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## WEEKLY COMMENT: FRIDAY 25 OCTOBER 2013

1. The *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* ("the Assets Expenditure Tax Act") enacted on 17 July 2013 contains the GST rules that apply to mixed-use assets.

2. I previously discussed these rules as first introduced in the Tax Bill in *Weekly Comment* 1 February 2013. The rules as enacted, following the review by the Finance and Expenditure Committee, are significantly different from the rules that were initially proposed. The details of the rules are set out in the attached PDF *The GST Mixed-Use Assets Rules*.

3. The topic this week is divided into the following sections (more or less following the format of the PDF attachment):

   (a) What is a mixed-use asset;

   (b) The application dates of the GST rules;

   (c) Interaction with the income tax exemption;

   (d) Apportionment formula;

   (e) What happens at acquisition;

   (f) Post-acquisition adjustments;

   (g) Inland Revenue example of GST adjustment for mixed-use assets;

   (h) Other apportionment rules adjustments: disposal and pre-registration acquisitions; and

   (i) Application of the apportionment rules depends on a number of variables.

**What is a mixed-use asset**

4. The assets involved (including related items, accessories etc.) are of 3 types:

   (a) Land, including improvements to land, whatever the cost;

   (b) Ships, boats or crafts used in navigation on or under water with a cost or initial market value of $50,000 or more; and

   (c) Aircraft with a cost or initial market value of $50,000 or more.

5. The "mixed-use" refers to the fact that:

   (a) The assets must be used: defined as "active use for its intended purpose; and

   (b) The use, in the income year, must be "mixed":

      (i) It must be used partly to derive income; and

      (ii) Part of the use must be 'private use' – as defined; and

      (iii) There must be a period of non-use of at least 62 days in the income year (or 62 working days if the asset is typically used only on working days).

6. There are some specified exclusions, notably residential properties, where the only income-earning use is as a long-term residential property.

7. Also, the rules do not apply to a company, other than a 'close company' as defined (refer to page 5 of the attached PDF).

**Application dates of GST rules**

8. The GST rules:

   (a) Apply to supplies of boats and aircraft and related goods made on or after 1 April 2014; and

   (b) Apply to supplies of land or improvements to land from 17 July 2013 - the date of assent of the Assets Expenditure Tax Act – although the income tax changes took effect from the 2013-14 income year.

9. This means if a person purchased a bach in 2012 and has apportioned their input tax claims under the existing rules, the mixed-use asset rules would not apply to that bach, but would apply to goods and services (such as rates, insurance and furnishings) acquired after the rules were enacted.

**Interaction with the income tax exemptions**

10. Submitters on the Bill (that introduced the legislation) were of the view that the GST apportionment rules should not apply when a person takes advantage of the exemption option for income tax purposes.

11. However, officials' views were that most people that qualify for the income tax exemption will do so because they derive significantly less than $60,000 a year in income from the asset. Therefore, if GST has to be charged on a supply when the turnover from the asset is less than $60,000 per annum, the person is voluntarily registered, or has deliberately included the asset in the same structure as a larger taxable activity, or is self-employed and owns the asset in their personal name.

12. Therefore, the GST rules will apply even where the income may be exempt for income tax purposes. This also has implication for the apportionment formula, as discussed in paragraph 15 below.

**Apportionment formula**

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

    (a) Expenditure on which a full input tax deduction will be available: this will be 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 on which no input tax deduction will be available: this will be expenditure related solely to the private use of the asset by the person who owns, leases, licenses or otherwise has the asset or by a person associated with them (regardless of any income derived), or any use where the income derived from that use is less than 80% of the market value amount (meaning the arm's length price in the open market, as defined in s. DG 3(5) of the *Income Tax Act 2007*).

    (c) Mixed-use expenditure: which will be all other expenditure including expenditure on acquiring the asset and repairs and maintenance expenditure (referred to from here on as "mixed-use expenditure").

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

15. For a registered person, income derived from "private use" where the income is less than 80% of market value will give rise to a GST output tax liability. The question is whether input tax on expenditure related solely to the "private use" will be fully deductible under the "general" GST input tax rules. For example, if an asset is being used privately where the income derived is 60% of market value, and there is a major accident resulting purely from that private use, the input tax relating to the resulting expenditure on repairs would conceivably be fully deductible under the "general" input tax rules.

16. The input tax deduction for "mixed-use expenditure" is calculated based on the proportion of "income-earning days" to "income-earning plus private days":

    **(Input tax on asset) x (income-earning days)/(income-earning days + private days)**

17. Note that the actual period of non-use is immaterial. It is only the periods of use – income earning or private use – that are relevant. Also, while 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.

18. "Income-earning days" is the total number of days in the period on which the person supplies the asset for use and derives a consideration for the supply, whether at, above, or below *market value* as that term is defined in s. DG 3(5) of the *Income Tax Act 2007*. It also includes:

    (a) Any days treated as "income-earning" for income tax purposes;

    (b) Days the asset is unavailable for use because someone else reserved it; and

    (c) Days on which an FBT liability arises.

19. It is noted in *Tax Information Bulletin Vol. 25 No. 9 (October 2013)* on page 21 that:

    "It is important to note that, if the owner supplies the asset to an associated person, s. 10(3) will generally require them to treat the supply as being made at market value. This will require output tax to be paid on the supply, but it will also be treated as "income-earning" for the purposes of calculating entitlement to input tax deductions. Similarly, if the supply is a fringe benefit, s. 21I will apply to deem consideration to have been received – this will also be an income-earning day."

20. "Private days" will be all other days when the asset is used that are not "income-earning days".

**What happens at acquisition**

21. For an acquisition that is not zero-rated under s. 11(1)(mb), the "standard" apportionment rules in s. 20(3G) and s. 20(3H) will apply:

    (a) Under s. 20(3G), a person must estimate at the time of acquisition how they intend to use the goods or services, choosing a determination method that provides a fair and reasonable result; and

    (b) The determination must be expressed as a percentage of the total use; that percentage then becomes the "*percentage intended use*" under s. 21G(1)(b) – (note that the definition of "percentage intended use" in s. 21G has been extended to apply to the mixed-use formula in s. 20G, therefore, the percentage intended use will be based on the result that the formula in s. 20G would produce; and

    (c) The input tax deduction must be determined based on the percentage intended use using the formula in s. 20(3H):

        (i) (Full input tax deduction) x (percentage intended use)

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

22. The input tax deduction upon acquisition, for a zero-rated supply of a mixed-use asset that includes land to which s. 20G applies, must be determined under s. 20(3JB)(a)(i) (the wording in that section is identical to the wording in s. 20(3J)(a)(i)):

    (a) The purchaser must, at the time of acquisition, identify the nominal amount of tax that would be chargeable on the value of the supply, as if the value were equal to the consideration charged for the supply, at the rate set out in s. 8(1) – (note that this is referred to in s. 20(3J)(a)(i) as the nominal GST component) – this will be 15% multiplied by the acquisition price (based on *Example 4* on page 35 of *Tax Information Bulletin Vol. 23 No. 1 (February 2011)* in which s. 20(3J) is explained;

    (b) The purchaser must then, under s. 20(3G), estimate at the time of acquisition how they intend to use the goods or services, choosing a determination method that provides a fair and reasonable result; the determination is expressed as a percentage of the total use: the *percentage intended use* as defined in s. 21G(1)(b); the percentage intended use will be based on the result that the formula in s. 20G would produce;

    (c) The purchaser must then account for output tax under s. 20(4) for the proportion of the nominal GST component for any non-taxable use of the goods and services, under s. 20(3J)(a)(iii).

23. Note that despite officials agreeing that the relationship between s. 20G and s. 20(3J) should be clarified, unfortunately, there has been no clarification other than the insertion of paragraph (a)(i) in s. 20(3JB), which appears to require input tax to be calculated as the nominal GST component in s. 20(3J)(a)(i). (Section 20(3JB)(a)(iii) refers to "account for input tax", and not "account for output tax" as in s. 20(3J)(a)(iii).)

**Post-acquisition adjustments**

24. Post-acquisition, new s. 20(3JB)(b) requires adjustments to be made under proposed new s. 20G(4) and (5). An amendment to s. 20(3J)(b) requires the post-acquisition adjustments to be made under s. 20G for the taxable supply of a zero-rated mixed-use asset.

25. The general rules for determining the first and subsequent adjustment periods and the number of adjustment periods will apply.

26. 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.

27. 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 paragraph 16 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.

28. Note especially, that for the purpose of the post-acquisition 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.

**Inland Revenue example of GST adjustment for mixed-use assets**

29. Inland Revenue has posted an example of "GST adjustment for mixed-use assets" on its website.

30. The example has been also set out on pages 17-18 of the attached PDF.

**Other apportionment adjustments: disposals and pre-registration acquisitions**

31. 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.

32. 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.

33. The rules on pre-registration acquisitions have been amended to accommodate the mixed-use assets rules. An amendment to s. 21B(2) requires 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**

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

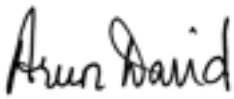
(a) Whether the asset was acquired pre- or post-1 April 2011 (to determine the application of the transitional rules in s. 21H – refer to the PDF attachment *The GST Apportionment Rules*, page 31).

(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.



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