Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill

Commentary on the Bill

Hon Todd McClay
Minister of Revenue

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Student loan scheme amendments

OVERVIEW

The main proposal relating to the student loan scheme will give effect in New Zealand law to the Arrangement for the Exchange of Information regarding New Zealand Student Loans, which was signed by the Commissioner of Taxation (Australia) and the Commissioner of Inland Revenue (New Zealand) in March 2015.

The proposal is intended to deal with the significant problem of student loan borrowers who move overseas and do not remain engaged with the scheme and consequently default on their repayment obligations. It will do so by allowing Inland Revenue to have borrower's names matched against the Australian Taxation Office database of Australian taxpayers. Inland Revenue will be able to contact matched individuals and, where appropriate, recover outstanding loan repayments.

Other amendments make write-off of loan interest more accessible to borrowers who are volunteering overseas, update the student loan rules and ensure that other policies introduced in recent years work as they should.

DISCLOSURE OF INFORMATION TO AUSTRALIAN TAXATION OFFICE ABOUT BORROWERS WHO ARE, OR MAY BE, OVERSEAS-BASED

(Clauses 26 and 73)

Summary of proposed amendment

The proposed amendment to the Student Loan Scheme Act 2011 will give effect in domestic law to the Arrangement for the Exchange of Information regarding New Zealand Student Loans, which was signed by the Commissioner of Taxation (Australia) and the Commissioner of Inland Revenue (New Zealand) in March 2015. It will prescribe what information may be communicated to the Australian Taxation Office and who may receive the information. An amendment to the Tax Administration Act 1994 will create an additional exception to taxation secrecy provisions to allow the two organisations to communicate this information in accordance with the Arrangement.

Application date

The amendment will come into force on the date of enactment.

Key features

Proposed new section 209A sets out the purpose of the exchange of information, which is to facilitate the exchange of information between Inland Revenue and the Australian Taxation Office in order to verify contact details of New Zealand student loan borrowers who are, or may be, overseas-based so the student loan scheme can be administered in relation to those borrowers.

It limits who in the Australian Taxation Office is authorised to receive the information from the Commissioner of Inland Revenue.

The information that may be provided by the Commissioner is prescribed and must be relevant for the purposes.

The requirement in the Tax Administration Act 1994 for officers to maintain secrecy will be amended by providing a new exception in section 81(4)(gbb) of the Tax Administration Act.

Background

One of the keys to collecting overdue student loan repayments is holding up-to-date contact details for defaulters. Not having contact details makes engaging with overseas-based borrowers, many of whom are believed to be living in Australia, difficult.

The proposed information exchange would allow Inland Revenue to receive up-to-date contact details for New Zealand student loan borrowers residing in Australia through matching borrower details against the Australian Taxation Office database of Australian taxpayers. Inland Revenue would then be able contact those individuals to keep them engaged with their loan obligations and, where appropriate, recover outstanding student loan repayment amounts.

APPROVAL OF CHARITABLE ORGANISATIONS

(Clauses 4, 7, 22, 23, 27, 29, 32, 33 and 40)

Summary of proposed amendment

The bill proposes to delegate to the Commissioner of Inland Revenue authority to approve charitable organisations for the purposes of the student loan scheme.

When student loan borrowers are volunteering overseas or working for a charitable organisation for a token payment they may apply to be treated as New Zealand-based and eligible for write-off of interest on their student loans. However, the charitable organisation must itself be approved for the purposes of the scheme. Delegation for that approval currently sits with the Governor-General, acting on the advice of Cabinet. Delegating approval authority to the Commissioner will speed up the approval process so that students will have more timely access to the interest write-off.

To improve the integrity of the list, the Commissioner will also be able to remove an organisation from it, if the organisation no longer meets the criteria for listing. If that happens, a borrower who has already been approved as eligible for interest write-off will remain eligible until the end date of the period for which the borrower's status had been approved, or until they cease volunteering for that organisation, whichever happens first.

The Student Loan Scheme (Charitable Organisations) Regulations 2011 will be consequentially revoked. The list of approved organisations will continue be published on the Inland Revenue website, but this will now be a legal requirement.

Application date

The amendments will come into force on the date of enactment.

Key features

Proposed new rules will specify what is required for a charity to be listed for student loan purposes, relying on existing requirements in the Charities Act 2005 and the Income Tax Act 2007.

The Commissioner will be required to maintain and publish a charities list for these purposes and will have the power to de-list organisations that no longer meet the requirements.

When the Commissioner de-lists an organisation, student loan borrowers who have already been approved for interest write-off will remain eligible until they complete their volunteering assignment or reach the end of the 24-month approval period, whichever is earlier.

Background

Under current law, charitable organisations must be approved by Cabinet for the purposes of the student loan scheme interest write-off and listed in regulations. The student loan borrower's status of being treated as physically present in New Zealand and therefore eligible for interest write-off cannot commence earlier than the date on which the organisation is listed in the regulations.

However, the approval process, which currently requires Cabinet approval and the making of regulations, is slow, so that some borrowers do not have access to the interest write-off because the organisation is not approved and listed in the regulations before the borrower's volunteer term is completed.

Detailed analysis

The definition of "charity" in section 4 of the Student Loan Scheme Act is proposed to be amended to remove the reference to the regulations, which will be revoked.

Proposed new section 27A will require the Commissioner to keep and publish a list of charities that have been approved. The list must include the date from which each charity's listing applies and the date of de-listing, if applicable.

Proposed new section 27B will prescribe the primary matters with which the Commissioner must be satisfied before listing a charity. The criteria rely on the definition of "tax charity" in the Income Tax Act 2007 for the purposes of eligibility for exemption from income tax and the essential requirements for registration under the Charities Act 2005. Supplementary criteria will be set out in guidelines for the exercise of the Commissioner's discretion.

The application requirements are set out in proposed new section 27C, allowing the Commissioner to seek more information if necessary and to list those charities that qualify under section 27B. The Commissioner will also be required to give an applicant prior advice of her intention to refuse a listing, with reasons, and allow the organisation time to rectify any deficiencies in their application. Applicants will be required to be notified of the final Commissioner's decision.

Under proposed section 27D the Commissioner will be able to list a charity even if no application has been made under section 27C. This is likely to occur when a borrower applies to be treated as being physically present in New Zealand while volunteering, but the organisation, although on the Charities Register or approved as a tax charity, has not yet been listed for student loan scheme purposes.

Proposed section 27E will allow the Commissioner to remove a charity from the list if she determines that the charity no longer meets the criteria for listing. The Commissioner will be required to give a charity prior advice of her intention to de-list, with reasons, allow the organisation time to make any arguments against the proposed decision and consider any such arguments before making and notifying the charity of the final decision.

The proposed amendments to section 173 remove a decision made by the Commissioner to refuse to list a charity or remove a charity from the list, from the process for disputing assessments under Part 4A of the Tax Administration Act 1994. Instead the decision can be challenged by the charity under new section 176A, which will bring the challenge under part 8A of the Tax Administration Act.

Transitional provisions in clause 20, part 4 of schedule 6 will provide for charities already listed in the regulations to continue to be treated as qualifying charities and will require the Commissioner to include them in the list referred to in section 27A.

Proposed section 32 in part 2 will consequentially revoke the Student Loan Scheme (Charitable Organisations) Regulations 2011.

TREATMENT OF OVER-RECOVERED ADDITIONAL DEDUCTIONS

(Clauses 8 and 9)

Summary of proposed amendments

The proposed amendments will align the treatment of over-recovered additional deductions of student loan repayments with the treatment specified for over-recovery of standard deductions made for student loan repayments. This will simplify administration by having one standard process.

Application date

The amendments will come into force on the date of enactment.

Key features

The proposed new sections set out the procedure to be followed when additional deductions have continued beyond what is required to fully recover the previous shortfall in student loan repayments.

The proposed replacement of the cross-heading above current section 63 will clarify that the section applies only to standard deductions.

Proposed new section 68A defines what is a Commissioner over-deduction and sets out what a borrower can do when the borrower believes there has been an over-deduction of additional deductions. The requirement for the Commissioner to respond is set out in proposed section 68B.

Under proposed section 68C, when the Commissioner identifies or determines that an over-deduction has been made, she will be required to notify the borrower of the amount of the over-deduction, that it has been offset against a borrower's consolidated loan balance, and give the borrower the option of requesting a refund of the over-deducted amount within a specified timeframe. The time limit on requests for refunds will be six months from the date of notification. If, however, another shortfall in repayment obligations is concurrently identified, the over-recovered amount will be offset against that shortfall.

Background

The Commissioner of Inland Revenue is able to require a New-Zealand-based student loan borrower's employer to make additional deductions from the borrower's wages or salary to meet a previous shortfall in repayment obligations. In doing so, the Commissioner advises the employer of the total additional amount to be deducted. However, sometimes employers continue the additional deductions beyond the amount necessary to fully recover the shortfall. Although the Student Loan Scheme

Act prescribes what the Commissioner must do when there is an over-deduction of standard deductions, it does not include an over-recovery of additional deductions.

APPLICATION OF REPAYMENT THRESHOLDS FOR OVERSEAS-BASED BORROWERS

(Clause 32)

Summary of proposed amendment

A transitional provision will make it explicit that the repayment thresholds for overseas-based borrowers introduced in 2014 apply to income tax years beginning on 1 April 2014 and later, as was intended.

Application date

The amendment applies to income tax years starting on 1 April 2014.

Key features

A "savings" provision in proposed clause 18 in part 3 of schedule 6 of the Student Loan Scheme Act 2011 ensures that previous amendments to repayment obligations of overseas-based borrowers do not apply to tax years that commenced before 1 April 2014. Instead, the previous repayment obligations apply to those years.

Background

New repayment thresholds for overseas-based borrowers introduced in the Student Loan Scheme Amendment Act 2014 were intended to apply for the tax years commencing on and after 1 April 2014, but that was not made explicit in the legislation. The effect was that the new rules could be applied to the assessment of repayment obligations for tax years prior to 1 April 2014, when the actual assessment is carried out after 1 April 2014.

NOTIFYING "ADJUSTED NET INCOME"

(Clauses 4, 5, 10 to 21, 24, 25, 31 and 32)

Summary of proposed amendment

Provisions for prescribed adjustments to net income were introduced to the student loan scheme in 2013 to ensure a borrower's repayment obligations more accurately reflected their ability to repay that loan.

The proposed amendment will require all borrowers to notify Inland Revenue if they have income of the type specified in schedule 3 of the Student Loan Scheme Act 2011 for adjustments to be made to their income. These types of income are generally not subject to income tax.

Application date

The amendments will come into force on the date of enactment.

Key features

New definitions of "adjusted net income", "schedule 3 adjustments" and "statement of adjusted net income" will support the proposed changes that will require all borrowers with the relevant types of income to provide the necessary details.

A number of consequential amendments are also proposed, to reflect the new terminology.

The proposed replacement of section 73 introduces new defined terms to clarify that adjusted net income is made up of net income as defined in the Income Tax Act 2007 and any adjustments provided for in schedule 3 of the Student Loan Scheme Act 2011. A borrower may fulfil requirements to make a statement of adjusted net income by filing a return of income only, notifying schedule 3 adjustments only, if they are not required to file a return of income, or filing a return of income and notifying schedule 3 adjustments.

Proposed replacement section 74 sets out when the section applies to New Zealand-based borrowers and the timing of required notification of schedule 3 adjustments.

Sections 75, 76, 79, 82 and 83 are to be amended to reflect the new terminology.

New section 114 deals with the notification of schedule 3 adjustments by New Zealand-based non-resident borrowers, similar to the requirements under section 74.

Sections 114A, 146A, 155, 156, 185, and clauses 1(f) and 2(c) in schedule 4 of the Student Loan Scheme Act 2011 are also amended to reflect the new terminology.

Background

The provisions introduced in 2013 require only borrowers who are not required to file a return of income for income tax purposes to make a declaration of their adjusted net income. However, the use of the term "declaration" places an unreasonable burden on borrowers to meet the requirements of the Oaths and Declarations Act 1957, including having the form witnessed by a person specified in section 9 of that Act.

In addition, the nature of adjusted net income amounts means that they are not required to be included in income tax returns. Borrowers who file income tax returns are effectively excluded from the requirements to provide details of their adjusted net income.

MAIN INCOME EQUALISATION SCHEME INCOME

(Clauses 4 and 30)

Summary of proposed amendments

The proposed amendments will ensure that refunds of main income equalisation scheme deposits made by an associated entity of a borrower are not included in the income of the borrower, to the extent of the borrower's interest in the associated entity. However, any interest earned on those deposits that is refunded will be included in the adjusted net income of the borrower in the same proportion as the borrower's interest in the entity.

Similarly, adjustments to net income to reflect deposits by associated entities of a borrower are to be further adjusted so that they are proportional to the borrower's interest in the entity.

Application date

The amendments will come into force on the date of enactment.

Key features

Proposed amendments to schedule 3 of the Student Loan Scheme Act 2011, which sets out the required adjustments to net income, will ensure that when a deposit has been made into, or a refund received from, a main income equalisation account by an associated entity of a borrower, the adjustments will affect the adjusted net income of the borrower only to the extent of the borrower's interest in that associated entity.

Proposed replacement clause 7 of schedule 3 and new clause 7A will apply only to deposits into or refunds from main income equalisation accounts made by a borrower.

However, new clauses 8 and 11 will apply respectively when a borrower is a major shareholder in a close company or is the settlor of a trust. These clauses set out the calculations to be used to ensure that the adjustments to the borrower's net adjusted income accurately reflect the extent of the borrower's interest in the associated entities.

Background

The main income equalisation scheme allows taxpayers carrying on an agricultural, fishing or forestry business to smooth their incomes for income tax purposes to deal with large fluctuations in income over several years. A deposit to a main income equalisation scheme is allowed as a deduction for income tax purposes. However, the effect of allowing the deposit as a deduction is to reduce the borrower's income for student loan purposes when that income would have been available to the borrower to contribute to loan repayments. An adjustment is necessary to net income to add back the deduction for student loan purposes. The treatment extends to deposits made by the borrower or associated entities, such as companies or trusts.

To prevent double counting, refunds from the accounts (excluding interest earned on deposits) are not counted for student loan purposes when they are received. However, the current provisions relating to refunds do not extend to refunds to associated entities (companies or trusts) of the borrower, with the risk that the associated entities' refunds would be counted in a borrower's income for a second time.

In addition, the adding back of deductions for deposits made by associated entities is not currently required to be adjusted in proportion to the borrower's interest in the entity. The proposed amendment will ensure that the borrower's net adjusted income accurately reflects the extent of the borrower's interest in the associated entity.

RETENTION OF ADJUSTED NET INCOME RECORDS

(Clause 70)

Summary of proposed amendment

The proposed amendments will make student loan borrowers who have adjusted net income subject to the record-retention requirements of the Tax Administration Act 1994 and explicitly subject to the obligations set out in that Act relating to retention and disclosure of information.

Application date

The amendments will come into force on the date of enactment.

Key features

Section 15B of the Tax Administration Act sets out a taxpayer's obligations. To ensure that there is no doubt that student loan borrowers are subject to these obligations, where appropriate, section 15B is being added to the list in section 202 of the Student Loan Scheme Act 2011 of provisions of the Tax Administration Act and Income Tax Act 2007 that apply to the Student Loan Scheme Act.

Section 22 of the Tax Administration Act requires taxpayers to keep business and other records. Student loan borrowers with adjusted net income will become subject to these requirements through the addition of proposed paragraphs 22(2)(fc) and 22(2)(n).

Background

Borrowers with income for which they are required to file annual tax returns are automatically subject to the requirements for retention of records in the Tax Administration Act 1994. However, with the introduction of the adjusted net income provisions in 2013, borrowers should also have been required to retain records of the adjustments to their net income. This is necessary to allow Inland Revenue to review source records to ensure the correctness of assessments, either as a result of borrowers exercising their dispute or challenge rights, or through its own audit activities.

CANCELLATION OF LOAN CONTRACTS

(Clause 6)

Summary of proposed amendment

The proposed amendment will allow a person to cancel their loan contract in writing or by electronic means.

Application date

The amendment is deemed to have come into force on 1 January 2012, when the current provision came into force, to ensure that borrowers who have already had their cancellations accepted by electronic means are not inadvertently in breach of the law.

Key features

The proposed amendment to section 15 will change the requirement for cancellation of a loan contract from "formally notify" to "notify in writing". The latter term is already defined for the purposes of the Student Loan Scheme Act 2011 and allows communication by electronic means, subject to compliance with relevant provisions of the Electronic Transactions Act 2002.

Background

Before January 2012, cancellation of loan contracts by electronic means was acceptable in accordance with the terms of the contract. However, an earlier amendment to the Act imposed a requirement of cancellation by formal notification, which, in accordance with the definition of that term, excludes notification by electronic means.

Following advice of their entitlement to a student loan, a student has seven days in which to give notice of their intention to cancel the contract. It is therefore more efficient, and in accordance with the Ministry of Social Development's current procedures, to accept cancellation by electronic means.

In addition, the 2012 change was one of a number intended to ensure consistency with the spirit and intent of the Credit Contracts and Consumer Finance Act 2003, even though that Act allows cancellation of contracts by giving written notice, including in electronic form.

Residential land withholding tax

OVERVIEW

The bill proposes a new withholding tax – residential land withholding tax (RLWT) on sales of residential property made by "offshore persons" within two years of acquisition.

The new measure is primarily intended to support the "bright-line test" announced by the Government in Budget 2015 as part of a package of proposals to improve compliance with the residential investment property tax rules. The bright-line test requires income tax to be paid on any gains from the sale of residential property bought and sold within two years, with some exceptions.

At the same time the Government announced its intention to investigate a withholding tax to improve compliance with the proposed bright-line test. Proposals for the RLWT were consulted on in an officials' issues paper, *Residential land withholding tax*, released in August 2015. Feedback from that consultation has helped shape the RLWT measures proposed in this bill.

As the RLWT will be a collection mechanism for the proposed bright-line test, the proposed RLWT follows as closely as possible the concepts used in the bright-line test.

RLWT will apply when:

- the property being sold is "residential land" located in New Zealand and defined for the purposes of the bright-line test as introduced in the Taxation (Bright-line Test for Residential Land) Bill;
- the vendor (seller) acquired the property on or after 1 October 2015 and has owned the property for less than two years before disposing of it (the two-year holding period used in the bright-line test); and
- the vendor (seller) is an "offshore person".

An "offshore person" includes all non-New Zealand citizens and non-permanent residents. It also includes a New Zealand citizen who is living overseas, if they have been overseas for the last three years. A holder of a New Zealand residence class visa may be an offshore person if are outside New Zealand and have not been in New Zealand within the last 12 months. New Zealand trusts and companies may also be "offshore persons" if there are significant offshore interests in them.

No exception for the vendor's main home will be available for the purposes of the RLWT. This is because RLWT will only apply to offshore persons, so it is unlikely that the property being sold is an offshore person's main home. However, there will be an exemption from RLWT for transfers upon death, and for transfers made in relation to a property relationship agreement, as in the bright-line test.

The obligation to pay RLWT will primarily be the vendor's conveyancing agent. A conveyancing agent provides conveyancing services as defined in the Lawyers and Conveyancers Act 2006. If the vendor does not have a conveyancing agent, the obligation to pay RLWT will be on the purchaser's conveyancing agent. In the absence of either, the obligation to pay RLWT will be on the purchaser themselves. If the vendor and purchaser are associated persons, the purchaser will be the person who is primarily liable for the payment of RLWT.

The amount of RLWT required to be withheld will be the lower of:

- 33% (or 28% if the vendor is a company) x (current purchase price – vendor's acquisition cost); and
- 10% x the current purchase price.

RLWT will be paid before other disbursements are made at the time of settlement. If the vendor's conveyancing agent is required to pay RLWT, this will be paid after the amount required to discharge the vendor's mortgage obligation with a New Zealand-registered bank or non-bank deposit taker licensed under the Non-bank Deposit Takers Act 2013. If this would result in insufficient funds being available to pay RLWT, the amount of RLWT payable will be restricted to the difference between the current purchase price and the amount required to discharge the New Zealand mortgage.

The person required to withhold must pay the required amount to the Commissioner of Inland Revenue.

The proposed RLWT is not a final withholding tax. The vendor will be able to claim a tax credit for the amount of RLWT withheld and paid to the Commissioner against their final income tax liability in relation to the sale of the residential property. In some cases, this may result in a tax refund.

The proposed RLWT will come into force on 1 July 2016.

NEW TAX TYPE: RESIDENTIAL LAND WITHHOLDING TAX

(Clauses 35, 36, 38, 39, 41, 42, 43, 44, 45, 72 and 73)

Summary of proposed amendment

The bill proposes a new refundable and creditable tax called residential land withholding tax (RLWT).

Key features

New section RA 6C of the Income Tax Act 2007 provides that a person required to pay RLWT under new section RL 2 and a person required to withhold and pay RLWT under new section RL 3, must pay RLWT to the Commissioner of Inland Revenue by the due date.

The RLWT rules are set out in new subpart RL. RLWT will apply to certain disposals of residential property.

RLWT will be, in effect, a new type of withholding tax. It will only be a true withholding tax if the vendor and purchaser are associated persons. This situation is specified in new sections BE 1(6) and RL 3. In other cases, the person required to pay RLWT on behalf of the vendor (the paying agent) will be able to retain the amount of RLWT from the purchase price to be paid to the vendor, similar to a withholding tax, but RLWT will instead be listed in section BF 1 (and in section YA 1 as an ancillary tax). The ability to retain an amount of RLWT from the purchase price is provided for in new section RL 2(7).

This distinction is necessary because, in general, the RLWT paying agent will not be liable for the underlying amount of RLWT. The exception to this general rule is when the vendor and purchaser are associated persons. In this case, the purchaser may be liable for the underlying amount of RLWT. The section titled "Person required to pay RLWT (the paying agent and the withholding agent)" provides further discussion on this issue.

When the obligation arises

The obligation to retain/withhold and pay RLWT is intended to arise upon settlement when, in most cases, the bulk of the purchase price will be paid by the purchaser to the vendor via a conveyancing agent. At this point the RLWT paying or withholding agent should retain or withhold RLWT from the funds being paid. Further information about who will be the paying agent or withholding agent can be found in the section titled "Person required to pay RLWT (the paying agent and the withholding agent)".

New section RL 1 provides that in general, the obligation to pay RLWT will arise if there is a "residential land purchase amount" and the conditions for withholding are satisfied. The section titled "When RLWT applies" discusses when RLWT will apply.

The definition of "residential land purchase amount" proposed in section YA 1 means an amount paid or payable for the disposal of the residential land in question, but excludes deposits and part-payments as long as all deposits and part-payments total in aggregate less than 50 percent of the purchase price for the land. This rolling aggregate is to ensure that part-payments are not used to circumvent the application of the RLWT.

Example

Elizabeth agrees to sell her house to Rebecca for $500,000. The contract requires Rebecca to pay a 10 percent deposit of $50,000, with the remaining $450,000 to be paid upon settlement. The $50,000 deposit is not a residential land purchase amount, but the $450,000 paid upon settlement is a residential land purchase amount.

Due dates for RLWT to be paid to the Commissioner

Once the obligation for RLWT has arisen and the appropriate amount of RLWT has been withheld or retained from a residential land purchase amount, new section RL 5 and an amendment to section RA 15 provide that the standard due dates for interim and other tax payments made on a monthly basis will apply. The due date is specified in section RA 15(2) as being the 20th day of the following month.

This will provide for the "batching" of various RLWT amounts, which may be preferable for a paying or withholding agent who handles a number of RLWT transactions in a month. Paying or withholding agents will also be allowed to pay RLWT amounts to the Commissioner on a transaction-by-transaction basis before the due date stipulated in section RA 15.

The transaction-by-transaction approach may be preferred by conveyancing agents who handle RLWT transactions on occasion, and by vendors who want to square up the amount of RLWT paid with their income tax liability in relation to the disposal of the residential land fairly soon after its disposal.

Example

Susanna is a conveyancer and retains RLWT from four transactions during the month of March. Susanna pays the retained RLWT amounts to the Commissioner on the stated due date, 20 April.

Example

Bill is a conveyancer who normally pays RLWT amounts to the Commissioner on the 20th of the following month. However, for a particular transaction, Bill agrees with his client to pay the amount RLWT to the Commissioner immediately.

Example

Scott is a solicitor who only occasionally handles RLWT transactions and prefers not to hold onto the retained funds. Scott retains RLWT from a residential land payment amount on 1 August. He is not required to pay this amount to the Commissioner until 20 September, but chooses to pay the RLWT amount to the Commissioner the following week.

Tax credit for RLWT paid

Under a proposed amendment to section LA 6 and new section LB 6B, a person will have a tax credit for a tax year equal to the amount of RLWT paid in relation to residential land they have disposed of.

It is expected that a credit under new section LB 6B will be used primarily to offset the person's income tax liability from the disposal of residential property.

To the extent that the amount of RLWT paid exceeds their income tax liability in relation to the disposal of the residential property, a proposed amendment to section LA 6 provides that the RLWT credit can be used to satisfy the person's other income tax liabilities.

If the person has no other income tax liabilities, the excess RLWT may be refunded.

Example

Patrick sold his residential property and $40,000 of RLWT was withheld from the settlement amount. Patrick's income tax liability in relation to the disposal is only $35,000. Patrick has no other tax liabilities. Inland Revenue issues a refund to Patrick of $5,000.

A person will be able to file an interim income tax return before the end of an income year, returning their taxable income arising from the disposal of residential land, in order to obtain a refund of excess RLWT. This return will not be considered final until the end of the income year.

RLWT will need to be paid to the Commissioner before a refund will be issued as part of an interim income tax return.

There is the possibility that a person's tax liability in relation to the disposal of residential land will arise in one tax year, but the RLWT will not be collected until the following tax year due to the timing of a property settlement. The proposed addition of RLWT to section LA 6 ensures that a person's RLWT credit may be used for earlier tax years.

RLWT must be paid before other disbursements

RLWT must be paid before other disbursements made as part of the settlement process – for example, mortgages. This is so RLWT cannot be easily circumvented by gearing up before disposal of the residential property.

Sometimes, the payment of RLWT before other disbursements may leave insufficient funds for the vendor's mortgage obligation to be discharged.

New section RL 4(6) provides that the amount of RLWT payable by the vendor's conveyancing agent will be reduced to the extent required to discharge a mortgage obligation held with a New Zealand-registered bank or non-bank deposit taker licensed under the Non-bank Deposit Takers Act 2013. Further information can be found in the sections titled "Calculating RLWT" and "Person required to pay RLWT (the paying agent and the withholding agent)".

Officials will monitor the situation to ensure that this provision is not used to undermine the integrity of the RLWT and the broader tax system.

Non-fulfilment of RLWT obligations

This is discussed in further detail in the section titled "When RLWT obligations are not met".

WHEN RLWT APPLIES

(Clauses 44 and 45)

Summary of proposed amendment

For RLWT to apply to a particular disposal, three conditions must be met. The first is that it must be a disposal of residential land located in New Zealand. The second is that the disposal is or would be treated as income of the vendor under the bright-line test, ignoring the "main home" exception. The third condition is that the vendor must be an offshore person.

Key features

Residential land in New Zealand

New section RL 1(2) provides that RLWT will only apply to residential land located in New Zealand. This restriction is necessary otherwise RLWT could apply to disposals of property situated overseas where the transaction has no link to New Zealand.

The meaning of "residential land" follows the definition used for the bright-line test, and is:

- land that has a dwelling on it;
- land for which the owner has an arrangement that relates to erecting a dwelling;
- bare land that may be used for erecting a dwelling under the rules in the relevant operative district plan;
- but does not include land that is farmland or used predominantly as business premises.

Further information on the meaning of "residential land" will be provided in Inland Revenue's *Tax Information Bulletin* on the bright-line test legislation.

Bright-line income

The second requirement is that the residential land purchase amount must be or would be treated as income for the vendor under the bright-line test, ignoring the "main home" exception. This is provided for in new section RL 1(2)(a). Proposed section RL 1(2)(a) refers specifically to new sections CB 6A and CB 16A, which provide for the bright-line test and the main home exception. This is because the RLWT is designed to be a collection mechanism for the bright-line test.

Note that this reference to "income" under the bright-line test means that there will not need to be a land title transfer for an RLWT obligation to arise; there will only need to be a residential land purchase amount. This means that off-the-plan sales, for example, will be subject to RLWT if other conditions are also met.

A disposal of New Zealand residential land will therefore be subject to RLWT if the vendor acquires the residential land on or after 1 October 2015 and disposes of it within two years of acquisition.

Further information on how to calculate the two-year period will be provided in the *Tax Information Bulletin* on the bright-line test legislation, but in most cases the holding period will begin on the date the person's title to the residential land is registered under the Land Transfer Act 1952, and will end on the date that the person enters into the agreement for the disposal of the residential land.

The bright-line test contains an exception, if the residential land being disposed of is the vendor's main home. The exception is not available for the purposes of the RLWT as it will only apply to offshore persons, and it is unlikely that the property being sold would be an offshore person's main home.

However, there will be an exemption or rollover relief from RLWT for inherited property and for transfers of relationship property, as provided under the bright-line test. This is achieved under section RL 1(2)(a), which refers to an amount that is, or would be "income" under section CB 6A but for the main home exception in section CB 16A.

A disposal of New Zealand residential land that is income for the vendor under both section CB 6A and another provision of the Income Tax Act 2007 (for example, the intention test) will be subject to RLWT.

Offshore persons

Under new section RL 1(2)(b), the vendor must be an "offshore person" for RLWT to apply. "Offshore person" is defined in section YA 1 and covers both individuals and non-individuals, such as companies or trusts.

Individuals

An individual will be an "offshore person" if they are not a New Zealand citizen and do not hold a New Zealand residence class visa as defined in the Immigration Act 2009. A residence class visa is a resident visa and or a permanent resident visa.

Example

Mary is an investor in residential property. She sells a piece of residential land located in Auckland to Jim. Mary is in New Zealand at the time of the sale, but she is not a New Zealand citizen and does not hold a residence class visa granted under the Immigration Act 2009. Mary is an "offshore person".

A New Zealand citizen will nevertheless be an offshore person if they are outside New Zealand and have not been in New Zealand within the last three years.

A holder of a New Zealand residence class visa will be an offshore person if they are outside New Zealand and have not been in New Zealand within the last 12 months.

Example

Tane is a New Zealand citizen and is relocated overseas with his job. Eighteen months after moving overseas, he sells his residential property. Tane has not been back in New Zealand since relocating. Tane is not an offshore person at the time of the sale.

In most cases it is likely that a New Zealand citizen or holder of a residence class visa who is selling their property within two years could satisfy the proof requirement by meeting with their New Zealand conveyancing agent in person and showing them their passport. The conveyancing agent would be able to copy the documentation and record that they have seen the person in New Zealand. As the vendor is currently in New Zealand, this means they would not be "an offshore" person.

If an individual is selling their property from outside New Zealand, a certified statement or other suitable proof from the vendor that they are not an offshore person should be provided to their conveyancing agent. This could include evidence of flights to New Zealand within the relevant timeframe.

The withholding tax will apply when two or more individuals jointly own a property, and at least one of them is an offshore person. This will help to ensure the integrity of the RLWT rules.

Further information can be found in the section titled "Information requirements".

Non-individuals (including companies)

A non-natural person will be considered to be an offshore person if any of the following conditions are met:

- it is incorporated outside New Zealand
- it is registered outside New Zealand
- it is constituted under foreign law
- it has a member that is an offshore person
- it has an executive or director that is an offshore person
- it is a company and 25 percent or more of the company's shareholder decision-making rights are held directly or indirectly by offshore persons.

Accordingly, for a company (including a unit trust) to qualify for the non-offshore exemption, the following conditions must all be met:

- the company is registered in New Zealand; and
- all directors of the company are non-offshore individuals; and
- no more than 25 percent of the shareholder decision-making rights of the company are held by offshore persons.

This could be satisfied, for example, by proof such as:

- a copy of the company's New Zealand registration; and
- a copy of each director's New Zealand passport or residence class visa sighted during a meeting with the conveyancing agent; and
- a statement from each director that, to their knowledge, no more than 25 percent of the shareholder decision-making rights of the company are held by offshore persons.

Further information can be found in the section titled "Information requirements".

A partnership will be an "offshore person" for the purpose of the RLWT rules if at least one of the partners is an offshore person.

A discretionary trust will be considered an offshore person if any of the trustees is an offshore person.

A discretionary trust will also be considered an offshore person if any settlor of the trust is an offshore person. This is to prevent the situation of a trust with an offshore settlor and resident trustees selling the property (without being subject to a withholding tax), with the settlor then replacing resident trustees with trustees who are offshore persons and beyond the reach of Inland Revenue. This requirement is consistent with the settlor focus in New Zealand's income tax rules.

In addition, the trustees of a discretionary trust have the ability to shift the tax liability to one of the beneficiaries by distributing the income to the beneficiary and treating it as beneficiary income. To ensure that the gain does not escape tax by being transferred to an offshore beneficiary, a trust will be an offshore person if:

- all natural person beneficiaries and all natural person discretionary beneficiaries of the trust are offshore persons;
- all beneficiaries and discretionary beneficiaries of the trust are offshore persons; or
- one or more of the beneficiaries are offshore persons, and the offshore beneficiary received a distribution from the trust within the last six years of a relevant disposal of residential land.

The definition of "offshore person" for the purposes of the RLWT rules has been designed so that it will not normally apply to properties held in ordinary family trusts where some of the beneficiaries may be New Zealand citizens but now reside overseas.

Example

Debbie and Greg are the settlors and trustees of a family trust. They are both New Zealand citizens and live in New Zealand. Dan and Natalie are discretionary beneficiaries of the trust and are also New Zealand citizens. Dan lives in New Zealand, but Natalie has lived in Australia for the past five years and has not been back to New Zealand. Debbie and Greg as trustees of the trust are not offshore persons, because they themselves are not offshore persons and, of the two beneficiaries, only Natalie is an offshore person.

To prevent a trust being set up in which all beneficiaries are foreign investors who are natural persons, with a New Zealand charity appointed as a discretionary beneficiary simply to avoid being classed as an "offshore person", the definition of "offshore person" includes the situation where all natural person beneficiaries and natural person discretionary beneficiaries are treated as "offshore persons".

Example

Matilda and Madeline are natural persons who are also offshore persons. They are the only individual beneficiaries of a trust. A New Zealand charity is appointed as a discretionary beneficiary of the trust. The settlor and trustees of the trust are not offshore persons. The trustees are treated as offshore persons for the purposes of the RLWT rules, because all natural person (individual) beneficiaries of the trust (Matilda and Madeline) are offshore persons.

A corporate trustee will be able to qualify for the non-offshore exemption if it meets both the company and trust criteria above.

PERSON REQUIRED TO PAY RLWT (THE PAYING AGENT AND THE WITHHOLDING AGENT)

(Clauses 35, 36, 41, 44 and 45)

Summary of proposed amendment

The vendor's conveyancing agent will be the paying agent for RLWT purposes, and will be required to fulfil the vendor's RLWT obligations. If the vendor does not have a conveyancing agent, the purchaser's conveyancing agent will be the paying agent. If neither the vendor nor purchaser has a conveyancing agent, the purchaser will be the paying agent.

If the vendor and purchaser are associated persons, the purchaser must withhold the RLWT.

Key features

The concept of a conveyancing agent will be incorporated into the Income Tax Act 2007 through a proposed definition of "conveyancer". The proposed definition of "conveyancer" in section YA 1 means a lawyer, incorporated law firm, conveyancing practitioner, or incorporated conveyancing firm that provides conveyancing services, as that term is used in the Lawyers and Conveyancers Act 2006, using a New Zealand-based trust account.

Under new section RL 2 the vendor is liable to pay an amount of RLWT, but the vendor's conveyancer is treated as the agent of the vendor's agent in relation to RLWT and must make assessments, provide returns and satisfy the vendor's liability. That is, the vendor's conveyancer is the "paying agent" in relation to RLWT.

If neither the vendor nor purchaser has a conveyancer as defined, the paying agent for RLWT will be the purchaser, as described in part (b) of the proposed definition of "conveyancer" in section YA 1.

What it means to be a paying agent or withholding agent is discussed in the section titled "New tax type: residential land withholding tax".

Associated persons

Under new section RL 3, if the vendor and purchaser are associated persons, the vendor is not liable to pay RLWT. Instead, the purchaser must withhold the requisite amount of RLWT in a separate bank account, segregated from other money, for the benefit of the Commissioner of Inland Revenue.

In this case, the purchaser will have a withholding tax obligation under section BE 1 and the standard requirements for other withholding taxes will apply.

The purchaser will not be precluded from using the services of a conveyancer to fulfil their RLWT obligations.

Not the vendor's agent for other purposes

While the paying agent is considered to be the vendor's agent for the purposes of RLWT, new section RL 2(3) ensures that the paying agent will not be considered the vendor's agent more generally, just because of their role as the RLWT paying agent.

New section RL 2(4) ensures that a paying agent who is only the vendor's agent in relation to RLWT will not be subject to sections HD 2 to 4, which relate to agents.

No liability for underlying RLWT

New section RL 2(5) provides that a paying agent will not be jointly and severally liable in relation to the vendor's RLWT debt, despite their obligation to satisfy the vendor's RLWT liability.

They may, however, be liable for the RLWT debt, if they have retained the RLWT amount from a residential land payment amount and have failed to pay the retained RLWT to the Commissioner.

New section RL 2(6) provides that the rules relating to penalties as set out in the Tax Administration Act 1994 will apply.

Cost recovery by paying agent

While it is not included in the bill, a paying agent is not precluded from recovering the costs incurred in satisfying the vendor's RLWT obligations.

CALCULATING RLWT

(Clauses 44 and 45)

Summary of proposed amendment

There are two main calculation methods for RLWT, with the amount of RLWT payable being the lesser of the amounts calculated under these methods. A third method is available, where the paying agent is the vendor's conveyancer and the amount of RLWT would exceed the amount available from the total purchase price once a mortgage obligation with a New Zealand-registered bank or non-bank deposit taker has been discharged.

Key features

New section RL 4 provides that the amount of RLWT to be paid will be the lesser of:

- 33% (or 28% if the vendor is a company that is not acting as a trustee) x (current purchase price – vendor's acquisition cost) (set out in proposed section RL 4(2)); and
- 10% x current purchase price (set out in proposed section RL 4(4)).

New section RL 4(3)(b) defines "current purchase price" as the price agreed by the vendor and purchaser for the disposal of the residential land that the residential land purchase amount relates to. This figure includes deposits and part-payments. New section RL 4(3)(c) defines the "vendor's acquisition cost" as being the purchase price paid by the vendor for their acquisition of the residential land being disposed of.

It is expected that the vendor's acquisition cost will generally be available from Quotable Value.

Example

Virginia agrees to sell her residential property in Tauranga to Thomas. Thomas pays a $100,000 deposit and another $400,000 upon settlement. In determining Virginia's RLWT liability, the "current purchase price" is $500,000. Virginia originally acquired the residential property for $350,000. The "vendor's acquisition cost" for the purposes of determining Virginia's RLWT liability is $350,000.

RLWT calculated using the formula in section RL 4(2) is 33% x ($500,000 – $350,000), or $49,500. RLWT calculated using the formula in section RL 4(4) is 10% x $500,000, or $50,000. Therefore the amount of RLWT payable is $49,500.

When RLWT exceeds the funds available following discharge of mortgage obligations

To maintain the integrity of the RLWT and the broader tax system, RLWT will generally be paid before other disbursements.

A vendor may have a mortgage secured over the residential land being disposed of. The mortgagee may require the vendor's mortgage obligation to be discharged before the title to the residential land can be released.

In most cases this should not be a problem, due to the vendor's gain approach used in new section RL 4(2), but in some situations, the amount of RLWT payable calculated using the two methods outlined above may result in insufficient funds to discharge the vendor's mortgage.

A third calculation method will be available when the vendor's conveyancer is the paying agent and the amount of RLWT payable will be the lesser of the amounts calculated using the methods set out in proposed sections RL 4(2), RL 4(4), and RL 4(6).

The amount of RLWT payable using the method in new section RL 4(6) is the current purchase price less the "security discharge amount". The security discharge amount is defined in section RL 4(7) and (8) and will be the total amount required by a New Zealand-registered bank or non-bank deposit taker (as licensed under the Non-bank Deposit Takers Act 2013) to discharge their mortgages or other securities over the residential land.

Officials will monitor the situation to ensure that this provision is not used to undermine the integrity of the RLWT and the broader tax system.

It is expected that the vendor's conveyancer will be the paying agent in the majority of transactions. However, when the paying or withholding agent is the purchaser's conveyancer or the purchaser themselves, this third calculation method will not be available. This is consistent with other withholding tax rules.

Example

Consider the previous example of Virginia and Thomas. Recall that the RLWT payable using the methods set out in section RL 4(2) and (4) will be $49,500. Virginia has a mortgage with a New Zealand bank for $460,000. The New Zealand bank requires the full $460,000 to be discharged upon settlement. This would not be possible, because after RLWT has been retained by the paying or withholding agent, only $450,500 will remain from the current purchase price.

Virginia's conveyancer is the paying agent for the purposes of RLWT. This, combined with the fact that Virginia's mortgage is with a New Zealand bank means that the third method in proposed section RL 4(6) will be available. The amount of RLWT payable will be $40,000 ($500,000 – $460,000).

INFORMATION REQUIREMENTS

(Clauses 44, 45 and 72)

Summary of proposed amendment

New section RL 1(4) of the Income tax Act 2007 and new sections 54B and 54C of the Tax Administration Act 1994 set out the information requirement in relation to RLWT obligations.

Key features

Information to be provided by vendors to paying and withholding agents

New section 54C of the Tax Administration Act 1994 sets out the information that vendors will be required to provide to their paying or withholding agent so that the agent will be able to fulfil any RLWT obligations.

The information requirements in section 54C of the Tax Administration Act 1994 will only apply if the vendor is within the two-year bright-line test. An amendment is proposed to the definition of "bright-line date" in section YA 1, so that the calculation of the two-year period for the purposes of RLWT will be the same as the bright-line test. The bright-line date is defined in new section CB 6A.

The calculation of the two-year period in new section 54C(1) of the Tax Administration Act 1994 will be almost identical to proposed section CB 6A(1) in the bright-line test. The only exception will be that section CB 6A(1)(a)(ii) will not be required in the context of RLWT, as it relates to land outside New Zealand.

In most cases, the start-date of the two-year period will be the date on which the instrument to transfer the land to the person was registered under the Land Transfer Act 1952. This information will be readily available on Landonline to conveyancers, and on Quotable Value's website.

The end-date will, in most cases, be the date on which the person enters into an agreement for the disposal of the residential land. This date will be available to both the vendor's and purchaser's conveyancers.

As a result, the paying or withholding agent should, in most situations, be able to determine, with little involvement from the vendor, whether the vendor is within the two-year bright-line period.

If the paying or withholding agent determines that the vendor is outside the two-year bright-line period, RLWT will not apply and the vendor will not need to provide any further information to the paying or withholding agent.

If the paying or withholding agent determines that the vendor is within the two-year bright-line period, new section 54C of the Tax Administration Act 1994 will require the vendor to give information in relation to the RLWT in the form prescribed by the

Commissioner of Inland Revenue. New section 54C(4) will require vendors to provide at the very least their full name, address, IRD number, and whether or not they are an offshore person. If they are an offshore person, the vendor must also state whether they are associated with the purchaser and whether their disposal of the residential land is or would be considered "income" under the bright-line test, ignoring the bright-line test's main home exception.

New section 54C(3) provides that a vendor's statement will need to be accompanied by certified copies of relevant and appropriate documents. The Commissioner will prescribe what documents will be acceptable in supporting the person's statement. For example, a vendor may need to provide a certified copy of their New Zealand passport or residence class visa to support their statement that they are not an offshore person.

If a vendor states that they *are* an offshore person (and will therefore be subject to RLWT), there should be no need for the vendor to provide evidence to support that statement.

Information to be provided by paying and withholding agents to the Commissioner

New section 54B of the Tax Administration Act 1994 will require paying and withholding agents to provide a statement detailing their RLWT withholding obligations at the time they pay RLWT to the Commissioner.

The Commissioner may also allow further time for paying and withholding agents to furnish their RLWT statements. However, this may affect a vendor's ability to apply for a refund if he or she wants to file an interim income tax return shortly after the disposal, as refunds will not be issued until the payment of RLWT to the Commissioner is reconciled with the vendor's account.

Information retention and the Privacy Act 1993

New section 54C(5) of the Tax Administration Act 1994 will require anyone who receives information under section 54C of the Tax Administration Act 1994 to retain that information for at least seven years. This rule will apply to everyone who receives information under this section, irrespective of whether RLWT is ultimately paid.

The provisions of the Privacy Act 1993 will also apply to information collected under section 54C of the Tax Administration Act 1994. Where the recipient of the information is a conveyancing agent, they will also have professional obligations regarding confidentiality.

WHEN RLWT OBLIGATIONS ARE NOT MET

(Clauses 42, 44, 72 and 73)

Summary of proposed amendment

The standard penalties that apply to other withholding taxes will also apply to RLWT. However, when RLWT has not been retained from a residential land purchase amount by a paying agent, late payment penalties will not apply.

The Commissioner of Inland Revenue will be able to report details of non-compliant paying agents to their relevant professional bodies.

Key features

Penalties

Under new section RL 2(6) the rules relating to penalties as set out in the Tax Administration Act 1994 will apply to paying agents as though they have failed to pay an amount of withholding tax equal to the amount of RLWT they failed to satisfy. This will mean that the general penalties rules that apply to withholding taxes (such as late filing penalties) will apply to RLWT, irrespective of whether the person required to satisfy RLWT is a paying agent or a withholding agent.

Late payment penalties

New section RL 2(6)(b) provides that when the paying agent has not retained the amount of RLWT from the residential land purchase amount, late payment penalties will not apply. This is because in most cases, the paying agent will not be liable for the underlying amount of RLWT and once they have released the funds to the vendor, they will not be able to pay the RLWT out of the residential land purchase amount.

However, new section RL 2(6)(a) provides that when a paying agent has subtracted or retained an amount of RLWT from a residential land purchase, but has failed to pay the RLWT to the Commissioner, late payment penalties will apply. The late payment penalties are set out in section 139B of the Tax Administration Act 1994.

Liability for underlying RLWT

As noted previously, under new section RL 2(5), a paying agent will not be jointly and severally liable in relation to the vendor’s RLWT debt, despite their obligation to satisfy the vendor’s RLWT liability. However, if a paying agent has retained RLWT from a residential land purchase amount, but has not paid the RLWT to the Commissioner, they may be liable for the RLWT.

If the vendor and purchaser are associated persons, the purchaser will be the withholding agent and will therefore be liable for the underlying RLWT, in a similar way to standard withholding taxes.

Reporting to professional body

An amendment to section 81 of the Tax Administration Act 1994 is proposed, to allow the Commissioner of Inland Revenue to provide details of RLWT paying agents to their relevant professional body when they have failed to fulfil their RLWT obligations. These professional bodies might include, for example, the New Zealand Law Society, Auckland District Law Society, and the New Zealand Society of Conveyancers. This will allow professional bodies to take appropriate action against members who do not comply with their legal obligations under the proposed RLWT.

This is an important design feature that will support the integrity of the RLWT, as paying agents will not be liable for the underlying RLWT in most circumstances.

GST on cross-border supplies of remote services

OVERVIEW

In principle, Goods and Services Tax (GST) should apply to all consumption that occurs in New Zealand, as this ensures that the system is fair, efficient and simple. Under the current rules, however, GST is not typically collected on cross-border services and intangibles that are purchased from offshore suppliers.

When GST was introduced in 1986, few New Zealand consumers purchased offshore services, and online digital products were not available. At that time, the compliance and administrative costs that would have been involved in taxing imported services outweighed the benefits of taxation.

The growth of e-commerce means the volume of services and intangibles on which GST is not collected is becoming increasingly significant. Many are concerned that the current tax settings distort consumer and business decisions, placing New Zealand suppliers of services and intangibles at a competitive disadvantage relative to offshore suppliers. The non-collection of GST on cross-border services and intangibles has also resulted in a growing gap in New Zealand's GST revenue base (estimated at around $40 million per year).

The amendments proposed in the bill apply GST to cross-border "remote" services and intangibles supplied by offshore suppliers (including e-books, music, videos and software purchased from offshore websites) to New Zealand-resident consumers, by requiring the offshore supplier to register and return GST on these supplies.

The new rules would apply GST to a broad range of "remote" services, rather than targeting the rules at specific digital services. This avoids complexity in the design of the rules and is more consistent with the broad base of New Zealand's GST system. A "remote" service is defined as a "service where, at the time of the performance of the service, there is no necessary connection between the physical location of the recipient and the place of physical performance." Non-digital services, such as consulting, accounting and legal services, will be subject to the proposed rules when they are supplied as remote services.

To ensure compliance costs are minimised, offshore suppliers will not be required to return GST on supplies to New Zealand GST-registered businesses, nor will they be required to provide tax invoices. Furthermore, offshore suppliers will only be required to register and return GST when their supplies of remote services to New Zealand resident consumers exceed NZ$60,000 in a 12-month period. This is consistent with the registration threshold that applies to domestic suppliers.

The amendments are intended to maintain the broad base of New Zealand's GST system and to create a level playing field between domestic and offshore suppliers of services and intangibles. The effect will be to reduce the extent to which differences in GST treatment distort consumers' purchasing decisions.

Non-collection of GST on cross-border services and intangibles is an international challenge faced by countries that have a GST or Value Added Tax (VAT) system. The Organisation for Economic Co-operation and Development (OECD) has released guidelines that establish an international set of principles for determining when countries should have the right to tax these supplies.

The guidelines suggest that, for remotely provided services and intangibles, the consumer's usual place of residence is the predominant test for determining which country has the right to tax. They also suggest that offshore suppliers could be required to register and return the GST on remote supplies to consumers.

The proposed amendments broadly follow the OECD guidelines, as well as the rules that apply in other jurisdictions, such as Member States of the European Union, Norway, South Korea, Japan, Switzerland and South Africa. Australia has announced plans to introduce similar rules that will apply from 1 July 2017.

Other features of the proposed rules include:

- Supplies of remote services by non-resident suppliers to New Zealand GST-registered businesses will not be subject to GST unless the supplier and recipient agree otherwise, in which case the supply will be zero-rated (taxed at a rate of zero percent). The supplier would then be able to claim back any New Zealand GST costs incurred in making the zero-rated supplies.
- Offshore suppliers will be required to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of commercially available evidence (for example, a billing address and the country code of their mobile phone SIM card). The Commissioner of Inland Revenue will be able to prescribe an alternative method of determining whether a customer is resident, in circumstances when sufficient information is not commercially available to apply the test.
- Offshore suppliers will be required to presume that a New Zealand-resident customer is not a GST-registered business unless the customer has provided their GST registration number, New Zealand Business Number or notified their status as a registered business. The Commissioner of Inland Revenue is also able to agree to an alternative method of determining whether the supply is made to a GST-registered person.
- If a GST-registered business is inadvertently charged GST, it will have to seek a refund from the non-resident supplier. However, if the payment for the supply (including GST) is $1,000 or less, a non-resident supplier will have the option to provide a tax invoice to the purchaser to allow them to claim a deduction, rather than to refund the GST charged.
- When certain conditions are satisfied, an operator of an electronic marketplace (such as an app store) will be required to register and return GST on supplies made through the marketplace instead of the underlying supplier.
- General insurance and gambling services are subject to special GST rules that apply GST on a net basis. Amendments will extend and modify these rules to apply where non-resident suppliers provide these services to New Zealand-resident consumers.
- The Commissioner of Inland Revenue will have the discretion to require a person to register and pay the GST in cases when a person provides false or

misleading information about themselves in order to avoid GST, if the GST amount involved is substantial or the behaviour is repeated.

- A simplified "pay-only" registration system should be made available to offshore suppliers that are only required to return GST and who do not have any New Zealand GST costs to claim back.
- For the period from 1 October 2016 to 31 March 2017, non-resident suppliers of remote services will have a default taxable period of six months (or an optional taxable period of two months). After this transitional period, these suppliers will have quarterly taxable periods.
- A new rule will prevent double taxation from arising on supplies of remote services performed in New Zealand to a non-resident consumer, by allowing a deduction against the supplier's liability for New Zealand GST to the extent that the supply has already been taxed in another jurisdiction.

The proposed amendments follow proposals outlined in the discussion document *GST: Cross-border services, intangibles, and goods* released in August 2015. Submissions generally supported the proposals in the discussion document. The new rules will apply to supplies made after 1 October 2016. All references are to the Goods and Services Tax Act 1985 (GST Act) unless otherwise specified.

CROSS-BORDER SUPPLIES OF REMOTE SERVICES TO NEW ZEALAND-RESIDENT CONSUMERS

(Clauses 47(1), 47(4), 47(8), 49(1), 49(2), 50, 53(1), 55(3), 62 and 63)

Summary of proposed amendment

The bill proposes amendments to the GST Act that will apply GST to cross-border "remote services" provided to New Zealand-resident consumers, by requiring offshore suppliers to register and return GST on these supplies.

Key features

Changes to the place of supply rules

A definition of "remote services" is inserted in section 2, which defines a "remote service" as a service where, at the time of the performance of the service, there is no necessary connection between the physical location of the customer and the place where the services are performed.

An amendment to the definition of "goods" under section 2 is proposed to further exclude a product that is transmitted by wire, cable, radio or other electromagnetic system, regardless of whether it is transmitted by a non-resident supplier to a resident recipient.

Proposed section 8(3)(c) is inserted into the place of supply rules, which deem supplies of "remote services" (as defined) supplied by a non-resident to a person resident in New Zealand to be a supply made in New Zealand, and therefore subject to GST.

Supplies of remote services that are physically performed outside New Zealand to residents in New Zealand who are not registered persons will be excluded from zero-rating through amendments proposed to section 11A(1)(j).

Registration threshold

As a consequence of proposed section 8(3)(c), non-resident suppliers will be required to register and return GST when their supplies of remote services to New Zealand exceed NZ$60,000 in a 12-month period. Supplies to New Zealand GST-registered businesses will only count towards this threshold if the parties agree that the supply is zero-rated (discussed in the next section of this commentary).

Determining whether a customer is resident in New Zealand

Proposed section 8B establishes rules that non-resident suppliers of remote services must follow to determine when a remote service is supplied to a person resident in New Zealand. Proposed section 8B(2) will require the non-resident supplier to treat a customer as a New Zealand resident on the basis of two non-conflicting pieces of evidence that support the conclusion the person is resident in New Zealand.

Proposed section 8B(2) provides a list of proxies that can be used for these purposes:

- the person's billing address;
- the internet protocol (IP) address of the device used by the person or another geolocation method;
- the person's bank details, including the account the person uses for payment or the billing address held by the bank;
- the mobile country code (MCC) of the international mobile subscriber identity (IMSI) stored on the subscriber identity module (SIM) card used by the person;
- the location of the person's fixed landline through which the service is supplied to them; and
- other commercially relevant information.

Proposed section 8B(3)(a) provides that, if a supplier has more than one set of evidence that meets the test of two non-conflicting pieces, where one set supports the conclusion that the customer is resident in New Zealand and another supports the conclusion that the customer is resident in another country, the supplier is required to choose the more reliable set of evidence.

Proposed section 8B(3)(b) allows the Commissioner of Inland Revenue to prescribe another method to determine a recipient's residence if a supplier is unable to establish a recipient's residence by two non-conflicting pieces of evidence as described above.

Non-double taxation rule

Proposed section 20(3)(dc) prevents double taxation from arising on supplies of remote services that are physically performed in New Zealand and received by a non-resident consumer in New Zealand, by allowing a deduction against their liability for GST in New Zealand, when the supply has been taxed in another jurisdiction, to the extent that the supply is taxed in the other jurisdiction.

Background

When GST was introduced in 1986, few New Zealand consumers purchased offshore services and online digital products were not available. The rules that determine whether GST applies to a supply of services (the "place of supply rules"), therefore envisaged GST applying on the basis of whether a service of a more tangible nature is physically performed in New Zealand. Under these rules, supplies of services that are physically performed outside of New Zealand are not subject to GST, even if they are supplied to New Zealand-resident consumers.

International developments

Non-taxation of cross-border remote services and intangibles is an international issue faced by countries that have a GST or VAT system. The OECD has developed international VAT/GST guidelines, which establish an international set of principles for determining when countries have the right to tax these supplies. This is expected to minimise the potential for double taxation or double non-taxation in the trade of cross-border services and intangibles.

The OECD guidelines recommend two general rules for determining the place of taxation for supplies of services and intangibles to consumers:

- for "on-the-spot" services, where it is necessary for the supplier and customer to be in the same location when the services are supplied, the jurisdiction where the service is performed should have taxing rights; and
- for "remote" services, where it is not necessary for the supplier and customer to be in the same location when the services are supplied, the jurisdiction in which the customer has their usual residence should have taxing rights.

The distinction between "remote" and "on-the-spot" services is intended to allocate taxing rights to the jurisdiction where it can reasonably be assumed that the consumer consumes these supplies.

The OECD guidelines suggest that in order to collect GST on these supplies, offshore suppliers could be required to register and return GST in the jurisdiction of the consumer's usual residence.

The OECD guidelines can be found at the link below:

http://www.oecd.org/ctp/consumption/international-vat-gst-guidelines.htm

The offshore supplier registration model has been adopted for cross-border services and intangibles in a number of jurisdictions, including the European Union, Norway, South Korea, Japan, Switzerland and South Africa. Australia has also announced plans to introduce the model. Countries that have implemented such a system report success in collecting GST/VAT on these supplies.

Current place of supply rules

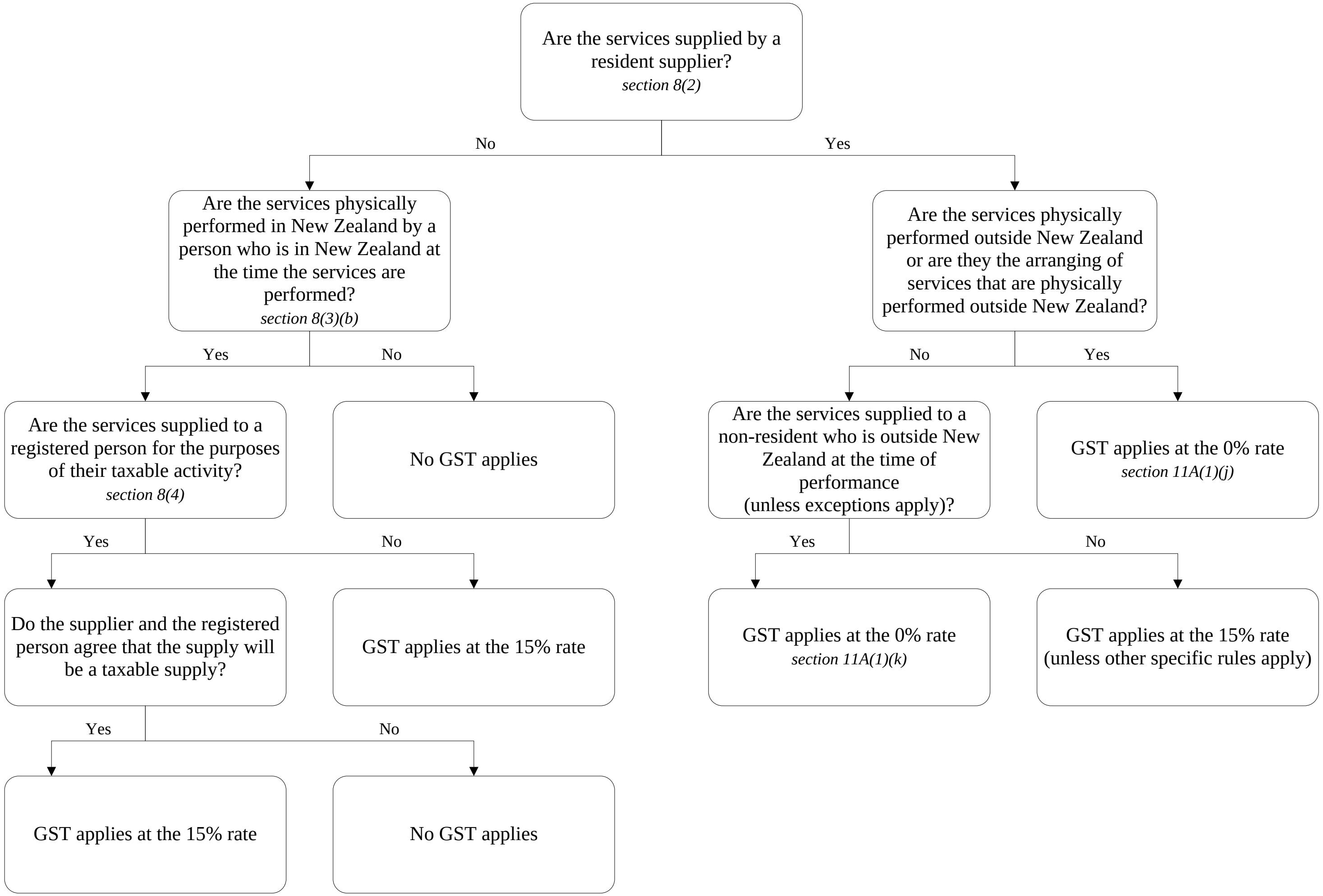
The GST Act adopts an iterative approach to determining whether a good or service is considered to be supplied in New Zealand, and therefore whether GST applies to the supply. The place of supply rules in section 8 of the Act are then followed by a range of exclusions that determine whether the supply is zero-rated or exempt.

The current place of supply rules generally apply GST on the basis of where services are physically performed. Services that are physically performed outside New Zealand will generally not be subject to GST if supplied by a non-resident, and will generally be zero-rated if supplied by a resident.

Under section 8(2) of the Act, when a New Zealand-resident person supplies services, the supply is deemed to be made in New Zealand and therefore subject to GST. However, if the services are physically performed outside New Zealand, the supply will be zero-rated under section 11A(1)(j).

If a non-resident person supplies services, the starting point is that the supply will be deemed to be made outside New Zealand, and therefore not subject to GST. However, under section 8(3)(b), services are deemed to be supplied in New Zealand if the services are physically performed in New Zealand by a person who is in New Zealand at the time of performance. However, section 8(4) provides that if a supply is made to a GST-registered business for the purposes of carrying on their taxable activity, the services are deemed to be supplied outside New Zealand, and therefore are not subject to GST, unless the parties agree that GST will apply.

Summary of the current place of supply rules for services



Detailed analysis

Changes to the place of supply rules

The amendments propose changes to the place of supply rules, so that GST applies to supplies of remote services that are physically performed outside New Zealand, where the services are supplied to a New Zealand resident.

Proposed section 8(3)(c) provides that services will be treated as being supplied in New Zealand (subject to GST) when a non-resident supplier supplies remote services to a New Zealand resident, unless the services are physically performed in New Zealand by a person who is in New Zealand at the time the services are performed (in which case the supply would be subject to GST under existing section 8(3)(b)).

Section 8(4) will apply to supplies made under proposed section 8(3)(c), so that remote services that are supplied to GST-registered businesses will be treated as being supplied outside New Zealand (not subject to GST), unless the supplier and the GST-registered recipient agree that the supply is a taxable supply. Where the parties have agreed, these supplies will be zero-rated under proposed section 11A(1)(x). (See following section of the commentary for more information on business-to-business supplies.)

Section 11A(1)(j) currently zero-rates services that are physically performed outside New Zealand or supplies that arrange services that are physically performed outside New Zealand. An amendment excludes supplies of remote services to a person resident in New Zealand that is not a registered person from this zero-rating rule. This creates a level playing field between resident and non-resident suppliers, as in both cases, GST will apply at the 15% rate when remote services are physically performed outside New Zealand and supplied to a New Zealand-resident consumer.

Example

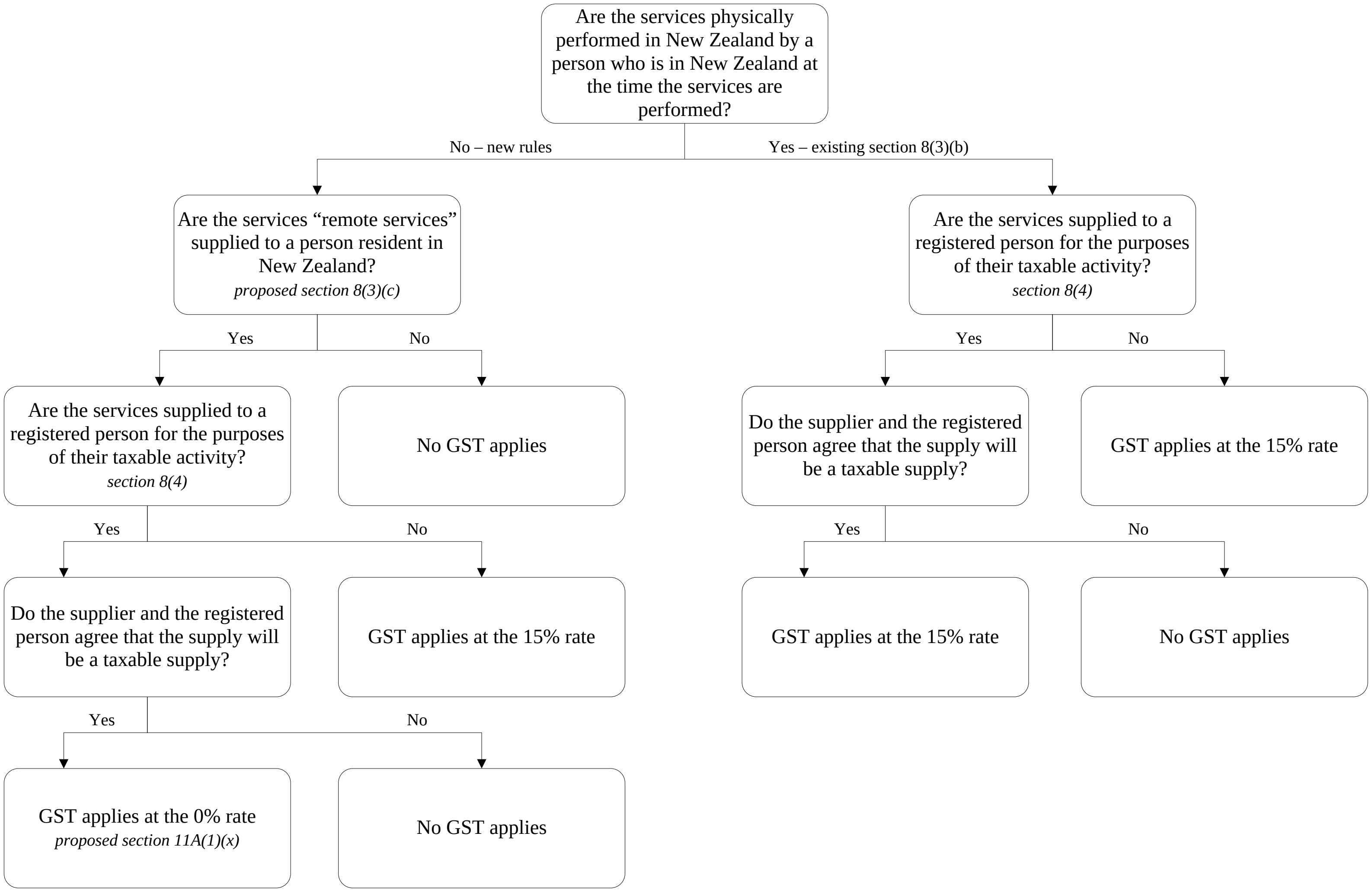
Movie Co. is a non-resident company that provides remote services to consumers in a number of countries, including New Zealand. As some of these services are remote services supplied to a New Zealand-resident consumer, these supplies will be subject to GST under proposed section 8(3)(c). If Movie Co. exceeds the registration threshold, it will be required to register and return GST on these supplies.

If Movie Co. was a resident of New Zealand that physically performed remote services outside New Zealand, its supplies would also be subject to GST at the 15% rate when supplied to New Zealand-resident consumers, due to the proposed exception to section 11A(1)(j).

The new place of supply rule in section 8(3)(c) applies to services that are not physically performed in New Zealand by a person who is in New Zealand at the time of performance. The place where a service is "physically performed" can be considered to be the place where the service is actually carried out or performed. For these purposes, all services are "physically performed", even if they are delivered through an automated process.

Services that are already exempt (such as supplies of financial services) or zero-rated under a specific rule would retain that character under the proposed amendments.

Summary of the new place of supply rules for non-resident suppliers of services



Definition of "remote service"

Under the GST Act, "services" are defined to include anything other than goods or money. "Goods" are defined to exclude "a product that is transmitted by a non-resident to a resident by means of a wire, cable, radio, optical or other electromagnetic system or by means of a similar technical system". Treating intangible digital products as services is consistent with the OECD framework, and recognises that it is impractical to treat these products like imported goods, as they cannot be taxed at the border. The bill proposes an amendment to the definition of "goods" to remove the reference to a non-resident supplier and resident recipient, in order to ensure that intangible digital products will be treated as services regardless of the tax residence of the supplier and recipient.

A "remote service" is defined as a service that, at the time of the performance of the service, has no necessary connection between the physical location of the recipient and the place where the services are performed.

Whether a service is a "remote service" will depend on whether the nature of the service requires that the recipient is present when the service is physically performed. If a service is either actually or is capable of being supplied when the recipient is not present, the test will be satisfied, as there is no necessary connection between the physical location of the recipient and the place of physical performance.

Requiring a necessary connection between the physical location of the customer and the place of physical performance of services means that the definition of "remote services" includes services that are capable of being supplied remotely, but that happen to be provided when the recipient and provider are in the same location.

Examples of services that could be supplied as remote services include:

- supplies of digital content such as e-books, movies, TV shows, music and online newspaper subscriptions;
- online supplies of games, apps, software and software maintenance;
- webinars or distance learning courses;
- insurance services;
- gambling services;
- website design or publishing services; and
- legal, accounting or consultancy services.

Examples of services that would not be remote services include:

- accommodation services;
- hairdressing, beauty therapy and physiotherapy;
- car rental services;
- entry to cinema, theatre performances, sports events and museums;
- gym memberships;

- passenger transport services; and
- restaurant and catering services.

Example

Legal Co. is a non-resident company based in Australia. Sam, a New Zealand tax resident, seeks general advice from Legal Co. about investing in an Australian company. The nature of the service is such that Sam is not required to be present when the advice is provided, and in fact the advice is provided via telephone and email, rather than in person.

The services are remote services, as there is no necessary connection between Sam's physical location and the place where the service is physically performed. If Legal Co exceeds the registration threshold, it will be required to register and return GST on this supply.

Telecommunications services

The GST Act includes special rules for cross-border supplies of telecommunications services, including specific place of supply and zero-rating rules. These rules determine the GST treatment of the supply based on the place that the customer is located when initiating or receiving services.

These rules zero-rate domestic telecommunications providers' supplies of international roaming services to New Zealand residents who are temporarily offshore. Offshore telecommunications providers are, however, required to charge GST on services used by non-resident consumers that are temporarily in New Zealand (known as inbound roaming services), if the total value of their supplies exceeds the registration threshold. However, if the threshold is exceeded only because of supplies to non-residents that are physically present in New Zealand, they are not required to register. Offshore telecommunications providers must register for GST for services provided to New Zealand residents if they exceed the $60,000 threshold.

The amendments proposed in the bill are not intended to disturb the current tax settings for telecommunications services. Section 8(5) of the GST Act excludes these services from the application of the relevant provisions.

"Telecommunications services" are defined in the GST Act to include the transmission, emission or reception of information by certain technical systems, including access to global information networks, but to exclude the content of the telecommunication. This means that telecommunications services, such as telephone calls or access to the internet via an internet service provider, will not be subject to the new place of supply or electronic marketplace rules.

GST registration threshold

Non-resident suppliers of remote services to New Zealand customers will be required to register for GST if their total value of supplies made in New Zealand exceed NZ$60,000 in a 12-month period, which is equivalent to the existing registration threshold for resident suppliers.

As these suppliers will be subject to the rules contained in section 51 of the GST Act, non-resident suppliers will be required to register if:

- the total value of their supplies made in New Zealand in the past 12 months exceeded NZ$60,000 (unless the Commissioner of Inland Revenue is satisfied that their supplies in the next 12 months will not exceed this threshold); or
- the total value of their supplies made in New Zealand in the next 12 months is expected to exceed NZ$60,000.

As remote services supplied by a non-resident to a New Zealand GST-registered business are generally treated as not being supplied in New Zealand (and therefore not subject to GST), these supplies will not count towards the registration threshold. However, if the parties agree that the supplies will be zero-rated, these supplies will count towards the threshold.

Where a non-resident supplier of remote services is carrying on a taxable activity in New Zealand, and their supplies fall below the NZ$60,000 threshold, they will be able to voluntarily register for GST.

The existing rules that allow non-resident businesses to register for GST, which are contained in section 54B of the GST Act, will continue to apply. These rules allow a non-resident business that has been charged GST on goods or services received in New Zealand, but that does not carry on a taxable activity in New Zealand, to register and claim back the GST paid, provided certain conditions are met.

Example

Music Co., a non-resident company based in the United States, supplies access to music on a subscription basis over the internet. Music Co also supplies licences for businesses such as restaurants and bars to play music in a commercial setting.

Each year, Music Co. makes supplies valued at NZ$50,000 to New Zealand customers who are not GST-registered. It makes supplies valued at NZ$20,000 to New Zealand GST-registered customers.

Unless Music Co. chooses to agree with its GST-registered business customers that these supplies that would bring them over the registration threshold are zero-rated, Music Co. will not be required to register and return GST on any of its supplies in New Zealand, as it has not exceeded the NZ$60,000 registration threshold.

Determining whether a customer is resident in New Zealand

When applying the new place of supply rules, a supplier will not be required to determine precisely whether their customer is a tax resident of New Zealand, and will instead be able to use objective proxies to determine the GST treatment of the supply. Under the proposed rules, an offshore supplier of remote services would be required to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of evidence.

This test is intended to strike a balance between accuracy in determining whether New Zealand GST should apply and the compliance costs imposed on offshore suppliers. The proposed rules will provide non-resident suppliers with certainty when determining whether a recipient of a supply should be treated as a New Zealand-resident. The test should also be familiar to many non-resident suppliers as the proposed approach is consistent with similar rules that apply in the European Union.

Proposed section 8B(2) provides a list of proxies that can be used for these purposes:

- the person's billing address;
- the internet protocol (IP) address of the device used by the person or another geolocation method;
- the person's bank details, including the account the person uses for payment or the billing address held by the bank;
- the mobile country code (MCC) of the international mobile subscriber identity (IMSI) stored on the subscriber identity module (SIM) card used by the person;
- the location of the person's fixed landline through which the service is supplied to them; or
- other commercially relevant information.

The supplier can use one or more pieces of other commercially relevant information to determine whether a person is resident in New Zealand, rather than using the other proxies that are listed. Examples of other commercially relevant information are the customer's trading history (such as the previous billing address of the customer) or the product purchased if it is linked to a geographic location (for example, some gift cards may only be used in a particular country). Information provided by a third party, such as by a payment service provider, can also be used if it is commercially relevant.

The rules are therefore intended to provide flexibility for suppliers, as the information that will be available to different businesses will vary and may change due to changes in technology and new business models. Compliance costs are reduced when a business is able to use information that it routinely collects through its normal processes, rather than having to request additional information from its customers for tax purposes.

Under proposed section 8B(3)(a), if a supplier has more than one set of evidence that meets the test, where one set supports the conclusion that the customer is resident in New Zealand and another supports the conclusion that the customer is resident in another country, the supplier is required to choose the more reliable set of evidence. Which items are more reliable will depend on the circumstances. For example, where the supplier applies the same price regardless of the country of the customer, the recipient's billing address could be a more reliable indicator than would otherwise be the case.

Example

Jacob, a New Zealand tax resident, purchases a navigational app on his phone while on holiday in the United States. The app store collects two pieces of evidence that supports the conclusion that Jacob is resident in New Zealand, which are his credit card information and the records of his billing addresses from transaction history with the app store.

The app store also has two pieces of evidence that suggest Jacob is resident in the United States, which are the SIM card in the phone he is using and his IP address. Proposed section 8B(3)(a) requires the app store to use the set of evidence that is more reliable to determine whether GST applies in New Zealand.

The app store has implemented system rules that give priority to its customers' credit card information and transaction history, as these indicators are more reliable in the context of their business. On this basis, the app store treats Jacob as a New Zealand resident, and charges New Zealand GST on the supply.

To provide additional flexibility, proposed section 8B(3)(b) enables the Commissioner of Inland Revenue to prescribe an alternative method of determining whether a customer is resident in New Zealand, in circumstances where sufficient information is not commercially available to apply the test. This information could be published by the Commissioner.

Non-double taxation rule

Under the current place of supply rules, GST would apply to services that are physically performed in New Zealand and supplied to a non-resident who is in New Zealand. However, according to the OECD guidelines, if that service was a remote service, the country of the consumer's usual residence would have taxing rights over this consumption.

Proposed section 20(3)(dc) prevents double taxation from arising on supplies of remote services that are physically performed in New Zealand to a non-resident consumer in New Zealand, by allowing a deduction that offsets their liability for GST in New Zealand to the extent that the supply has already been taxed in another jurisdiction.

Proposed section 20(3)(dc) provides a deduction for the New Zealand GST charged when:

- there is a supply of remote services that are physically performed in New Zealand and supplied to a non-resident person in New Zealand who is not registered for New Zealand GST; and
- the supplier has, in relation to the supply, incurred liability for, returned and paid a consumption tax in another jurisdiction.

The deduction will be limited to the extent of the consumption tax paid in the other jurisdiction.

Example

After the proposed Australian rules for cross-border services are implemented, Book Co. a New Zealand seller of e-books, supplies e-books to an Australian resident who is temporarily in New Zealand on holiday. Book Co. is liable for and has returned and paid GST in Australia. Therefore, new section 20(3)(dc) will allow it to claim a deduction against the New Zealand GST charged on the supply. As the Australian GST rate is 10%, Book Co. effectively returns output tax of 5% on the supply.

Effect on suppliers' residency and income tax obligations

Although these amendments treat certain services provided by non-residents as "supplied in New Zealand", there is no intention that this will have a broader impact on whether a supplier is a resident of New Zealand for GST or income tax purposes, or whether a supplier has a "permanent establishment" in New Zealand.

The definition of "resident" in the GST Act includes a resident as defined in the Income Tax Act 2007. For GST purposes, a person is also considered to be a resident of New Zealand to the extent that the person carries on a taxable activity or other activity in New Zealand, and has a fixed or permanent place in New Zealand relating to that activity. The proposed amendments will not affect the extent to which a person carries on an activity in New Zealand, despite their effect of making certain supplies taxable for GST purposes.

Double tax agreements primarily deal with whether a resident of one country is subject to income tax on income derived in another country. The concept of "permanent establishment" is used in double tax agreements between New Zealand and other countries. Under double tax agreements, a company that does not have a "permanent establishment" in New Zealand will have no New Zealand income tax. The fact that a supplier is registered for New Zealand GST under the proposed rules should not affect whether or not the supplier has a "permanent establishment" in New Zealand for double tax agreement purposes or the application of the definition of resident used for GST purposes.

SUPPLIES TO NEW ZEALAND GST-REGISTERED BUSINESSES

(Clauses 47(2), 47(5), 47(6), 47(7), 49(1,), 49(2), 50, 52(2), 53(2), 53(3), 55(4), 55(5), 56, 57(1), 57(2), 59(1), 59(2), 60(1,) 60(2) and 64)

Summary of proposed amendment

The bill proposes that supplies to New Zealand-registered businesses (business-to-business supplies) will not be subject to GST unless the supplier and recipient agree to zero-rate the supply. Zero-rating the supply would allow the offshore suppliers to deduct any New Zealand GST costs incurred (in the same way as resident suppliers).

There will be special rules when GST is inadvertently charged to a New Zealand GST-registered person and when a GST-registered person receives a remote service from a non-resident supplier and uses it, or intends to use it, for non-taxable purposes.

Key features

Currently, section 8(4) treats supplies of goods and services by a non-resident person to a GST-registered person, as being made outside New Zealand (and so not subject to GST) unless the suppler and recipient agree that the supply is treated as being made in New Zealand (subject to GST). Under the proposed rules, this section will also apply to remote services supplied to persons resident in New Zealand to which proposed section 8(3)(c) applies.

This means that remote services provided by a non-resident to a GST-registered person will be considered to be supplied outside New Zealand, unless the supplier and recipient agree that the supply be treated as being supplied in New Zealand.

If the supplier and recipient come to an agreement, proposed section 11A (1)(x) will apply to zero-rate the supply. This allows the supplier to deduct any New Zealand GST costs incurred in relation to the supply.

As a consequence of these rules, non-resident suppliers may be required to identify whether a New Zealand-resident recipient of the supply is GST-registered. Proposed section 8B(4) and (5) require the supplier to treat the recipient as not being a registered person unless the recipient:

- notifies the supplier that they are a registered person; or
- provides the supplier with their registration number or New Zealand business number.

GST-registered recipients of remote services should not identify themselves as a GST-registered person, or provide their GST registration number or a New Zealand business number, if they intend to use the service for 100 percent non-taxable purposes.

The Commissioner will be able to agree with a supplier on the use of another method to determine whether the supply is made to a registered person (see proposed section 8B(6)).

Invoices

A non-resident supplier will not need to provide a tax invoice in relation to supplies of remote services under section 8(3)(c) (see proposed amendments to section 24(5)). However, under proposed section 24(5B), a non-resident supplier can choose to provide a full tax invoice if the recipient has been inadvertently charged GST and the payment for the supply is NZ$1,000 or less (inclusive of GST).

Input tax deductions

Under proposed section 20(4C), a recipient will not be able to claim an input tax deduction for a supply of remote services, unless the recipient has obtained a tax invoice under section 24(5B), resulting from the recipient being inadvertently charged GST and the consideration for the supply is NZ$1,000 or less.

The recipient will not be denied an input tax deduction when the supply is treated as made in New Zealand by the recipient of the supply (under section 5B) and the recipient has applied the reverse charge under section 8(4B).

Incorrect GST treatment

When a GST-registered recipient is inadvertently charged GST, a non-resident supplier may make an output tax adjustment in the return when it is apparent that a mistake has been made, under amendments proposed to section 25(1)). These amendments apply when:

- the supply was standard-rated when it should not have been treated as a taxable supply (see proposed subsection 25(1)(aab)); or
- the supply was standard-rated when it should have been zero-rated (see proposed subsection 25(1)(abb)).

A non-resident supplier will have the option to issue a tax invoice when the recipient has been inadvertently charged GST at the standard-rate when it should not have been taxed or should have been taxed at zero percent (see proposed section 24(5B)(a)(i) and (ii)). However, the non-resident supplier may only provide a tax invoice when the consideration for the supply is NZ$1,000 or less, and the recipient notifies the supplier that he or she is a registered person (see proposed section 24(5B)(b) and (c)).

When the remote supply has been incorrectly taxed, and the supplier opts to issue an invoice, the invoice must contain all the details in existing section 24(3) (see proposed section 24(4)). The provision of a tax invoice allows the GST-registered recipient to claim the inadvertently charged GST to the extent to which the recipient uses the services, or the services are available for use in, making taxable supplies.

The option to provide a tax invoice is not available to the supply of a contract of insurance (see proposed section 24(5C)).

When a non-resident supplier opts to provide a tax invoice under section 24(5B):

- the supplier must not make an adjustment under section 25 to correct the amount of GST shown on the invoice (see section 25(1)(aab)(ii) and exception to section 25(1)(abb));
- the supplier and recipient are deemed to have agreed that the supply is made in New Zealand (and so is subject to GST) under section 8(4) (see proposed section 24(5D)); and
- the proposed zero-rating provision under section 11A(1)(x) does not apply (see proposed exception to the zero-rating provision under section 11A(7)).

Reverse charge

A proposed amendment to section 8(4B) extends the existing reverse charge to supplies of remote services that are not treated as being made in New Zealand under section 8(3)(c) and (4). The reverse charge applies if the percentage intended or actual use of the services is less than 95 percent of the total use. The reverse charge treats the services as being made in New Zealand by the recipient in the course and furtherance of a taxable activity carried on by the recipient (see section 5B).

A new reverse charge is also proposed in relation to zero-rated supplies received by a registered person. Proposed section 20(3JC) will require the recipient of a remote service under new section 8(3)(c), that is zero-rated under 11A(1)(x), to return output tax on the nominal GST component for any non-taxable use of the services. Consistent with section 8(4B), this proposed section will only apply when at the time of acquisition, or at the end of an adjustment period, the taxable use of the service is less than 95 percent.

Background

A feature of the proposals is the fact that business-to-business supplies are excluded (unless the parties agree to zero-rate the supply). From a revenue perspective, there is little value in applying GST to business-to-business supplies as the GST-registered recipient would, in most cases, be able to claim back the GST in their normal GST return, resulting in no net GST liability. Other advantages of excluding business-to-business supplies include:

- Tax invoice requirements can be relaxed because no New Zealand consumers charged with GST would be in a position to claim back the GST.
- There are some fiscal risks associated with applying GST to business-to-business supplies, which would arise if any offshore supplier purported to charge GST but did not return the GST. Registered New Zealand businesses would then seek to claim the GST back in the normal manner.
- Excluding business-to-business supplies is consistent with how similar rules have been applied in other countries.

Because business-to-business supplies are proposed to be excluded, special rules are required when a GST-registered recipient acquires or uses the services they receive from a non-resident supplier for non-taxable purposes (such as private purposes or for making exempt supplies). In these situations, a GST-registered recipient should be treated in a similar way to a final consumer, otherwise the services may be under-taxed. It is therefore proposed that the existing reverse charge (section 8(4B)) and a proposed reverse charge for the receipt of zero-rated supplies (section 20(3JC)) will apply to ensure GST is returned by the GST-registered recipient on the portion of non-taxable of the service.

This would ensure that businesses receiving services and intangibles from an offshore supplier, other than for making taxable supplies, are treated in the same way as individual consumers.

Detailed analysis

Section 8(4) will apply to supplies made under proposed section 8(3)(c), so that remote services that are supplied to GST-registered businesses will be treated as being supplied outside New Zealand, unless the supplier and the GST-registered recipient agree that the supply is a taxable supply. Where the parties have agreed, these supplies will be zero-rated under proposed section 11A(1)(x).

Example

Accommodation Co. is a non-resident company that provides facilitation services, in that it matches customers who are looking for accommodation in a particular location with local providers of these services.

The facilitation services provided by Accommodation Co. to the local accommodation providers are remote services, as there is no necessary connection between the location of the recipients and the place where the facilitation services are performed.

If the local providers are not registered for GST, these supplies will be subject to GST under section 8(3)(c), as the facilitation services are remote services that are supplied to a New Zealand resident who is not a GST-registered business.

If the local providers are registered for GST, then under section 8(4) the facilitation services will be treated as being supplied outside New Zealand, unless Accommodation Co. and the local accommodation providers agree that these supplies are zero-rated. If Accommodation Co. incurs New Zealand GST costs, it may wish to agree with the local providers of accommodation to make these supplies zero-rated, as this would allow them to deduct these costs incurred in New Zealand in making the supplies.

As a result of these rules for business-to-business supplies, non-resident suppliers will need to differentiate between individual consumers and GST-registered businesses. When similar rules have been applied in other countries, GST or Value Added Tax (VAT) numbers are used to identify a business customer. Similarly, the proposed rules require the supplier to treat the supply as being to a consumer, unless the recipient notifies the supplier that they are registered or provides their GST registration number or a New Zealand business number. Note that GST-registered recipients of remote services should not identify themselves as a GST-registered person, or provide their GST registration number or a New Zealand business number, if they intend to use the service for 100 percent non-taxable purposes.

Non-resident suppliers with services targeted at individual consumers can assume those recipients are not GST-registered and apply GST at the 15% rate. Suppliers may collect further information if it is likely that the services they provide may be purchased by GST-registered businesses.

It is recognised that it may not be practical for all suppliers to ask for evidence that a customer is GST-registered. Therefore, to provide additional flexibility, the proposed rules allow the Commissioner to agree an alternative method to determine whether the supply is made to a GST-registered person. The Commissioner's discretion is expected to apply in situations when a supplier distinguishes between businesses and individual consumers due to the nature of the services they supply and can provide evidence that the services targeted at businesses are supplied to GST-registered businesses.

Example

Software Co. is a non-resident that provides software to New Zealand businesses and individual consumers. Factors such as price, and licensing terms and conditions mean that there is a clear division between the software purchased by businesses and individual consumers. Businesses that purchase the software are likely to be GST-registered persons.

Software Co. has a large number of customers and it is impractical to ask for evidence to identify their customers as GST-registered. Software Co. is able to apply to the Commissioner to use an alternative method for identifying whether their customers are GST-registered persons.

Evidence such as the nature of the products, pricing, licensing terms and other conditions could be used, as well as a sample of their customer base that supports the notion that future customers will be GST-registered.

GST inadvertently charged to a GST-registered recipient

There may be instances when a non-resident supplier accidently treats a GST-registered business as an individual consumer and therefore charges the business GST. In this situation, the GST-registered recipient should seek a refund from the non-resident supplier and not claim an input tax deduction for the inadvertently charged GST (see proposed deduction prohibition under section 20(4C)). There is, however, a proposed exception to the deduction prohibition for supplies under NZ$1,000 (see commentary below).

Proposed amendments to section 25(1) will allow a supplier to make adjustments to the payment of output tax in the return in which it is apparent that the mistake has been made. This will apply when the supply was standard-rated when it should not have been treated as a taxable supply (see proposed subsection 25(1)(aab)), or the supply was standard-rated when it should have been zero-rated (see proposed subsection 25(1)(abb)).

Note that an adjustment will only be required if the non-resident supplier has already furnished a return and has accounted for an incorrect amount of output tax as a result of the mistake (see existing section 25(1)(e)). If the mistake becomes apparent before the relevant return has been furnished, the mistake will be able to be rectified before the return is filed.

Since non-resident suppliers are not required to provide a tax invoice under the amendment to section 24(5), they will not be required to issue a credit note under section 25(4).

Supplies of $1,000 or less

An exception to the above rules applies when the payment for the supply (including GST) is NZ$1,000 or less. In this situation, when the supplier inadvertently charges a GST-registered recipient GST, the supplier can choose to provide a full tax invoice to the GST-registered recipient. This option is intended to be a compliance-saving measure for non-resident suppliers in relation to low-value supplies, when the cost of issuing a refund may exceed the cost of issuing a tax invoice. Note that if the supplier chooses to provide a tax invoice, the supplier must provide a full tax invoice, even if the payment for the supply (including GST) is less than $50 (see amendments to section 24(5)).

The tax invoice must be a full invoice as set out in section 24(3), and therefore must contain the following particulars:

- the words “tax invoice” in a prominent place;
- the name and registration number of the supplier;
- the name and address of the recipient;
- the date upon which the tax invoice is issued;
- a description of the services supplied;
- the quantity of the services supplied;

and either—

- the total amount of the tax charged, the consideration, excluding tax, and the consideration, inclusive of tax for the supply; or
- where the amount of tax charged is the tax fraction of the consideration, the consideration for the supply and a statement that it includes a charge in respect of the tax.

An exception to the deduction prohibition (discussed above, under section 20(4C)) allows the GST-registered recipient to claim an input tax deduction under the normal deduction provisions to the extent to which the services are used for, or available for use, in making taxable supplies.

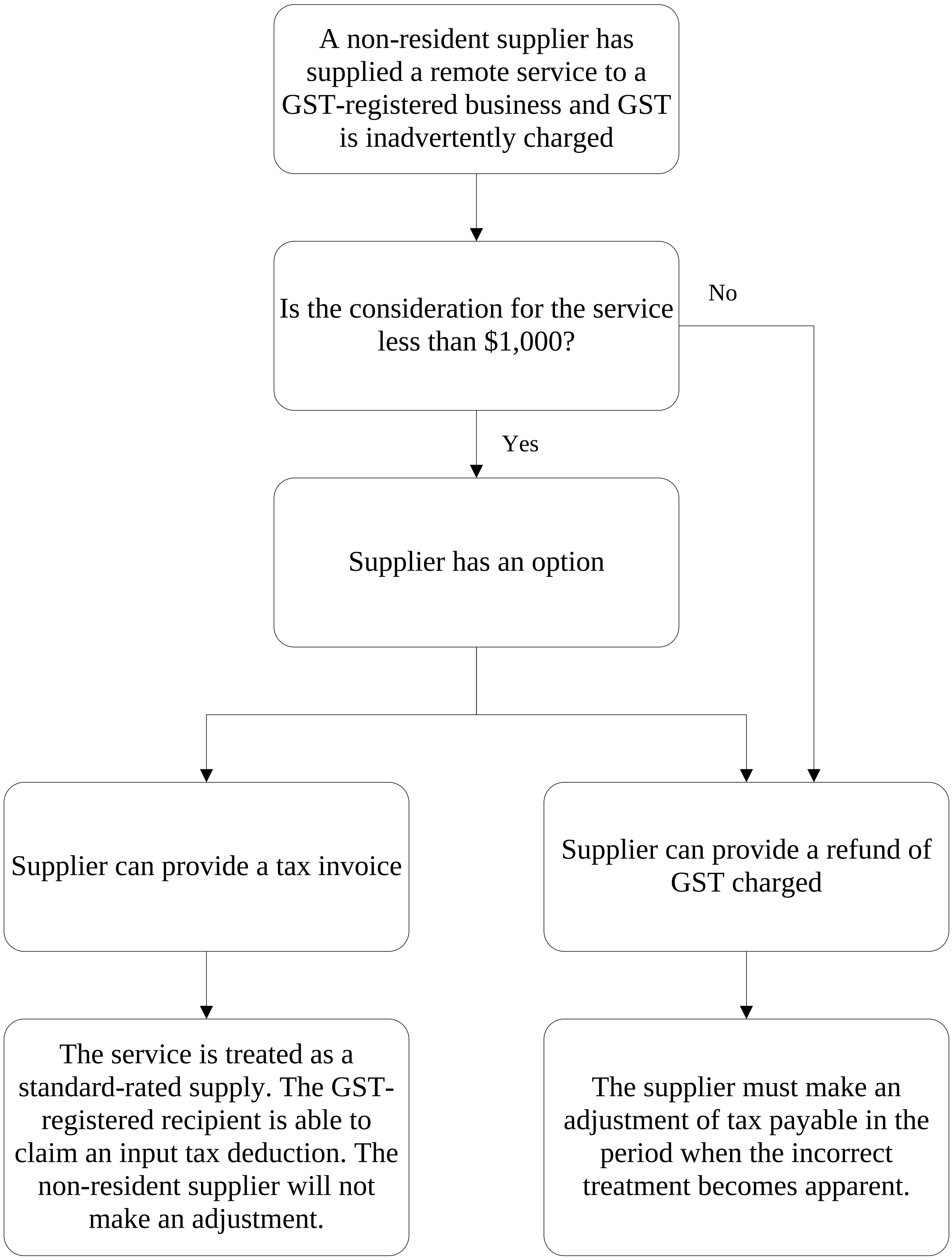
If the supplier chooses to provide a tax invoice;

- the supplier is not required to make an adjustment under section 25 to correct the amount of GST shown on the invoice (see section 25(1)(aab)(ii) and exception to section 25(1)(abb));

- the supplier and recipient are treated as having agreed that the supply is made in New Zealand (and therefore subject to GST) under section 8(4); and
- the proposed zero-rating provision under section 11A(1)(x) does not apply (see proposed exception to the zero-rating provision under section 11A(7)).

These provisions are intended to turn a supply that should not have been taxed or was taxed at zero percent, into a supply that is taxed at the standard rate of 15%. In this situation, the correct amount of GST is returned by the supplier and therefore an adjustment to the supplier's GST return, under section 25, is not required.

The diagram below summarises how these rules will apply.



The option to provide a tax invoice is not available for the supply of a contract of insurance (see section 24(5C) and the commentary on the special provisions that apply to contracts of insurance).

Reverse charge (GST-registered recipient of remote services)

An amendment to the existing reverse charge under section 8(4B) will require recipients of a remote service under new section 8(3)(c), that are not treated as being supplied in New Zealand, to return output tax on the supply if the percentage intended or actual use of the services is less than 95 percent of the total use.

An exception (proposed section 20(4D)) to the prohibition on input tax deductions (proposed section 20(4C)) allows a recipient of remote services, that is required to return output tax under the reverse charge, to claim an input tax deduction to the extent to which the services are used for, or available for use, in making taxable supplies.

Example 1

Melissa is a self-employed project manager who is registered for GST. She purchases a software package from an offshore supplier for $400 and identifies herself as a GST-registered person and therefore is not charged GST. She uses the software 50 percent for her taxable project management services and 50 percent for home/recreational use.

Under the reverse charge, Melissa is treated as making a supply to herself of $400 at the 15% rate. She must return output tax of $60 ($400 x 15%). However, Melissa can claim an input deduction for the portion of the value of the software package (50 percent) that is attributed to her taxable use. This input tax deduction is $30 ($60 x 50 percent). Her net position in the relevant return (assuming no other supplies) is therefore an output tax liability of $30 ($60 output tax minus $30 input tax).

If Melissa's taxable use of the software package had been 95 percent or more, she would not have been required to apply the reverse charge.

The existing reverse charge only applies when the supply of services is not treated as a supply being made in New Zealand. Therefore, the reverse charge under section 8(4B) will not apply when the non-resident supplier and the recipient agree to treat the service as being made in New Zealand under section 8(4) as the service will be zero-rated under section 11A(1)(x).

In this situation, proposed section 20(3JC) requires the recipient of a remote service under section 8(3)(c), that is zero-rated under proposed section 11A(1)(x), to return output tax on the nominal GST component for any non-taxable use of the services. The nominal GST component is the tax that would be chargeable on the value of the supply, as if the value were equal to the consideration charged on the supply.

This proposed section will only apply when at the time of acquisition, or at the end of an adjustment period, the taxable use of the service is less than 95 percent. This is consistent with the application of the reverse charge under section 8(4B). This provision is also similar to the existing reverse charge applied to recipients of zero-rated supplies of land under section 20(3J).

Example 2

Consider the same example as above (example 1), however, this time Melissa agrees with the supplier to treat the service as a supply in New Zealand, in which case the service is zero-rated under section 11A(1)(x). Because the supply is zero-rated, Melissa will be required to return output tax on the nominal GST component for any non-taxable use of the services under section 20(3JC).

Since the value of the software is $400, the nominal GST component is $60 ($400 x 15%). The amount of output tax Melissa is required to return is $30; this is calculated by multiplying the nominal GST component ($60) by the non-taxable use of the service (50 percent).

Note that an equivalent amount of tax is paid on the services as with the application of section 8(4B).

Amendments are also proposed to existing sections 10(15C) (reduction of value of related party internal charges), 24B (records to be kept by recipient of imported services), and 56B (branches and divisions in relation to certain imported services) to ensure these provisions apply when the recipient is required to apply the proposed reverse charge under section 20(3JC).

Reverse charge for supplies of $1,000 or less

There may be instances when a GST-registered recipient applies the reverse charge and the non-resident supplier also inadvertently charges the GST-registered recipient GST. In this situation, GST may be returned twice on a single supply (by the non-resident supplier and the GST-registered recipient). This issue will likely be resolved if the non-resident supplier subsequently returns the GST to the GST-registered recipient and makes an adjustment under section 25 as described previously (note that an adjustment may still be necessary under section 25AA(1)(a)(iii) to ensure the correct amount of tax is accounted for under the section 8(4B) reverse charge).

To ensure the correct amount of tax is paid in a situation when the supplier provides a tax invoice under section 24(5B), an addition to section 25AA will allow the GST-registered recipient to correct the amount of output tax paid and deductions claimed as a result of the application of the reverse charge under section 8(4B). The recipient will then be able to claim, in the normal manner, the portion of the GST charged by the non-resident supplier to the extent to which the services are used for, or available for use, in making taxable supplies.

Example 3

Consider example 1 again, where Melissa has applied the reverse charge under section 8(4B). However, she subsequently finds out that the price for the software included GST at the standard 15% rate (3/23 x $400 = $52.17).

Melissa contacts the non-resident supplier and seeks a refund for the incorrectly charged GST. Instead of providing a refund, since the consideration for the supply is $1,000 or less, the supplier issues Melissa with a full tax invoice.

The tax invoice enables Melissa to claim an input tax deduction to the extent the services are used for, or available for use, in making taxable supplies, which means she can deduct $30. The non-resident supplier is also not required to make any adjustments under section 25.

Under proposed section 25AA(1)(a)(v), Melissa makes an adjustment in the return during which it is apparent that a mistake has been made to the amount of output tax and deductions claimed as a result of the application of section 8(4B). Melissa can claim a deduction under section 20(3) for the output tax actually accounted for ($60 – section 25AA(2)) and return output tax for the deduction actually claimed ($30 – section 25AA(3)).

ELECTRONIC MARKETPLACES

(Clauses 47(3), 65 and 66)

Summary of proposed amendment

Special rules will apply when remote services are supplied through an electronic marketplace to a New Zealand-resident consumer. The proposed rules will require the non-resident operator of the marketplace, as opposed to the underlying supplier, to register and return GST.

Key features

Definition of "electronic marketplace"

An addition to section 2 will define an electronic marketplace as a marketplace that is operated by electronic means through which a person (the underlying supplier) makes a supply of remote services by electronic means through another person (the operator of the marketplace) to a third person (the recipient).

This definition includes a marketplace operated via a website, internet portal, gateway, store, distribution platform or other similar marketplace. It excludes a marketplace that solely processes payments.

Non-resident electronic marketplace rule

Proposed section 60C will apply to supplies of remote services made to a person resident in New Zealand through an electronic marketplace operated by a non-resident. The section treats the operator of the electronic marketplace, as opposed to the underlying supplier, as making the supply in the course or furtherance of a taxable activity.

Proposed section 60C will not apply when:

- the documentation provided to the recipient identifies the supply as made by the underlying supplier and not the marketplace; and
- the underlying supplier and the operator of the marketplace have agreed in a document signed by them that the supplier is liable for the payment of tax; and
- the electronic marketplace does not:
  - authorise the charge to the recipient;
  - authorise the delivery to the recipient; or
  - set the terms and conditions under which the supply is made.

Subsection 60C(3) will apply when multiple electronic marketplaces may be liable to register and return GST in relation to a supply of remote services. In this situation, the first operator that authorises a charge or receives payment for the supply is treated as making the supply. If no operator exists that meets this requirement, the first operator that authorises delivery of the supply is treated as making the supply.

Subsection 60C(4) ensures that the electronic marketplace rules override the general agency rules under section 60(1).

Specific rule for resident underlying suppliers

Proposed section 60(1B) is a specific rule that applies to New Zealand-resident suppliers supplying remote services through an electronic marketplace. In this situation, the supplier and marketplace may treat the supply as two separate supplies:

- a supply of services from the underlying supplier to the operator; and
- a supply of those services from the operator of the marketplace to the recipient.

Background

An electronic marketplace is generally in a better position to register and return GST on supplies than the underlying suppliers. Typically, the electronic marketplace would be larger, better resourced and have a closer relationship with the customer. Requiring the electronic marketplace to register may also reduce the compliance costs, from a large number of smaller suppliers not having to register for GST.

Requiring intermediaries to register for GST in this context has been a relatively recent international development. Australia announced proposed rules that would require an operator of an "electronic distribution platform" to register and return the GST. This will occur when the operator controls any of the key elements of the supply such as delivery, charging or terms and conditions. These proposed rules are modelled on similar rules currently in operation in the European Union and Norway.

It is likely that many of the electronic marketplaces that will be required to register under the proposed rules will already be registered in Member States of the European Union and Norway. Therefore, to avoid confusion and to promote compliance, the rules proposed are intended to be consistent with the rules in these other jurisdictions.

Detailed analysis

Definition of "electronic marketplace"

A marketplace is a medium that allows consumers and suppliers of goods and services to interact in order to facilitate the sale and purchase of the goods and services. The marketplaces we envisage here are virtual marketplaces where consumers and suppliers do not physically interact (typically, online marketplaces).

The proposed definition of electronic marketplace requires that:

- the marketplace allows underlying suppliers to make supplies of remote services through the marketplace to customers;

- the marketplace must be operated by electronic means, including by a website, internet portal, gateway, store, distribution platform or other similar marketplace; and
- the supplies made by the marketplace must be made by electronic means.

In the context of the proposed rules that apply to supplies of remote services, the proposed marketplace rules will apply to virtual or electronic marketplaces. The proposed definition of "electronic marketplace" therefore captures marketplaces that are operated by electronic means, including via a website, internet portal, gateway, store, distribution platform or other similar marketplace. The supplies made through the marketplace must also be made by electronic means.

Payment providers will be excluded from the definition of "electronic marketplaces" as these providers merely facilitate the exchange of money between the supplier and consumer, rather than the exchange of the remote service itself.

Non-resident electronic marketplace rule

Proposed section 60C states that when a supply of remote services is made through a non-resident operator of an electronic marketplace to a person resident in New Zealand, the operator of the marketplace will be treated as making the supply in the course or furtherance of their taxable activity. As the rules will only apply to non-resident operators of electronic marketplaces through which supplies of remote services are made to New Zealand residents, this rule is not expected to affect existing GST arrangements that apply in the domestic context.

Proposed section 60C will treat the non-resident operator of the electronic marketplace as the supplier, when a supply of remote services is made through a non-resident electronic marketplace to a New Zealand resident.

However, the operator of the electronic marketplace will not be considered to have made the supply if they do not control any of the key elements of the supply, and the liability of the underlying supplier is made clear in the documentation relating to the transaction. Accordingly, under proposed section 60C, the non-resident operator of an electronic marketplace will be the supplier, unless all of the following conditions are satisfied:

- the electronic marketplace does not authorise the charge to the recipient, or authorise the delivery of the supply, or set the terms and conditions under which the supply is made;
- the documentation provided to the recipient identifies the supply as made by the underlying supplier and not the marketplace;
- the underlying supplier and the operator of the marketplace have agreed in writing that the supplier is liable for GST.

As a result of being treated as making the supply, the operator of the electronic marketplace will be responsible for returning GST. The operator of the electronic marketplace will include these supplies in their turnover for the purpose of determining whether the registration threshold is exceeded and, if it is exceeded, will be liable for the GST. The operator will make any adjustments arising from the supply, for example, when GST is refunded to a GST-registered business.

Specific rule for resident underlying suppliers

A specific rule in proposed section 60(1B) will apply to New Zealand-resident suppliers supplying remote services through an electronic marketplace. These underlying suppliers may already be registered for GST under the existing rules. If these suppliers were subject to the general rule under proposed section 60C(3), the services they supply through the electronic marketplace would no longer be taxable, as the operator of the marketplace will have been treated as the supplier. This would mean that GST incurred by the underlying supplier in making these supplies would be unrecoverable.

A specific rule is therefore proposed to treat the supply of remote services as two separate supplies – a supply of services from the underlying supplier to the operator, and a supply of those services from the operator of the marketplace to the recipient. The first supply to the marketplace is likely to be zero-rated under the existing provisions as the supply is to a non-resident outside New Zealand. This will generally enable the resident underlying supplier to recover the GST costs incurred in making the supply.

Example

Gaming Co. a New Zealand GST-registered app developer, contracts with Applications Co. a non-resident operator of an app store, to distribute its smartphone games. Applications Co. collects payments from customers and authorises delivery of the app.

Applications Co. is treated as the supplier under proposed section 60C, and therefore is responsible for GST on the supply. If Applications Co. makes supplies that exceed the registration threshold, it will be required to register and return GST on supplies of the remote services that are made through it to New Zealand-resident consumers.

Even though Applications Co. is treated as a supplier of the app due to proposed section 60C, under proposed section 60(1C), Gaming Co. and Applications Co. can agree to treat the supply from Gaming Co. to Applications Co. as a separate supply. This will allow Gaming Co. to deduct its GST costs incurred in making supplies to Applications Co.

GST ON CROSS-BORDER SUPPLIES OF INSURANCE

(Clauses 48(3), 48(4), 49(1), 55(1), 55(2) and 57(2))

Summary of proposed amendments

Consistent with the new rules for other supplies of remote services, the amendments will extend the special rules for general insurance to cross-border supplies of insurance services provided to New Zealand-resident consumers.

Key features

Insurance services are an example of "remote services", as there is no requirement for the recipient to be present when the services are performed.

As with other supplies of remote services under the amendments, the proposed new rules will:

- apply GST to insurance services supplied by offshore insurers to New Zealand-resident consumers (proposed section 8(3)(c)); and
- exclude insurance services supplied by offshore insurers to New Zealand GST-registered businesses from GST, unless the insurer and the recipient agree that these supplies will be zero-rated (existing section 8(4) and proposed section 11A(1)(x)).

The proposed amendments will ensure that when an offshore insurer and a GST-registered recipient agree that supplies of insurance services will be zero-rated, the insurer will not be entitled to a deduction for insurance payments on payments to that GST-registered recipient (proposed section 20(3)(d)(vii)), and the GST-registered recipient of the payment will not be required to return output tax under section 5(13) (proposed section 5(13)(d)).

The reverse-charge provisions in section 8(4B) and proposed section 20(3JC) will apply when a GST-registered business purchases insurance services that relate partly to private or exempt use.

The option to provide a tax invoice when GST is inadvertently charged on a supply for consideration of NZ$1,000 or less will not be available for insurance premiums charged to GST-registered businesses (proposed section 24(5C)).

Background

The GST Act contains special rules for general insurance that apply GST on a net cashflow basis, where a GST-registered insurer is required to return GST on insurance premiums received and claim a deduction for insurance payments. A GST-registered business is able to deduct input tax on the premiums it is charged and is required to return GST on insurance payments received.

These rules do not apply to the provision of life insurance, which is treated as exempt supplies of financial services under the GST Act.

Insurance services are an example of a remote service, as there is no necessary connection between the physical location of the insured party and the location where the insurance service is performed. Insurance services are performed and consumed over the period of the contract of insurance.

In the OECD's guidelines, insurance services are listed as an example of a remote service that, when supplied to a consumer, should be taxed in the consumer's usual residence.

Detailed analysis

The proposed rules that apply to cross-border supplies of insurance services provided by non-resident suppliers will differ depending upon whether the services are supplied to resident consumers or GST-registered businesses.

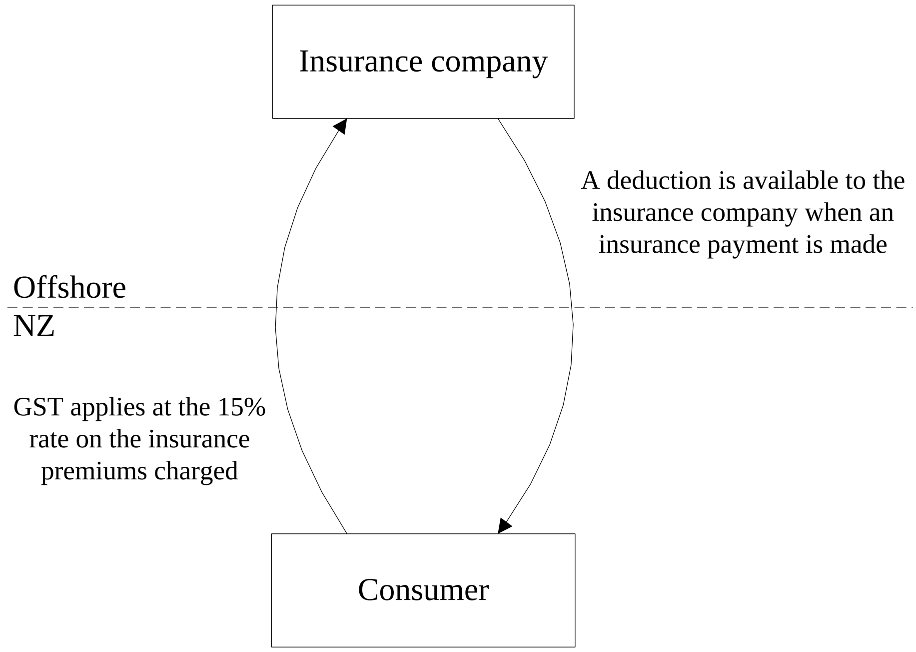
Supplies of general insurance services to New Zealand-resident consumers

Under the proposed amendments, a non-resident provider of insurance will be required to return GST on premiums charged to New Zealand-resident consumers (if its supplies to New Zealand residents exceed the registration threshold), as the supply of the contract of insurance will be taxable under proposed section 8(3)(c).

If registered, a non-resident insurer would also be able to claim a deduction when making an insurance payment under a contract with a New Zealand-resident consumer (through existing section 20(3)(d)), or on New Zealand GST costs incurred in paying for replacement goods or repair services.

The diagram below shows how the rules will apply to cross-border supplies of insurance to New Zealand residents who are not GST-registered businesses.

Cross-border supplies of general insurance services to New Zealand-resident non GST-registered consumers

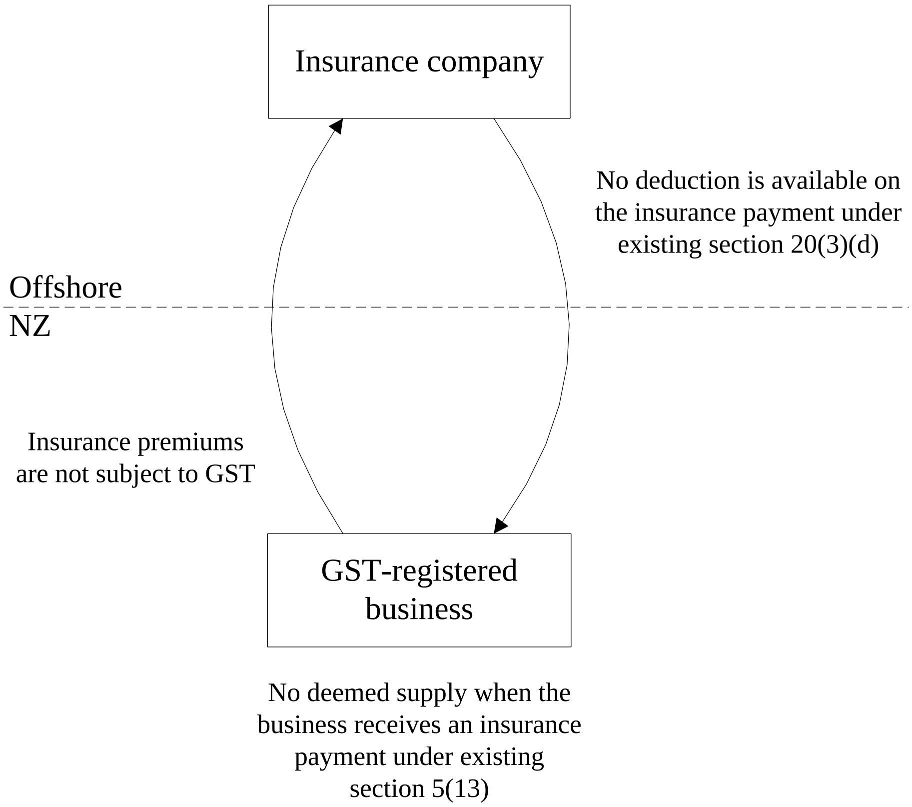


Supplies of general insurance services to New Zealand GST-registered businesses

Unless the insurer and the GST-registered recipient agree that the supply will be zero-rated under proposed section 11A(1)(x), cross-border supplies of insurance services to a GST-registered businesses will continue to be excluded from GST under the proposed amendments.

Consequently, a non-resident insurer will not return GST on premiums charged to GST-registered business customers, and will not be entitled to a deduction under section 20(3)(d). A GST-registered recipient of an insurance payment will not be required to return output tax on the payment under existing section 5(13). This means that the current arrangements for GST on supplies of insurance services by a non-resident insurer to a GST-registered business will not change, unless the parties agree that the contract of insurance is a zero-rated supply. The diagram below shows how the proposed rules will apply.

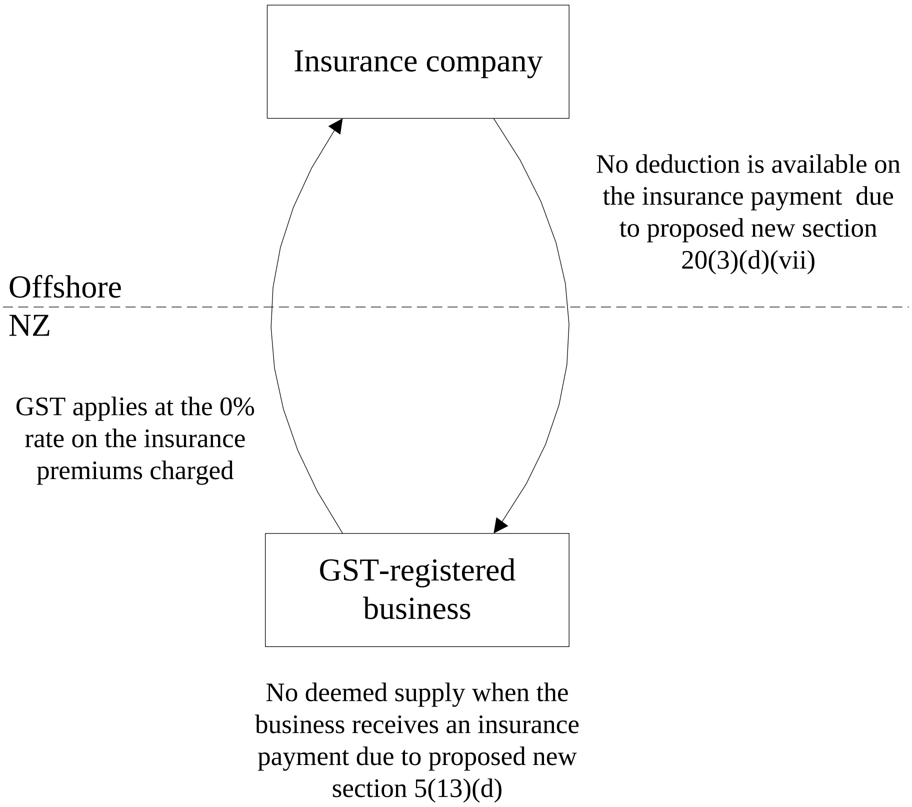
Cross-border supplies of insurance services to New Zealand GST-registered businesses (when the supply is not zero-rated)



If the non-resident insurer and GST-registered business customer have agreed that the supply of a contract of insurance will be zero-rated, GST will apply at 0% on the insurance premiums. This will allow the insurance company to claim back GST costs incurred in New Zealand in making these supplies, which could include costs incurred in repairing or replacing goods. This should mean that non-resident insurers, in the same way as resident insurers, are indifferent, from a GST perspective, about whether they make a payment to the insured GST-registered business, or replace or repair damaged goods.

However, amendments will ensure that an insurer is not entitled to claim a deduction for insurance payments under these contracts (proposed section 20(3)(d)(vii)), and that a GST-registered recipient of an insurance payment is not required to pay output tax under section 5(13) (proposed section 5(13)(d)). This treatment is equivalent to that in situations when the supply is treated as being made outside of New Zealand and the insurer and GST-registered business have not agreed that the supply will be zero-rated, with the exception of the non-resident insurer's ability to claim back related New Zealand GST costs. The diagram below shows how these rules will apply.

Cross-border supplies of zero-rated insurance services to New Zealand GST-registered businesses



No option to provide a tax invoice

The option to provide a tax invoice when GST is inadvertently charged on a supply for consideration of NZ$1,000 or less will not apply to supplies under a contract of insurance. Allowing this option would require changes to ensure that GST applies correctly on a cashflow basis, which would lead to significant complexity in the operation of the rules. Due to the nature of insurance services, an insurance company is likely to have access to the information to determine whether their client is a GST-registered business.

SUPPLIES OF REMOTE GAMBLING SERVICES

(Clauses 48(1), 48(2), 51 and 52(1))

Summary of proposed amendment

Payments made for remote gambling services or prize competitions by a New Zealand resident performed outside New Zealand are treated as a supply for GST purposes. Special rules will apply to determine the consideration for a remote supply of gambling services or prize competitions, based on amounts received from New Zealand residents, less a share of worldwide prizes.

Key features

Proposed section 5(10B) will treat payments for remote gambling services or prize competitions by a New Zealand resident performed outside New Zealand as payment for the supply of services by the person who conducts the gambling or prize competition.

An addition to section 5(11) will apply the definition of "gambling" under the Gambling Act 2003 to proposed section 5(10B).

Proposed section 10(14B) will apply to determine the consideration for the supply of remote gambling services or prize competitions for the purposes of proposed section 5(10B). The amount of consideration is:

$$\textit{resident amount} - \textit{worldwide prizes} \times \left(\frac{\textit{resident amounts}}{\textit{worldwide amounts}}\right)$$

Resident amounts, worldwide prizes and worldwide amounts are defined under section 10(14C) as follows:

- "resident amounts" is the total amount in money received in relation to the supply by the non-resident who conducts the gambling or prize competition from all the persons resident in New Zealand;
- "worldwide prizes" is the total amount of all prizes paid and payable in money worldwide in relation to the supply; and
- "worldwide amounts" is the total amount in money received worldwide in relation to the supply by the non-resident person who conducts the gambling or the prize competition.

Background

Gambling and prize competitions conducted in New Zealand are currently supplies for GST purposes. Gambling is defined under the Gambling Act 2003 as:

- paying or staking consideration, directly or indirectly, on the outcome of something seeking to win money when the outcome depends wholly or partly on chance;
- includes a sales promotion scheme;
- includes bookmaking; and
- includes betting, paying, or staking consideration on the outcome of a sporting event.

A "prize competition" is defined in the GST Act as a scheme or competition:

- for which direct or indirect consideration is paid to a person for conducting the scheme or competition;
- that distributes prizes of money or in which participants seek to win money; and
- for which the result is determined:
  - by the performance of the participant of an activity of a kind that may be performed more readily by a participant possessing or exercising some knowledge or skill; or
  - partly by chance and partly by the performance of an activity as described above, whether or not it may also be performed successfully by chance.

Currently, when these services are performed in New Zealand, the person who conducts the gambling or prize competition must determine the consideration for these supplies using the following formula:

$$\textit{amounts received} - \textit{prizes}$$

The amount received is the total of all amounts in money received in relation to the supply for gambling or a prize competition. Prizes are the total amount of all prizes paid and payable in money in relation to the supply.

The rules proposed ensure that gambling services and prize competitions performed in New Zealand are treated in the same way as supplies performed remotely outside New Zealand.

Detailed analysis

Gambling and prize competitions conducted outside New Zealand are likely to be supplied electronically (such as through an offshore gambling website). The person who conducts the gambling or prize competition is therefore likely to have participants in a number of countries. Prizes can also be paid out to any of these and the supplier is likely to have little influence over which participant receives a prize.

In this context, a rule for calculating consideration (the value of the supply with the addition of the tax charged) that reflects the existing rule for calculating consideration for gambling services performed in New Zealand (such as determining consideration by amounts received by New Zealand residents less prizes paid to New Zealand residents) may not be appropriate for gambling services performed outside New Zealand. This approach could produce arbitrary results, depending on the country in which the winner resides.

Example 1

Gambling Co. operates an offshore gambling website. Gambling Co. offers a game of chance to two participants, one in Australia and the other in New Zealand. The Australian resident and the New Zealand resident each make a payment of $100 to participate in the game of chance for a 50 percent chance to win $150.

Depending upon who won the prize, the amount of consideration calculated by Gambling Co. could vary significantly if consideration was solely based on amounts received by New Zealand residents less the amount of prizes paid to New Zealand residents.

If the Australian resident wins, the amount of consideration in New Zealand would be $100 ($100–$0); if the New Zealand resident wins, the amount of consideration in New Zealand would be nil ($100–$150).

To better reflect the level of services supplied to New Zealand residents, and to smooth out the amount of consideration for the gambling services attributed to New Zealand residents, the proposed rules determine the consideration for a remote supply of gambling services or a prize competition based on amounts received from New Zealand residents less the appropriate share of worldwide prizes.

The amount of consideration is proposed to be calculated using the following formula:

$$\textit{resident amounts} - \textit{worldwide prizes} \times \left(\frac{\textit{resident amounts}}{\textit{worldwide amounts}}\right)$$

Example 2

Consider again Example 1. Using the proposed formula for calculating consideration, the amount of consideration attributed to supplies to New Zealand residents will be $25 regardless of whether the prize is won by the Australian resident or the New Zealand resident:

$$\$25 = \$100 - \$150 \times \left(\frac{\$100}{\$100 + \$100}\right)$$

The proposed formula reflects the fact that remote gambling services performed outside New Zealand are likely to be supplied to a number of participants in a number of countries and will produce outcomes more consistent with the rules that apply to gambling services performed in New Zealand.

ADMINISTERING THE OFFSHORE SUPPLIER REGISTRATION SYSTEM

(Clauses 48(5), 54(1), 54(2), 58, 61, 67, 68 and 71)

Summary of proposed amendment

An amendment proposes that the Commissioner will have the discretion to require a person who has knowingly provided altered, false or misleading information to register for GST and to repay the GST that should have been charged, when their behaviour is repeated or when a substantial amount of GST is involved.

The proposed amendments contain several features that are intended to reduce the costs for offshore suppliers in complying with their obligations under the rules. These measures will be complemented by simplified registration and return filing processes that Inland Revenue is developing for these customers.

Key features

Misrepresentations by recipients of remote services

Proposed sections 5(27) and 51B(7) will provide a discretion for the Commissioner to require a person to register and pay GST that should have been charged, when the person has knowingly provided incorrect information that leads to GST not being charged on a supply, and this behaviour is repeated or a substantial amount of GST is involved.

Taxable periods

Proposed section 15(6) provides that between 1 October 2016 to 31 March 2017, a non-resident supplier of remote services that are taxed under the new rules will have a default taxable period of six months, with the option of a two-monthly taxable period. From 1 April 2017, these suppliers will have calendar quarterly taxable periods.

Inland Revenue intends to develop a tailored, simplified registration process for offshore suppliers registering under the new rules, which will be accessible through its website.

A simplified GST return is also expected to be developed that is tailored to the needs of offshore suppliers registering under the new rules. As many offshore suppliers would not incur GST costs in New Zealand and therefore would not need to claim back any GST in their returns, a simplified "pay-only" return would not include the fields that are not relevant to these customers. This "pay-only" GST return should be available when the Business Transformation programme is deployed in 2017. Offshore suppliers that are claiming input tax deductions for any New Zealand GST costs will be required to use the existing GST return.

Expressing amounts in a foreign currency

Amendments to section 77 are proposed that will allow a non-resident supplier of remote services that are taxed under the new rules to choose to express the amount of consideration for their supplies in a foreign currency at the time of supply, with the amounts being converted into New Zealand currency at the date of filing (or the due date if the return is filed after the due date).

Holding records outside New Zealand and in a language other than English

Proposed section 75(3F) will provide an automatic exception for non-resident suppliers who only supply remote services from the requirement to apply to the Commissioner for authorisation to keep and retain records in a language other than English or at a place outside New Zealand.

Exception from the bank account requirement

Proposed section 24BA(1B) of the Tax Administration Act 1994 will provide an exception for non-resident suppliers to the existing requirement for an offshore person to have a fully functional New Zealand bank account to obtain an IRD number, if this is required solely because they are a non-resident supplier of remote services that are taxed under the proposed rules.

Detailed analysis

Misrepresentations by recipients of remote services

Proposed sections 5(27) and 51B(7) provide a discretion for the Commissioner to require a person to register and pay GST that should have been charged, when:

- the person has knowingly provided information that is altered, false or misleading, which leads to a supply being treated as being zero-rated or as not being supplied in New Zealand; and
- the person has repeatedly knowingly, provided altered, false or misleading information, or the amount of GST that was not charged is substantial.

The existing "knowledge offences" are also expected to apply when a person deliberately supplies incorrect information for the purpose of avoiding GST by misrepresenting themselves as a registered business or as a resident of another country (section 143A of the Tax Administration Act 1994). A person convicted of a knowledge offence is liable for a fine of up to NZ$25,000 for a first-time offence, or NZ$50,000 for repeated offences.

If a customer provided incorrect false information to access content that is geographically restricted, which consequentially resulted in GST not being charged, the reverse charge in proposed section 5(27) and the existing knowledge offences would not be expected to apply.

Example

Luke purchases a number of remote services online, including online dating services, music and movie content. To avoid paying GST, Luke has used a false IP address, billing address and other details to mask the fact that he is a resident of New Zealand. On other occasions, he has provided a false GST registration number.

The Commissioner of Inland Revenue exercises her discretion to register Luke from the time the services were physically performed, and requires him to repay the GST that was not charged, plus penalties and interest.

Taxable periods

Currently, GST returns must be filed on a one-monthly, two-monthly or six-monthly basis, depending on turnover levels. Current systems are unable to support other taxable periods. However, these systems are expected to be replaced with a new solution during the first quarter of 2017, as part of Inland Revenue's Business Transformation programme.

For the period beginning 1 October 2016 to 31 March 2017, non-resident suppliers of remote services will have a default taxable period of six months, or an optional taxable period of two months. This initial six-month taxable period provides a "soft start" to the rules, as a non-resident supplier of remote services will be able to register, file and pay by 7 May 2017 without facing interest or penalties.

From 1 April 2017, non-resident suppliers of remote services that are subject to GST under the new proposed rules will have quarterly taxable periods. This is intended to align with these suppliers' filing obligations in other jurisdictions, to reduce their compliance costs.

Expressing amounts in a foreign currency

Currently, the GST Act requires that all amounts are expressed in New Zealand currency at the time of supply. This means that if a supply is paid for in a foreign currency, the value of the supply must be expressed as the amount of foreign currency converted to New Zealand currency at the exchange rate applying at the time of supply.

As this requirement could result in significant compliance costs for offshore suppliers who register under the new rules, amendments are proposed to section 77 that will provide non-resident suppliers of remote services with the option of expressing amounts in a foreign currency. The foreign currency amounts would then be converted into New Zealand dollars at the time of filing their return (or at the due date for filing, if the return was filed past the due date). To ensure that suppliers to do not switch between currencies to take advantage of currency movements, a "lock-in" rule will prevent the non-resident supplier from changing their election within two years.

Holding records outside New Zealand and in a language other than English

Proposed section 75(3BA) will provide an automatic exception to the requirement to keep and retain records in English or at a place in New Zealand for non-resident suppliers of remote services that are subject to GST under proposed section 8(3)(c).

Currently, a GST-registered person must apply to the Commissioner of Inland Revenue for authorisation to keep records at a place outside New Zealand or in a language other than English.

Exception from the bank account requirement

Recent amendments to the Tax Administration Act 1994 require an offshore person to have a fully functional New Zealand bank account in order to obtain an IRD number. This is to ensure that an offshore person has first been subjected to New Zealand's anti-money laundering and Countering Financing of Terrorism rules.

Proposed section 24BA(1B) will provide an exception to this requirement for non-resident supplier who required an IRD number solely because they are a non-resident supplier of remote services that are taxed under the proposed rules. As these suppliers will often have no connection with New Zealand other than supplying a remote service to New Zealand customers, this requirement would otherwise impose compliance costs, and may discourage GST registration.