Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Bill

Supplementary Report No. 2 to the Officials' Report to the Finance and Expenditure Committee on submissions on the proposed retrospective GST legislation to be included in the bill

27 August 2001

Prepared by the Policy Advice Division of the Inland Revenue Department and the Treasury

BACKGROUND

Policy intent

The proposed changes, currently before members of the Finance and Expenditure Committee, reflect the unambiguous policy intent of GST when it was introduced in 1986: to tax all consumption that takes place in New Zealand. This includes expenditure incurred by tourists visiting New Zealand. The policy intent is evident from papers provided to the Committee and has not been questioned by submissioners.

Wilson & Horton v Commissioner of Inland Revenue

The *Wilson & Horton* decision,[1] of 15 September 1995, concerned the zero-rating of advertising services that were supplied to a non-resident in relation to a newspaper published in New Zealand. The Court of Appeal held that the zero-rating provisions were directed to the contractual arrangements between the supplier and the recipient. Any benefits that accrued in New Zealand arising from the advertising were disregarded because of the indirect relationship that the benefits had with the contract between Wilson & Horton and the non-resident.

One interpretation of the decision suggests that in circumstances when services are supplied to a non-resident who is outside New Zealand at the time of supply, those services may be zero-rated, regardless of any benefits that may be enjoyed in New Zealand. In a number of situations this interpretation potentially allowed some services that were contracted for by non-residents outside New Zealand to be zero-rated, even though the services were consumed in New Zealand. An example of this was the tuition of overseas students in New Zealand. In this situation the education services would be zero-rated because the contract was between the New Zealand school or tertiary institution and the non-resident parent of the student (as illustrated in the annex). Another example involves the selling of holiday packages to overseas tour wholesalers (also illustrated in the annex).

1999 legislative amendments

The Taxation (Remedial Matters) Act 1999 introduced new section 11(2A), now re-numbered as section 11A(2), which excludes from the zero-rating provisions services that are supplied to a non-resident if another person receives the performance of the services in New Zealand. The amendment applies to services from the date of introduction of that Act – 20 May 1999.

[1] *Wilson & Horton* v *Commissioner of Inland Revenue* (1995) 17 NZTC 12,325

Proposed legislation to be included in the Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Bill

As announced on 14 May 2001, the proposed legislation will extend the application of section 11A(2) of the GST Act to a supply made by a registered person after 1 October 1986 if the person has sought, after 15 September 1995 (the date of the Court of Appeal decision in *Wilson & Horton*), to adjust on any basis, or to have the Commissioner adjust, the GST treatment of the supply.

The proposed legislation will not apply if, as a result of the person having sought the adjustment, the Commissioner has, on or before 14 May 2001, to the extent of the adjustment sought, paid a refund to the person or made an offset against, or reduction in, a tax liability.

In addition, supplies of services made before 20 May 1999 to which section 11A(2) would otherwise apply will be treated as zero-rated if:

- the registered person seeking to adjust the GST treatment of the supply proves to the satisfaction of the Commissioner that the person who received the performance of the services in New Zealand (or a person who is associated with that person) has received a payment from the registered person equal to the amount of the adjustment sought; and

- the registered person has written evidence of the payment to the person.

OVERVIEW OF SUBMISSIONS

Opposition to proposed amendment

The Committee has received close to sixty submissions opposing the proposed amendment and recommending that it should not proceed. Many submissioners describe the proposed amendment as “immoral”, “iniquitous”, “a constitutional outrage” or “an abuse of power”.

Submissioners are generally concerned with retrospective legislation that impacts negatively on taxpayers and therefore how it might impact on investor confidence in New Zealand. They are also concerned that the proposed amendment will adversely affect confidence in the tax system.

Submissioners note the impact the proposed amendment would have on different groups of taxpayers who are in similar situations and consider the outcome to be unfair and unjust. They recommend that all affected taxpayers be treated equally through alternative savings provisions.

Savings provisions

A number of submissioners suggest alternative savings provisions to preserve existing disputes that taxpayers have with Inland Revenue. They consider that the savings provision for those who have received refunds is too narrow and unfairly favours this group against those who may have experienced delays in resolving the matter with Inland Revenue.

Application of clause 228A(7)

Submissioners have not generally commented on the wording of the draft legislation. The exception is with regard to clause 228A(7), which requires taxpayers to pay an equivalent amount to the GST refund sought to the tourist or foreign student who received the services in New Zealand, in order to have the transaction zero-rated. Many submissioners consider that the clause is unworkable.

GST treatment of warranties

Submissioners raise concerns with the application of the recent Court of Appeal decision in *Suzuki New Zealand* v *Commissioner of Inland Revenue*[2] (in favour of the Commissioner) and its impact on the treatment of warranty agreements provided by offshore manufacturers. Submissioners consider that the situation in the *Suzuki* case is comparable to that addressed by the proposed legislation and that it would be appropriate for the Government to introduce retrospective legislation in this instance also.

[2] (2001) 20 NZTC 17,096

GST RETROSPECTIVE LEGISLATION – ZERO-RATING

Clause 228A

Issue: Opposition to the proposed retrospective amendment

Submissions

(12W – Silver Fern Holidays, 13 – New Zealand Law Society, 14W – Thomas Cook (New Zealand) Ltd, 15W – Polson Higgs & Co, 16W – Vodafone New Zealand Ltd, 17W – Northpower, 18W – Nissan New Zealand Ltd, 19W – Fyers Wickham Ltd, 20 – Bradbury & Muir on behalf of Kiwi English Academy of Learning, 21 – Bradbury & Muir on behalf of ID Tours; Travel Arrangements; Pan Pacific; Tourmasters; General Travel; Inbound Tour Services, 22W – Southern Capital Ltd, 23 – ITS South Pacific, 24W – Retail Merchants Association of New Zealand Inc, 25W – Malley & Co, 26W – Elms Hotel, 27W – Polson Higgs & Co, 28 – ATS Pacific, 29 – Mitchell Corp New Zealand, 30 – Kevin R Sarjeant, 31 – Contract Pacific Ltd, 32 – Tourism Holdings Ltd, 33W – University of Otago, 34W – Kent Wooldridge, 35W – Next Electronic Servicing Ltd, 36 – Southern World Vacations (New Zealand) Ltd, 37 – Vacations Pacific, 38W – Kingdom Tours, 39 – Vacations Pacific Ltd, 40W – Tourism Industry Association New Zealand, 41W – Pacific Delight Ltd, 42W – University of Waikato, 43W – Stamford, 44W – ASB Bank, 45W – Kirra Tours, 46W – Farm to Farm New Zealand Tours, 47 – Travel Arrangements South Pacific Limited, 48W – Rest New Zealand Tours, 49W – Datacom Group, 50 – PricewaterhouseCoopers, 51W – Bayfield High School Board of Trustees, 52W – Royal & Sunalliance, 53 – Landmark Travel, 54 – General Travel New Zealand Ltd, 55W – Tourlink New Zealand Ltd, 56W – ID Tours New Zealand Ltd, 57 – Tourmasters South Pacific Ltd, 58W – Nationwide Rental Cars, 59 – Pan Pacific, 60W – Genesis, 61W – Viking Pacific, 62 – Institute of Chartered Accountants of New Zealand , 63W – KPMG, 65W – Deloitte Touche Tohmatsu on behalf of the Inbound Tour Operators Council, 67W – KPMG, 68W – Motor Industry Association Inc, 69 – Ernst & Young, 69A – Ernst & Young, 70W – PDL Holdings Ltd, 71W – Terry Baucher, 72W – Brown Wooley Graham, 73W – Richmond Ltd, 74W – Peter Holl & Associates, 75W – Montana Wines Limited)

Submissioners oppose the proposed change and submit that it should not proceed. This is because they consider that retrospective legislation is not justified, and rarely can be, as it affects things which have occurred in the past. The submissioners consider that if people are to have confidence in the laws passed by Parliament, they need to be certain as to the effects of those laws on their actions.

A number of comments are made to the effect that the proposed amendments are "immoral" and "unjust". Many submissioners assert that the legislation invalidates rightful claims by inbound tour operators and denies them the legal right to have their disputes with Inland Revenue considered. They state that in so doing the amendment breaches moral, ethical and legal codes. Some consider that the legislation is an arbitrary way to deny claims. Other submissioners consider the proposed amendments an "abuse of power" by the Government that is "tantamount to thievery" and as such would be "a constitutional outrage". One submissioner compares the Government to "an African dictatorship".

Specifically, submissioners list the following concerns about the proposed amendment as the reasons why it should not proceed:

- *(14W – Thomas Cook (New Zealand) Ltd, 16W – Vodafone New Zealand Ltd, 40W – Tourism Industry Association New Zealand, 65W – Deloitte Touche Tohmatsu, 63W – KPMG, 69 – Ernst & Young)*

  Retrospective legislation should only be considered when it is absolutely necessary, or the circumstances are extraordinary and there has been some form of manifest error in the legislation. The proposed amendment does not "clarify" the legislation in relation to the treatment of services supplied contractually to a non-resident but received in New Zealand. Rather, it is a policy change which invalidates legitimate claims.

- *(22W – Southern Capital Ltd, 23 – Inbound Tourist Services South Pacific Ltd, 25W – Malley & Co, 56W – Elms Hotel Ltd, 27W – Polson Higgs & Co, 28 – ATS Pacific, 29 – Mitchell Corp New Zealand Ltd, 30 – Kevin R Sarjeant, 31 – Contract Pacific Ltd, 32 – Tourism Holdings Limited, 26 – Southern World Vacations (New Zealand) Ltd, 37 – Vacations Pacific Ltd, 41W – Pacific Delight, 42W – The University of Waikato, 46W – Farm to Farm New Zealand Tours)*

  The *Wilson & Horton* decision allowed inbound tour operators to zero-rate their services and activities. Many submissioners consider that the *Wilson & Horton* decision held that the services and activities of inbound tourist operators should be zero-rated.

- *(16W – Vodafone New Zealand Ltd, 17W – Northpower, 18W – Nissan New Zealand Ltd, 22W – Southern Capital Ltd, 24W – Retail Merchants Association of New Zealand Inc, 32 – Tourism Holdings Ltd, 35W – Next Electronic Servicing Ltd, 43W – Stamford, 44W – ASB Bank, 45W – Kirra Tours, 49W – Datacom Group, 52W – Royal & Sunalliance, 55W – Tourlink New Zealand Ltd, 59 – Pan Pacific, 60W – Genesis, 69 – Ernst & Young, 70 – PDL Holdings Ltd, 73W – Richmond Ltd, 74W – Peter Holl & Associates)*

  The Government should not introduce retrospective legislation on the grounds of fiscal risk alone. The revenue risk quoted in the Minister of Finance and Revenue's press release, 14 May 2001, is overstated as it does not take into account any income tax implications.

- *(65W – Deloitte Touche Tohmatsu)*

  Retrospective legislation should only be enacted in exceptional circumstances and the amendments must be made in a timely fashion. This is not the case here.

- *(17W – Northpower, 16W – Vodafone New Zealand Ltd, 18W – Nissan New Zealand Ltd, 22W – Southern Capital Ltd, 24W – Retail Merchants Association of New Zealand Inc, 35W – Next Electronic Servicing Ltd, 43W – Stamford, 44W – ASB Bank, 45W – Kirra Tours, 49W – Datacom Group, 52W – Royal & Sunalliance, 55W – Tourlink New Zealand Ltd, 60W – Genesis, 61W – Viking Pacific, 70W – PDL Holdings Ltd, 73W – Richmond Ltd, 74W – Peter Holl & Associates, 75W – Montana Wines Limited)*

Retrospective legislation reduces the level of business certainty in taxation matters. One submissioner notes that retrospective legislation makes it difficult for businesses to effectively plan for the taxation effects on new products and investments.

- *(15W – Polson Higgs & Co, 17W – Northpower, 18W – Nissan New Zealand Ltd, 22W – Southern Capital Ltd, 24W – Retail Merchants Association of New Zealand Inc, 33W – The University of Otago, 32 – Tourism Holdings Ltd, 35W – Next Electronic Servicing Ltd, 41W – Pacific Delight Ltd, 43W – Stamford, 44W – ASB Bank, 45W – Kirra Tours, 49W – Datacom Group, 52W – Royal & Sunalliance, 55W – Tourlink New Zealand Ltd, 59 – Pan Pacific, 60W – Genesis, 62 – Institute of Chartered Accountants of New Zealand, 70W – PDL Holdings Ltd, 74W – Peter Holl & Associates, 75W – Montana Wines Limited)*

  Retrospective legislation potentially reduces the level of confidence business has in the integrity of the taxation system.

- *(16W – Vodafone New Zealand Ltd, 22W – Southern Capital Ltd, 25W – Malley & Co, 29 – Mitchell Corp New Zealand, 32 – Tourism Holdings Ltd, 34W – Kent Wooldridge, 35W – Next Electronic Services Ltd, 36 – Southern World Vacations New Zealand Ltd, 37 – Vacations Pacific Ltd, 40W – Tourism Industry Association of New Zealand, 41W – Pacific Delight Ltd, 46W – Farm to Farm New Zealand Tours, 55W – Tourlink New Zealand Ltd, 58W – Nationwide Rental Cars Ltd, 61W – Viking Pacific Holdings Ltd, 62 – Institute of Chartered Accountants of New Zealand, 70W – PDL Holdings Ltd, 75W – Montana Wines Limited)*

  Retrospective legislation is damaging to business confidence in the way that international and domestic investors view New Zealand and the New Zealand Government. Retrospective legislation significantly reduces international investor willingness to do future business and make further investments in New Zealand. It creates doubt as investors cannot be sure that the law at the time a transaction is entered into will not be changed to suit the current wishes of the Government at a later date. Certainty in the law is paramount in enabling foreign investors to have confidence in the New Zealand economy and confidence that taxpayers are entitled to rely on Court of Appeal decisions.

- *(18W – Nissan New Zealand Ltd, 24W – Retail Merchants Association of New Zealand Inc, 43W – Stamford, 44W – ASB Bank, 49W – Datacom Group, 55W – Tourlink New Zealand Ltd, 59 – Pan Pacific, 60W – Genesis, 61W – Viking Holdings Ltd, 69 – Ernst & Young, 70W – PDL Holdings Ltd, 74W – Peter Holl & Associates)*

  The proposed retrospective changes will discourage full and frank disclosure by taxpayers to the Inland Revenue and, in the opinion of some submissioners, may harm self-assessment by taxpayers.

Comment

Officials' comments in response to the submissions are:

- Officials agree that retrospective legislation should only be considered in exceptional circumstances. As submissioners note, it is desirable both to avoid retrospective legislation from a constitutional perspective and to maintain investor confidence in New Zealand, its government and its tax system. In most cases educational institutions and inbound tourist operators expected GST to be payable when they entered into the transactions in question. This is clear from the Ernst & Young submission. Returns were filed and GST was paid on that basis. The best evidence that people entered into transactions on the basis that no GST would be charged on supplies is that they filed GST returns on such a basis. In terms of PricewaterhouseCoopers' submission, these are the taxpayers that "acted bona fide on the basis that the supply was zero-rated". The proposal is not to change the law in those cases. Those who have zero-rated their supplies will be able to rely upon unchanged law in any dispute with Inland Revenue. In addition, any taxpayer that has already received a refund (whether or not Inland Revenue considers that they remain entitled to it) will be able to continue to rely on existing law.

- Officials also agree that any retrospective amendments should be made on a timely basis. In this case, the proposed amendments are a reaction to events after the legislation in 1999 was passed and so, in that respect, are timely.

- The proposed amendment clarifies the policy intent and the correct legal position as noted by the Solicitor-General in the most recent advice received by Inland Revenue on the issues.

- Officials do not, therefore, accept the comment that the *Wilson & Horton* decision clearly allows inbound tourist operators or education providers to zero-rate their supplies. The Court of Appeal's decision needs to be read according to the facts, which concerned the treatment of advertising services.

- The proposed amendment is intended to reflect the policy intent of the legislation as is clear from background papers on the issues. While submissioners are concerned that it takes away an absolute right to refunds, Inland Revenue considers that the supplies in question by the inbound tourist operators were liable to GST.

- The proposed amendment has rightly taken account of the fiscal risk and has also taken account of the correct policy intent. The Government's decision to introduce the legislation was, therefore, not based solely on fiscal risk.

- Comments that the revenue risk has been overstated are incorrect. The estimated revenue risk was based on GST amounts that were known to be in dispute between Inland Revenue and taxpayers. The estimated revenue risk was given a range of between $150 - $200 million, which was considered to adequately reflect any income tax implications.

- While some submissioners may consider that the amendments will affect full and frank disclosure, officials note that full and frank disclosure by taxpayers is a legal requirement under the Tax Administration Act 1994.

Recommendation

That the submissions be declined.

Issue: Policy underlying proposed amendment is incorrect

Submissions
(13 – New Zealand Law Society, 15W – Polson Higgs & Co, 20 – Bradbury & Muir on behalf of Kiwi English Academy of Learning, 21 – Bradbury & Muir on behalf of ID Tours New Zealand Ltd; Travel Arrangements South Pacific; Pan Pacific Travel Corporation Ltd; Tourmasters South Pacific Ltd; General Travel New Zealand Ltd; Inbound Tour Services South Pacific Ltd), 27W – Polson Higgs & Co, 28 – ATS Pacific Ltd, 31 – Contract Pacific Ltd, 33W – The University of Otago 36 – Southern World Vacations (New Zealand) Ltd, 42W – The University of Waikato, 51W – Bayfield High School Board of Trustees, 62 – Institute of Chartered Accountants of New Zealand)

Submissioners consider that the legislation should not proceed because accepted industry practice by tax practitioners, educational institutions and inbound tourist operators is that the services in question are zero-rated. This view was reached with the consent of the Government and Inland Revenue, as indicated by the two years that were spent debating the technical issues.

Several submissioners consider that the time delay in implementing the 1999 legislation and the current retrospective amendment indicates tacit approval for the claims. Some note that the retrospective legislation confirms that their claims are valid and that the Government is only concerned about cancelling a debt that is owed to them. Some question the true intent of the legislation, suggesting that it does not clarify the legislation because the previous 1999 amendments did not address prior periods. They claim that officials should have been aware that refund claims were going to be made for the period before 20 May 1999.

Comment

Officials and Government were considering the policy issues well before 1999. The delay in legislating in 1999 was caused by other priorities on the tax policy work programme and cannot be construed as tacit approval for zero-rating. In not recommending in 1999 to address earlier periods, officials took into account a number of factors, including the need for open consultation and the revenue risk (which has now been shown to have been underestimated). Again, this recommendation cannot be regarded as tacit approval for zero-rating.

The policy with regard to the supplies in question has been clear since the introduction of GST in 1986. The *Wilson & Horton* decision raised the question of whether the correct policy was reflected in the wording of the legislation. Advice received from the Solicitor-General states that, subject to the facts of the arrangement, it would not be correct for services supplied by the inbound tourist operators to be zero-rated.

Therefore the purpose of the proposed amendment is to ensure that it reflects, and indeed clarifies, the policy when GST was introduced in 1986.

Recommendation

That the submissions be declined.

Issue: Inconsistent application of proposed amendment

Submissions
(14W – Thomas Cook (New Zealand) Ltd, 16W – Vodafone New Zealand Ltd, 18W – Nissan New Zealand Ltd, 19W – Fyers Wickham Ltd, 20 – Bradbury & Muir on behalf of Kiwi English Academy of Learning, 21 – Bradbury & Muir on behalf of ID Tours New Zealand Ltd; Travel Arrangements South Pacific; Pan Pacific Travel Corporation Ltd; Tourmasters South Pacific Ltd; General Travel New Zealand Ltd; Inbound Tour Services South Pacific Ltd, 23 – Inbound Tour Services South Pacific Ltd, 24W – Retail Merchants Association of New Zealand Inc, 32 – Tourism Holdings Ltd, 35W – Next Electronic Servicing Ltd, 40W – Tourism Industry Association of New Zealand, 43W – Stamford, 44W – ASB Bank, 45W – Kirra Tours, 51W – Bayfield High School Board of Trustees, 52W – Royal & Sunalliance, 55W – Tourlink New Zealand Ltd, 57 – Tourmasters South Pacific Ltd, 59 – Pan Pacific, 61W – Viking Pacific Holdings Ltd, 70W – PDL Holdings Ltd, 72 – Brown Woolley Graham, 73W – Richmond Ltd, 74W – Peter Holl & Associates)

The proposed legislation has different effects on taxpayers that are in similar circumstances. Many submissioners emphasise that some taxpayers have already received refunds and are not required to pay the refund back. Submissioners also note that the proposed amendment is silent for those that did not pay GST in the first instance. Submissioners are concerned that the legislation applies only to those that seek to adjust earlier returns and therefore two parallel laws are created.

Comment

While it is not desirable that taxpayers in potentially the same situation be treated differently, addressing the issues raised by submissioners may result in less desirable outcomes, such as taxpayers who have been allowed their refund claims being required to repay those refunds. That is why the proposed amendment provides a savings provision for these taxpayers. Officials do not recommend "levelling the playing field" by rewording the savings provision to require repayment of any refunds already paid.

Officials' comments in relation to the four classes of taxpayer, as identified in the legal opinion from Chen & Palmer (attached to the Ernst & Young submission), are:

- *Inbound tourist operators who paid GST on supplies to non-residents up until 20 May 1999 and applied for a refund before 15 September 1995 (the date of the Wilson & Horton decision)*

The amendment will not affect taxpayers in this category. To the best of our knowledge there are no taxpayers in this group. Not applying the legislative change to pre-1995 refund requests ensures that the legislation is backdated only to the extent necessary.

- *Inbound tourist operators who paid GST on supplies to non-residents before 20 May 1999, applied for a refund after 15 September 1995 and who have received a GST refund.*

  The amendment will not affect taxpayers in this category. This is for two reasons. First, because of the way in which GST is designed, it is not uncommon for taxpayers to seek to adjust an earlier return. In practice, therefore, this category can be seen as similar to those who zero-rated supplies. Secondly, those who received refunds may be said to have an expectation that this money could be spent, and the Government considers it unnecessary to alter any such expectation by retrospective legislation. As at 20 July 2001, approximately 50 refunds had been paid to three inbound tourist operators and 47 educational institutions. The three refunds to inbound tourist operators may be reviewed and investigated further.

- *Inbound tourist operators who zero-rated their supplies to non-residents before 20 May 1999 (primarily because of the Wilson & Horton decision by the New Zealand Court of Appeal in 1995, which they consider made it clear that inbound tourist operators could zero-rate their supplies).*

  The amendment will not affect taxpayers in this category. Those who zero-rated supplies may be considered to have a rational and legitimate expectation that they could argue that such supplies are zero-rated. The Government considers that any such expectation should not be overturned by retrospective legislation.

  There is a range of zero-rated supplies reported in the GST returns of inbound tourist operators. Officials have compared these returns before and after the 1999 amendments to the GST Act. The ratio of zero-rated supplies to gross supplies before and after 1999 varies in some instances – some inbound tourist operators have increased their zero-rated supplies, in other instances the supplies they have remained the same and in others there has been a decline in zero-rated supplies. Inland Revenue considers that this pattern is inconclusive. Inland Revenue will, however, investigate cases where there has been a significant increase in the level of standard rated supplies following the 1999 amendments. At this stage Inland Revenue is aware of only one such case. Submissioners have indicated that a further two taxpayers have zero-rated from 1998 to 1999.

- *Inbound tourist operators who paid GST on supplies to non-residents up until 20 May 1999 and for the period before 20 May 1999 applied for a refund after 15 September 1995 (or have not yet applied) but have not yet received a refund.*

  Inbound tourist operators in this category will not receive a GST refund under the proposed GST amendments. There is an obvious tension between taxpayers who have received a refund and those who have not. To a lesser degree there are also tensions between those who zero-rated and those who did not. The amendments are designed to apply according to the expectations of most educational institutions and inbound tourist operators when they entered into the transactions in question. The present claims for refunds suggest that most of these taxpayers expected that GST was payable and returned GST on that basis.

This category also includes five schools that have taken disputes to the TRA and one university that has taken a dispute to the High Court.

Recommendation

That the submission be declined.

Issue: Proposed amendment is inconsistent with section 6 of the Tax Administration Act 1994 and the Inland Revenue Charter

Submissions
(15W – Polson Higgs & Co, 20 – Bradbury & Muir on behalf of Kiwi English Academy of Learning, 21 – Bradbury & Muir on behalf of ID Tours New Zealand Ltd; Travel Arrangements South Pacific; Pan Pacific Travel Corporation Ltd; Tourmasters South Pacific Ltd; General Travel New Zealand Ltd; Inbound Tour Services South Pacific Ltd, 27W – Polson Higgs & Co, 33W – The University of Otago, 54 – General Travel New Zealand Ltd, 69 – Ernst & Young)

Submissioners consider that the legislation should not proceed because it is inconsistent with section 6 of the Tax Administration Act 1994 and the Inland Revenue charter, in that taxpayers in similar instances will not be treated consistently under the law.

Comment

This matter is currently subject to litigation. It would be inappropriate to comment further, but officials note that the Minister of Finance and Revenue and the Commissioner of Inland Revenue intend vigorously to dispute the assertion that they have acted outside the law.

Recommendation

That the submissions be declined.

Issue: Proposed amendment is inconsistent with the Bill of Rights Act 1990 and Legislative Advisory Guidelines

Submissions
(15W – Polson Higgs & Co, 33W – The University of Otago, 62 – Institute of Chartered Accountants of New Zealand, 69 – Ernst & Young)

Submissioners consider that the legislation should not proceed as it is inconsistent with the Bill of Rights Act 1990 and Legislative Advisory Guidelines, resulting in taxpayers being denied their right to proceed with active disputes with Inland Revenue at the time the legislation was announced.

Comment

Advice received from the Attorney General has stated that the proposed amendments are not inconsistent with the Bill of Rights Act 1990.

Recommendation

That the submission be declined.

Issue: Inland Revenue administration

Submissions
(27W – Polson Higgs, 29 – Mitchell Corp New Zealand Ltd, 31 – Contract Pacific Ltd, 36 – Southern World Vacations (New Zealand) Ltd, 37 – Vacations Pacific Ltd, 38W – Kingdom Tours, 51W – Bayfield High School Board of Trustees, 54 – General Travel New Zealand Ltd, 58W – Nationwide Rental Cars Ltd, 65W – Deloitte Touche Tohmatsu, 69 – Ernst & Young)

Submissioners consider that the amendment should not proceed because Inland Revenue has delayed the settlement of their refund claims on the basis that it was waiting for the Government to announce legislation to remove their claims. Some note that Inland Revenue has been particularly unhelpful, and many state that they have found the experience of dealing with Inland Revenue frustrating. Submissioners note that taxpayers have incurred substantial costs in pressing for their refund claims to be considered.

Comment

Inland Revenue is required to carefully consider the facts and applicable law in each case, and this can take time. Inland Revenue did not delay the processing of refunds until the announcement of retrospective legislation. The issue of retrospective legislation was first raised in April 2001, whereas refund applications were received, in the case of inbound tourist operators, as early as December 1999.

Inland Revenue accepts that this issue has demonstrated a need for some improvements in three areas: systems, communication with taxpayers and consistency in reaching views on the interpretation of the law. Those matters have been reported on separately to the Committee.

Recommendation

That the submissions be declined.

Issue: Industry concerns

Submissions
(12W – Silver Fern Holidays, 14W – Thomas Cook (New Zealand) Ltd, 20 – Bradbury & Muir on behalf of Kiwi English Academy of Learning, 21 – Bradbury & Muir on behalf of 23 – Inbound Tourist Services South Pacific Ltd, 26W – Elms Hotel Ltd, 28 – ATS Pacific Ltd, 29 – Mitchell Corp New Zealand Ltd, 30 – Kevin R Sarjeant, 31 – Contract Pacific Ltd, 31 – Tourism Holdings Ltd, 36 – Southern World Vacations (New Zealand) Ltd, 37 – Vacations Pacific Ltd, 38W – Kingdom Tours, 41W – Pacific Delight Ltd, 46W – Farm to Farm New Zealand Tours, 47 – Travel Arrangements South Pacific Ltd, 53 – Landmark Travel (South Pacific) Ltd, 54 – General Travel New Zealand Ltd, 55W – Tourlink New Zealand Ltd, 56W – ID Tours New Zealand Ltd, 58W – Nationwide Rental Cars Ltd, 69 – Ernst & Young)

A large number of submissions have been made by inbound tourist operators who note that the amendment will adversely affect the industry. The issues raised in the submissions are mainly to the effect that the amendment should not proceed as affected inbound tourist operators consider that they have been disadvantaged by having to charge GST on the supply of their services, while some of their competitors have purportedly not returned GST at all. Some note that their competitors have received refunds and that the Government's proposed legislation exacerbates the competitive disadvantage that they face. Many said that the Government should pay the refund claims on the grounds of levelling the playing field. Some submissioners outline how the GST refund would be used to promote New Zealand tourism and, in one case, retire outstanding debts arising from the Asian economic crisis of the late 1990s.

Comment

The purpose of the proposed amendment is to ensure that law operates as was intended, and indeed was applied often for many years, by those now seeking refunds. Over a range of tax issues there are always likely to be some taxpayers who take a more aggressive position than others. The Commissioner has a four-year time frame within which to ensure that the law is correctly applied.

No specific evidence has been provided that the submissioners were, in fact, operating at a competitive disadvantage as a result of GST. The price for holidays in New Zealand is set by world prices relative to other popular tourist destinations such as Australia or the Pacific Islands. Moreover, inbound tourist operator packages also compete with other New Zealand tour options such as direct payment to the hotel or tour provider. Competitive pressures are more likely to result from changes in the tourist market such as the increased use of direct booking using the Internet and other moves away from traditional intermediation services. The fact that some operators (evidence from submissioners suggest that this may number up to four or five taxpayers) in the industry may have been zero-rating some supplies is unlikely to have had a significant impact on price relative to the larger structural changes in the tourist market.

Within the tourism industry there is a range of zero-rated supplies reported in the GST returns of inbound tourist operators. Officials have compared these returns before and after the 1999 amendments to the GST Act. If an inbound tourist operator was zero-rating prior to 1999, then post-1999 transactions would now incur GST. The ratio of zero-rated supplies to gross supplies before and after 1999 varies in some instances – some inbound tourist operators have

increased their zero-rated supplies, in other instances the supplies have remained the same and in others there has been a decline in zero-rated supplies. Inland Revenue considers that this pattern is inconclusive. Inland Revenue will, however, investigate cases where there has been a significant increase in the level of standard rated supplies after the 1999 amendments. At this stage Inland Revenue is aware of only one such case. In addition, submissioners indicated that two taxpayers zero-rated supplies from 1998 to 1999.

Recommendation

That the submissions be declined.

SAVINGS PROVISION

Issue: Alternative savings provision proposals

Submissions
(13W – New Zealand Law Society, 19W – Fyers Wickham Ltd, 40W – Tourism Industry Association New Zealand, 50 – PricewaterhouseCoopers, 51 – Bayfield High School Board of Trustees, 62 – Institute of Chartered Accountants of New Zealand, 65W – Deloitte Touche Tohmatsu, 69 – Ernst & Young, 69A – Ernst & Young)

Submissioners note that retrospective legislation is often accompanied by a comprehensive savings provision allowing for existing disputes to be preserved. Many submissioners recommend that Parliament should not deprive taxpayers of the benefit of judgements obtained under earlier law or prevent the continuation of proceedings.

Submissioners consider that the following savings provisions would be appropriate:

- *(13 – New Zealand Law Society, 40W – Tourism Industry Association New Zealand, 62 – Institute of Chartered Accountants of New Zealand, 65W – Deloitte Touche Tohmatsu on behalf of the Inbound Tour Operators Council)*
  Disputes under parts IVA and VIIIA of the Tax Administration Act 1994 should be excluded from the scope of the proposed amendment.

- *(50 – PricewaterhouseCoopers)*
  Suppliers acting bona fide on the basis that the supply was zero-rated should be excluded from the scope of the proposed amendment.

- *(19W – Fyers Wickham Ltd)*
  The proposed legislation should only apply from the date that it is enacted.

- *(51W – Bayfield High School Board of Trustees)*
  Claims submitted by schools up to May 2001 should be excluded from the effect of the amendment.

- *(50 – PricewaterhouseCoopers)*
  Telecommunication supplies should be excluded from the ambit of the proposed legislation.

- *(69 – Ernst & Young)*
  Refund claims should be allowed for the period between 15 September 1995 and 20 May 1999 but limited to claims filed before 14 May 2001.

- *(69 – Ernst & Young)*
  Alternatively, refund claims should be allowed if made within four years from the date the claim was filed, again limited to claims filed before 14 May 2001.

- *(69 – Ernst & Young, 69A – Ernst & Young)*
  Alternatively, refund claims should be allowed if made within two years before 20 May 1999, again limited to claims filed before 14 May 2001.

Comment

Officials' comments are:

- The potential revenue loss that the proposed amendment is seeking to address arises from refund claims which are being disputed by Inland Revenue. Providing a comprehensive saving provision that preserves claims in dispute would, therefore, defeat the purpose of the amendment.

- The application of legislation is limited to those taxpayers who seek to adjust an earlier return. Those that entered into transactions on the expectation that GST was not payable will have filed returns on that basis. In that case the legislation will not apply, and, indeed, will exclude, taxpayers who acted bona fide on the basis that the supply was zero-rated. The proposal, therefore, seems to be the most viable means of meeting the concerns expressed by PricewaterhouseCoopers.

- The issues that the proposed legislation is seeking to address relate to schools as much as to others that are affected. There is no sound basis for differentiating between schools and others.

- In relation to telecommunication supplies, officials noted in their report to the Finance and Expenditure Committee on submissions on the Taxation (Annual Rates and Remedial Matters) Bill 1999 that telecommunications were not affected by the change to the GST Act proposed in that bill (now the subject of the proposed amendment in this bill). The Committee agreed to this recommendation. Therefore officials do not consider it necessary to address the issue again in the current context. In any event, the proposed amendment has been targeted to those claiming refunds post-*Wilson & Horton* in part to limit any consequences for telecommunication suppliers.

- In relation to the proposed saving provisions raised by Ernst & Young (to allow refund for a limited time period), savings provisions of this nature create their own inequalities of treatment and a potential significant revenue risk.

Recommendation

That the submissions be declined.

APPLICATION OF CLAUSE 228A(7)

Description of the refund mechanism

As outlined in the Government's announcement on 14 May 2001, it is proposed to provide relief from the retrospective amendment where there is written proof that an equivalent amount to the refund that is being sought from Inland Revenue has been paid to the international student or tourist who received the performance of the services in New Zealand. In these circumstances it is proposed that the legislation treat the transaction (the provision of education or the holiday package) as a zero-rated supply.

Issue: Clause 228A(7) is unworkable

Submissions

(13 – New Zealand Law Society, 15W – Polson Higgs & Co, 16W – Vodafone New Zealand Limited, 20 – Bradbury & Muir on behalf of Kiwi English Academy of Learning, 21 – Bradbury & Muir on behalf of ID Tours New Zealand Ltd, Travel Arrangements South Pacific Ltd, Pan Pacific Travel Corporation Ltd, Tourmasters South Pacific Ltd, General Travel New Zealand Ltd, Inbound Tour Services South Pacific Ltd, 28 – ATS Pacific Ltd, 32 – Tourism Holdings Ltd, 33W – The University of Otago, 36 – Southern World Vacations (New Zealand) Ltd, 47 – Travel Arrangements South Pacific Ltd, 50 – PricewaterhouseCoopers, 54 – General Travel New Zealand Ltd, 62 – Institute of Chartered Accountants of New Zealand, 69 – Ernst & Young, 72W – Brown Woolley Graham)

- The proposed clause 228A(7) is unworkable and the practical requirements are difficult to meet. Submissioners consider it to be "misconceived" and "impractical". Some consider that the clause does not reflect the reality of the transactions concerned, and they are not prepared to incur the costs associated with tracing the refund to the student or tourist who received the performance of the services in New Zealand.

- Clause 228A(7) is contrary to the scheme of the Act as it distinguishes between the recipient under the contract and the person that receives the performance of the services. Clause 228A(7) is an impossible condition designed to give the appearance of fairness, but all the while hiding the inequity of the amendment. To require the refund to be passed back imposes compliance costs and opens up the possibility that New Zealand suppliers may be caught up in civil disputes with overseas parties concerning the application of the words "GST if any".

- Clause 228A(7) should be removed or amended as it imposes regulation on contracts that does not exist elsewhere in the Act, except to the extent that a registered person can gross up the price where there is a mistake in the belief that a supply of a going concern is not, in fact, a going concern. This is not appropriate in the case of an inbound tourist operator and an overseas tourist. The clause presupposes that the operation of GST is similar to a withholding obligation, which is not the case – therefore the windfall argument used by the Minister of Finance and Revenue is not correct.

Comment

The general view held by submissioners is that subclause 7 is unworkable and would impose significant compliance costs on the industry. It has also been suggested that to allow this provision to proceed would create further inequities in treatment. Submissioners point out, for example, that tourist operators with offshore affiliations could benefit from the measure so as to place domestic inbound tourist operators at a competitive disadvantage. Moreover, the proposed subclause distinguishes between supplies where inbound tourist operators have facilitated holiday packages for tourists and situations where the tourist has purchased hotel accommodation or car rental directly. Other submissioners argue that to the extent that the refund mechanism is widely used it would create a fiscal risk that could be significant. For these reasons the Government has invited the Committee to consider whether this subclause should be included in the Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Bill.

Recommendation

That the Committee consider whether clause 228A(7) should proceed.

If clause 228A(7) is included the Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provision) Bill the following submissions should be considered.

Issue: Application of refund mechanism in clause 228A(7)

(13 – New Zealand Law Society, 15W – Polson Higgs & Co, 20 – Bradbury & Muir on behalf of Kiwi English Academy of Learning, 21 – Bradbury & Muir on behalf of ID Tours New Zealand Ltd, Travel Arrangements South Pacific Ltd, Pan Pacific Travel Corporation Ltd, Tourmasters South Pacific Ltd, General Travel New Zealand Ltd, Inbound Tour Services South Pacific Ltd, 28 – ATS Pacific Ltd, 32 – Tourism Holdings Ltd, 33W – The University of Otago, 36 – Southern World Vacations (New Zealand) Ltd, 47 – Travel Arrangements South Pacific Ltd, 50 – PricewaterhouseCoopers, 54 – General Travel New Zealand Ltd, 62 – Institute of Chartered Accountants of New Zealand, 69 – Ernst & Young, 72W – Brown Woolley Graham)

- Where the New Zealand supplier has refunded, or will refund, the GST amount to any overseas purchaser the supplier should be excluded from the scope of the proposed amendment.

- The requirement to pay an equivalent amount to the amount of tax being sought before a refund is received from Inland Revenue should be removed. In other jurisdictions where an “unjust enrichment” operates, it is not a requirement that the supplier prepay the tax before claiming it from the appropriate Revenue authority.

- To resolve some of the practical difficulties with the clause, payment should go to parties with whom the supplier has a contract. Failure to do otherwise means that the legislation does not reflect the commercial reality of the transaction.

- The requirement to receive written evidence of the payment before the tax is refunded should be removed.

Comment

Officials' comments are:

- A savings provision as suggested that relies on an assessment that the refund will be passed on is both uncertain (in that the intention could be to pass on the refund years into the future or could be expressed rather than real) and administratively complex (in that each transaction would have to be carefully audited).

- Paying the refund back to the person with whom the New Zealand supplier had the contract would not meet the Government's objective of ensuring that the person who generally bore the cost of the GST, being the person who received the performance of the service in New Zealand, receives the refund. Once the refund has gone offshore it would be impossible, in the absence of a requirement such as that in the bill, to ascertain to whom the refund was ultimately paid.

- The requirement to have written evidence that payment has been made to the person that received the performance of the services is necessary to ensure the clause meets the Government's objectives.

Recommendation

That the submissions be declined.

Issue: Application of clause 228A(7) – Commissioner discretion

Submissions
(15W – Polson Higgs & Co, 33W – The University of Otago, 62 – Institute of Chartered Accountants)

The reference to the "Commissioner's satisfaction" should be deleted. It is inconsistent with the remainder of the bill, which seeks to remove such Commissioner discretions from the Income Tax Act 1994.

Comment

In legislating for self-assessment, many Commissioner discretions have been retained, particularly, where these are needed for enforcement purposes. The discretion is, therefore, not inconsistent with the rest of the bill.

Recommendation

That the submission be declined.

Issue: Application of clause 228A(7) to groups and where payment is made by an employer (or similar) on behalf of an employee

Submissions
(13 – New Zealand Law Society)

Clause 228A(7) does not consider the situation where the supplier is part of a group of companies. Clause 228A(7) will therefore impact on the representative member, which is deemed under the GST Act to make all supplies and purchases by the group. As such, the representative member will be required to make the refund on behalf of the member that made the supply.

(69 – Ernst & Young)

Clause 228A(7) does not consider the situation where the person receiving the services is an employee, or the recipient of a prize under an incentive scheme. In these circumstances payment has been made by the employer or promoter of the incentive scheme. Similar rules in other jurisdictions are satisfied with the payment going to the contractual recipient.

Comment

The legislation arguably does not allow a refund where the representative member of the group is not the company that made the supply. This issue can be resolved by inserting in paragraph (a), after the words "registered person", the words "or an associated person of the registered person".

The purpose of the savings provision is to ensure that the refund is paid to the tourist or foreign student (or an associate) who bore the cost of the GST. If the tourist, foreign student or associate received the services for no consideration and the cost is instead borne by an employer or sponsor, the legislation ought to extend to a payment made to an employer or sponsor and thus allow a refund following such payment.

Recommendation

That the submissions be accepted.

Issue: Application of clause 228A(7) – Income tax implications

Submission
(13 – New Zealand Law Society)

Clause 228A(7) should address the necessary corresponding adjustment for income tax purposes.

Comment

The point raised by the submissioner appears to be that the payment made to the tourist or foreign student would not be liable to income tax, but that in some circumstances at least the payment made by Inland Revenue to the supplier will be subject to income tax. To address this imbalance a provision should be inserted that states that where a payment made to the recipient of the supply (or associate) is not liable to income tax and a refund is made by the Commissioner to the supplier, the refund will also not be liable to income tax.

Recommendation

That the submission be accepted.

Issue: Application of clause 228A(7) – Gift duty implications

Submissions

(13 – New Zealand Law Society, 20 – Bradbury & Muir on behalf of Kiwi English Academy of Learning, 21 – Bradbury & Muir on behalf of ID Tours New Zealand Ltd, Travel Arrangements South Pacific Ltd, Pan Pacific Travel Corporation Ltd, Tourmasters South Pacific Ltd, General Travel New Zealand Ltd, Inbound Tour Services South Pacific Ltd, 62 – Institute of Chartered Accountants of New Zealand, 69 – Ernst & Young)

Suppliers with no contractual obligation to refund GST to the non-resident could be subject to gift duty, and there needs to be a change to the gift duties legislation to deal with this.

Comment

The refund to the non-resident is an adjustment to the consideration to reflect the GST that is no longer required to be paid because of the application of subclause 7. Regardless of whether or not this is a gift in individual cases, officials note that the Estate and Gift Duties Act 1968 provides an exemption for gift duty in relation to a single donee receiving gifts of $NZ2,000 or less where these gifts are made as part of the normal expenditure of the donor. This exemption should apply in the current case as it would be part of the normal expenditure of a business such as an inbound tourist operator to make refunds. The cost of the initial supply would need to have been $NZ18,000 or more in order for gift duty to arise – exceeding this threshold in relation to the supplies in question would appear to be a rare event.

Recommendation

That the submission be declined.

GST & WARRANTIES

Clause N/A

Issue: Suzuki New Zealand v Commissioner of Inland Revenue

Submission

(16W – Vodafone New Zealand Ltd, 18W – Nissan New Zealand Ltd, 23 – Inbound Tour Services South Pacific Ltd, 24W – Retail Merchants Association of New Zealand Inc, 35W – Next Electronic Servicing Ltd, 43W – Stamford, 44W – ASB Bank, 45W – Kirra Tours, 49W – Datacom Group, 52W – Royal & Sunalliance, 55W – Tourlink New Zealand Ltd, 59 – Pan Pacific, 60W – Genesis, 70W – PDL Holdings Ltd, 73W – Richmond Ltd, 74W – Peter Holl & Associates)

The proposed retrospective amendment appears to indicate the Government is willing to selectively overrule Court of Appeal decisions that go against it, such as *Wilson & Horton* v *Commissioner of Inland Revenue*, while requiring full compliance with other Court of Appeal cases which go the Government's way, such as *Suzuki New Zealand* v *Commissioner of Inland Revenue* (which concerned the GST treatment of payments made under warranty agreements).

(64W – Deloitte Touche Tomatsu, 68W – Motor Industry Association Inc)

New legislation should be introduced as part of this bill to zero-rate the supply of goods and services under a warranty as the treatment of warranty payments, as highlighted in Court of Appeal decision *Suzuki New Zealand* v *Commissioner of Inland Revenue*, gives rise to almost identical issues to those being considered.

Comment

The facts presented in, and policy implications of, *Wilson & Horton* and *Suzuki* are quite different. The issues in *Suzuki* concern the taxation of warranty payments, under contracts that involve the making of warranty payments by an offshore manufacturer in respect of goods sold to a New Zealand customer at a price that includes the cost of the warranty. Officials have agreed to work with industry representatives to determine whether the case gives rise to any policy issues that need to be addressed in legislation. As work on the issues has only recently begun, it would be inappropriate to recommend any changes to the current bill in relation to the issues.

Recommendation

That the submission be declined but note that officials will continue discussions with the industry.

GST RETROSPECTIVE LEGISLATION – GENERAL

Clause N/A

Issue: Reinstatement of section 11(2B)

Submission
(62 – Institute of Chartered Accountants of New Zealand)

Accompanying the reforms contained in the Taxation (Remedial Matters) Act 1999 was an amendment defining when a taxpayer was "outside New Zealand". As clauses 227A and 228A retrospectively apply to the substantive amendments contained in the Taxation (Remedial Matters) Act 1999, the omission of this definition is noted but not considered to be significant.

Comment

The backdating of this section is not necessary as it concerns the treatment of companies in respect of determining whether they are "outside" New Zealand when certain services are performed. The proposed amendment in this bill concerns the consumption of services in New Zealand by persons other than those making taxable or exempt supplies, so the section is unlikely to be relevant in this context.

Recommendation

That the submission be noted.

Issue: Statement on when retrospective legislation may be used

Submission
(66W – Deloitte Touche Tohmatsu)

Officials should be instructed to draft a paper for public comment outlining circumstances where retrospective legislation may be required or considered in relation to taxation matters.

Comment

There are general guidelines concerning when retrospective legislation is appropriate. In considering the application of legislation the same considerations should apply equally in the field of tax as with any other legislation. Whether particular retrospective measures are justified is a policy issue for Government and Parliament to determine.

Recommendation

That the submission be declined.

ANNEX