended to ensure that standard commercial leases are not zero-rated unless there are significant lump sum payments that pass under the agreement. (At present this is somewhat ambiguous.)

34. The suggested application date is the application date of the newly enacted s. 11(8D) itself, which is 1 April 2011.

(c) Procurement of a lease is a supply of land

35. In some transactions where a vendor/lessee is selling its business, the lease will not be assigned. Instead the vendor will procure that the lessor enters into the new lease with the purchaser. At present, the transfer of the lease may not be subject to the zero-rating of land rules.

36. The suggested solution is that payments for the procurement of a lease should be added to the list of "land" transactions in section 11(8D). This would ensure that such transactions are zero-rated.

Changes relating to the "dwelling" and "commercial dwelling" definitions

37. There are 2 proposed changes relating to the changed definitions of "dwelling" and "commercial dwelling".

(a) Confirming that rest homes and retirement villages are dwellings

38. The change in the definition of "dwelling" requires "quiet enjoyment" in order for the GST exemption to apply. The question has arisen regarding whether the provision of accommodation in retirement villages and residential rest homes could technically breach the "quiet enjoyment" requirement. If so, it is an unintended policy outcome.

39. The suggested solution is to clarify the "dwelling" definition so as to include retirement village and rest home accommodations that could broadly be described as a principal place of residence where the occupant is living independently.

40. The suggested application date is 1 April 2011 with a "savings" provision for taxpayers who filed their returns on the basis that independent living arrangements are not "dwellings" as defined.

(b) Supplies do not have to be aggregated with any other taxable activity in determining the requirement to be registered

41. Registered persons affected by the changed definitions of "dwelling" and "commercial dwelling" are able to claim input tax deductions under s. 21HB if they are required to be registered (i.e. not voluntarily registered). An issue has been identified in circumstances where a sole trader operating under the threshold becomes liable to be registered because of additional taxable supplies resulting from the changes to the definitions of "dwelling" and "commercial dwelling".

42. Officials consider that a sole trader who owns a property and is affected by the changed definitions should not be automatically registered in relation to that property. The suggested solution is an amendment to section 21HB to allow a person an option of including the commercial dwelling as part of a broader taxable activity if the person:

    (a) Is affected by changes to the definitions; and

    (b) Is required to be registered for reasons other than the supply of a commercial dwelling.

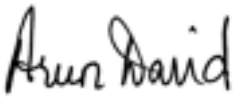
43. The suggested application date is 1 April 2011.

Credit notes

44. This issue concerns circumstances where a supply has been incorrectly treated as subject to GST, when no GST should have been charged. The credit and debit note provisions do not necessarily require a credit note or debit note to be issued in such circumstances. Therefore, the supplier could arguably receive a windfall gain in terms of a refund of GST incorrectly accounted for, without having to refund the GST paid to the purchaser because a credit note is not required.

45. The suggested solution is to amend s. 25(1) to clarify that it also applies in situations where the GST treatment of a supply has been incorrectly accounted for. Consequential amendments may be necessary to s. 25(3).

46. Submissions have been requested regarding whether the adjustment should be treated as taking place in the same period as the original supply. A further issue requiring consideration is that of compliance costs if the incorrect GST accounting is minor and spread over a wide customer group. In this case officials consider that the requirements for credit or debit notes could be limited to situations where the supplier has sought a GST refund.



Arun David, Director

DavidCo Limited