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WEEKLY COMMENT: FRIDAY 14 FEBRUARY 2014

1. The *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill* ("the November Bill"), which was introduced on 22 November 2013, contains a number of proposed GST amendments. The Bill had its first reading on 10 December 2013 and has been referred to the Finance and Expenditure Committee, which is due to report back by 10 June 2014.

2. Most of the GST amendments were initially proposed in *GST remedial issues – An officials' issues paper* ("the GST IP"), released in December 2012, which I discussed in *Weekly Comment* 8 February 2013. This week and next week I look at the proposed GST amendments in the November Bill.

3. The topics covered this week are:

   (a) Hire purchase agreements to include agreements to hire with an option to purchase;

   (b) GST treatment of director's fees;

   (c) Retirement accommodation and the changed "dwelling" and "commercial dwelling" definitions;

   (d) Limiting input tax deductions due to the changed "dwelling" and "commercial dwelling" definitions;

   (e) Relaxing the requirements for zero-rating services supplied to non-residents.

Hire purchase agreements to include agreements to hire with an option to purchase

4. In the *Goods and Services Tax Act 1985* ("the GST Act"), **"hire purchase agreement"** has the same meaning as in s. YA 1 of the *Income Tax Act 2007* ("the Income Tax Act"), but includes an agreement that would be a hire purchase agreement but for the exclusion in paragraph (f) of the definition (i.e. for GST purposes the definition includes hire purchase agreements where the property that is the subject of the agreement is livestock or bloodstock).

5. In the GST IP, officials raised the concern that this definition did 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.

6. Paragraph (a)(i) of the definition of "hire purchase agreement" in the Income Tax Act currently refers to:

   "An agreement under which goods are let or hired with an option to purchase, however the agreement describes the payments, under which the person who agrees to purchase the goods is given possession of them before the total amount payable has been paid:"

7. The proposed amendment, in clause 123(19) of the November Bill, will result in paragraph (a)(i) being replaced by:

   "An agreement under which goods are let or hired with an option to purchase, however the agreement describes the payments:"

8. An additional proposed amendment, in clause 123(20) of the November Bill, will clarify that agreements of the kind described in paragraphs (a)(i) or (a)(ii) – which latter paragraph refers to "an agreement for the purchase of goods by instalment payments" – being treated as hire purchase agreements even if the property in the goods passes absolutely to the purchaser at the time of the agreement or before delivery of the goods.

9. An equivalent amendment to the hire purchase definition in s. OB 1 of the Income Tax Act 2004 is contained in clause 180 of the November Bill. The combined effect of the amendments is to backdate the amendment to the 2005-06 and later income years. However, a "savings" provision applies, in clauses 180(2) and 123(42), to taxpayers who took a tax position between 1 April 2005 and the date of introduction of the Bill (22 November 2013), applying the existing income tax definition of "hire purchase agreement" for GST purposes.

10. A second amendment was proposed in the GST IP for deferred settlement land transactions to be removed from the hire purchase definition, so as to remove the requirement for the up-front payment of GST, and be replaced with an anti-avoidance rule.

11. The anti-avoidance rule was thought necessary because the amendment would have meant 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. The suggested solution was 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.

12. This second proposed amendment has not been proceeded with, and deferred settlement land transactions are not being explicitly removed from the hire purchase definition.

GST treatment of director's fees

13. 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.

14. 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.

15. 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*.

16. 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.

17. Section 6(3)(b) of the GST Act currently states that the term "taxable activity" shall not include, in relation to any person:

    "Any engagement, occupation, or employment under any contract of service or as a director of a company:

    Provided that where any person, in carrying on any taxable activity, accepts any office, any services supplied by that person as the holder of that office shall be deemed to be supplied in the course or furtherance of that taxable activity;"

18. Section 6(3)(c)(iii) of the GST Act currently states that the term "taxable activity" shall not include, in relation to any person:

    "Any engagement, occupation, or employment as a Chairman or member of any local authority or any statutory board, council, committee, or other body;"

19. A proposed amendment to s. 6(3)(b) is contained in clause 164(2) under which s. 6(3)(c)(iii) will read as follows:

    "Any engagement, occupation, or employment under any contract of service or as a director of a company, subject to subsection (4);"

20. A similar proposed amendment to s. 6(3)(c)(iii) is contained in clause 164(1) under which the proviso will be repealed, and s. 6(3)(b) will simply read as follows:

    "Any engagement, occupation, or employment as a Chairman or member of any local authority or any statutory board, council, committee, or other body, subject to subsection (4);"

21. Proposed new s. 6(4) and 6(5) in clause 164(3) state:

    "(4) Despite subsection (3)(b) and (c)(iii), if a director, member, or other person referred to in those paragraphs is paid a fee or another amount in relation to their engagement, occupation, or employment in circumstances in which they are required to account for the payment to their employer, the payment is treated as consideration for a supply of services by the employer to the person who made the payment to the director, member, or other person.

    (5) For the purposes of subsection (3)(b), (c)(iii), and (4), if a person in carrying on a taxable activity, accepts an office, any services supplied by that person as holder of that office are deemed to be supplied in the course or furtherance of that taxable activity."

22. The effects of these proposed amendments will be to:

    (a) Allow an input tax deduction to a company that pays director's fees to an employee of another company, as if the fees were, in fact, being paid directly to the company that employs the director;

(b) Provide for the same treatment when an employee of a company acts as a Chairman or member of any local authority or any statutory board, council, committee, or other body – i.e. the employing company is treated as having provided the service;

(c) Expand the proviso to s. 6(3)(b), which currently applies in respect of directors who accepted the office as part of their taxable activity, to Chairmen and members of any local authority or any statutory board, council, committee, or other body: such persons will be treated as having received their fees in the course of carrying on their taxable activity.

23. The proposed amendments to director's fees and fees derived by members of other boards, as described above are to apply from the date of enactment.

Retirement accommodation and the changed "dwelling" and "commercial dwelling" definitions

24. The revised definition of "dwelling", in s. 2 of the GST Act, that has applied since 1 April 2011 requires, under paragraph (a)(ii) of the definition, that "the person has quiet enjoyment, as that term is used in s. 38 of the *Residential Tenancies Act 1986*". This requirement has raised concerns regarding whether accommodation in a retirement village or a residential rest home would continue to be regarded as a "dwelling" for GST purposes.

25. A proposed amendment to the definition is meant to clarify that accommodation in retirement villages and residential rest homes will continue to be treated as "dwellings" for GST purposes. A new paragraph (b)(iii) is proposed to be inserted into the "dwelling" definition by clause 161(2) of the Bill, which will provide that:

"Despite paragraph (a)(ii) (i.e. despite the requirement for quiet enjoyment), a residential unit in a retirement village or rest home when the consideration paid or payable for the supply of accommodation in the unit is for the right to occupy the unit;"

26. The corresponding exclusion from the definition of "commercial dwelling", in s. 2 of the GST Act, is to be replaced. The current exclusion refers to:

"A dwelling situated in a retirement village or rest home if the consideration paid or payable for the supply of accommodation in the dwelling is for the right to occupy the dwelling:"

27. This is to be removed and replaced under clause 161(1) by:

"A dwelling referred to in paragraph (b)(iii) of the definition of dwelling:"

28. These proposed amendments apply to the 2011-12 and later income years. However, the amendments will not apply to a tax position taken between 1 April 2011 and 31 March 2015 relating the tax treatment of a residential unit in a rest home or retirement village, and relying on the definitions of "dwelling" and "commercial dwelling" as they were before the proposed amendments.

Limiting input tax deductions due to the changed definitions of "dwelling" and "commercial dwelling"

29. 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). Two changes are proposed in connection with this rule.

30. First, the goods or services affected by the changed definitions of "dwelling" and "commercial dwelling" need to have been acquired after the introduction of GST – i.e. on or after 1 October 1986 and before 1 April 2011.

31. The law at present requires only that the goods or services were acquired before 1 April 2011, so could potentially include goods or services acquired before the introduction of GST. Therefore, the reference in s. 21HB(1) to "before 1 April 2011" is to be changed, by clause 169(1), to "in the period between 1 October 1986 and 1 April 2011".

32. This first change is to apply to a tax position taken after the date of introduction of the November Bill (i.e. after 22 November 2013).

33. Second, persons who have some other (unrelated) activity with a turnover below the registration threshold, who are pushed over the registration threshold due to the changed definitions of "dwelling" and "commercial dwelling" will not be liable to be registered and, therefore, will not be entitled to claim input tax deductions if they do become (voluntarily) registered. Officials consider that a sole trader operating under the threshold, who owns property, should not become liable to be registered only because of additional taxable supplies resulting from the changes to the definitions of "dwelling" and "commercial dwelling".

34. Two new subsections (4) and (5) are to be inserted, by clause 169(2), into s. 21HB:

    (a) Subsection (4) states that subsection (5) will apply to a person who is required to treat a dwelling as a commercial dwelling because of the changed definitions, and who becomes liable to be GST-registered as a result;

    (b) Subsection (5) states that such a person may choose not to include the supply of a commercial dwelling that results from the changed definitions, when calculating the total value of their supplies for determining whether they have exceeded the GST registration threshold.

35. This second change is to apply to supplies made on or after 1 April 2011.

Relaxing the requirements for zero-rating services supplied to non-residents

36. Two related changes are to be made to allow services supplied to non-residents to be zero-rated even though such non-residents visit New Zealand during the period of service. These changes follow from *The GST treatment of immigration and other services – An officials' issues paper* ("the Immigration IP") issued in June 2013, and *GST on immigration services* ("the draft Immigration IS") released in April 2012. Both of these documents were discussed in *Weekly Comment* 12 July 2013.

37. The changes relate to s. 11A(1)(k) under which services must be zero-rated when supplied to a person who:

    (a) Is a non-resident; and

    (b) Is outside New Zealand at the time the services are performed.

38. The conclusion in the draft Immigration IS was that if the recipient comes to New Zealand over the period during which the services are performed, the entire supply of services must be standard-rated, unless it is possible to apportion the supply.

39. In the Immigration IP it is acknowledged that the rule requires the supplier to have knowledge of the recipient's physical location and the recipient's status during the period of service, and this can be difficult if the service is provided over an extended period of time. The solution suggested was that services supplied to non-residents should remain zero-rated even if the non-resident visits New Zealand, as long as the non-resident's presence in New Zealand is not in connection with the services performed.

40. Proposed new s. 11A(3B) in clause 166 of the Bill, which is to apply from the date of enactment, provides that:

    "For the purpose of subsection (1)(k), outside New Zealand, for a natural person, includes a minor presence in New Zealand that is not directly connected with the supply."

41. It was also recognised in the Immigration IP that a non-resident could retrospectively become resident during the period when services are being supplied through the retrospective application of the income tax "count test" of tax residence.

42. Section YD 1 of the Income Tax Act deals with the residence of natural persons. Sections YD 1(3) to (6) provide as follows:

    (3) A person is a New Zealand resident if they are personally present in New Zealand for more than 183 days in total in a 12-month period.

    (4) If subsection (3) applies, the person is treated as resident from the first of the 183 days until the person is treated under subsection (5) as ceasing to be a New Zealand resident.

    (5) A person treated as a New Zealand resident only under subsection (3) stops being a New Zealand resident if they are personally absent from New Zealand for more than 325 days in total in a 12-month period.

    (6) The person is treated as not resident from the first of the 325 days until they are treated again as resident under this section.

43. The proposed addition, in clause 161(3) of the Bill, of paragraph (c) to the GST definition of "resident" will result in sections YD 1(4) and (6) being "switched off", and tax residence or non-residence for GST purposes, therefore, applying prospectively from the date on which tax residence or non-residence is triggered for income tax purposes, as follows:

    "The effect of the rules in section YD 1(4) and (6) of that Act are ignored in determining the residence or non-residence of a natural person, and residence is treated as:

    (a) Starting on the day immediately following the relevant day that triggers residence under section YD 1(3) of that Act; or

    (b) Ending on the day immediately following the relevant day that triggers non-residence under section YD 1(5) of that Act."

44. This proposed amendment is also to apply from the date of enactment of the Bill.

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