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WEEKLY COMMENT: FRIDAY 20 FEBRUARY 2015

1. This week and next week I look at the GST amendments enacted last year in the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* (the "Employee Allowances Tax Act"), which received the Royal assent on 30 June 2014. The amendments are explained in *Tax Information Bulletin* Vol. 26, No. 7 (August 2014) pages 95-102 (the "TIB item").

2. I discussed the GST amendments proposed in the Bill as originally introduced in *Weekly Comment* 14 February 2014 and 21 February 2014. 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.

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;

   (f) Non-resident registrants claiming GST on importation.

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

4. The definition of a "hire purchase agreement" for GST purposes has important GST implications. Where goods are supplied under a "hire purchase agreement", the supply is deemed to take place, under s. 9(3)(b) of the GST Act, at the time the agreement is entered into. Whereas when goods are supplied under an "agreement to hire", the supplies take place, under s. 9(3)(a), period-by-period at the earlier of the time when payments become due or are received.

5. An "agreement to hire" excludes, under s. 9(3)(c), an agreement under which the property in the goods passes to the bailee (i.e. the lessee) or which expressly contemplates that the property will pass to the bailee. This exclusion will not apply if the lessee merely has the option of acquiring the goods. In such circumstances if the agreement is not a "hire purchase agreement" as defined, the supplies are deemed to be made periodically.

6. Apparently, it was always the policy intent that where the lessee has the option of acquiring the goods, the supply, for GST purposes, should take place at the time the agreement is entered into. The definition of "hire purchase agreement" has been amended so as to achieve this.

7. For GST purposes, s. 2 of the *Goods and Services Tax Act 1985* ("the GST Act") provides that "hire purchase agreement" has the same meaning as in s. YA 1 of the *Income Tax Act 2007* ("the Income Tax Act"), except that the exclusion in paragraph (f) of the income tax definition (of hire purchase agreements where the property that is the subject of the agreement is livestock or bloodstock) does not apply (i.e. for GST purposes such agreements remain hire purchase agreements).

8. With effect from 1 April 2008, an amendment, in s. 144(20) of the Employee Allowances Tax Act has resulted in paragraph (a)(i) of the income tax definition of "hire purchase agreement" being replaced by:

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

9. It is noted in the TIB item that this amendment means the definition of "hire purchase agreement" has been broadened to include any contract where the person has an option to purchase.

10. An additional amendment, in s. 144(21) of the Employee Allowances Tax Act clarifies 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.

11. Despite the 1 April 2008 effective date, a "savings" provision in s. 144(45) of the Employee Allowances Tax Act applies to taxpayers who took a tax position between 1 April 2008 and the date of introduction of the Bill (22 November 2013), by adopting the pre-amendment income tax definition of "hire purchase agreement" for GST purposes.

12. 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.

13. 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 potentially 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.

14. 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

15. Under s. 6(3)(b) of the GST Act a person acting as an employee is not carrying on a taxable activity.

16. Additionally, under s. 6(3)(b) of the GST Act prior to its amendment by s. 187 of the Employee Allowances Tax Act, a director was not carrying on a taxable activity, subject to a proviso that where any person, in carrying on any taxable activity, accepted any office, any services supplied by that person as the holder of that office were deemed to be supplied in the course or furtherance of that taxable activity.

17. A company may, however, charge GST on director's fees. When GST is charged on director's fees, the paying company will generally be entitled to an input deduction. However, this will not happen in circumstances where a company's employee acts as a director. Because an employee is precluded from having a taxable activity under s. 6(3)(b), the paying company would not have any basis for claiming an input tax deduction.

18. It was noted in Inland Revenue Public Ruling BR Pub 05/13 *Directors' fees and GST* that this could result in a mismatch where an employee of a company acts as a director on behalf of the employing company and remits any director's fees received to the employing company. The employing company will have to account for GST on the director's fees, whereas the paying company is denied an input tax deduction because the payment was ostensibly made to an employee and was, therefore, not subject to GST.

19. The same problem arises under s. 6(3)(c) when an employee of a company has been engaged as a member of a local authority or statutory board. While the employing company would have to return GST on fees relating to the board membership of its employee, the paying entity will not be entitled to an input tax deduction because s. 6(3)(c)(iii) prior to its amendment by s. 187 of the Employee Allowances Tax Act stated that such board members are not carrying on a taxable activity.

20. A new s. 6(4) has been inserted by s. 187(3) of the Employee Allowances Tax Act which states that if the director's fee or board membership fee is paid in circumstances where the employee is required to remit the payment to their employer, the payment is treated as a supply by the director or board member's employer and, therefore, subject to GST. Section 6(3)(b) and s. 6(3)(c) are subject to s. 6(4).

21. The proviso to s. 6(3)(b) under which director's fees received as part of a taxable activity were subject to GST has been retained but "re-arranged" into a separate s. 6(5). The effect is that the proviso now also applies to local authority and statutory board memberships undertaken in the course of a taxable activity.

22. The effects of these amendments is 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 are, 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), so that it also applies 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. These amendments to director's fees and fees derived by members of other boards, as described above apply from the date of enactment, 30 June 2014.

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. An amendment to the "dwelling" definition clarifies that accommodation in retirement villages and residential rest homes will continue to be treated as "dwellings" for GST purposes. A new paragraph (b)(iii) has been inserted into the "dwelling" definition by s. 185(2) of the Employee Allowances Tax Act, which provides that 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 will be a "dwelling" for GST purposes.

26. The corresponding exclusion from the definition of "commercial dwelling" has been inserted, under which a "dwelling" under paragraph (b)(iii) of the dwelling definition will be excluded from being a commercial dwelling.

27. A transitional rule has been inserted in s. 21HB(6) and (7), which applies to supplies of accommodation in a residential unit in a retirement village or rest home acquired before 1 April 2015 where the supply of that residential unit in a retirement village or rest home has been treated as a taxable supply following the 2011 amendments.

28. Under the transitional rule, a person may irrevocably choose in a GST return for a period starting before 1 April 2015 to either:

    (a) Continue to treat the supply of that accommodation as a taxable supply for that period and for subsequent periods; or

    (b) Change to treating the supply as an exempt supply for that period and for subsequent periods.

29. In the latter case the new one-off wash-up rule in new s. 21FB will not apply. It is noted in the TIB item that:

    "Therefore, these taxpayers would not be required to return input tax deductions claimed between 1 April 2011 and 31 March 2015 in one lump-sum payment. Instead, the regular apportionment rules would apply to take into account the change of use brought about by the dwelling amendment, thereby allowing the payments to be spread over time."

30. These amendments apply to the 2011-12 and later income years. However, the amendments do 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 amendments.

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

31. 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 have been made in connection with this rule.

32. First, in order to claim input tax deductions 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. The reference in s. 21HB(1) to "acquired or produced before 1 April 2011" has been changed, by s. 192(2)(b) of the Employee Allowances Tax Act to "acquired or produced in the period between 1 October 1986 and 1 April 2011".

33. This restriction on input tax deductions applies to tax positions taken after the date of introduction of the Bill (i.e. after 22 November 2013).

34. Second, persons who have some other 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" may choose not to treat a supply of accommodation in a dwelling affected by the amendments as a taxable supply.

35. It is noted in the TIB item that this second change could potentially apply in two types of situations:

    (a) When other potentially taxable supplies were previously made but fell below the $60,000 threshold and the newly taxable supplies caused total taxable supplies to exceed the threshold, even though the newly taxable supplies were, by themselves, lower than the $60,000 threshold; and

    (b) When the person making the newly taxable supplies was already previously GST-registered in relation to another activity, and the newly taxable supplies were tacked on and became taxable supplies, even though the newly taxable supplies were, by themselves, lower than the $60,000 threshold.

36. In both of the above situations new s. 21HB(4) allows the person who is affected by the changed definitions of "dwelling" and "commercial dwelling" to choose not to treat a supply of accommodation in a dwelling affected by the amendments as a taxable supply.

37. New s. 21HB(5) provides that this concession will not apply if the newly taxable supplies by themselves will exceed the $60,000 threshold. This second change applies from 1 April 2011.

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

38. Two related changes have been made, effective from 30 June 2014, to allow services supplied to non-residents to be zero-rated even though such non-residents visit New Zealand during the period during which the services are being provided. 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.

39. 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.

40. The conclusion in the draft Immigration IS was that if the recipient comes to New Zealand in 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.

41. 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.

42. New s. 11A(3B) inserted by s. 189(2) of the Employee Allowances Tax Act, applies from 30 June 2014 and 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."

43. It is noted in the TIB item that:

    "The policy rationale behind the new section is to deal with situations when it is unreasonable for the supplier to be aware that the non-resident is in New Zealand during the time the services are performed, and therefore, whether the services should be zero-rated. In practice, if the supplier is unaware of the person's presence in New Zealand, it is less likely that the presence is directly connected with the services being performed.

    The requirement that the presence be "minor" is to ensure the non-resident is predominantly outside New Zealand while the services are being performed. If the non-resident is present in New Zealand for most of the time the services are being performed (despite the fact that the presence may be unrelated to the services being performed) the person's presence will not be considered as minor, and therefore, the services cannot be zero-rated."

44. 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.

45. Section YD 1 of the *Income Tax Act 2007* 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.

46. The amendment in s. 185(3) of the Employee Allowances Tax Act, effective from 30 June 2014, has resulted in sections YD 1(4) and (6) being "switched off" when determining the residence of natural persons for GST purposes, and tax residence or non-residence for GST purposes, therefore, applies prospectively from the date on which tax residence or non-residence is triggered for income tax purposes, as follows:

    (a) Tax residence for GST purposes starts on the day immediately following the day that triggers tax residence under s. YD 1(3) (i.e. the day immediately following 183 days presence in New Zealand in a 12-month period); and

    (b) Tax residence ceases for GST purposes on the day immediately following the day that triggers non-residence under s. YD 1(5) (i.e. the day immediately following 325 days of absence from New Zealand in a 12-month period).

47. It is noted in the TIB item that:

    "It is important to note that the day-count rules are not the only rules for determining an individual's tax residency status, and the amendment does not affect the application of the "permanent place of abode" test."

48. This amendment also applies from the date of enactment, 30 June 2014.

Non-resident registrants claiming GST on importation

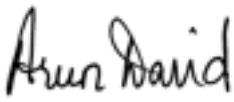
49. Officials were concerned with a potential fiscal risk whereby the new rules that enabled non-residents to register for GST would allow them to sell high-value goods to New Zealand private consumers without the net imposition of GST.

50. This would happen if the non-resident was the importer of the goods so that the non-resident is liable for the GST on importation. The non-resident would then be able to claim an input tax deduction for the GST paid on importation. However, there would be no corresponding output tax liability because the goods were offshore at the time of supply.

51. New sections 20(3LB) and (3LC) limit the ability of GST-registered non-residents to claim input tax deductions for GST paid on importation. When the non-resident acts as importer, the New Zealand recipient of the good will be treated as if they had paid the GST and will be entitled to an input tax deduction if the good is imported as part of a taxable activity.

52. The new sections will not apply if the non-resident is the actual recipient of the good, unless the non-resident is merely delivering the good to another person in New Zealand.

53. This amendment applies from 1 April 2014, the date on which the non-registration rules came into force.



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