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WEEKLY COMMENT: FRIDAY 27 FEBRUARY 2015

1. This week I complete looking 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 look at amendments to the apportionment rules and the zero-rating of land transactions rules. As noted last week, 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. All section references are to the *Goods and Services Tax Act 1985*.

3. The topics covered this week are:

   (a) Apportionment rules: wash-up rule for complete taxable or non-taxable use;

   (b) No apportionment rules adjustments for non-profit bodies;

   (c) Zero-rating of land: Allowing inputs to a registered person purchaser when a transaction is incorrectly zero-rated;

   (d) Ensuring land transactions are zero-rated only if requirements for zero-rating are met;

   (e) Zero-rating of land rules will apply to a payment to procure a lease;

   (f) What is not included in the Act: Apportionment rules: output tax on the disposal of land;

   (g) What is not included in the Act: supplies by a company to an associated natural person;

   (h) What is not included in the Act: credit notes when GST incorrectly charged.

Apportionment rules: wash-up rule for complete taxable or non-taxable use

4. The issue identified in the GST IP was 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. The suggested solution, which would apply to all assets and not just land, is a wash-up calculation, which would be compulsory.

5. The criteria for the "wash-up" to be made, in new s. 21FB inserted by s. 191 of the Employee Allowances Tax Act, are:

   (a) The person makes an adjustment under:

      (i) Section 21A – which requires an adjustment at the end of an adjustment period if a percentage difference arises, of 10% or more or, that exceeds $1,000; or

(ii) Section 21B – which allows an adjustment for goods and services acquired before the person became GST-registered (or, if the person is a member of a partnership, before the partnership became GST-registered); and

(b) The person's use of the goods or services changes in an adjustment period to either total taxable use or total non-taxable use; and

(c) The total taxable use or non-taxable use remains unchanged for an unbroken period (of up to two years) that is:

(i) The remainder of the adjustment period in which the use was changed; and

(ii) The adjustment period following the period in which the use was changed.

6. Where the above criteria are all met, a "wash-up" adjustment must be performed as follows for the adjustment period referred to in paragraph (c)(ii) above – i.e. for the adjustment period following the period in which the use was changed to total taxable or non-taxable use:

(a) When the use changes to total non-taxable use, there is a claw-back of the "actual deduction", as defined in new s. 21FB(3)(b), and all the input tax on the supply that has previously been claimed, including adjustments made up to the end of the adjustment period in which the wash-up adjustment is made, becomes an output tax liability in the wash-up adjustment period; and

(b) When the use changes to total taxable use, a "full input tax deduction", as defined in new s. 21FB(3)(a), is allowed (including any input tax paid by the recipient of a zero-rated supply of land), reduced by the "actual deduction" – see paragraph (a) above.

7. This amendment applies from the date of assent, 30 June 2014.

No apportionment rules adjustments for non-profit bodies

8. Section 20(3K) is a special rule that allows non-profit bodies input tax deductions on all goods and services other than those used to make exempt supplies. The apportionment rules, however, allow input tax deductions only for goods and services actually used to make taxable supplies. Therefore, some uncertainty has arisen regarding the application of the rule in s. 20(3K).

9. An amendment to s. 20(3K) in s. 190(1) of the Employee Allowances Tax Act makes the concession in s. 20(3K) effective in relation to the definitions of "percentage actual use" and "percentage intended use" in the apportionment rules. Therefore, goods and services used by non-profit bodies will be treated as used to make taxable supplies, unless they are used to make exempt supplies.

10. The amendment applies from the date of introduction of the apportionment rules – 1 April 2011.

Zero-rating of land: Allowing inputs to a registered person purchaser when a transaction is incorrectly zero-rated

11. An issue identified in the GST IP involves a zero-rated supply of land to a GST-registered purchaser that 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 of land as a supply to itself and output tax must be paid (the "domestic reverse charge"). However the pre-amendment wording of s. 20(4B) would have denied the

purchaser (who is already a registered person) an input tax credit because an input tax credit was only allowed if the purchaser "later becomes a registered person".

12. The solution in s. 190(3) of the Employee Allowances Tax Act is that s. 20(4B) will apply both to a person who later becomes registered and to a person who is already registered. This allows 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.

13. The amendment applies from the date of introduction of the apportionment rules – 1 April 2011.

Ensuring land transactions are zero-rated only if requirements for zero-rating are met

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

15. The solution in s. 188(2) of the Employee Allowances Tax Act is to change the wording of s. 11(8D) so that an assignment or surrender of an interest in land is "a supply under s. 11(1)(mb) if it meets the requirements set out in that subsection", 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.

16. The wording of s. 11(8D)(b)(ii) has also been amended to ensure that a standard commercial lease is not zero-rated if the payments made under the lease agreement meet the criteria in that subparagraph – i.e. payments of 25% or less of the consideration, or where no contemporaneous or advance payment has been made. Under the pre-amendment wording this is somewhat ambiguous.

17. These amendments apply from the date of introduction of the zero-rating of land rules – 1 April 2011.

Zero-rating of land rules will apply to a payment to procure a lease

18. 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. The issue identified in the GST IP was that at present, the transfer of the lease may not be subject to the zero-rating of land rules.

19. The solution in s. 188(2)(c) of the Employee Allowances Tax Act is the insertion of a new s. 11(8D)(c) specifying that a supply of an interest in land by way of a procurement by a third party of an existing lease is a supply of land. This will mean that such transactions are subject to the zero-rating of land rules.

20. This amendment applies from the date of assent, 30 June 2014.

What is not included in the Act: Apportionment rules: deemed supply of land on disposal

21. An issue identified in the GST IP was that when a person uses land for making taxable supplies and then fully devotes it to a non-taxable purpose before disposal, the person will arguably not be disposing of the land in the course or furtherance of their taxable activity, and, therefore, there is no output tax liability on the sale.

22. The suggested solution, which was targeted on land, was 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 s. 5(16) applies only to dwellings).

23. The proposal was to replace s. 5(16), so that it would apply to a supply of "land or a dwelling" for which a registered person has a deduction under s. 20(3). A subsequent supply of all or part of the land or dwelling, or appurtenances belonging to or used with the dwelling, would be treated as a taxable supply. The supplier would be required to charge output tax and also perform the existing final adjustment on disposal calculation in section 21F.

24. However, there were a number of serious objections to this proposal. Officials considered that submitters had raised valid concerns over the practical application of this proposed amendment, particularly the GST implications of selling essentially private land where a relatively small input tax deduction had been claimed in the past. Officials considered the new wash-up rule and the general anti-avoidance provision would address many of the concerns underlying the proposed amendment to s. 5(16). Therefore, this proposal has not been proceeded with.

What is not included in the Act: supplies by a company to an associated natural person

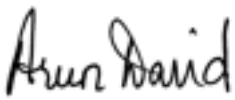
25. The issue identified in the GST IP is that under the present rules there is an interpretation that would allow a company to claim full input tax on assets that are provided to owners for private use. The supply to the owner is an associated supply, to which the market value rules apply and for which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

26. The suggested solution was to amend the definition of "percentage actual use" in s. 21G(1) so as to exclude associated supplies from being "taxable supplies" when the recipient of the supply is a natural person. There would need to 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. This suggestion has not been included in the legislation.

What is not included in the Act: credit notes when GST incorrectly charged

27. The issue identified in the GST IP 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.

28. The suggested solution was 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 to s. 25(3) were also suggested. However, this suggestion has not been included in the legislation.



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