

GST: CROSS- BORDER SERVICES, INTANGIBLES AND GOODS

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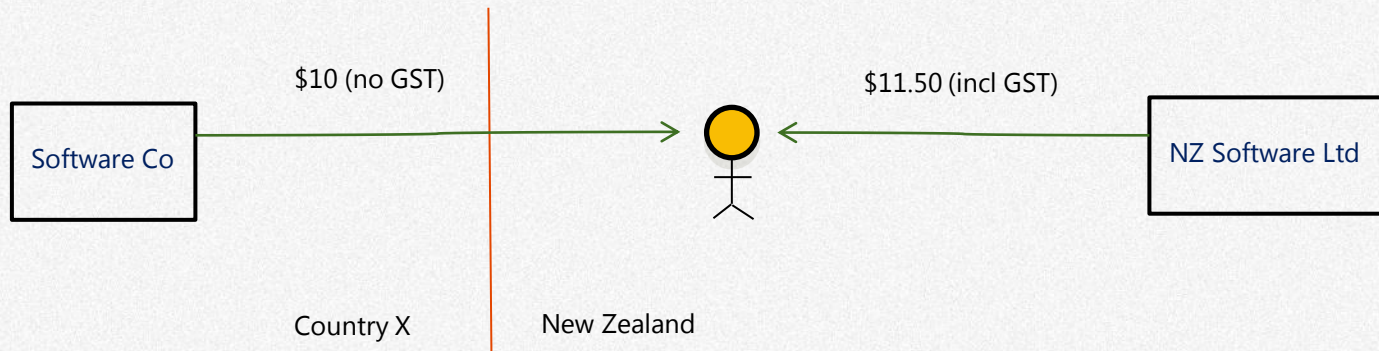
Background and proposal

Implications of non-collection

GST should apply evenly to all consumption that occurs in New Zealand as this helps to ensure that GST is fair, efficient and simple. At present imported services and low-value goods are not subject to GST.

The growth in online shopping has benefitted New Zealand by giving consumers access to a wider market and increasing competition in the domestic retail market. However, ideally, tax treatment should not be a consideration in consumers' purchasing decisions. When GST does not apply evenly, it may bias consumer decisions, which could lead to unfair and inefficient outcomes.

(The examples in this document assume the consumer is purchasing a software programme for NZ\$10, to which GST will be added if appropriate.)



All things being equal, the New Zealand consumer will purchase from the non-resident supplier in preference to the New Zealand supplier. The uneven GST treatment has biased consumer behaviour.

International developments

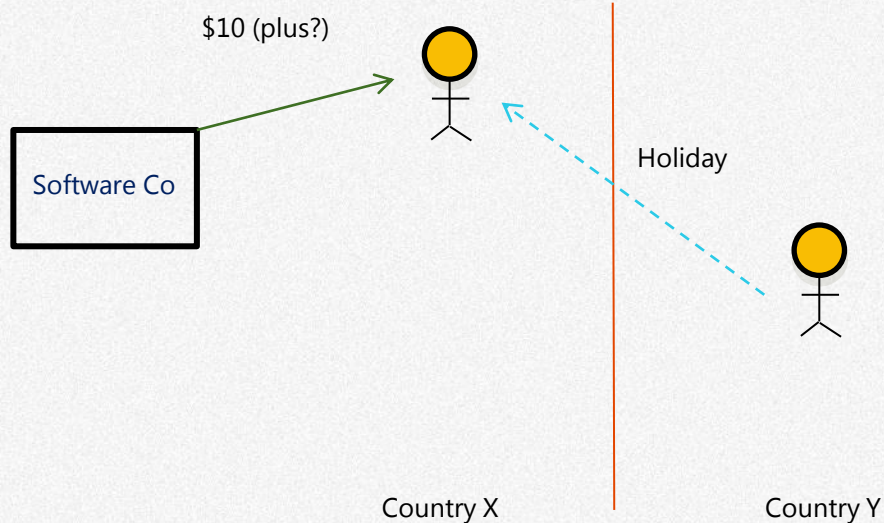
The OECD has developed draft guidelines addressing issues of double taxation and non-taxation that may arise from inconsistent application of GST in international trade

The OECD work on VAT/GST is part of the broader “base erosion and profit shifting” (BEPS) programme. For services and intangibles, the issue of which country has the right to tax arises. The taxing rights for goods is clear: it is the country of import that has the right to tax.

Sometimes it is not clear where a service is consumed and therefore which country should impose tax (see the example over the page). Without international consensus on taxing rights, it is possible that services could be taxed in two or more countries or not at all.

Draft OECD guidelines broadly divide cross-border services into “remote” services and “on-the-spot” services, with different treatment for each.

Double taxation and non-taxation



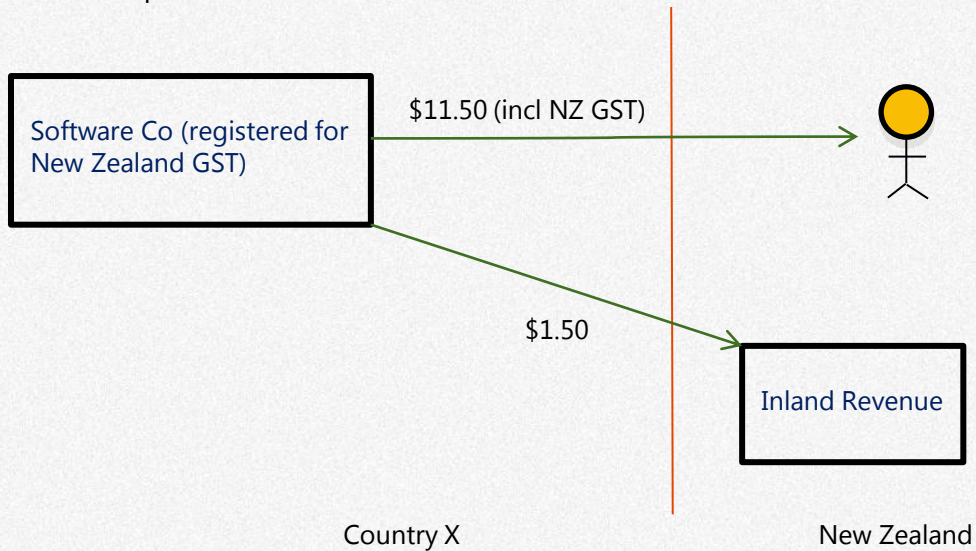
A consumer is a resident in Country Y and visits Country X for a holiday. While there he downloads software onto his phone.

Depending on the GST rules of Country X and Country Y, the customer could be taxed in Country X, Country Y, neither or both.

OECD recommended option

OECD recommended option

The OECD has suggested that, when a remote service is supplied to a person, the supplier of the service (Software Co in the example below) could be required to register and return GST in the country where the person is resident.



Proposed system for New Zealand

This document suggests that New Zealand adopt a model for cross-border services and intangibles that is consistent with OECD guidelines.

This would require non-resident providers of remote services to New Zealand tax residents to register for New Zealand GST and return GST on those sales.

These proposals broadly match legislation that already operates in the European Union, Norway, South Korea, Switzerland and South Africa. Similar rules have also been proposed in Australia and Japan.

Details of how this system might operate are discussed on the following pages.

It is anticipated that the GST treatment of low-value imported goods will be consulted on separately in the near future.

**Imported
low-value
goods**

Low-value goods

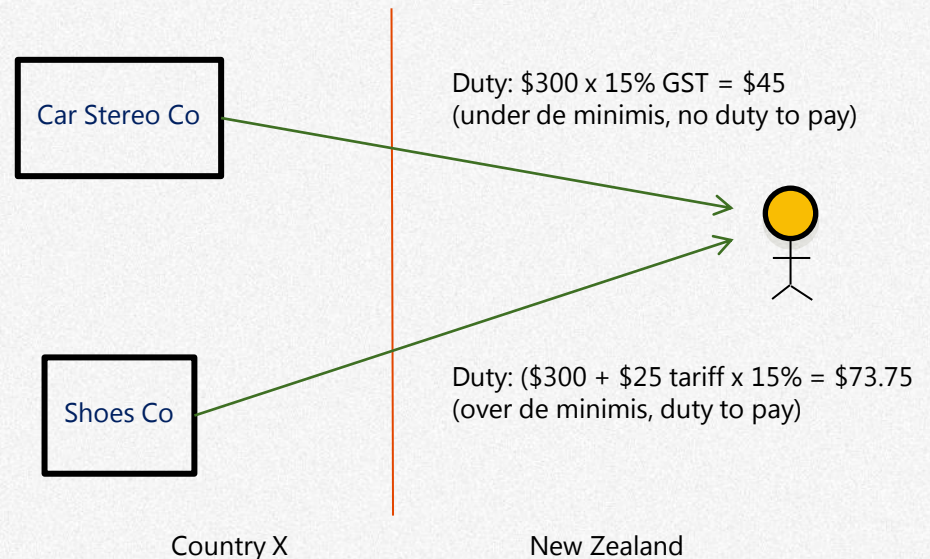
De minimis threshold

GST on imported goods is either collected at the border by Customs or on their behalf by courier companies, unless the total duty value (which includes GST, tariffs and other duties) is less than \$60. This is known as the de minimis threshold.

New Zealand is required to have a de minimis threshold. It is set at a level where the costs of collection exceed the revenue collected.

Example

A New Zealand consumer buys a car stereo and a pair of shoes online. Both cost NZ\$250 and have a NZ\$50 postage charge. The stereo attracts no tariff, but the shoes attract a 10% tariff.



Despite the goods having the same underlying value, the customer is required to pay GST on the imported shoes, but not the car stereo.

Lowering the de minimis and other collection options

Customs review

Customs has been asked to look at the options for simplifying GST collection and changing the level of the de minimis. They will report to Cabinet with options by October this year and it is anticipated that this will be followed by public consultation on the issue.

Potential future changes

It is currently the Government's intention to align, where possible, the collection of GST on imported goods with the proposals in the paper relating to the collection of cross-border services and intangibles.

However, no other country has adopted such a system and, therefore, the success of its application to goods is currently uncertain.

Issues to be resolved

Further work is required to determine the viability of options and whether they would in fact lower costs of collection.

It is likely that a combination of approaches would be required.

Place of supply rules

On-the-spot services

On-the-spot services

These are services that are performed at a certain location and consumed at the same time and place they are physically performed. Examples are:

- A hair cut
- Accommodation
- A restaurant meal
- Entry to a cinema, museum, sports event etc.

Who taxes these services?

These are services that should be taxed in the country where they are received. The current GST rules already provide this result, so it is not proposed that they change.

This means that on-the-spot services received offshore will remain outside the GST net altogether.

Example

A New Zealander on holiday in Australia pays for and visits a theme park. Australia has the right to tax that service and New Zealand does not.

Remote services

Remote services

These are services where the customer and supplier are not generally required to be in the same location and so are generally not consumed at the place they are performed. Examples are:

- Online supply of software
- Online supply of digital content (movies TV shows, music etc.)
- Consultancy, accountancy and legal services
- Financial and insurance services

Who taxes these services?

These are services that should be taxed in the country where the consumer is resident. This means that residence is treated as a proxy for consumption.

An example of what this means in practice follows.

Residence as a proxy: example



**Services
covered**

Definition of “services”

Broad definition of services

In New Zealand’s GST Act, “services” is broadly defined to include anything other than physical goods and money.

It is proposed that this definition be retained so that any new rules would cover all “remote” services (as mentioned earlier, this includes digital as well as traditional services such as legal advice).

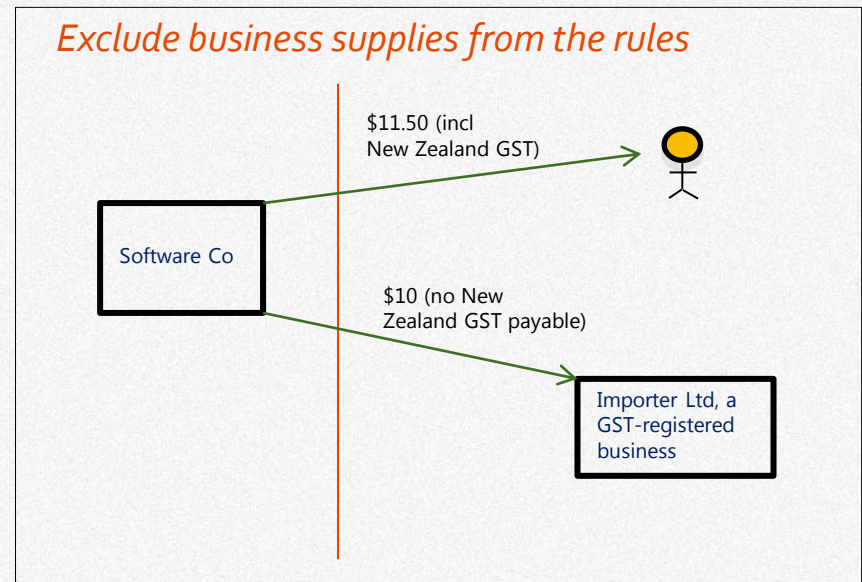
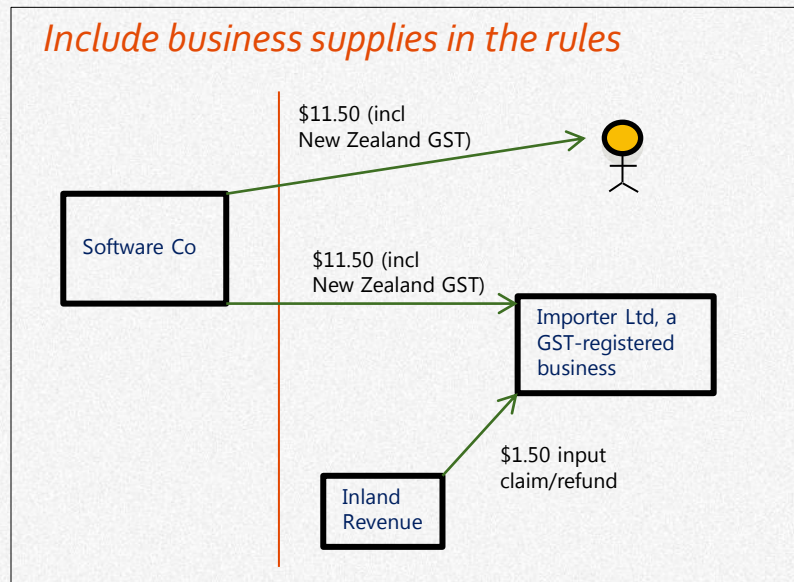
Although some countries have limited their version of these rules to digital services only, there is a risk that such restrictions could:

- Create customer biases between digital and non-digital services.
- Make the rules unnecessarily complex, as suppliers would be required to work out whether a service was “digital” and therefore subject to GST.

Supplies to GST-registered businesses

The options

It is suggested that GST always apply to “business-to-consumer” supplies. However, there are two options for supplies by non-residents to GST-registered New Zealand businesses.



In both examples, the net revenue collected from the transactions is the same. This is because the GST-registered business can normally claim back any GST charged. Therefore, it comes down to assessing the relative compliance costs on New Zealand and non-resident businesses and the revenue risks associated with each option.

**Who should
register?**

Electronic marketplaces

Registration by marketplaces

Non-resident suppliers can use electronic marketplaces to sell their services and intangibles to New Zealand consumers.

It is proposed that the marketplace be treated as the supplier and therefore be required to register.

When would the marketplace register?

It is proposed that an electronic marketplace would be required to be registered when the customers would normally consider the marketplace to be the supplier and this is reflected in the contractual arrangements. This could be when the marketplace:

- Authorises the charge to the customer
- Authorises delivery to the customer
- Sets the terms and conditions of the transaction

It is not suggested that these rules would require a payment service provider to register.

Registration threshold

Domestic threshold...

The domestic registration threshold is \$60k.

Applying this to non-resident sellers has the advantage of consistency, but:

- New Zealand is likely to be only a small part of their international market.
- Non-residents may be able to “fracture” their business into parts to come under the threshold.
- Non-residents under the threshold may be registered in their home country so could claim input tax there.

... or something lower?

A lower threshold would be in line with international norms. Countries with similar rules have low or (in the case of the European Union) nil thresholds.

A lower threshold could address concerns with applying the domestic threshold.

BUT, it could increase compliance costs on small/medium businesses selling into New Zealand.

Identifying New Zealand customers

Identifying New Zealand resident customers

Two options

Again, there are two main options for determining whether a customer is a New Zealand resident.

Option 1: Take reasonable steps

Rules could require the non-resident business to:

- Take reasonable steps to obtain information on the customer's residence.
- Charge GST unless they are satisfied that the customer is not a New Zealand resident.

Option 2: Use proxies

As part of the transaction, the seller will likely collect information on the customer, such as:

- Billing/home address
- IP address
- Bank details
- Location of originating payment
- For some services, the location of the customer's fixed landline

In Europe, the supplier can rely on two non-conflicting pieces of evidence to determine a customer's residence.

Suggested approach

There is a trade-off between accuracy (taking reasonable steps) and simplicity (using proxies).

Option 2 maybe preferable because of its lower compliance costs to businesses, however:

- The rules should focus on proxies that are least susceptible to error.
- The supplier should not be able to rely on less accurate proxies if better information can be relatively easily obtained.

Identifying New Zealand businesses

This is only relevant if it is decided that supplies to GST-registered businesses should not be subject to the proposed rules

Nature of supply

In many cases, due to the nature of the supplies, an offshore supplier will be able to assume that the services will be received by an unregistered individual. In these cases, GST will be charged.

When it's not clear

A New Zealand customer may provide their IRD number to an offshore supplier as evidence that they are GST-registered.

An offshore supplier should be able to rely on the IRD number of the business and not charge GST.

Incorrect representation

If an unregistered person represents that they are a GST-registered business, it is proposed that:

- The existing tax knowledge offence provisions apply, with fines of up to \$25k for a first offence and \$50k for subsequent offences.
- In more egregious cases, Inland Revenue should be able to register the customer and require them to account for the GST .

The non-resident business will be required to retain the IRD numbers provided.

Enforcement

Enforcement for non-resident suppliers

Self-assessment with penalties for non-compliance

New Zealand's tax system works on a self-assessment basis, with the assumption that most people do the right thing.

The normal enforcement rules and penalties would apply, including:

- Inland Revenue has the ability to require a supplier to register and return GST.
- Statutory penalties and interest obligations apply for non-payment.

International assistance

The OECD envisages international mechanisms helping with enforcement, including:

- The Convention on Mutual Assistance in Tax Matters, to which New Zealand is a signatory.
- New Zealand's network of double tax agreements, which normally include information-sharing provisions that cover GST.
- Future agreements with other jurisdictions.

Registration and filing

Registration and filing periods

Registration

Three registration options are being considered:

- Requiring non-residents to use the domestic registration system.
- Having a special “pay-only” system for non-residents that are only required to return GST, but do not incur New Zealand expenses.
- A regional “one-stop-shop”. This system operates in Europe and means that a non-resident only registers and returns GST in one country. The country of registration then distributes their share of the GST to other members. This option would require international cooperation, for example with Australia.

Filing periods

It is suggested that non-residents required to register under the proposed rules should be on a fixed two-monthly filing period (New Zealand's normal filing period).