Hon Stuart Nash, Minister of Revenue

Information Release

GST policy issues

February 2020

Availability

This information release is available on Inland Revenue's Tax Policy website at
https://taxpolicy.ird.govt.nz/publications/2020-ir-cab-dev-20-sub-0005/overview

Documents in this information release

1. IR2019/593 – Tax policy report: Cabinet paper - GST policy issues: an officials' issues paper (13 November 2019)
2. DEV-20-SUB-0005 – Cabinet paper: GST policy issues: an officials' issues paper (12 February 2020)
3. DEV-20-MIN-0005 – Minute: GST policy issues: an officials' issues paper (12 February 2020)

Additional information

The Cabinet paper was considered by the Cabinet Economic Development Committee on 12 February 2020 and confirmed by Cabinet on 17 February 2020.

One attachment to the Cabinet paper is not included in this information release as it is publicly available:

- GST policy issues – an officials' issues paper

Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

9(2)(a)	to protect the privacy of natural persons, including deceased people
9(2)(f)(iv)	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
9(2)(g)(i)	to maintain the effective conduct of public affairs through the free and frank expression of opinions

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: **Cabinet paper – GST Policy Issues: an officials' issues paper**

Date:	13 November 2019	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2019/593

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations **Refer** a copy of the report to the Minister of Finance	21 November 2019

Contact for telephone discussion (if required)

Name	Position	Telephone
Gordon Witte	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	s 9(2)(a)

13 November 2019

Minister of Revenue

Cabinet paper – GST Policy Issues: an officials' issues paper

Executive summary

1. This report seeks cabinet approval to release *GST Policy Issues* an officials' issues paper for public consultation. A draft officials' issues paper and draft cabinet paper are attached to this report, for your consideration.

2. The GST system currently collects approximately $28 billion per annum (or approximately 32% of tax revenue) and like other tax revenue regimes, requires regular updates and improvements to maintain the certainty, efficiency and fairness of the GST system.

3. In recent months, officials have been engaging with internal and external stakeholders (including private sector GST advisors) to identify GST policy issues that need to be addressed by amending the Goods and Services Act 1985 (the GST Act). Officials have undergone a prioritisation process through consultation with internal and external stakeholders. As a result, officials are confident that the proposed items for inclusion should be addressed.

4. To consult on these changes, officials have prepared an officials' issues paper on a range of current GST policy issues. The officials' issues paper will seek feedback on various policy options to protect against identified gaps in the GST base as well as responding to changes to commercial practice and technology.

5. The key policy issues proposed for inclusion are:

   - modernising the tax invoice requirements;
   - the GST treatment of crypto-assets;
   - apportionment and adjustment rules for assets used both for taxable and private use;
   - the GST treatment of domestic transport of goods, where it is a part of the service of transporting goods internationally;
   - the difficulties for non-residents attending a business conference and staff training event in New Zealand and being unable to practically recover their GST costs;
   - the GST treatment of certain fees and services in the managed funds industry;
   - the GST treatment of insurance pay-outs to third parties; and
   - changes to the compulsory zero-rating of land.

6. These issues are discussed further in this report. A number of other technical and remedial policy issues will also be included in the officials' issues paper. This report briefly summarises these issues and seeks your approval to publicly consult on these items.

7. If you agree to the recommendations in this report, the next step is to obtain Cabinet's approval to publicly release the *GST Policy Issues* consultation document for public submissions and feedback. A draft Cabinet paper is attached for lodgement with the Cabinet Office by 10.00am Thursday, for consideration by the Economic Development Committee the following Wednesday.

8. The estimated overall fiscal cost of the changes suggested in the paper are unknown. Public consultation will provide an opportunity for officials to obtain data to support the fiscal impact analysis process. Where a particular policy proposal has been well developed, officials have provided a likely range, depending on the final policy design. Any final policy decisions are likely not to be effective until the 2022/23 fiscal year onwards.

9. Officials anticipate the fiscal cost for the *non-residents attending New Zealand business conferences* policy issue could be up to s 9(2)(f)(iv) . This is based on historical conference spend survey data and is based on all spending being zero-rated – and does not account for goods and services that are unlikely to be zero-rated as part of final policy decisions (such as private expenditure or domestic airfares).

Recommended action

I recommend that you:

(a) **Note** the contents of the attached *GST Policy Issues* draft officials' issues paper.

Noted

(b) **Note** that the draft officials' issues paper is still subject to minor technical and editorial changes.

Noted

(c) **Agree** that the following issues and recommended solutions are included in the issues paper:

i. Tax invoice requirements.

Agreed/Not agreed

ii. Crypto-assets.

Agreed/Not agreed

iii. Apportionment and adjustment.

Agreed/Not agreed

iv. Domestic leg of the international transport of goods.

Agreed/Not agreed

v. Business conferences and staff training.

Agreed/Not agreed

vi. Managed funds.

Agreed/Not agreed

vii. Insurance pay-outs to third parties.

Agreed/Not agreed

viii. Compulsory zero-rating of land.

Agreed/Not agreed

(d) **Agree** with the minor technical and remedial issues as outlined in chapter 10 of the *GST Policy Issues* officials' issues paper.

Agreed/Not agreed

(e) **Note** that the fiscal implications of the recommended policy solutions are yet to be determined. Public consultation will provide an opportunity for officials to obtain data to support the fiscal impact analysis process.

Noted

(f) **Agree** that, subject to Cabinet approval, you will have the authority to prescribe the date to release the *GST Policy Issues* officials' issues paper for public consultation.

Agreed/Not agreed

(g) **Sign** and **refer** the attached Cabinet paper and draft officials' issues paper to Cabinet Office, for consideration by the Cabinet Economic Development Committee in December 2019 or February 2020, depending on when the officials' issues paper is to be released for public consultation.

Signed and referred

(h) **Agree** to release a media statement when the issues paper is released.

Agreed/Not agreed

(i) **Agree** to proactive release of the cabinet paper, cabinet minutes and key advice papers when the officials' issues paper is released.

Agreed/Not agreed

(j) **Refer** a copy of this report to the Minister of Finance.

Referred

Graeme Morrison
Policy Lead
Policy and Strategy

Hon Stuart Nash
Minister of Revenue
/ /2019

Background

Background

10. The latest Tax Policy Work Programme includes the release of a GST officials' issues paper. The proposed changes in the officials' issues paper will ensure the Goods and Services Tax Act 1985 (the Act) is well maintained and best reflects new technologies and business practices. GST accounts for almost a third of total tax revenue in New Zealand and so any issues or potential loopholes in the GST base need to be remediated.

11. Over the years, Inland Revenue has established a tradition of releasing GST officials' issues papers to consult on various changes to the Act. The previous GST officials' issues papers were released in 2015 and 2012 and were well received. GST practitioners welcome these officials' issues papers and increasingly expect regular consultation on these matters.

12. Since 2015, a number of GST issues have arisen. These include a mix of significant policy issues, as well as minor policy issues and base maintenance (remedial) items.

13. Officials have prepared a draft GST officials' issues paper (*GST Policy Issues*) that outlines these GST issues and seeks public submissions on the problem definition and potential policy solutions.

14. Below is a brief description of the policy issues in the officials' issues paper. The attached draft cabinet paper and officials' issues paper provides more detail on each item.

Tax invoice requirements

15. The GST system has relied in the widespread use of tax invoices since GST was first introduced. The tax invoice is a useful tool for both businesses and Inland Revenue. Significant changes in commercial practice and technology since then has meant the current tax invoice requirements are imposing excessive compliance costs on businesses.

16. Officials have proposed a number of changes to the tax invoice requirements, including better use of existing electronic information (such as accounting software), not requiring the permission of Inland Revenue to create buyer-created tax invoices, as well as other proposed initiatives.

17. It is anticipated that these changes will better align the tax invoice requirements with current commercial practice and will reduce compliance costs for businesses. The proposals should have no fiscal impact.

Cryptocurrencies

18. Cryptocurrencies (also known as crypto-assets) are digital assets such as digital coins (or tokens) that use cryptography and a decentralised computer network to securely produce coins and verify the transfer and ownership of coins between individuals. New Zealand has a fast-growing market for crypto assets – including investors and exchanges.

19. For GST purposes, the definitions of "money" or "financial services" are classified as exempt supplies and consequently, GST does not apply. The current definitions were largely developed in 1985 with the introduction of GST and at the time did not contemplate crypto-assets. This has meant that certain crypto-assets may incur GST, but not others.

20. As well, the broad definition of "money or money's worth" used in the financial arrangements rules mean certain crypto-assets will be subject to income tax on unrealised gains and losses (crypto-assets can be very volatile).

21. The officials' issues paper proposes to remove crypto-assets from both the GST rules (by deeming it an exempt supply) and the financial arrangements rules (by deeming it an exempted financial arrangement). Other services relating to crypto-assets such as computer services and exchange services will continue to be subject to the existing GST and income tax rules.

22. Given crypto-assets are often discussed in the media, it is likely that this issue and proposed solution will attract public and media interest. Officials expect most stakeholders will welcome the proposed solution, although some may suggest wider tax and regulatory crypto-asset reforms.

23. The proposals should have no fiscal or administrative costs as they align with current practices.

Apportionment and adjustment

24. The apportionment and adjustment rules apply when a GST registered person uses goods and services for both taxable and non-taxable (private use) purposes. Essentially the rules determine the portion of GST that can be claimed back on the purchase of the asset (because it is being used for taxable purposes). These rules can be complex and difficult to apply to every situation. In some situations, the taxpayer can be over-taxed or under-taxed.

25. It is proposed to simplify the rules while also reducing the instances of over or under taxation. Importantly, the changes aim to reduce compliance costs for taxpayers. The officials' paper is also seeking submitters suggestions on ways the rules could be further simplified.

26. Stakeholders are likely to appreciate simplifying the rules. Given the range of policy options available and the fact that they are not mutually exclusive, it is difficult to undertake a fiscal impact analysis. Some of the proposals may have a positive or negative fiscal impact. Officials will provide a fiscal impact analysis before final policy decisions are sought.

Domestic leg of the international transport of goods

27. The GST Act zero-rates (GST is charged at zero percent) the service of transporting goods into or out of New Zealand (e.g. Sydney to Auckland mail centre and then onto Hamilton) by transport suppliers, such as parcel courier service suppliers. Exported goods are zero-rated (so the underlying transport cost is also zero-rated) and the value of transport services is already included in the cost of importing goods and is subject to GST to the importer (and so GST has already been paid on the transport service).

28. The current zero-rated rule only applies where the whole transport service is supplied by one transport supplier (i.e. Sydney to Hamilton). The rule is strictly applied to the extent that where an international transport supplier subcontracts to a domestic transport supplier (for the Auckland to Hamilton leg of the transport service), the zero-rated rule does not apply and GST must be charged by the domestic supplier for the domestic delivery service. The international supplier cannot easily claim that GST back. This means the GST becomes imbedded into the price of an international transport service if the international transport supplier is not registered for New Zealand GST.

29. Officials propose to allow domestic transport services supplied to a non-resident international transport supplier (as part of the international transport of goods) to be zero-rated. This will essentially involve extending the current zero-rated rule to include commercial subcontracting arrangements. This approach will also align existing rules for postal letters mailed to New Zealand and mirror similar GST rules in Australia and Singapore.

30. If adopted, it is anticipated that the likely fiscal cost will be minimal. It is understood that it is the current commercial practice within the industry not to impose GST where it is not a single transport supplier.

31. It is expected that stakeholders will be supportive of this change, as it will provide certainty and fairness as well as recognising that the law is catching up with commercial practice.

Business conferences and staff training

32. Business conferences, conventions and staff training (for a New Zealand event) is subject to GST. This GST can be claimed back by businesses because GST is a tax on private consumption rather than business expenses. New Zealand residents can claim back the GST using the usual GST return processes. Non-residents can claim back the GST by registering for New Zealand GST (non-resident supplies).

33. For non-residents, the cost of having to register for GST and filing a GST return can exceed the GST recovered, especially where the non-resident is attending for a one-off NZ event.

34. It is proposed to zero-rate GST imposed on New Zealand events services provided to non-resident businesses. This change will not apply to education and training services provided to students. This change would remove a compliance cost that may be otherwise dissuading non-residents to attend New Zealand events. This is a similar approach to that taken by Australia and Singapore.

35. It is likely that the New Zealand conference and convention industry will support this change, as it will further encourage international conferences and conventions to be hosted in New Zealand.

36. Officials anticipate the fiscal cost for the *non-residents attending New Zealand business conferences* policy issue could be up to s 9(2)(f)(iv) . This is based on historical conference spend survey data and is based on all spending included in the survey becoming zero-rated.

37. The expected fiscal impact is likely to be significantly less on the final policy design as the policy design is likely to exclude types of spending counted by the survey. This includes goods purchased in New Zealand as well as other forms of private expenditure, and certain domestic airfares (both which are unlikely to be zero-rated). As well, the survey results include non-resident spending that is already recovered by GST registered non-residents.

Managed funds

38. For GST purposes, financial services are exempt from GST. This is because it is quite difficult to accurately determine the cost or the service fee of a financial service when it is bundled with a return on savings or investment income (which is considered "money" and GST exempt). Where the taxpayer is earning exempt income, they cannot claim GST paid on the business expenses incurred in providing the exempt good or service. This essentially means this GST exemption is used to partly tax financial services.

39. Within the fund manager and investment management industry, both financial services and other services (such as investment advice) can be supplied as a single service, meaning there can be differing treatment for GST claimed back, resulting in inconsistency, complexity and compliance costs. Some fund managers apply GST to all their fees (therefore claim back all GST paid on their business expenses), some do not apply GST (therefore cannot claim back any GST on their business expenses), and some have a mix. This situation is occurring to the extent that it is creating competitive distortions in the marketplace.

40. It is proposed to amend the definition of "financial services" to apply across the industry. The officials' issues paper presents five potential options:

- broadening the GST exemption to all fund management services;
- narrowing the GST exemption to make their fees fully subject to GST;
- deeming a percentage of their services to be exempt;
- to zero-rate for all GST to be claimed back (without requiring GST on services); or
- allow a reduced GST credits mechanism.

41. No option is preferred over the others currently, so this consultation is exploratory in nature at this stage .

42. s 9(2)(g)(i)

43. At this stage, it is difficult to accurately determine what the fiscal impact may be under any of the policy options.

Insurance pay-outs to third parties

44. GST applies to general (non-life) insurance where the taxpayer is GST registered and they are insuring their taxable activity (i.e. their business). They can claim GST deductions on the insurance premiums paid, and correspondingly GST output tax is imposed on any insurance pay-outs and settlements. GST does not apply to compensation payments such as out-of-court settlements.

45. In certain situations, a third party may be paid directly by the insurer for damage or loss incurred by the insured claimant. The third party is still required to account for the GST – but may be unaware of whether the source of the funds is from a compensation payment or insurance settlement. Some insurers may not readily disclose the GST treatment of any potential payments as part of the settlement negotiation process.

46. Officials have received mixed reports about the scale of this issue. The insurers officials have spoken with believe this issue is not endemic within the industry, however both Inland Revenue investigators and external tax advisors have raised on-going concerns.

47. The officials' issues paper proposes three options:

- to make the insurer responsible for any GST obligations on behalf of the claimant;
- require the insurer to disclose that the payment is subject to GST to the claimant or third party; and

- or provide education and guidance material for advisors and taxpayers.

48. Officials have discussed this policy issue with several large insurers. Industry stakeholders are likely to strongly oppose option one and, to a lesser extent option two as these options may impose compliance costs on insurers (however it will reduce compliance costs for the claimant and third party). The insurers are likely to prefer option three.

49. At this stage, it is difficult to accurately determine what the fiscal impact may be under any of the three policy options. Based on historical insurance data, officials do not anticipate that the fiscal impact will be significant.

Compulsory zero-rating for land

50. The compulsory zero-rating rules for land were introduced to reduce the risk of phoenix fraud, whereby the purchaser of the land would claim a GST deduction but the vender did not return the GST paid on the sale price.

51. There are several technical and remedial issues with these rules in relation to where the GST resides if the GST registration status of the vendor or purchaser changes during or after the sale process, and circumstances where a GST adjustment is required if the GST deducted was incorrect.

Additional issues

52. The officials' issues paper also includes a range of smaller issues, alongside the eight key issues outlined above. These smaller issues are summarised below, under the same headings and in the same order as in the draft officials' issues paper. It is not anticipated that the remedial items below will have any material fiscal impact.

GST grouping rules

53. It is proposed to clarify that the GST grouping rules apply before applying the other provisions of the GST Act, rather than applying the other provisions of the GST Act before applying the GST grouping rules. As well, it is proposed to allow the representative member of the group to issue invoices on behalf of all members of the group.

Members of non-statutory boards

54. The scope of the GST exclusion for board members from having a GST taxable activity may be narrower than was intended. Inland Revenue's current view is that the rule only applies to members of statutory bodies and consequently members of non-statutory bodies are treated differently despite the documented policy intent being broader to exclude board members generally.

55. It is proposed to widen the exclusion, so it clearly applies to members of non-statutory boards.

Right to challenge Commissioner's decision to reopen time-barred GST returns

56. The Act does not allow a person to challenge the Commissioner's decision to reopen a time-barred GST return. For income tax purposes, a decision of the Commissioner to amend a return outside the time bar is a decision which could be subject to challenge.

57. It is therefore proposed that a decision of the Commissioner to amend a GST return outside the time bar is also subject to challenge. This would ensure consistency across returns for income tax and GST.

Input credits on goods not physically received yet at the time a GST return is filed

58. Under the GST rules, where goods are acquired by a GST registered person, an input tax deduction is allowed to the extent that they are used for, or available for use, in making GST taxable supplies. An issue has been raised whether the goods are "available for use" but the taxpayer has not physically acquired the goods by the time they have filed their GST return (i.e. they have received an invoice for purchase, but the goods are still in transit).

59. It is proposed that the GST Act be amended to clarify that the taxpayer can claim a GST deduction for goods that have been purchased and "are expected to be used for" making taxable supplies. This remedial amendment would be retrospective to 1 April 2011 from when the original section was introduced.

Second-hand goods credits on supplies between associated persons

60. In many situations, a supplier may have purchased an asset for which they were not charged any GST, potentially denying them the ability to claim a second-hand goods input credit.

61. Officials propose to amend the second-hand goods credit rules to allow a second-hand goods credit to be limited to the original cost to the supplier. This law would apply prospectively.

Providing more flexibility for the Commissioner to approve the end date of a taxable period

62. It is proposed to remove the requirement that the end of a taxable period must be within seven days before or after the last day of the month, to allow for certain accounting periods (such as the 4-4-5 accounting period commonly used for shift or manufacturing planning).

Consultation

63. The Treasury has been consulted in the preparation of this report and agrees with its recommendations.

64. The New Zealand Customs Service, the Ministry of Business, Innovation and Employment (MBIE), the Ministry of Foreign Affairs and the Financial Markets Authority have been consulted about the policy proposals in the officials' issues paper.

Timing of an officials' issues paper

65. The officials' issues paper which includes the policy issues referred to in this report is attached. A draft cabinet paper is also attached to this report.

66. If you agree to the inclusion of the policy items outlined above, the next step is to obtain Cabinet approval to release the officials' issues paper for public consultation. For the paper to be considered by the Cabinet Economic Development Committee at its weekly meeting, it will need to be lodged with the Cabinet Office by the preceding Thursday by 10.00am.

67. If Cabinet approval is obtained, you will have the delegated authority to prescribe the date for officials to release the officials' issues paper for public consultation.

Next steps

68. Officials recommend you refer a copy of this report to the Minister of Finance.

69. If Cabinet approval is obtained, advise when you would like officials to release the officials' issues paper for public consultation. Officials propose to proactively release the cabinet paper, minutes and key advice papers when the officials' issues paper is released.

70. Officials will report back to you on public submissions received. The feedback will help develop final policy proposals with a view of obtaining Cabinet approval in time for their inclusion in the next available tax bill.

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

GST Policy Issues: an officials' issues paper

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to the release of an officials' issues paper, *GST Policy Issues*, which is attached. The paper discusses a number of policy issues with the existing goods and services tax (GST) legislation and suggests potential solutions.

2. I seek Cabinet's approval for the paper to be finalised and publicly released for consultation. Subject to Cabinet approval, I plan to direct officials as to when the officials' issues paper should be released for consultation. I also intend to publish a press release announcing the release of the officials' issues paper.

Executive Summary

3. A number of GST-related issues, mainly technical in nature, have been raised regarding the Goods and Services Tax Act 1985 (the Act). These reflect circumstances where the legislation does not produce outcomes that are consistent with the underlying policy, or where an update is required in response to changing technology, business practices, jurisprudence or other factors. These issues need to be addressed to maintain the certainty, efficiency and fairness of the tax system.

4. In recent months, my officials have met with key stakeholders such as private sector GST advisors to identify relevant GST policy issues, for inclusion into a GST issues paper.

5. This consultation has informed the attached officials' issues paper *GST Policy Issues*, which seeks public submissions on these policy issues and suggested solutions. The key issues raised in the officials' issues paper include:

   - Proposal to remove cryptocurrency from the GST and financial arrangements rules, to ensure these tax rules are not an unreasonable barrier to investing into or using cryptocurrencies;

   - Proposal changes to the rules apportioning GST input tax deductions for assets with a mix of taxable and non-taxable use, particularly the apportionment and adjustment rules applying to land;

   - Proposal to make it easier for domestic freight transport suppliers to zero-rate their services to non-resident freight transport suppliers;

- Proposal to allow non-resident businesses to recover their GST costs where their employees are attending business conferences, conventions and staff training events while in New Zealand;

- A review of the GST treatment of investment management services to managed funds; and

- Potential policy options to provide clarity to both insurers and GST-registered recipients of an insurance pay-out, to ensure GST is returned on these amounts.

6. The paper also contains a variety of smaller policy issues. These are issues where the current legislation does not give effect to the underlying policy, or where technical changes are required to ensure that the legislation continues to operate efficiently. The suggested solutions to these issues are consistent with the general principles and policy of the GST system.

7. The estimated overall fiscal impact of the changes suggested in the paper are unknown. Where a particular policy proposal has been well developed, a preliminary range has been provided, dependent on the final policy design. Any final policy decisions are likely not to be effective until the 2022/23 fiscal year onwards.

8. Officials anticipate the fiscal cost for the *non-residents attending New Zealand business conferences* policy issue could be up to s 9(2)(f)(iv). This is based on historical conference spend survey data and is based on all spending being zero-rated – and does not account for goods and services that are unlikely to be zero-rated as part of final policy decisions (such as private expenditure or domestic airfares).

Background

9. GST is a broad-base, low-rate consumption tax on goods and services which are supplied by registered persons (such as businesses) in New Zealand. Most goods and services are subject to GST and are taxed at a single rate of 15%.

10. Although the GST system generally works well, many of the specific provisions in the GST Act need to be regularly maintained or updated in response to changing technology, business practices, jurisprudence and other factors. Where the requirements fall behind current technology and practices, it can lead to undue compliance costs and inadvertent non-compliance.

11. A number of issues have been identified where the legislation produces an outcome that does not reflect the underlying policy intent. These issues need to be addressed to maintain the certainty, efficiency and fairness of the tax system.

12. The Government’s tax policy work programme, published in August 2019, noted that tax policy officials would be developing “a GST issues paper to consult on various changes to ensure GST aligns with business practices and modern technology and to maintain the GST Act more generally.”

13. In recent months, my officials have met with some key stakeholders such as private sector GST advisors to identify relevant GST policy issues, for inclusion into this GST issues consultation paper.

14. Six key GST policy issues have been identified:

- The GST treatment of crypto-assets;
- The complexity of the current GST appointment and adjustment rules and the potential for these rules to over-tax or under-tax compared to the actual mix of business and private / exempt use;
- Make it easier for domestic freight transport suppliers to zero-rate their services to non-resident freight transport suppliers, where it involves the international transport of goods;
- The difficulty of non-residents attending a business conference or undertaking formal staff training in New Zealand to be unable to practically recover their GST costs, compared to New Zealand registered businesses;
- The GST treatment of certain fees and services in the managed funds industry; and
- The GST treatment of insurance pay-outs.

15. These six issues, and the anticipated views of the affected stakeholders are explained below.

16. In addition to these, a number of smaller issues have also been identified. These issues are mainly technical and remedial issues where the GST legislation does not effectively reflect the underlying policy intent or has become out-of-date compared to modern commercial practices. The proposed solutions provide appropriate policy outcomes whilst minimising compliance costs.

17. Officials have drafted the attached officials' issues paper, *GST Policy Issues*, that consults on these issues and potential policy solutions. Resolving these issues would help to ensure that GST continues to operate efficiently as a broad-based, low-rate tax on consumption in New Zealand.

Comment

Cryptocurrencies

18. Cryptocurrencies (also known as crypto-assets) are digital assets (commonly known as coins or tokens) that use cryptography and a decentralised network of computers to secure transactions and verify the transfer of the coins and tokens between individuals. There are over 3,000 crypto-assets, with an approximate total market value of all crypto-assets exceeding US$222b.

19. New Zealand has a fast-growing crypto-asset market which includes currency start-ups, crypto-asset investors and crypto-asset exchanges for buyers and sellers

(exchanging crypto-assets and traditional currencies - such as the US or NZ dollar). The market value for crypto-assets can be very volatile.

20. The definitions used for money or financial services as “exempt supplies” (meaning they are not subject to GST) did not contemplate crypto-assets, meaning GST may be imposed on certain types of crypto-assets, but not others – depending on their particular purpose and design. This inequitable GST treatment is unintentionally favouring certain types of crypto-assets over others and likely resulting in a distortion in the crypto-asset marketplace.

21. As well, the broad definition of “money” or “money’s worth" used in the financial arrangements rules mean certain crypto-assets will be subject to income tax on unrealised gains and losses - as opposed to a realisation basis (taxed when the crypto-assets are sold).

22. The officials’ issues paper proposes to remove crypto-assets from both the GST rules (by making the crypto-asset an exempt supply) and the financial arrangements rules (by making a crypto-asset an excepted financial arrangement). Other services related to crypto-assets such as computer services, exchange services and professional advice will continue to be subject to the existing GST rules. Crypto-assets will also continue to be subject to income tax when they are sold under the ordinary income tax rules.

23. Given crypto-assets are often discussed in the media, there is likely to be public and media interest in the proposals raised in this chapter. This has been the case for previous guidance material Inland Revenue has published relating to crypto-assets. It is anticipated that most stakeholders will welcome the proposals, although some will consider that the proposals are too limited and wider reforms to the tax or regulatory treatment of crypto-assets are needed.

Apportionment and adjustment

24. The apportionment and adjustment rules apply when a GST registered person uses or intends to use goods and services for both taxable and non-taxable purposes. The rules determine the proportion of GST incurred in purchasing an asset that can be claimed back as an input tax deduction. For example, a contractor that purchases a car to be used equally for both their contracting business and private travel will only be able to claim an input tax deduction for 50% of the GST they paid on acquisition of the car.

25. The apportionment and adjustment rules can be complex and difficult to apply. Furthermore, some of the rules can result in registered persons being either overtaxed or undertaxed compared to the actual mix of business and private / exempt use. This can be a particular problem for land due to the high and appreciating value of land.

26. The officials’ issues paper proposes a number of specific changes to ensure the rules do not result in over or under taxation, as well as reduce compliance costs. The officials’ issues paper also seeks submitters views on ways in which the rules could be simplified more generally.

27. Stakeholders will likely appreciate simplifying these rules, as well as the opportunity to provide further simplification changes.

Domestic legs of the international transport of goods

28. The GST Act zero-rates (GST is charged at zero percent) the service of transporting goods into or out of New Zealand. This is because exported goods are zero-rated, and the value of transport services is already included in the cost of imported goods which is subject to 15% GST.

29. The current rules only apply where the whole transport service is supplied by one transport provider (usually the international freight transport service supplier). Where a NZ-based courier is subcontracted by an international courier to supply the domestic transport portion of the freight delivery service, they must charge GST on this supply at 15%. This strict interpretation of the GST rules can lead to unrecoverable GST becoming imbedded in the price of international transport service as the international courier is often not registered for New Zealand GST.

30. It is understood that this zero-rating rule is not well understood. This has resulted in some goods transporters erroneously zero-rating domestic transport services they supply as part of the international transport of goods.

31. Officials propose to allow domestic transport services supplied to a non-resident transport supplier (as part of the international transport of goods) to be zero-rated. This aligns with a common commercial practice and existing rules for postal letters mailed to New Zealand. Similar rules have already been adopted in Australia and Singapore.

32. It is expected that stakeholders will be supportive of this change, as it will provide certainty and fairness to the current rules, as well as recognising that the law needs to catch up with commercial practice.

Business conferences and staff training

33. Business conference and staff training services held in New Zealand is subject to 15% GST with both non-residents and New Zealand businesses claiming back the GST paid on the cost of attending these events. In 2018, it was estimated that international conference and convention attendees spent a total of $163 million, with an average delegate spend of $2,162 in New Zealand. New Zealand's conference and convention industry is expected to grow over time.

34. To recover the GST paid on attending these events, non-residents businesses must be registered for New Zealand GST. For many of these businesses, the cost of GST registration and filing a GST return (to claim back the GST paid), can exceed the GST recovered. This issue is likely to arise where the non-resident is coming to New Zealand for a one-off conference or convention event.

35. The officials' issues paper proposes to zero-rate GST on conference, convention and staff training events that are provided to non-resident businesses. This is consistent with GST being a tax on private consumption rather than business expenses and the fact that GST-registered New Zealand businesses can already recover these GST costs.

36. Importantly, this change would not apply to education and training services provided to students in a personal capacity or "incentive tours" used to reward employees with tourism experiences – these activities will remain subject to 15% GST.

37. Officials anticipate the fiscal cost is unlikely to be more than s 9(2)(f)(iv) [redacted]. This is based on historical conference spend survey data and is based on all spending included in the survey becoming zero-rated. The expected fiscal impact is likely to be significantly less – because the final policy design is likely to exclude spending counted by the survey including goods purchased in New Zealand as well as other forms of private expenditure of conference attendees, and domestic airfares (both which are unlikely to be zero-rated). As well, the survey results include non-resident spending that is already recovered by GST registered non-residents.

38. Conference industry representatives have advised officials that the current rules place them at a disadvantage in attracting international conferences and conventions to New Zealand, compared to other destinations such as Australia and Singapore (that do not impose GST on these events). Ensuring that GST charged is practicably recoverable by overseas businesses will likely make New Zealand international conference and convention facilities more attractive to international conference and convention organisers.

39. s 9(2)(g)(i) [redacted]

Managed funds

40. The GST definition of "financial services" is broadly unchanged since the introduction of GST in 1986, with financial services provided to GST non-registered taxpayers being exempt from GST. This recognises that it is often difficult to accurately determine the cost or the service fee of a financial service where this has also been bundled with a return on savings or investment income (which is essentially money and not a good or service). The GST exemption is used to partly tax financial services because the taxpayer cannot claim GST input credits on any business costs such as office space, computer systems or outsourced services that they need to purchase to enable them to produce the financial services.

41. Because fund managers may be providing both financial services (such as arranging financial products) and other services (such as investment advice) as a single product, the differing GST treatment can result in inconsistency, complexity and compliance costs. Some fund managers currently apply GST to all their fees, while others consider they supply a mix of taxable and exempt supplies. The complexity in GST treatment is also creating competitive distortions as some funds may prefer fund managers that do not charge GST on their fees.

42. The officials' issues paper proposes to amend the GST definition of financial services to provide more certainty and consistency for manager and investment manager services that are supplied to managed funds.

43. Three potential options are discussed including:

- broadening the current GST exemption for retirement scheme managers to all fund management services;
- narrowing the GST exemption and making these fees fully subject to GST (and consequently allow the fund managers to claim more of their GST input costs); or
- deeming a percentage of the relevant services to be exempt (and the remaining services subject to GST).

44. These options involve trade-offs between different policy objectives including ensuring 15% GST applies to a broad range of services and ensuring GST does not unduly distort competition or increase managed fund fees overall.

45. s 9(2)(g)(i) [redacted]

Insurance pay-outs to third parties

46. The GST Act has special rules for applying GST to general (non-life) insurance. If the taxpayer is GST registered and they are insuring their taxable activity (i.e. their business) then they can claim GST deductions on insurance premiums paid and, correspondingly, GST output tax is imposed on any insurance pay-outs by insurance companies. Importantly, GST does not generally apply to compensation payments such as out-of-court settlements.

47. In some situations, an insured person may cause damage or loss to a third party and then arrange for their insurer to provide an insurance payout to the third party. In such cases a GST registered third party may be unaware of whether the source of the funds are from a compensation payment (not subject to GST) or insurance (subject to 15% GST).

48. In some situations, the insurer may have a commercial incentive to not disclose the GST treatment of the insurance pay-out. This can lead to adverse outcomes where the third party is required to pay GST on an insurance settlement, but the payment has not been grossed up to account for GST (so the third party is undercompensated), or the GST amount has not been returned to Inland Revenue.

49. Officials have received mixed reports about the scale of this problem. The insurers officials have spoken to do not consider this problem to be endemic within the industry, but Inland Revenue's investigators and several legal and GST advisors have raised concerns about cases of GST non-compliance involving this issue.

50. As well as seeking stakeholder views as to whether this is a significant problem, the officials' issues paper also discusses three potential options for mitigating this issue, with all three options seeking to provide more certainty to insured claimants and third parties when negotiating insurance settlements.

51. The most effective policy option is to make the insurer responsible for any GST obligations, on behalf of the claimant. This will require insurers to be aware of the GST registration and business activities of the claimant and any associated third parties (including the GST apportionment rules - such as a home office).

52. Another policy option is for the insurer to disclose to the third party that part or all of the insurance payment is subject to GST and the claimant or third party may be required to return GST on the settlement amount. The third option is to provide education and guidance for advisors and taxpayers to be mindful of any GST implications when negotiating and finalising an insurance pay-out.

53. Insurance providers will likely strongly oppose option one (making the insurer responsible for GST) and, to a lesser extent, option two (requiring the insurer to disclose information) as these options will impose compliance and IT systems costs on insurers (however it will reduce compliance costs on the claimants and associated third parties). Insurers' will likely prefer option three (education and guidance) because it does not have any significant compliance or systems costs for them. Some large insurers and their advisors have been notified about the proposed consultation options.

Other issues

54. A number of other technical and remedial issues with the current legislation have been identified. The suggested solutions align with the existing GST policy intent and do not have a forecast fiscal impact and are likely to be supported by submitters.

55. An example of these technical changes is the proposal to allow a wider range of ordinary business-to-business information to be used to support a business's GST tax invoice requirements. Allowing businesses to use more of its existing electronically held information to support their GST tax invoice requirements will reduce businesses compliance costs over time.

Consultation

56. The attached officials' issues paper has been prepared by Inland Revenue.

57. The Treasury has been consulted in the preparation of this paper and supports the proposals.

58. The New Zealand Customs Service, the Ministry of Business, Innovation and Employment (MBIE), the Ministry of Foreign Affairs and the Financial Markets Authority have been consulted about the policy proposals in this cabinet paper and attached officials' issues paper.

Financial Implications

59. There are no financial implications associated with releasing the *GST Policy Issues* officials' issues paper. However, if following public consultation certain policy options are progressed, then their introduction may have an impact on forecast crown revenue. Any final policy decisions are likely not to be effective until the 2022/23 fiscal year onwards.

60. In particular, it is anticipated that the proposal to allow non-resident businesses to recover their GST paid for attending NZ conferences and conventions events may have a negative fiscal impact of up to s 9(2)(f)(iv)

Legislative Implications

61. The decision to consult on the GST policy proposals does not give rise to any immediate legislative implications. If, following consultation, Cabinet decides to implement the changes suggested in the officials' issues paper, enabling legislation will be required. The relevant Taxation Bill is likely to be introduced after the election in either late 2020 or early 2021.

Impact Analysis

62. The officials' issues paper substitutes for a Regulatory Impact Assessment. Inland Revenue's Quality Assurance panel has reviewed the issues paper and confirms that it is likely to lead to effective consultation and support the delivery of Regulatory Impact Analysis to support subsequent decisions.

Human Rights

63. The issues contained in the draft issues paper and their proposed solutions do not give rise to any human rights implications.

Gender Implications

64. There are no gender implications arising from these proposals.

Disability Perspective

65. No disability issues arise from these proposals.

Publicity

66. The Minister of Revenue proposes to issue a media release when officials make the issues paper available for public consultation.

Proactive Release

67. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers.

Recommendations

The Minister of Revenue recommends that the Cabinet Economic Development Committee:

1. **Note** that a number of issues with the current GST legislation have been identified;

2. **Note** that the attached draft officials' issues paper, in essence, suggests that:

   2.1 Some of the rules for apportioning GST input deductions (especially for land) need to be amended to reduce over-taxation or under-taxation compared to the actual mix of business and private / exempt use or to be easier to apply.

2.2 Crypto-assets should not be subject to the GST or financial arrangements rules but will still be taxed under other ordinary tax rules.

2.3 New Zealand freight delivery suppliers should be able to zero-rate their delivery services to non-resident freight transport suppliers, where that service relates to transporting goods to and from New Zealand.

2.4 Non-resident businesses should be able to more easily recover their GST costs when attending conferences, conventions and staff training events in New Zealand (GST-registered New Zealand businesses can already recover these GST costs).

2.5 The GST rules relating to manager and investment management services to managed funds need to be reformed, but due to inconsistent practices within the industry, some managers will face compliance costs from changing how they apply GST.

2.6 There are fiscal and fairness concerns about non-compliance with the rules that require GST to returned on insurance pay-outs, and there are several options to address this issue, some of which impose costs on insurers.

2.7 Other amendments should be made that would ensure that continued effective operation of the Goods and Services Act, particularly in cases where the legal requirements need to be amended to align with the policy intent or to better accommodate modern technology and commercial practices.

3. **Agree** that, subject to minor editorial changes, the attached officials' issues paper *GST Policy Issues*, be approved to be released on Inland Revenue's website for public consultation.

4. **Authorise** the Minister of Revenue to approve minor changes to the officials' issues paper prior to its release;

5. **Authorise** the Minister of Revenue to prescribe the date for when the officials' issues paper will be released;

6. **Note** that the Minister of Revenue will issue a media release at the time that the *GST Policy Issues* officials' issues paper is published;

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue

Cabinet Economic Development Committee

Minute of Decision

GST Policy Issues: An Officials' Issues Paper

Portfolio **Revenue**

On 12 February 2020, the Cabinet Economic Development Committee:

1 **noted** that a number of issues with the current GST legislation have been identified;

2 **noted** that the draft officials' issues paper on *GST Policy Issues*, attached to the submission under DEV-20-SUB-0005 (the officials' issues paper), in essence, suggests that:

2.1 some of the rules for apportioning GST input deductions (especially for land) need to be amended to reduce over-taxation or under-taxation compared to the actual mix of business and private / exempt use, or to be easier to apply;

2.2 crypto-assets should not be subject to the GST or financial arrangements rules but will still be taxed under other ordinary tax rules;

2.3 New Zealand freight delivery suppliers should be able to zero-rate their delivery services to non-resident freight transport suppliers, where that service relates to transporting goods to and from New Zealand;

2.4 non-resident businesses should be able to more easily recover their GST costs when attending conferences, conventions and staff training events in New Zealand (GST-registered New Zealand businesses can already recover these GST costs);

2.5 the GST rules relating to manager and investment management services to managed funds need to be reformed, but due to inconsistent practices within the industry, some managers will face compliance costs from changing how they apply GST;

2.6 there are fiscal and fairness concerns about non-compliance with the rules that require GST to be returned on insurance pay-outs, and there are several options to address this issue, some of which impose costs on insurers;

2.7 other amendments should be made that would ensure that continued effective operation of the Goods and Services Tax Act 1985, particularly in cases where the legal requirements need to be amended to align with the policy intent or to better accommodate modern technology and commercial practices;

3 **agreed** to the release of the officials' issues paper for public consultation, subject to any minor or editorial changes that may be approved by the Minister of Revenue before its release;

4 **authorised** the Minister of Revenue to prescribe the timing of the release of the officials' issues paper.

Jack Petterson
Committee Secretary

Present:
Rt Hon Winston Peters
Hon Kelvin Davis
Hon Grant Robertson (Chair)
Hon Phil Twyford
Hon Dr Megan Woods
Hon Chris Hipkins
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Jenny Salesa
Hon Damien O'Connor
Hon Shane Jones
Hon Tracey Martin
Hon Kris Faafoi
Hon Willie Jackson
Hon James Shaw
Hon Julie Anne Genter
Hon Eugenie Sage

Officials present from:
Office of the Prime Minister
Officials Committee for DEV

Hard-copy distribution:
Minister of Revenue