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## WEEKLY COMMENT: FRIDAY 1 JULY 2022

1. On 8 March 2022, *GST apportionment and adjustment rules – An officials' issues paper* (“the GST IP 2022”) was released for consultation. Submissions closed on 27 April 2022.
2. A number of quite significant amendments have been proposed and I review these this week and next week. This week I look at the election to exclude an asset, de minimis and other rounding options, and accommodation services supplied in dwellings. Next week I will look at the sale of dwellings, land developed and sold by residential property developers and other proposals to simplify the apportionment rules.
3. A key issue identified by officials is that a GST-registered person who uses a private home for business purposes may be unaware that GST would be payable on a portion of the selling price of the home, and are not accounting for GST on its disposal. As noted in paragraph 1.7 of the GST IP 2022:

“... the use, and disposal, of the private asset .. in the course and furtherance of the registered person’s taxable activity .. can lead to a GST liability or adjustment if the asset is sold or there is a decreased percentage of taxable use of the asset. The GST liability on a dwelling or land can be significant as land is a high-value, appreciating asset that is often held for long periods before disposal.”

### Summary of the reforms proposed

4. A summary of the reforms proposed is provided in paragraphs 1.14 to 1.20 of the GST IP 2022, as follows:
  - (a) A registered person could be allowed to elect to exclude certain capital assets from their taxable activity (subject to some integrity measures);
  - (b) Rounding-based options to remove certain assets from the GST apportionment rules:
    - (i) A principal purpose test for assets under \$5,000;
    - (ii) A 20% de minimis rule under which taxable use of less than 20% would mean the asset is treated as totally private use only;
    - (iii) An 80% rounding-up rule under which assets used at least 80% for taxable use would be treated as 100% taxable use;
    - (iv) For assets costing \$5,000 or more and with more than 20% but less than 80% taxable use, adjustments under the GST apportionment rules would still be

required, but limited to situations where there is at least a 20% change in use from the initial estimate or the previous use;

- (c) Submissions are sought to improve the definitions of “dwelling” and “commercial dwelling”, particularly where the same premises are used to provide commercial guest accommodation and private use/residential rental;
- (d) A potential reform being floated is to make house sales by a registered person an exempt supply, if the person is not a property developer – but this would require new definitions and officials are interested to hear whether other reforms (such as being able to elect out) may be simpler;
- (e) Potential rules for applying GST to land that is developed and sold by property developers, including a full input tax deduction, subject to integrity rules;
- (f) Other incremental ways to reduce compliance, such as expanding eligibility to use the “wash-up” rule and reducing the number of adjustment periods so that assets can be monitored for fewer years.

#### **Election to exclude an asset**

5. Officials have noted that the GST treatment is different in two more or less similar situations:
  - (a) An asset would be subject to GST if owned by a GST-registered person and used in their business of making taxable supplies;
  - (b) However, if not owned by the GST-registered person, for example, if the GST-registered person is a company, and the asset being used, for example, a home office, is owned by a shareholder in the company or by a family trust, the same asset would not be subject to GST.
6. The proposed election would allow GST-registered owners of private and appreciating assets (such as home offices or holiday homes) to treat these assets as being separate from their taxable activity at the time of purchase. This would result in the same GST treatment as if the asset was owned by a shareholder or a trust.
7. This means they would be unable to claim GST input tax deductions on the purchase of, or capital improvements to, the asset, and they would not return GST when they disposed of the asset.
8. Officials propose that:
  - (a) The election would only apply to assets held on capital account (i.e. goods, land and intangible assets held on capital account);
  - (b) The election would not apply to assets acquired for the principal purpose of making taxable supplies;
  - (c) The election would not preclude using the asset for making taxable supplies – for example, taxable Airbnb supplies from a holiday home excluded from being a taxable asset, or claiming proportional insurance and maintenance costs for a home office where the house was excluded from being a taxable asset;

- (d) The election may not be taken up in all cases, for example:
- (i) Some registered persons who do not intend to dispose of an asset may prefer an input tax deduction to help fund their business;
  - (ii) Most registered persons will probably prefer to continue to claim input tax deductions on depreciating assets, such as cars, because the output tax on sale would be less than the input tax on purchase;
- (e) For assets that were acquired as zero-rated purchases:
- (i) If the purchaser wanted to elect to remove the asset from their taxable activity, they would be required to make an adjustment to return output tax of 15% of the zero-rated purchase price;
  - (ii) However, a GST-registered purchaser of zero-rated land is already required to make an output tax adjustment for any non-taxable use of the land under s 20(3J) of the Goods and Services Tax Act 1985 (the GST Act), and the proposed election would simply require the purchaser to make an output tax adjustment for the full purchase price of the land;
  - (iii) In any case, in most cases where the supply of an asset is zero-rated, this is because the asset is predominantly used as a business asset, and this would probably continue to be the case;
- (f) A retrospective application date be adopted – 1 April 2011 is suggested, which would mean that most GST positions already taken would be ratified, together with a savings provision to protect persons who have correctly complied with the current law;
- (g) A 12-month transitioning rule be adopted to allow registered persons to elect that assets purchased before 1 April 2023 be non-taxable assets, to be applied between 1 April 2023 and 1 April 2024, however, this would require GST output tax to be paid, and officials expect it would mainly be used when an imminent sale of the relevant appreciating asset is contemplated;
- (h) Registered persons be required to disclose the following information to Inland Revenue when they acquire certain high-value assets (such as land, pleasure craft and aircraft at a GST-exclusive price of \$150,000) to make taxable supplies and do not elect that they not be a taxable asset:
- (i) The consideration paid;
  - (ii) The GST input tax deducted on purchase (or the nominal GST amount in the case of a zero-rated supply);
  - (iii) A statement as to how the asset will be used to make taxable supplies;
- (i) The disclosure requirements would:
- (i) Apply prospectively to assets purchased after a certain date; and
  - (ii) Not apply in specific circumstances, for example, to GST groups who have made taxable supplies of land of more than \$5 million in a 12-month period;

- (j) When a registered person purchases an asset they intend to use to make taxable supplies, and does not elect that the asset is not a taxable asset, the future disposal of that asset would be deemed to be a taxable supply made in the course or furtherance of the registered person's taxable activity (similar to the existing deeming rule in s. 5(16) of the GST Act for dwellings for which an input tax deduction has been claimed), applying, for example, to assets disposed of on or after 1 April 2023.

### **De minimis and other rounding options**

9. A principal purpose test is proposed for assets costing less than \$5,000 (excluding GST) purchased on or after 1 April 2023. Examples provided are smartphones, computers and tools. No adjustments would be required after purchase unless the principal purpose changed, in which case, output tax would be payable if the principal purpose became non-taxable, or input tax could be claimed if the principal purpose became taxable. No change is proposed for assets already acquired because the existing \$5,000 de minimis should apply once intended taxable use has been estimated.
10. For assets purchased for \$5,000 or more (excluding GST), officials propose that an adjustment would only be made if the difference between the estimated taxable use (or previous actual use) and the actual taxable use exceeded a 20 percent threshold. Officials maintain that such a change would be large enough to indicate a deliberate change of use, rather than an unintended one.
11. A new 20% de minimis test is proposed, under which if taxable use is 20% or less, the asset is treated as 100% non-taxable, and no input tax deduction will be allowed.
12. An asset that is used 80% or more to make taxable supplies would be treated as 100% taxable use – i.e. rounding up to 100% is proposed in these circumstances. Officials believe that this will significantly reduce compliance costs in the case of work-related vehicles, many of which are likely to be used at least 80% for business purposes.
13. Registered persons with taxable use between 21% and 79% would continue to use the existing apportionment rules, but adjustments would only be required if there is a change in use of 20% or more.
14. Officials have noted that in most cases, houses would be excluded from being taxable assets under the 20% de minimis test. However, in some cases, such as a GST-registered person using a small home, or a holiday home fully rented out as short-term commercial accommodation, the house may not be excluded under the de minimis test. In such cases, an additional option may be necessary, such as the election to exclude discussed in paragraphs 5 – 8 above, or a proposed new exempt supply rule (dealt with in next week's *Weekly Comment*).
15. Officials have also proposed offering registered persons who have between 21% and 79% taxable the option of reducing use to 20% or less, or increasing use to 80% or more, as the case may be, and extending the existing wash-up calculation in s 21FB to apply to these situations. The effects would be either:
  - (a) Repaying existing input tax claimed if taxable use is reduced to 20% or less; or
  - (b) Claiming input tax that has not been claimed if taxable use increases to 80% or more.

16. Officials propose that the new rounding rules would apply to assets acquired on or after 1 April 2023, subject to the following transitional rules:
- (a) Assets acquired before 1 April 2023 could be transitioned into the new rounding rules over the 2 subsequent adjustment periods; however
  - (b) Registered persons could elect to transition into the new rounding rules in the first subsequent adjustment period if they wanted to;
  - (c) The transitional rules could be applied on an asset-by-asset basis, but by the end of the second subsequent adjustment period all assets would be subject to the new rounding rules.

### **Accommodation services supplied in dwellings and commercial dwellings**

17. Officials maintain that it is difficult, in some scenarios, to distinguish between the GST definitions of “dwelling” and “commercial dwelling”. They suggest this is partly because the definition of “dwelling” is based on the nature of accommodation services received by the occupant, and whether an occupant has “quiet enjoyment” can be difficult to assess.
18. The definition of “commercial dwelling” is a list of types of premises including hotels, motels, farmstays and homestays (among others). The definition of “dwelling” excludes a commercial dwelling. But officials note that this exclusion creates issues when premises such as a farmstay or homestay are used to provide commercial accommodation services as well as residences for the owner or residential tenants.
19. Officials have proposed that the definition of “dwelling” be replaced by a new definition of “residential accommodation services”. This could be defined as “accommodation provided in premises or part of premises to a person who occupies, or will occupy, the premises (or part of the premises) predominantly as their place of residence or abode and includes any appurtenances belonging to, or used with, the premises”. This is similar to the pre-2011 definition of “dwelling”.
20. As far as “commercial accommodation services” are concerned, which would remain taxable supplies when supplied by a GST-registered person, officials have proposed a few options:
- (a) First, the existing definition of “commercial dwelling” could be retained, but the exclusion in the definition of “dwelling” would be limited to “the supply of accommodation services in a commercial dwelling”, rather than a blanket exclusion for commercial dwellings, which would allow residential accommodation in a commercial dwelling to be treated as an exempt supply;
  - (b) Second, the existing list of types of premises could be replaced with a more general definition of “commercial accommodation services” which could include:
    - (i) Short-term accommodation services that are ordinarily intended to be provided to the recipient for periods of less than 28 days at a time (which would include accommodation for more than 28 days, if intended to be less than 28 days);
    - (ii) Serviced accommodation where regular services such as meals, cleaning or care services are part of the supply of accommodation services (as opposed to an optional extra);

(iii) Retaining the existing 60% GST rate concession in section 10(6) for both of the above types of accommodation for guests staying longer than 4 weeks in a commercial dwelling (i.e. the GST rate reduces from 15% to 9%);

(c) Third, GST-registered persons who own a single piece of land, building or premises used predominantly to provide one type of accommodation services could be allowed to make an irrevocable election to deem all the accommodation services to be of that type – subject to the requirement that a change of use from taxable to exempt would require output tax adjustments for the capital cost of the premises – for example:

(i) A retirement village operator could choose to make all units exempt supplies or taxable supplies (if they have mainly services units); or

(ii) A hotel could choose to include staff accommodation in its taxable supplies; or

(iii) Temporary accommodation for fixed-term or seasonal workers could be treated as taxable supplies; and

(iv) Emergency social housing accommodation services provided in premises usually intended for short-term occupancy could be treated as either exempt or taxable supplies, depending on the predominant use of the premises.

21. Officials propose that the new definitions would apply to accommodation services supplied on or after 1 April 2023. However, a transitional rule, similar to the rule in section 21HB, could apply to preserve the current GST treatment if altered as a result of the new definitions.



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