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*A special report from the*  
Policy Advice Division of Inland Revenue

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## **Further proposed changes to the Goods and Service Act 1985 to help businesses transition to the new GST rate**

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The Government has announced that it intends to include a number of amendments to the Goods and Services Act 1985 by way of a supplementary order paper to the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Bill. The Government has also released a draft of the legislative amendments for public comment (available on request from Inland Revenue (04 890 6386) and the Minister of Revenue's office (04 817 9728). Feedback on that draft is sought by 16 August 2010. This paper provides background and further explanation on the changes.

### **Annual contracts involving successive supplies**

Many contracts, particularly in the general and health insurance area, are for a period of one year or are at least reviewed annually. In some cases the customer pays the premium in one payment while in other cases the premiums are paid progressively, say by monthly instalment. Most of these arrangements will straddle the GST rate change date of 1 October 2010 so that, in the absence of legislative change, some instalments will be at the new GST rate and some at the old.

Businesses may be able to seek additional payment from customers to cover the additional GST, but in many cases the compliance cost to them of doing so is excessive relative to the amounts of GST involved. For example, there will be individual cases when the additional costs of collecting the additional GST exceed the additional GST because the contract has very little time to run.

The proposed amendment would allow insurers and others the option of applying the 12.5% rate for the rest of the insured period up to the next annual review date (or less if the contract is for a lesser period) provided certain criteria are satisfied. The key criteria are that all the remaining GST is accounted for in the return period ending before 1 October 2010 and GST-registered recipients only claim back GST at the 12.5% rate. This would be achieved by treating the remaining supplies to have been made on 30 September 2010.

In the event that an insurance policy or other contract subject to the transitional rule is cancelled and, therefore the supply is not fully provided, businesses would need to issue credit notes to adjust for the change in consideration and the GST incorrectly paid.

A business would elect this option by making a tax return on this basis.

### **Example**

A policy for car insurance covers the period 28 April 2010 to 27 April 2011 and the customer chooses to pay by monthly instalments. The insurer normally pays GST when instalments are due or received but elects to apply the transitional rule and returns the remaining GST at 12.5% in its September GST return.

### **Subrogation payments**

A subrogation payment is the recovery income received by an insurer for the damages caused by a third party to their insured party. The GST Act deems the time of supply to be the day on which the insurer receives the payment. This means subrogation payments received on or after 1 October 2010 will be subject to the new 15% GST rate, even when the underlying claim to which the payment relates was at 12.5%.

The proposed change would allow the rate of GST to remain at 12.5% for subrogation payments received on or after 1 October 2010 provided the underlying claims are agreed and settled before 1 October 2010.

### **Finance leases**

In agreements to hire that are finance leases, GST is applied to the supply of the good in question (a motor vehicle, for example) but not to the finance component of the transaction as financial services are GST-exempt. In finance leases the interest and principal components are calculated actuarially but to ease compliance GST payments are able to be based on a straight-line approach over the term of the lease. This means that more GST is payable on the earlier lease payments than is actually required. A square-up adjustment is normally only done when the lease terminates, to reflect any difference between the actual and expected residual value of the leased asset.

With a rate change occurring during the contract term, the new rate would apply to the remaining payments under the finance lease contract. The subsequent reconciliation that would have to be undertaken on these existing contracts becomes complex and substantial systems changes would be required to accommodate it. Most contracts are with GST-registered businesses who would be able to claim back the GST anyway.

The proposed change would allow finance leases entered into before 1 October 2010 for a maximum term of five years to continue to be able to be accounted for at the 12.5% rate, provided GST-registered lessees were advised by the lessors to deduct input tax at the 12.5% rate on payments made after 1 October 2010. This solution would be elective, at the option of the supplier.

### **Aligning legislation and practice**

There are several instances where further legislative flexibility is needed so that GST practices adopted through systems or other commercial imperatives are not unduly affected by the rate increase.

## **The issuing of tax invoices for pre-October supplies**

The first issue relates to goods or services that are supplied on or before 30 September 2010 but for which the invoice is not issued until early October even though dated before 1 October 2010. Under the GST Act, it is the date when the invoice is issued that is relevant for determining the time of the supply, so these invoices could technically be considered subject to the higher rate even though the goods or services are provided, and the invoice dated, when the rate was 12.5%.

Accordingly, for the GST rate transition, the proposal is that suppliers may treat tax invoices issued on or before 11 October 2010 for goods or services provided on or before 30 September 2010 as having been issued on the date of the invoice. This is provided that the invoice is dated on or before 30 September and payment is due no later than 60 days from the invoice date. A cut-off date of 11 October has been chosen to provide two weekends to send out invoices in relation to September supplies.

## **Option of general time of supply or successive supplies rule**

The second instance arises because some suppliers of what are arguably successive supplies (for example, utilities and phone line rentals) account for GST on the basis of when the invoice is issued rather than when payment is due or received. Technically, the GST rate on a successive supply should be determined by when the payment is due or received rather than when the invoice is issued. Under normal circumstances this makes no difference but with a rate change some suppliers are uncertain about whether a September invoice, for example, would need to be charged at 12.5% or at 15% as this could be dependent on whether the customer paid or was required to pay before 1 October.

To address this, it is proposed that for successive supplies, suppliers have the choice of using either the invoice or the “payment due or received” rule provided, as with the previous issue, that the goods or services are provided before 1 October 2010, the invoice for the supply is dated on or before 30 September 2010, the invoice is issued by 11 October 2010 and payment is due not later than 60 days from the invoice date.

## **Replacement invoices**

The third issue concerns the use of replacement tax invoices. Legally, a supplier cannot issue two tax invoices for the same supply and should be instead issuing credit or debit notes when, for example, goods are returned or additional GST is due as a result of the GST rate increase. Although longer-term this issue needs to be considered in a wider review, in the interim the proposal is that for the GST rate transition period:

- As an alternative to issuing a debit note, replacement tax invoices could be issued to replace pre-1 October 2010 invoices for supplies that are being provided successively, to cover the amended GST payable on the remaining services provided from 1 October.
- Since in some cases a replacement invoice would alter the time of supply and hence the applicable GST rate, there would be an option of allowing the issue of a new invoice at the previous GST rate of 12.5% if it relates to revising an invoice issued before 1 October 2010, as an alternative to issuing a credit note.

## **Layby sales**

For GST purposes, a layby sale is only recognised as taking place when the goods are delivered, which is normally after the last instalment payment. Goods uplifted after 30 September will, therefore, attract the new 15% GST rate. Although paying all of the layby instalments and collecting the layby item before 1 October would preserve the old 12.5% GST rate, this will not always be possible because of the costs involved or the goods simply not being able to be delivered before that date.

An amendment is proposed for layby sales contracts that span the GST rate change date and for which a binding contract was in place before Budget night (20 May 2010). The proposal would allow suppliers to elect to apply the old 12.5% GST rate to the extent that any payments in relation to the transaction were received before 1 October 2010. Under this option, the supplier would be required to return these payments in their September 2010 GST return as there would be a deemed supply to the extent of these payments.

This would be in effect an apportionment rule, with payments made from 1 October 2010 being at 15%.

## **Private Training Establishments**

Private Training Establishments (PTEs) are registered with the New Zealand Qualifications Authority (NZQA) and are required to use a trust arrangement when students pay their course fees in full. This is to help protect students from the risk that their intended course provider does not deliver the course. As the courses are delivered, the trustee progressively pays out the funds to the PTE.

In the absence of any law change, any payments released by the trust to the PTE after 1 October 2010 would be accounted for at the new 15% rate even when students have paid the full course fees before 1 October 2010. This is because the services are considered to be supplied when the payments are released to the relevant PTEs. It would be impractical for the PTEs to seek additional payments from the students.

Accordingly, it is proposed to allow registered private training establishments the option of making an up-front adjustment in their 30 September GST returns that would give them a credit to cover the additional GST that would be payable when course fees held in trust as at 30 September 2010 were subsequently released to them. This would apply irrespective of whether the PTE returned GST on an invoice, hybrid or payments basis.

The credit would be based on the amount held in trust for the PTE as at 30 September 2010.

## **Application date**

These changes would apply from Royal assent.