

GST apportionment and adjustment rules

An officials' issues paper



Inland Revenue
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CHAPTER 1

Background and summary of options

- 1.1 Goods and Services Tax (GST) is a 15% tax on goods and services that are supplied to consumers in New Zealand by GST-registered persons (such as businesses).
- 1.2 A GST-registered person can deduct GST paid on purchases of assets (such as buildings and vehicles) that they use in their business. This is known as an input tax deduction. However, where an asset is used for both business use (known as taxable use) and non-taxable use (that is, private use or making exempt supplies, such as financial services or residential accommodation), the person can only deduct a percentage of the total input tax. The percentage that is deductible is based on the person's estimate of the percentage of taxable use. Consequently, GST is collected on the non-taxable use of an asset by denying a portion of the input tax deduction. This is known as apportionment.
- 1.3 Once a taxpayer has apportioned their input tax deduction based on their estimated taxable use, they are required to monitor their actual use of the asset over time. If the actual use differs from the estimated use, the taxpayer must account for this difference annually in their GST return. This is known as an adjustment or change in use.

Issues with the current apportionment and adjustment rules

- 1.4 We understand there are two main issues with how GST applies to assets that are used in a GST-registered business and also for non-taxable use (private use or to make exempt supplies).
- 1.5 First, the current GST apportionment and adjustment rules are complex and have high compliance costs. They require the registered person to monitor whether they use any of their business assets for non-taxable use and to make annual adjustments if there has been any change of use.
- 1.6 Second, unexpected liabilities and compliance costs can arise because GST applies to private assets that have some business use and are owned by a GST-registered person.
- 1.7 The GST system does not tax most private assets, such as dwellings. This is because they are not part of a registered person's taxable activity (that is, their business). However, some private assets may also be used by a GST-registered person to make taxable supplies. For example, a GST-registered contractor may work from a home office, or a GST-registered person may own a holiday home they stay in but which they also rent as a taxable supply of guest accommodation. In such cases, the use, and disposal, of the private asset may be in the course and furtherance of the registered person's taxable activity. This can lead to a GST liability or adjustment if the asset is sold or there is a decreased percentage of taxable use of the asset. The GST liability on a dwelling or land can be significant as land is a high-value, appreciating asset that is often held for long periods before disposal.
- 1.8 We understand that many registered persons are unaware that GST consequences can arise if their dwelling is partly used to make taxable supplies. Consequently, they are not accounting for GST on their dwelling on its disposal.

- 1.9 The issue with dwellings only arises if the dwelling is owned by a GST-registered person who uses the dwelling for both a taxable and a non-taxable use. Under slightly different fact scenarios, such as when the GST-registered person does not own the dwelling (for example, the GST-registered business is a company or partnership, or the house is owned by a company or trust that is not registered for GST), there may be no need to apportion or account for GST on disposal. The current rules may therefore impose higher liabilities and compliance costs on some taxpayers when compared to those imposed on other taxpayers in similar situations.
- 1.10 The current GST apportionment and adjustment rules may create uncertainty, complexity, unintended consequences, or undue compliance costs. This issues paper seeks input on these issues and various reform options that could mitigate the issues and simplify the application of the rules. One constraint is that the reform options should not undermine the overall purpose of the GST system, which is a simple, broad-based tax on the private consumption of goods and services by New Zealand consumers.
- 1.11 We consider the best way to simplify the apportionment and adjustment rules is to target their application.
- 1.12 The main reform options proposed in this issues paper are intended to substantially reduce the number of registered persons who are required to apportion GST on their business or private assets. To address some of the gaps and weaknesses in each option, a reform package, with a combination of potential solutions, may be required. On the other hand, some of the options discussed in this issues paper may increase the complexity of GST by creating new boundaries and definitions, so these may not be progressed if alternative options are simpler or more effective.
- 1.13 Apportionment and adjustment rules may still be required for high-value business assets that are clearly used to make taxable supplies while also having a significant amount of non-taxable use. This issues paper discusses options for reducing compliance costs for these assets, such as reducing the need to closely monitor their use and make annual adjustments.

Summary of reform options

- 1.14 Chapter 2 discusses an option that would enable registered persons to elect to exclude certain capital assets from their taxable activity. These excluded assets would not be subject to GST. This would provide the same GST outcome as the situation where an asset is purchased by an unregistered person, such as an unregistered shareholder of a business, rather than directly by the GST-registered business itself. This chapter also proposes two potential integrity measures that would apply to assets included in a registered person's taxable activity at the time of acquisition. These measures would better ensure GST was properly accounted for when the taxable activity ceased or the assets were sold.
- 1.15 Chapter 3 discusses rounding-based options for removing most assets from the apportionment and adjustment rules. They include:
- A principal purpose test for assets purchased for less than \$5,000 (GST exclusive).
 - A 20 percent de minimis. If the registered person's taxable use of the asset was less than 20 percent, the asset would be regarded as non-taxable. No input tax deduction could be claimed on purchase and no GST would be accounted for on disposal.

- An 80 percent rounding-up rule. Assets with 80 percent or more taxable use would be deemed to have 100 percent taxable use. This would allow a full input tax deduction for most business assets with only small amounts of non-taxable use.
 - Input tax deductions would still be apportioned on assets purchased for \$5,000 or more (GST exclusive) with between 20 percent and 80 percent taxable use. However, a 20 percent change threshold is proposed to ensure adjustments would only be made if a major change in use occurred. For example, if the initial taxable use was 66%, an adjustment would only be made if the taxable use fell below 46% or increased above 86%.
- 1.16 GST apportionment issues arise when the same premises are used to make a combination of supplies of commercial guest accommodation and private use or residential rental. The GST treatment in such cases depends on the definitions of “dwelling” and “commercial dwelling”, which can overlap and be uncertain. Chapter 4 seeks submissions on potential options for improving these definitions.
- 1.17 Chapter 5 discusses another potential reform option that would involve developing a new set of special rules for house sales. The special rules could make house sales (including owner-occupied houses, residential rental properties and holiday homes) by a registered person who is not a property developer an exempt supply. This would require new definitions and could add complexity and uncertainty to the GST rules for land. We are therefore interested in submitters’ views on whether other reform options, such as the election discussed in chapter 2, may be a simpler or more effective way to remove mainly private dwellings from the GST system.
- 1.18 Chapter 6 discusses some potential rules for applying GST to land that is developed and sold by property developers. This includes an option of allowing a full input tax deduction for land that a registered person commenced developing with the intention to sell as a taxable supply. This would be bolstered by some integrity rules to manage the fiscal risk that can arise when a GST-registered person claims an input tax deduction for purchasing land because of an initial intention to develop the land, but the land is not subsequently developed or sold. Under any of the proposals discussed in this issues paper, land that was developed and sold by a GST-registered property developer would remain a taxable supply subject to GST on sale.
- 1.19 Chapter 7 discusses a range of minor or incremental ways to reduce compliance costs in those cases where apportionment would still be required. This includes expanding eligibility to use the “wash-up” rule and reducing the required number of adjustment periods to allow the use of an asset to be monitored for fewer years.
- 1.20 We invite submissions on the various options proposed – in particular, their design, effectiveness and compliance costs. We also welcome submissions on any alternative options submitters may identify.

How to make a submission

- 1.21 Submissions are invited on the proposed reform options in this issues paper.
- 1.22 Your submission should include a brief summary of your main points and recommendations. Please also indicate whether officials from Inland Revenue may contact you to discuss the points raised, if required.

1.23 The closing date for submissions is **27 April 2022**.

1.24 Submissions can be made:

- by email to policy.webmaster@ird.govt.nz with "GST apportionment and adjustment rules" in the subject line, or
- by post to:

GST apportionment and adjustment rules
C/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
Wellington 6140.

1.25 Officials intend to proactively release submissions. Please clearly indicate in your submission if any information should be withheld on the grounds of privacy, or for any other reason. Information withheld will be determined using the Official Information Act 1982.

Questions for submitters

- In your view, what are the problems with the GST apportionment and adjustment rules?
- Have we identified the correct range of policy reform options to focus on? Are there other options we should consider?

CHAPTER 2

Election to exclude assets from a registered person's taxable activity

- 2.1 Some dwellings (and other mainly private assets) are owned by GST-registered persons who use part of the asset (such as a home office) to conduct their business of making taxable supplies. Under the current GST rules, this can lead to unexpected liabilities and compliance costs.
- 2.2 One option that could address this issue would be to allow GST-registered persons to elect to treat the affected assets as being separate from their taxable activity. The design and impacts of this election method are discussed in this chapter.
- 2.3 This chapter also proposes two potential integrity measures. The first would involve requiring registered persons to provide information to Inland Revenue if they acquire land, aircraft or pleasure craft that they intend to use to make taxable supplies. The second would apply if a registered person had claimed taxable use when acquiring an asset and would clarify that the future disposal of that asset would be deemed to be a taxable supply made in the course or furtherance of the registered person's taxable activity.

Allowing registered persons to elect to exclude an asset

- 2.4 The UK's and Singapore's GST rules allow GST-registered persons to elect to exclude an asset from their taxable activity (and therefore ensure the asset is not subject to GST) by not claiming input tax deductions for the purchase of the asset. New Zealand could consider introducing a similar rule.
- 2.5 The proposed election would allow GST-registered owners of private and appreciating assets (such as home offices or holiday homes) to treat these assets as being separate from their taxable activity at the time of purchase. This means they would be unable to claim GST input tax deductions on the purchase of, or capital improvements to, the asset, and they would not return GST when they disposed of the asset.
- 2.6 This would provide the same GST outcome as the situation where an asset is purchased by an unregistered person, such as an unregistered shareholder of a business, rather than directly by the GST-registered business itself. In these circumstances, the purchaser of the asset cannot deduct GST input tax on the purchase of the asset and does not account for GST output tax on any subsequent disposal – their purchase is the final consumption.
- 2.7 We propose that the election should only be available for assets held on capital account (which could include goods, land or intangible assets). The sale of revenue account property, such as trading stock, would normally relate to the registered person's core business or taxable activity so should remain a taxable supply on sale or disposal.
- 2.8 We also propose that a registered person would be unable to make the election for an asset they had acquired for the principal purpose of making taxable supplies.
- 2.9 The effectiveness of such an election option would ultimately depend on the extent to which the affected registered persons chose to adopt it. If the majority made the election, this could reduce compliance costs and remove GST

liabilities on private assets. However, if the number of registered persons making the election was low, the compliance costs and liabilities would remain.

- 2.10 We expect it is already a common practice to not claim an input tax deduction for the purchase of, or capital improvements to, a dwelling (even though part of the house, such as a home office, may be used to make taxable supplies). If this is accurate, the proposed election should mean most registered person's houses would be excluded from their taxable activity. An election option could also allow GST-registered persons to choose to exclude their capital asset of a holiday home or apartment from being part of their taxable activity, while still applying GST to their taxable supplies of short-term accommodation services.
- 2.11 Under the proposed election option, if the registered person claimed GST input tax deductions for a portion of the operating or holding costs of owning a house (such as insurance, local authority rates or utilities) to the extent that these services were used to make taxable supplies, this would not automatically lead to the house being regarded as part of the person's taxable activity. Only if the registered person had claimed a GST input tax deduction for the purchase of, or capital improvements to, the dwelling would it be a taxable supply when sold.
- 2.12 In addition to dwellings and holiday homes, some registered persons may also prefer not to claim input tax deductions on other types of land or appreciating assets. This is because this would remove any future obligation to charge and return GST output tax if they subsequently disposed of the asset.
- 2.13 However, other registered persons may not intend to dispose of the asset and therefore may still prefer to claim an input tax deduction on purchase. This may be because the initial deduction for their taxable use of the asset would exceed their expected compliance costs from the apportionment rules. Others may simply prefer the upfront cashflow benefit of claiming a GST input tax deduction (or from paying a GST-exclusive price) at the time they purchase the asset, as this can then be used to help fund their business.
- 2.14 For depreciating assets such as vehicles, it seems likely that most registered persons would prefer to continue to claim input tax deductions to the extent the asset is used to make taxable supplies. This is because any corresponding output tax liability on the disposal of the depreciating asset would be less than the input tax claimed on purchase.

Applying the election to purchases of zero-rated land and going concerns

- 2.15 For most capital assets, the registered person would exercise the proposed election by choosing not to deduct input tax for the purchase price of the asset (or any subsequent capital improvements to the asset) at the time these were purchased or used to make taxable supplies.
- 2.16 However, some assets may have been zero-rated (that is, 0% GST was charged by the vendor) at the time they were acquired because they involved a business-to-business supply of land or a supply of business assets as a going concern. Land that will be used as a principal place of residence for the purchaser, or a close relative, is not a zero-rated supply.
- 2.17 For assets that were acquired as zero-rated purchases, if the purchaser wanted to elect to remove the asset from their taxable activity, they would be required to make an adjustment to return output tax of 15% of the zero-rated purchase price. This 15% output tax adjustment would ensure the purchaser incurred the same GST cost as that incurred where the same asset was not purchased to make taxable supplies or was purchased by an unregistered person.

- 2.18 We note that a GST-registered purchaser of zero-rated land is already required to make an output tax adjustment for any non-taxable use of the land under section 20(3J) of the Goods and Services Tax Act 1985 (the GST Act). The proposed election would simply require the purchaser to make an output tax adjustment for the full purchase price of the land (rather than for the percentage of expected non-taxable use) to exclude the land from their taxable activity.
- 2.19 This requirement to make an output tax adjustment on purchases of zero-rated assets could represent a significant upfront tax liability. It would also require the registered person to make an active choice to return GST output tax for any taxable use, rather than the passive choice of simply not claiming an input tax deduction. This could reduce the number of registered persons who make the election for zero-rated assets.
- 2.20 On the other hand, in most cases where the supply of an asset is zero-rated, this is because the asset is predominantly used as a business asset. In these cases, it seems an appropriate policy outcome for the asset to remain part of the registered person's taxable activity (assuming they did not make an output tax adjustment).

Retrospective application date

- 2.21 We recognise that, for the proposed reforms to be effective, a retrospective application date may be needed, such as 1 April 2011. This would accommodate GST positions that some of the affected registered persons may have already taken for assets they have disposed of before the enactment of any proposed reforms.
- 2.22 A retrospective application date would mean that if a registered person had previously taken a tax position consistent with the proposed election option (such as regarding a dwelling as not being part of their taxable activity even though it may have been partly used to make taxable supplies), this tax position would become correct.
- 2.23 A savings provision may also be necessary to preserve tax positions taken in accordance with the current GST law.

Transitioning pre-application date assets

- 2.24 A transitional rule may also need to be considered to allow affected registered persons to apply the proposed new election option to pre-reform assets they had purchased before the application date of the election (assuming it was enacted).
- 2.25 A potential transitional rule could apply to assets purchased before 1 April 2023 (assuming the relevant legislation was enacted in early 2023 and applied from this date). The transitional rule would allow a registered person who has claimed input tax deductions for the purchase of, or capital expenditure on, an asset before 1 April 2023 to notify Inland Revenue that they were electing to exclude the asset from their taxable activity. They would then have to return output tax equal to those input tax deductions in their next GST return. We propose a 12-month period between 1 April 2023 and 1 April 2024 during which

such registered persons could apply this transitional rule to assets purchased before to 1 April 2023.¹

- 2.26 The main disadvantage of this proposed transitional rule is that it could create negative cashflow issues because the repayment of the input tax would need to be funded by the registered person. We acknowledge that this could reduce the adoption, and effectiveness, of the transitional rule. We expect it would mainly be used when the registered person was planning to sell or dispose of an asset that had appreciated in value.

Disclosure of information about high-value land, pleasure craft or aircraft

- 2.27 Under the current GST rules, a person can register for GST because they have an intention to develop a property or use a high-value asset to conduct a taxable activity, and they can then claim GST input tax deductions on the purchase of the land or asset. Sometimes, however, the person's plans change, and the property development or other taxable activity is abandoned before it starts. In such cases, the person is required to deregister for GST and pay output tax on disposal of their assets. However, this relies on the person self-assessing their tax at a time when they may no longer be in business or using a tax advisor or accountant. The result is that often no output tax is accounted for on disposal of the assets.
- 2.28 To help mitigate this fiscal risk, we propose that registered persons be required to notify Inland Revenue when they acquire certain high-value assets and provide certain information. This proposed information disclosure rule would apply when a registered person:
- acquires land, a pleasure craft² (for example, a yacht or launch) or an aircraft for an amount of consideration exceeding \$150,000 (GST exclusive), and
 - intends to use the high-value asset to make taxable supplies, and
 - does not make the proposed election (discussed above) to treat the asset as being separate from their taxable activity.
- 2.29 The information disclosed could include the amount of consideration paid for the asset, the initial amount of GST input tax deducted on purchase (or the nominal GST amount that would otherwise have been charged if the asset was purchased from another registered person as a zero-rated supply of land or a going concern) and a statement of how the asset will be used to make taxable supplies.
- 2.30 This type of information could assist Inland Revenue to better monitor and promote compliance by registered persons who have previously claimed large GST input tax deductions (or acquired zero-rated land) but no longer appear to be proceeding with, or carrying on, a taxable activity (for example, they have been continuously filing GST returns with no or low sales).

¹ This proposed rule would be like the temporary elections that were previously available under sections 5(19) (which applied to dwellings not principally used to make taxable supplies) and 20(3KB) (which applied to assets not used in a non-profit body's taxable activity) of the GST Act. These elections provided asset owners with one or two years to repay input tax deductions previously claimed on the asset so that GST output tax would not apply to a subsequent disposal of those assets.

² 'Pleasure craft' is already used in section 11 of the GST Act and adopts the meaning set out in section 2 of the Maritime Transport Act 1994.

- 2.31 In cases where a registered person is regularly buying and selling land as part of their taxable activity of selling land, the compliance costs of requiring GST information to be disclosed each time they purchase land could outweigh their risk of non-compliance. For this reason, there could be an exception to the disclosure requirement for certain GST-registered persons. We are interested in submissions on the best way to identify low-risk registered persons who could be excluded from the proposed requirement. One possibility is to exclude GST-registered persons or GST groups who have made taxable supplies (sales) of land of more than \$5 million in a 12-month period.
- 2.32 The information disclosure requirement proposed above would be more targeted than the requirement in Australia's GST system, which requires all GST-registered persons to report on the total value of their capital purchases in their activity statements (GST returns).
- 2.33 The proposed information disclosure requirement would apply prospectively to assets purchased after a certain date.

Deeming the disposal of an asset to be a taxable supply

- 2.34 In general, supplies of goods or services by a registered person in the course or furtherance of their taxable activity are taxable supplies. This includes selling or otherwise disposing of assets used by the registered person in their taxable activity.
- 2.35 In cases where a registered person never commenced a taxable activity or ceased their taxable activity many years ago, they should have made an output tax adjustment for such assets at the time their taxable activity was abandoned or ceased. They may not have done so because they were unaware of their obligations or because they believed they were still carrying on, or intending to commence, a taxable activity. They may also fail to return GST when they sell or dispose of the relevant assets.
- 2.36 To reduce this risk, we propose that when a registered person purchases an asset they intend to use to make taxable supplies, the future disposal of that asset would be deemed to be a taxable supply made in the course or furtherance of the registered person's taxable activity. This rule would only apply where the registered person did not elect to treat the asset as separate from their taxable activity under the proposed election option (discussed above) or had not previously made an output tax adjustment to account for the fact the asset was no longer being used to make taxable supplies.
- 2.37 This proposal would make it clear that a registered person is required to return output tax on the disposal of assets they previously considered would be used to make taxable supplies, even if they no longer have a taxable activity or if their taxable activity never commenced in the first place. This would align with the proposed election option discussed above as the output tax position on disposal would depend on whether the registered person had claimed an input tax deduction on the purchase of the asset.
- 2.38 This proposed deeming rule would effectively broaden the existing deeming rule in section 5(16) of the GST Act that currently applies to dwellings for which a registered person has claimed an input tax deduction. A similar rule would therefore apply to all types of assets (including purchases of zero-rated land and going concerns). The proposed deeming rule would also be similar to the existing deeming rule in section 20(3K). That section applies to assets acquired by non-profit bodies and deems the relevant assets to have been acquired in the course or furtherance of a taxable activity carried on by the non-profit body and therefore subject to GST on disposal.

2.39 This proposed new deeming rule could apply to assets disposed of on or after 1 April 2023 (assuming the relevant legislation was enacted in early 2023 and applied from this date).

Questions for submitters

- What are the current practices of registered persons? How do they account for GST on dwellings and other mainly private assets?
- What are the potential impacts of introducing an election to allow registered persons to exclude an asset from their taxable activity? Are there other options we should consider instead?
- What type of assets should be eligible for the proposed election?
- How should the proposed election apply to past GST positions and assets acquired before the proposed reform?
- What are the potential impacts of the proposed requirement to provide information to Inland Revenue about acquisitions of high-value land, pleasure craft and aircraft? What is the best way to identify low-risk taxpayers who could be excluded from this requirement?
- What are the potential impacts of the proposed rule deeming a disposal to be a taxable supply? Would it improve compliance?
- Are there other options for improving GST compliance on land and other high-value assets we should consider instead?

CHAPTER 3

De minimis and other rounding options

- 3.1 The current GST apportionment and adjustment rules generally require GST-registered persons to monitor their business assets for any private or exempt use and to make an annual adjustment for any change of use. This has high compliance costs.
- 3.2 This chapter discusses some potential policy reforms aimed at reducing the need, in most circumstances, for a registered person to closely monitor the percentage of taxable use and to make an annual adjustment.

Principal purpose test for low-value assets

- 3.3 The current apportionment rules apply to any asset that is not 100 percent used to make taxable supplies.
- 3.4 Many low-value business assets, such as smartphones, computers and tools, may have a minor amount of private use that needs to be monitored and accounted for under the current apportionment rules. This results in high compliance costs for little GST revenue benefit.
- 3.5 To reduce these compliance costs, we propose that a new principal purpose test could apply to assets purchased for less than \$5,000 (excluding GST). If such an asset was acquired for the principal purpose of making taxable supplies, a full input tax deduction could be claimed and there would be no requirement to apportion or make GST adjustments. If such an asset was not acquired for the principal purpose of making taxable supplies, no input tax deduction could be claimed.
- 3.6 This test would reduce compliance costs for taxpayers by reducing the number of assets subject to the apportionment and adjustment rules. A GST adjustment would only be made if the principal purpose the asset was acquired for changed (which should be uncommon). A change from a taxable to non-taxable purpose would require an output tax adjustment to repay the input tax previously deducted on purchase, while a change from non-taxable to taxable purpose would allow a deduction to be claimed for the input tax incurred when the asset was purchased.
- 3.7 A principal purpose test would be much less accurate than the current apportionment rules. Some private use of relevant business assets could be undertaxed, and some business use of private assets could be overtaxed. However, with a \$5,000 threshold, the maximum GST adjustment would be \$750 per asset. This may be an acceptable loss of accuracy when compared with the potential compliance cost savings.
- 3.8 Furthermore, some GST-registered persons may already be claiming full input tax deductions on low-value work assets, rather than applying the apportionment and adjustment rules. This may be because the non-taxable use is minimal, or because they think the pre-2011 principal purpose test still applies.
- 3.9 This proposed principal purpose test would apply to low-value assets purchased on or after 1 April 2023 (assuming the relevant legislation was enacted in early 2023 and applied from this date). This is because, for assets acquired for less than \$5,000 before this date, GST-registered persons would already have

estimated an initial expected taxable use percentage on acquisition and the existing \$5,000 de minimis in section 21(2)(b) of the GST Act means no further adjustments would be performed unless the asset was sold or disposed of. In these circumstances, the compliance costs of transitioning all existing low-value assets into the proposed new principal purpose test would be higher than continuing with the current rules for those assets.

No adjustments for less than 20 percent change in use

- 3.10 For assets purchased for \$5,000 or more (excluding GST), we propose that an adjustment would only be made if the difference between the estimated taxable use (or previous actual use) and the actual taxable use exceeded a 20 percent threshold.³ For example, if an asset had an initial apportionment of 66 percent business use, then an adjustment would only be made if the business use dropped below 46 percent (-20 percent) or increased above 86 percent (+20 percent).
- 3.11 A 20 percent threshold has been proposed as we understand that a deliberate change in use of an asset has likely occurred, rather than an unintended change, where a registered person experiences a 20 percent change in use of an asset. Consequently, a 20 percent threshold should remove most compliance costs associated with closely monitoring and maintaining records on the use of each asset and making adjustments each year.
- 3.12 In cases where an asset had a more than 20 percent reduction in taxable use, the registered person could face a potentially large output tax liability in their next GST return, which could create cashflow difficulties. Similar cashflow difficulties can already arise in other situations, such as when a person deregisters from GST or when the wash-up rule in section 21FB of the GST Act has applied to require an output tax adjustment – although these situations are more within a registered person’s control.

20 percent de minimis and rounding up

- 3.13 In theory, a registered person should try to accurately estimate their percentage of taxable use and then claim that percentage of input tax deductions to reduce the likelihood of requiring an adjustment. However, the proposed 20 percent threshold above may encourage “cherry-picking”, whereby registered persons may claim a higher percentage of taxable use for depreciating assets and a lower percentage for appreciating assets that they intend to eventually sell (such as land).
- 3.14 For example, a registered person with more than 80 percent taxable use of an asset may prefer to claim 100 percent of their input tax deduction and rely on the 20 percent threshold to support this larger tax deduction. A different registered person with less than 20 percent taxable use of an appreciating asset (such as land) may prefer to claim they have 0 percent taxable use and rely on the 20 percent threshold to disregard their taxable use, so they do not need to return output tax when they dispose of the land.

³ A 10 percent threshold for adjustments exists under the current apportionment rules, but this can only be used if the actual adjustment would be less than \$1,000. This means the existing rule only allows a full 10 percent change in use if the actual asset was purchased for less than \$76,666. For assets valued above this, the threshold is less than 10 percent. Under this proposal, the \$1,000 limitation would be removed, and a more generous threshold of 20 percent would be introduced.

3.15 For this reason, it may be simpler and more consistent to bolster the 20 percent threshold with mandatory rules for assets that are more than 80 percent used for either taxable or non-taxable purposes. These rules could include:

- A new 20 percent de minimis. If the taxable use of an asset is 20 percent or less, then the asset would be deemed to be non-taxable when used or disposed of by the registered person. This would mean no input tax deduction on purchase of the relevant asset or output tax on its disposal.
- Rounding up to 100 percent taxable use where an asset is used 80 percent or more to make taxable supplies.
- Registered persons with assets used between 21 to 79 percent for taxable use would continue to apply the existing apportionment and adjustment rules to claim input tax deductions on the basis of their estimated intended taxable use percentage. However, subsequent adjustments would only be required if the percentage use changes by plus or minus 20 percentage points (as per the 20 percent threshold outlined above).

3.16 These proposals are summarised in Table 1.

Table 1: Summary of proposals

Percentage estimated or actual taxable use	Percentage used for GST purposes
0 to 20 percent	0 percent (de minimis)
21 to 79 percent	The estimated intended taxable use percentage, with subsequent adjustments only required if the percentage use changes by plus or minus 20 percentage points
80 to 100 percent	100 percent (rounding up)

3.17 Canada’s GST rules follow a similar approach to the above table for apportioning GST inputs on real property (land and buildings), except they use a 10 percent threshold, rather than 20 percent. In Canada, any taxable use of a building of less than 10 percent is treated as 0 percent and use of 90 percent or more is treated as 100 percent. No input tax adjustments are made unless the taxable use of the land or buildings has changed by 10 percent or more compared to its original use.

20 percent de minimis could exclude some homes

3.18 The proposed 20 percent de minimis appears consistent with current practices, whereby most registered persons would not regard their home as a business asset, even though it may be partly used to make taxable supplies. We anticipate that the business use of a house or farmhouse that is owned by a GST-registered person would often be 20 percent or less where one room is used some of the time as a home office for the registered person’s taxable activity.

3.19 However, in some situations the business use of a dwelling will exceed 20 percent, for example, a small property where a GST-registered independent contractor mainly works from home. In addition, many holiday homes owned by GST-registered persons would have more than 20 percent taxable use if they

are regularly rented out to make taxable supplies of short-term commercial accommodation.⁴

- 3.20 These cases suggest another policy reform option, such as those discussed in chapter 2 (the election method to remove an asset from a registered person's taxable activity) or chapter 5 (a potential new exempt supply rule for the sale of dwellings), may also be required if the policy objective is to exclude a greater range of assets from being treated as taxable when owned and used by a registered person to make taxable supplies.

Rounding up percentage of taxable use

- 3.21 Rounding up taxable use of 80 percent or more to 100 percent could significantly reduce the number of assets for which registered persons would need to apportion GST input tax. It would also reflect a practical reality that some business assets may occasionally be used privately and that the compliance costs of preventing this, or accounting for it, may outweigh any GST recoverable for the private use.
- 3.22 On the other hand, allowing GST-registered persons, particularly sole traders and closely-held businesses, to enjoy up to 20 percent private use of their business assets without incurring GST costs may be viewed as concessionary. This is because unregistered persons are charged GST on almost all the goods and services they purchase.

Work-related vehicles with limited private or non-taxable use

- 3.23 Currently, the usual apportionment and adjustment rules apply where a registered person utilises a motor vehicle as part of their taxable activity, with registered persons able to refer to the vehicle logbook⁵ to determine the extent of taxable use.
- 3.24 We anticipate that many registered persons will have recorded an intended and actual taxable use of 80 percent or more. This would generally be because the vehicle has a high business mileage during working hours and only minimal private use.
- 3.25 If there are a high number of vehicles with 80 percent or more taxable use, the proposed rule to round up taxable use to 100 percent could reduce compliance costs by removing annual apportionment monitoring and adjustments for these vehicles. However, taxpayers would still face some compliance costs from recording actual use or maintaining a logbook for income tax deductions and depreciation.
- 3.26 We are therefore interested in submissions on how many work-related vehicles would have 80 percent or more taxable use and whether the proposed 80 percent rounding-up rule for GST would be effective at reducing overall tax compliance costs for vehicles. We also welcome submissions on other potential methods for apportioning GST on motor vehicles that could reduce compliance costs while ensuring a fair and reasonable apportionment between taxable and non-taxable use.

⁴ For some holiday homes, the taxable use could be less than 20 percent because of more private use or use in making exempt supplies of residential accommodation during the period the property was owned.

⁵ The logbook method is set out in sections DE 6 to DE 11 of the Income Tax Act 2007.

A transitional wash-up calculation

- 3.27 Some registered persons may currently have assets they use between 21 and 79 percent for making taxable supplies, and those assets would continue to be subject to apportionment under the option described above.
- 3.28 We are considering whether to give registered persons the ability to choose to permanently change how they use such an asset so that their taxable use of the asset would be either 20 percent or less or 80 percent or more for all future years. They would then perform a wash-up calculation under section 21FB of the GST Act based on:
- 0 percent taxable use (if they have chosen to have 20 percent or less taxable use). The wash-up calculation would require them to pay output tax equal to any input tax deduction previously claimed.
 - 100 percent taxable use (if they have chosen to have 80 percent or more taxable use). The wash-up calculation would allow them to claim an input tax deduction based on the tax fraction of the original cost when they acquired the asset.
- 3.29 We welcome feedback on whether affected registered persons would change their behaviour and taxable use to be able to use such a wash-up calculation.

Application date and transitional rules for applying rounding rules

- 3.30 The proposed rounding options discussed above would apply to assets purchased on or after 1 April 2023 (assuming the relevant legislation was enacted in early 2023 and applied from this date).
- 3.31 To provide sufficient time for registered persons to understand and apply the proposed rounding rules to assets acquired before 1 April 2023, we propose allowing registered persons to transition assets purchased before that date into the proposed new rules within the next two adjustment periods. Any assets purchased after the application date of the provisions would be subject to the new rules in the adjustment period they are purchased in.
- 3.32 However, given the proposed new rules would be designed to be more effective and reduce compliance costs for registered persons, some registered persons may want to apply the new rounding rules sooner than the end of the second adjustment period. Therefore, we propose to allow registered persons to optionally elect to apply the new rounding rules to pre-reform assets at the end of the adjustment period in which the date of application of the new rules occurs (the first adjustment period).
- 3.33 Registered persons may apply the new rounding rules in either the first or second adjustment period on an asset-by-asset basis. However, by the end of the second adjustment period, the expectation is that all assets (both pre- and post-application date assets) would adhere to the new rules.

Questions for submitters

- What are the potential impacts of a principal purpose test for low-value assets? How would it align with current business practices?
- What are the potential impacts of only making GST adjustments for assets if there has been a more than 20 percent change in use?
- What type of assets would be either above 80 percent taxable use or below 20 percent?
- Would removing these assets from the GST apportionment and adjustment rules be effective at reducing overall tax compliance costs, given any private use may still need to be monitored for income tax purposes?
- How can we best reduce GST compliance costs on work vehicles that have only a small amount of non-taxable use?
- What are the potential impacts of the proposed application date and transitional rules?
- Are there other options we should consider for removing most assets from the compliance costs associated with tracking modest changes in use?

CHAPTER 4

Accommodation services supplied in dwellings and commercial dwellings

- 4.1 GST apportionment issues can arise when the same premises are used to make taxable supplies of commercial accommodation as well as being used for private use or to make exempt supplies of accommodation in a dwelling.
- 4.2 The GST treatment of such supplies can depend on the GST Act definitions of "dwelling" and "commercial dwelling". This chapter seeks submissions on whether new definitions could be developed that are more certain and easier to apply than the existing definitions.
- 4.3 We also welcome submissions on any alternative definitions or possible amendments that submitters consider may make the dwelling and commercial dwelling rules easier to apply.

Current issues

- 4.4 If a person lives in their own house, no rent is charged for this accommodation and accordingly no GST is paid on these accommodation services. There is no supply for GST purposes.
- 4.5 To ensure the GST system does not favour owner-occupied housing over renting a house, the service of accommodation in a dwelling is an exempt supply. This means no GST is charged on a residential tenancy and similar long-term accommodation services, but also no input tax deductions can be claimed by the landlord on the purchase price of the rental property or on any expenses incurred in providing the exempt accommodation service.
- 4.6 The definition of "dwelling" in the GST Act uses the definitions of "premises" and "quiet enjoyment" in section 2 and section 38 of the Residential Tenancies Act 1986 respectively. The definition also excludes "commercial dwellings", such as hotels, motels and boarding houses.
- 4.7 The interaction of the "dwelling" definition with the "commercial dwelling" definition can be difficult to determine in certain scenarios. For example, it may be unclear whether land and buildings is a "dwelling", a "commercial dwelling" or a combination of both that requires apportionment.
- 4.8 This difficulty is partly because the definition of "dwelling" is based on the nature of the accommodation services received by the occupant and determining whether an occupant has "quiet enjoyment" can sometimes be difficult to assess. In contrast, the definition of "commercial dwelling" is simply a list of different types of premises – hotels, motels, homestays, farmstays, B&Bs, inns, hostels, boardinghouses, serviced apartments, convalescent homes, nursing homes, rest homes, hospices, camping grounds and premises of a similar kind.
- 4.9 The definition of "dwelling" excludes a commercial dwelling. This exclusion can create issues where the same premises (such as a homestay or farmstay) are used to provide commercial accommodation services to guests but are also the residence or abode of other persons (such as the owner and their family or residential tenants).

Residential accommodation services

- 4.10 We propose that the current definition of “dwelling” be replaced by a new definition of “residential accommodation services”. This could be defined as “accommodation provided in premises or part of premises to a person who occupies, or will occupy, the premises (or part of the premises) predominantly as their place of residence or abode and includes any appurtenances belonging to, or used with, the premises”. This is similar to the pre-2011 definition of “dwelling”.

Commercial accommodation services

- 4.11 Several alternative options exist for defining the “commercial accommodation services” that would remain taxable supplies when supplied by a GST-registered person.
- 4.12 The first option would be to retain the existing definition of “commercial dwelling” but clarify how premises that are both dwellings and commercial dwellings should be treated. As mentioned above, there are cases where the same land, building or premises are used to provide either private accommodation to the owners or exempt residential accommodation services as well as commercial accommodation services to guests. In such cases, the private or residential tenancy accommodation services should still qualify as exempt supplies of residential accommodation. This outcome could be achieved by excluding “the supply of accommodation services in a commercial dwelling” from the proposed new definition of “residential accommodation services” (rather than the current approach of simply excluding commercial dwellings from the definition of “dwelling”).
- 4.13 However, another issue with the existing definition of “commercial dwelling” is that it uses a list of specified kinds of premises. To apply this definition, taxpayers and Inland Revenue need to subjectively assess whether a particular property fits within the specified kinds of premises on the list.
- 4.14 The list may also become less relevant and harder to apply over time as new types of accommodation are introduced or changes to how guest accommodation is provided are made. To some extent, the list is future-proofed because a property can qualify as a commercial dwelling if it is “premises of a similar kind” to one or more of the types of premises specified on the list. However, applying this test can be subjective, which creates uncertainty.
- 4.15 For these reasons, an alternative option would be to replace the current list of commercial dwellings with a new, more general, definition that describes some key features of commercial accommodation services – namely that the accommodation is usually short term or is bundled with additional regular services. Such a new definition of “commercial accommodation services” could include:
- Short-term accommodation services that are ordinarily intended to be provided to the recipient for periods of less than 28 days at a time. This would ensure short-term accommodation services are a taxable supply, regardless of the type of premises (such as a holiday home or hotel) they were provided in. To clarify, if a visitor was provided accommodation services for more than 28 days, these services could still be a taxable supply if they represented services that were ordinarily intended to be provided for less than 28 days.
 - Serviced accommodation that includes certain regular services (such as meals, cleaning or care services) being provided to the recipient as part

of the supply of accommodation services. In other words, the regular services are not provided as an optional extra or for a separate amount of consideration. This is intended to ensure serviced apartments, rest homes and certain types of student accommodation that include additional services remain taxable supplies.

- 4.16 Either of these new types of commercial accommodation services could be subject to the valuation rule in section 10(6) of the GST Act if they were, in fact, provided to a recipient for more than 28 days. Section 10(6) currently applies when a guest stays more than four weeks in a commercial dwelling, and the section effectively reduces the GST rate to 9% (by applying the 15% GST rate to 60 percent of the value of the supply). This valuation rule reflects the fact that longer-term stays can become a closer substitute for a residential tenancy so 40 percent of the consideration paid becomes exempt. However, 60 percent remains taxable as it may be for other domestic services, such as cleaning, electricity or telecommunications.

Land satisfying both definitions

- 4.17 Even under the proposed changes to the definitions of “dwelling” and “commercial dwelling” discussed above, an overlap and uncertain boundary between these two types of accommodation services would still exist.
- 4.18 One option that could address this uncertainty would be to allow GST-registered persons who own a single piece of land, building or premises used predominantly to provide one type of accommodation services to make an irrevocable election to deem all the accommodation services to be of that type.
- 4.19 For example, a retirement village will often have a mix of independent care units (exempt) and serviced units (taxable). This proposed option would allow some retirement village operators to choose either to exempt all their units (if they only make a small percentage of taxable supplies) or, alternatively, to treat all their units as taxable (if they predominantly have serviced units).
- 4.20 Similarly, a hotel or motel may provide staff accommodation in one part of their site. The hotel or motel could choose to treat this staff accommodation as a taxable commercial accommodation service. This would mean they would not need to apportion the land and other inputs, but they would also return output tax on the accommodation service and the sale of the hotel or motel complex.
- 4.21 This option could also potentially apply to temporary accommodation services provided to fixed-term or seasonal workers. Applying the election would typically clarify these are a taxable supply of commercial accommodation services based on the predominant type of accommodation services provided on these premises.
- 4.22 In cases where emergency social housing accommodation services are provided in premises usually intended for short-term occupancy, such as motels, hotels and hostels, this option could be used by the supplier to treat these accommodation services as either an exempt or taxable supply, depending on the predominant use of their premises.
- 4.23 Note, however, that if a change in use occurs such that premises that had been previously used by the registered person to make taxable supplies are now used to make exempt supplies, GST output tax adjustments would need to be returned for the capital cost of the premises.

Application date and transitional rule

- 4.24 If changes were made to the “dwelling” and “commercial dwelling” definitions, these changes would apply to accommodation services supplied on or after 1 April 2023 (assuming the relevant legislation was enacted in early 2023 and applied from this date).
- 4.25 The proposed changes in this chapter are intended to clarify and simplify the boundary and overlap between the current definitions rather than change the GST treatment of the relevant accommodation services. However, a transitional rule, similar to the rule in section 21HB of the GST Act, could be used to preserve the current GST treatment of dwellings or commercial dwellings if they are altered as a result of the proposed new definitions.

Questions for submitters

- What issues or uncertainties arise due to the current GST definitions of “dwelling” and “commercial dwelling”?
- Should the “dwelling” and “commercial dwelling” definitions be replaced to address these issues?
- What are the potential impacts of the options discussed in this chapter?
- Are there other options we should consider to make the dwelling and commercial dwelling rules easier to apply?

CHAPTER 5

Should the sale of a dwelling be an exempt or separate supply?

- 5.1 As discussed in chapter 1, under the current GST rules, when a GST-registered person owns land they use to make taxable supplies, the sale of that land can itself be a taxable supply. This is even though the land may include a house that has predominantly non-taxable use (such as a private residence, family use of a holiday home for no consideration, or exempt rental accommodation) and only a modest amount of taxable use.
- 5.2 One way to allow GST-registered persons to remove houses (and other assets) from their taxable activity is the election option discussed in chapter 2. An alternative option would be to make the sale of a house an exempt supply of land. This chapter discusses whether sales of dwellings should be made an exempt supply of land. However, note that if a registered person had developed the land with an intention to sell it (such as in the case of a property developer), the supply of the land would remain a taxable supply. Some potential rules for property developers are discussed in chapter 6.
- 5.3 This chapter also discusses how the GST rules should apply on the sale of land and buildings containing a combination of a dwelling and other types of spaces used to make taxable supplies. In general, we propose that when land that includes a dwelling is sold, the dwelling could be treated as a separate supply from other land or buildings contained on the land. This proposal is relevant even if house sales themselves are not made an exempt supply. This is because it could be used to identify the relevant premises (or part of the premises) that the proposed election option in chapter 2 or the rounding options in chapter 3 should be applied to.

Potential option of making the sale of a dwelling an exempt supply

- 5.4 Australia and Singapore have specific exemptions in their GST rules for sales of existing residential premises (as opposed to new builds or developments, which are subject to GST).
- 5.5 New Zealand could consider adding a new exemption to the GST Act so that sales of dwellings by registered persons who had not developed the property would become an exempt supply. There would therefore be no GST output tax on disposal of the property, and no input tax deduction for the purchase of, or capital improvements to, the property. A dwelling would include a person's principal place of residence, residential rental properties, and holiday homes.
- 5.6 A new exempt supply rule for houses could help align the GST rules with current practices. This is because GST-registered persons who are only using part of a house (such as for a home office) to make supplies of goods or services are unlikely to consider their house to be a business asset or the sale of the house as being in the course or furtherance of their taxable activity. It also achieves similar GST outcomes for GST-registered persons (such as sole traders) who own their house and use it in their business when compared to other GST-registered business owners who are separate to the person or entity who owns the house.
- 5.7 An exempt supply rule would prevent most registered persons from claiming an input tax deduction on purchases of dwellings. Such registered persons would also be prevented from claiming input tax deductions for capital expenses, such

as improvements to the dwelling. They would still be able to claim and apportion input tax for operating expenses, such as electricity or internet services provided to a home office, to the extent to which they are used to make taxable supplies. This could potentially add complexity by introducing a capital/revenue expenditure boundary into the GST Act, although the boundary could be the same as that used for income tax purposes. This would mean that if an input qualified as a revenue expense for income tax (as opposed to a capital improvement to the dwelling), an input tax deduction could be claimed for GST purposes to the extent the input was used to make taxable supplies.

- 5.8 This option would require new definitions of dwellings that are exempt when sold and dwellings that remain taxable supplies when sold (for example, properties that have been developed or built by property developers). We acknowledge these new definitions would add complexity and uncertainty to the GST rules for land.
- 5.9 A new type of exempt supply for the sale of a dwelling may not be necessary if the election option discussed in chapter 2 is introduced to allow GST-registered persons to exclude houses (and certain other assets) from their taxable activity. We are therefore interested in submitters' views on whether developing the option of a new exempt supply rule for sales of dwellings is worthwhile.

Defining dwellings for exemption

- 5.10 The current GST Act definition of "dwelling" appears unsuitable for applying an exemption to the sale of houses as it is based on the nature of the accommodation services received by the occupant rather than the type of property sold. For example, it would exclude houses, such as holiday homes, that are not used as a principal place of residence.
- 5.11 Accordingly, we consider a new definition of "dwelling" would be needed to identify land and buildings that could be an exempt supply when sold. This definition could be based on the characteristics of the building and would apply to owner-occupied houses and to properties that are close substitutes for owner-occupied housing (that is, they would be suitable for a person to move into and live permanently as their principal place of residence). This would include holiday homes.
- 5.12 The new definition could be based on paragraph (a) of the Income Tax Act definition of "dwelling", which is "any place configured as a residence or abode, whether or not it is used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place." This is similar to Australia's GST Act definition of "residential premises", which is "a building which can be occupied, is occupied, or is intended to be occupied, predominantly as a dwelling."
- 5.13 Any land (including dwellings) that was developed and sold by a GST-registered property developer would remain subject to GST on disposal as a taxable supply. Some potential rules for applying GST to land that is developed and sold by property developers are discussed in chapter 6.

Guest accommodation provided in holiday homes

- 5.14 If an exempt supply rule was introduced for the sale of houses by registered persons, we propose that the sale of a holiday home by a registered person could qualify as an exempt supply. However, any short-term accommodation services supplied when leasing a holiday home to a guest would remain a taxable supply for GST.

- 5.15 In cases where a GST-registered person uses part of their home or a holiday home to make taxable supplies of short-term guest accommodation services, we propose that the entire sale of the home or holiday home could still be a non-taxable or exempt supply of a private house, rather than being treated as a taxable supply or a partly taxable supply. This is because the home or holiday home would be a close substitute for owner-occupied housing, which would not typically be a taxable supply on sale (unless it was developed and sold by a property developer).
- 5.16 Alternatively, if the election method discussed in chapter 2 was introduced, that method could be used by GST-registered owners of holiday homes to exclude their purchase and disposal of the holiday home from being considered part of their taxable activity (even if it is partly used to make taxable supplies of short-term guest accommodation services).
- 5.17 Under either of these options, we anticipate that most GST-registered owners of a holiday home would not claim input tax deductions on the purchase of the holiday home or for capital spending on the house. GST output tax would then not apply to any subsequent disposal of the holiday home. However, the GST-registered person would still charge GST on their taxable supplies of leasing the holiday house as commercial accommodation and claim GST input tax deductions on operating expenses used to make these taxable supplies (for example, cleaning, property managers, rates and insurance, repairs).
- 5.18 Another possible option could be to introduce a special rule that would generally prevent input tax deductions from being claimed⁶ for the purchase of a holiday home (and any capital improvements) unless the registered person supplied taxable accommodation services to guests of at least \$60,000 per annum. Supplies made to associated persons, such as the owners or close family members, would be ignored, as they would be more akin to private consumption than a commercial activity. Such a rule would only allow input tax to be deducted on the purchase of, or capital improvements to, a holiday home when the holiday home operated on a similar scale to other commercial accommodation operators, such as hotels or motels (which would typically make more than \$60,000 per annum of taxable supplies to guests).
- 5.19 In any case where a GST-registered guest accommodation host had claimed input tax deduction in respect of buying their holiday house, they would be liable for GST output tax if they sold the house or stopped their taxable activity of selling guest accommodation.

Sales of land and buildings with a mix of dwellings and commercial spaces

- 5.20 Another key question is how the GST rules should apply on the sale of land and buildings that contain a combination of dwellings and other types of spaces used to make taxable supplies. This question is relevant even if house sales themselves are not made an exempt supply. This is because it could be used to identify the relevant asset (is it all the land or just the dwelling?) that the proposed election option in chapter 2 or the rounding options in chapter 3 should be applied to.
- 5.21 In general, we propose that when land that includes a dwelling is sold, the dwelling would be treated as a separate supply to other land or buildings contained on the land. Section 5(15) of the GST Act already achieves this for

⁶ Or require an adjustment to be made to return output tax of 15% GST on the zero-rated purchase price in cases where they purchased the house as a zero-rated supply of land or a going concern from another registered person.

dwellings that are a principal place of residence or have been exclusively used to make exempt supplies of accommodation in a dwelling for at least five years. Section 5(15) could be expanded to apply to a wider range of dwellings, such as holiday homes.

- 5.22 Such a rule would mean that farmhouses and curtilage would continue to be regarded as the supply of a separate asset that could be a non-taxable or exempt supply, while the surrounding farmland, which is used to make taxable supplies, would be a taxable supply of land.
- 5.23 Another common example is a residential dwelling with an attached retail shop or medical practice. In these cases, the intended policy outcome would be that the dwelling part of the building should be considered a separate supply to the business premises. This is because significant physical modifications would have been made to construct a shop or medical practice that make these spaces separate and different to the private rooms in the dwelling.
- 5.24 In contrast, a home office is often not physically separate or objectively different to other rooms within the dwelling. It is likely to closely resemble a study or bedroom. The policy intention would be to allow such home offices to be treated as the same supply as the other parts of the dwelling when the dwelling is sold.
- 5.25 Another common scenario is worker or employee accommodation provided on business premises. For example, a farmer may provide accommodation for seasonal workers, or there may be a unit or building within a hotel complex that a hotel manager or other staff members use as their principal place of residence. In these cases, we propose that the GST treatment of the dwelling would follow the GST treatment of the accommodation services. We note that chapter 4 discussed the option of allowing registered persons to elect to treat the accommodation services in these cases as being either all taxable or all exempt supplies based on the predominant type of accommodation provided.

Application date and dwellings purchased before that date

- 5.26 If the proposed new exempt supply rule for sales of dwellings was implemented, it would apply prospectively from a certain date after the new rules were enacted, such as 1 April 2023.
- 5.27 The potential option to exempt the supply of a dwelling would not apply to dwellings owned by registered persons where they had claimed an input tax deduction for the purchase of the dwelling before the application date of the new exempt supply rule.⁷ However, if such registered persons wanted to exclude a house from their taxable activity, we propose that they could choose to use the proposed election option in chapter 2. Paragraphs 2.24 to 2.26 of chapter 2 explain how this option could be applied to assets, such as dwellings, that were purchased before the application date of the proposed reforms.
- 5.28 If a new exempt supply rule was introduced, some dwellings purchased before the application date of the reforms would remain taxable supplies when disposed of, while other dwellings would qualify as exempt supplies. Managing these differences could be complex and confusing for taxpayers, tax advisors and Inland Revenue, which means this option could be difficult to implement.

⁷ It would also not apply to dwellings where the registered person had purchased the house as a zero-rated supply of land, or a going concern from another registered person, before the date the new exempt supply rule applied.

Questions for submitters

- What are the impacts of potentially making the sale of an existing dwelling an exempt supply?
- If a new exempt supply rule was introduced for the sale of an existing dwelling, how should a dwelling be defined?
- How should GST apply to the rental and sale of holiday homes?
- How should GST apply to sales of land with a mix of dwellings and commercial spaces?
- Would there be a practical way to transition into an exemption for sales of existing dwellings?
- Are there other options for simplifying GST on sales of existing dwellings we should consider instead?

CHAPTER 6

Land developed and sold by residential property developers

- 6.1 Under any of the proposals discussed in this issues paper, land that was developed and sold by a GST-registered property developer would remain subject to GST on sale as a taxable supply.
- 6.2 This chapter discusses the option of allowing a full input tax deduction for land when a registered person has commenced a housing development with the intention to sell the land as a taxable supply.
- 6.3 The proposals in this chapter would not apply to developers of commercial land, as such developers would typically only be making taxable supplies (the sale or lease of commercial land) so would not need to apply the apportionment and adjustment rules.
- 6.4 Under both the current and proposed GST rules discussed in this issues paper, there is a risk that a GST-registered person could claim a full input tax deduction on the purchase of land they intend to develop and sell as new or improved housing, but they do not proceed with the development and end up holding the property for a long time rather than selling it and returning GST.
- 6.5 This chapter discusses some options that could mitigate this risk. These include requiring the registered person either to have an existing business of developing land or for their development activity to have commenced before an input tax deduction could be claimed for the purchase of the land. A time limit could also be introduced that would require the housing developer to sell the land within 36 months of claiming a full input tax deduction or apply to Inland Revenue for an extension.
- 6.6 Finally, this chapter invites submissions on how GST should apply to build-to-rent developers.

Full input tax deduction for land used for housing developments

- 6.7 The current GST apportionment rules are complex to apply if the land is being developed to be sold as a taxable supply of new or improved housing but also has some non-taxable use (such as owner-occupation or a residential tenancy) during the period of the registered person's ownership. Some developers may be able to use the existing de minimis in section 20(3D), which provides that they do not need to apportion input tax for an adjustment period if the total value of their exempt supplies will not exceed the lesser of \$90,000 or 5 percent of the total consideration for all their taxable and exempt supplies for the adjustment period.
- 6.8 To reduce compliance costs for housing developers with a greater amount of non-taxable use of land, we propose that instead of applying the apportionment rules to such land, a full input tax deduction could be claimed by the GST-registered property developer for the purchase of the land and for other capital development costs once the development activity has commenced. This would simplify GST compliance for residential property developers.
- 6.9 The proposal could also ensure build-to-sell developers face a similar GST treatment, regardless of whether they are building new houses on vacant land or replacing or renovating existing buildings, which may be tenanted until the major development work commences. This could encourage more efficient use

of housing. For example, property developers may currently prefer to have vacant properties rather than letting them to a residential tenant until they are ready to be developed or sold. This is because having vacant properties ensures the developer gets a full input tax deduction and simpler GST compliance, whereas if the property is let, that non-taxable use would mean GST apportionment would apply to the land.

- 6.10 Under the proposal a property developer's holding costs (such as insurance and local authority rates) would still need to be apportioned between taxable and non-taxable use. Expenses directly attributable to providing an exempt supply of accommodation in a dwelling (such as a property management service, cleaning services used between tenants, repairs to damage caused by tenants) would remain non-deductible for GST input tax purposes.
- 6.11 A possible way to further simplify the rules could be to provide an option for property developers to return (but not charge) GST on the rent paid for the exempt supply of accommodation in a dwelling (or the market value rent that could have been charged if an owner-occupied property had instead been tenanted). If this option was implemented, it would allow the GST-registered property developer to claim a full input tax deduction for all their input costs. We are interested in submissions on whether this method should be extended to other types of registered persons (not just property developers) who have concurrent use of land, as it appears simpler than using the current concurrent use of land rules. This could be implemented by allowing such registered persons to apply to the Commissioner of Inland Revenue to agree an alternative apportionment method. This is further discussed in chapter 7.

Defining land used for housing developments

- 6.12 If special GST rules were introduced for land that will be developed and sold as new or improved housing by registered persons, then the land these rules would apply to would need to be defined.
- 6.13 One option could be to define the land using the descriptions of this type of land recently included in proposed provisions in Supplementary Order Paper No 64 to the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill. These descriptions are used to exempt from the income tax interest limitation rules land that is part of a land business or is being developed for new housing. These descriptions are:
- land that the person holds as part of a business described in section CB 7 of the Income Tax Act 2007 (Disposal: land acquired for purposes of business relating to land), and
 - land that is subject to the person's undertaking or scheme involving development, division, or building for the purpose of creating new build land.
- 6.14 The GST reform options that are proposed in this chapter could apply to similar housing developments. That is, a full GST input tax deduction could be claimed on the purchase of land by a GST-registered person if that person buys the land as part of a business described in section CB 7. Note that the definition in section CB 7 includes land acquired by persons who are associated with an existing business that meets the eligibility requirements if the land will be used in the land development business. This means that if an existing business establishes a new GST-registered person, such as a company or partnership, to buy and develop the land, the new registered person could still be a business described in section CB 7 due to being associated with the existing business relating to land.

- 6.15 A full input tax deduction could also be claimed on land that is subject to the person's undertaking or scheme involving development, division, or building for the purpose of creating new build land. However, such an input tax deduction would only be claimed from the time that the undertaking or scheme commenced (rather than the date of purchase). This is intended to mitigate the potential fiscal risk that a purchaser of land could register for GST and claim GST input tax deductions because they intend to develop the property, but then the development does not commence and the registered person fails to make output tax adjustments to reflect their non-taxable use of the land.⁸
- 6.16 If a GST-registered person did not buy the land as part of an existing business of land described in section CB 7, we propose that they would not be able to claim an input tax deduction for the cost of the land at the time of purchase. However, once they started developing the land and had an intention to sell the land when they finished the development, they would then be able to claim a full input tax deduction on the purchase price of the property in their next GST return. Evidence that they had commenced the development activity could include that they had lodged a building consent or a resource consent with the local authority for a development, or that they had begun to incur development costs, such as expenses for draftspersons, surveyors or engineering services.

Time limit to sell land intended for residential development

- 6.17 The proposed rules would need to address the risk that a GST-registered person claimed a full input tax deduction for the purchase of the land, but then did not proceed with the development and continued to hold the property for a long period, rather than sell it and return GST.
- 6.18 We therefore propose that a time limit could be introduced for the property development. More specifically, if a registered person claimed a full input tax deduction for land under the proposed new property development rules but does not sell the land within 36 months, there would be a deemed disposal of the land for its current market value.
- 6.19 We acknowledge that a deemed sale would create cashflow difficulties. To mitigate this, we propose that the GST-registered person could apply to Inland Revenue to request an extension to the 36-month time limit. The person would have to provide sufficient evidence that they have developed the property, or are continuing to develop it, and that they intend to sell the property within a certain timeframe. Evidence of this might include that they are actively marketing the land for sale. At the end of any such extension period given, if the registered person has not already disposed of the property, they would either need to reapply for a further extension or face a deemed disposal.

Application date

- 6.20 If the proposed options discussed above were implemented, they would apply prospectively to land purchased from a specified date after the new rules had been enacted, such as 1 April 2023.

⁸ Alternatively, a GST-registered purchaser may buy land from another registered person, who sells it as a zero-rated supply of land under section 11(1)(mb), and the purchaser does not make an adjustment for non-taxable use under section 20(3J).

Build-to-rent developers

- 6.21 Rather than selling land as a taxable supply, build-to-rent developers buy land and develop new and improved housing to make long-term exempt supplies of accommodation in a dwelling (as a residential landlord). Accordingly, build-to-rent developers are charged GST on their inputs, such as land purchases and construction costs, and are generally unable to register for GST or claim input tax deductions to recover the GST on their development costs. This is because these costs are connected to making exempt supplies, rather than taxable supplies.
- 6.22 We understand that some build-to-rent developers consider the current GST settings to be a barrier to investment, as the GST cost on their expenses leads to higher upfront costs and increases the amounts that build-to-rent developers need to borrow or finance for their projects.
- 6.23 From a GST policy perspective, there does not appear to be a good rationale for build-to-rent developers being able to deduct their input tax and receive a GST concession that is not available to other residential landlords or owner-occupiers (who are charged GST on their costs).

Questions for submitters

- What are the potential impacts of allowing a full input tax deduction (instead of applying apportionment and adjustment rules) for land and capital improvements purchased by housing developers who intend to sell new or improved housing? Are there other options we should consider instead?
- What are the potential impacts of requiring the registered person to have an existing business of land development or to wait until their development activity has commenced before claiming an input tax deduction for purchasing land?
- How should land developed for the purpose of sale be defined?
- What are the potential impacts of the proposed 36-month time limit for developers to develop and sell residential land?
- Are there other options for simplifying GST compliance for housing developers and encouraging housing developments to commence and be sold within a reasonable timeframe?
- How should GST apply to build-to-rent developers? What issues arise with the current settings?

CHAPTER 7

Other options for simplifying the GST apportionment rules

- 7.1 The previous chapters in this issues paper discussed major policy reform options that, if progressed, could allow registered persons to exclude certain assets from their taxable activity or be deemed to have 100 percent taxable use of an asset.
- 7.2 These major reform options could greatly reduce the number of situations where registered persons would need to apply the apportionment rules to assets, in particular for dwellings.
- 7.3 However, various assets would remain subject to apportionment calculations and adjustments, and therefore it makes sense to consider some smaller changes that may improve the apportionment rules. This chapter discusses some of these potential improvements.
- 7.4 We invite submissions on these proposals or other suggestions for simplifying the current apportionment rules for those registered persons who may need to continue to apply them and make annual adjustments.

Reduce the required number of adjustment periods

- 7.5 Under the current GST apportionment rules, registered persons estimate their percentage taxable use at the time they acquire an asset and are then generally required to monitor for any changes in the percentage taxable use for either two, five or ten adjustment periods (up to ten years) after an asset is purchased. A de minimis applies, so that for assets purchased for less than \$5,000 (excluding GST) no subsequent adjustment is required unless the asset has been disposed of.
- 7.6 To reduce compliance costs for lower-value assets, we propose that the required number of adjustment periods should be reduced to two for assets acquired for less than \$20,000 (excluding GST). Thus, the actual use of these assets would only need to be monitored for two adjustment periods. This would be in addition to the proposed principal purpose test for assets acquired for less than \$5,000 (discussed in chapter 3) that, if introduced, would mean a subsequent adjustment would only be required when such assets are sold.
- 7.7 For land, a registered person must currently monitor their taxable use every adjustment period (that is, every year) until disposal. To reduce compliance costs, we propose that a ten-period limit could be introduced for land – the same limit that currently applies to other types of assets acquired for \$500,000 or more.
- 7.8 Table 2 shows how the current rules compare to the proposals in this issues paper. All values exclude GST.

Table 2: Comparison of the current rules and the proposed changes

Required number of adjustment periods (that is, annual balance dates)	Current rules	Proposals in this issues paper
None (just estimated percentage taxable use when purchased)	Less than \$5,000	New principal purpose test for assets less than \$5,000
Two	\$5,000 to \$10,000	\$5,000 to \$20,000
Five	\$10,000 to \$500,000	\$20,000 to \$500,000
Ten	\$500,000+	\$500,000+ and all land
Unlimited	Land	Not applicable

Expand the wash-up rule eligibility

- 7.9 Section 21FB of the GST Act contains a wash-up calculation that applies when a registered person has experienced a change to either 100 percent taxable use or 100 percent non-taxable use of an asset during the current adjustment period and for all the following adjustment period. This is measured at two consecutive annual balance dates. If their use has changed to 100 percent taxable use, the wash-up rule requires the registered person to claim a full input tax deduction for the input tax they incurred at the time they acquired the asset. If, instead, their use has changed to 100 percent non-taxable use, they are required to make an output tax adjustment to repay input tax previously deducted.
- 7.10 Some taxpayers may purchase business assets before they are GST registered that they subsequently use to make taxable supplies after they register for GST. If they had been registered for GST at the time they purchased the business asset, they would have been able to claim an input tax deduction in their next GST return to the extent to which they used the asset to make taxable supplies. The apportionment and adjustment rules allow such taxpayers to gradually claim input tax deductions on such assets after they have registered for GST. They may also be able to claim a full input tax deduction if the wash-up rule in section 21FB applies. This is because they would have had two adjustment periods where they had 100 percent taxable use of the asset. However, this delays their ability to claim a full input tax deduction for assets used to make taxable supplies. To address this issue, we propose that a registered person should not have to wait two adjustment periods to use the wash-up rule if their use has permanently changed to 100 percent taxable use. Instead, we propose they should be able to make the adjustment to the new percentage at the end of the current adjustment period.
- 7.11 Another potential improvement to the wash-up rule would be to allow it to be used for any permanent change to a particular fixed percentage use (as opposed to only those cases where the use has permanently changed to 100 percent taxable or 100 percent non-taxable). For example, if a person's use changed to 50 percent taxable and they expected this percentage to remain stable for the foreseeable future, they would be able to perform the wash-up calculation to claim 50 percent of the input tax deductions. It is also proposed that, in these circumstances, the registered person would be able to perform the wash-up calculation at the end of the adjustment period when the permanent change in use occurred, rather than having to wait two adjustment periods.

Repeal the mixed-use asset rules in section 20G

- 7.12 The mixed-use asset rules in section 20G of the GST Act add the complexity of another potential formula but have limited application. The rules only apply to certain assets, such as holiday homes, aircraft and yachts, and only when their use is a mixture of private days, taxable days and at least 62 unused days.
- 7.13 In addition, it is likely that many of the assets currently subject to these mixed-use asset rules could be excluded from a registered person's taxable activity as a result of the major policy reforms discussed in this issues paper. For example, a registered person could use the election method proposed in chapter 2 to exclude a holiday home from their taxable activity, or they could deem an aircraft or pleasure craft to be non-taxable if their taxable use was less than the 20 percent de minimis proposed in chapter 3.
- 7.14 For these reasons, we propose that the current mixed-use asset rules in section 20G should be repealed. In those cases where GST apportionment continued to apply to a registered person's mixed-use assets, their GST input tax deductions and adjustments would instead be calculated using the same general GST apportionment rules that apply to other assets.

Repeal the concurrent use of land rules in section 21E

- 7.15 As discussed in chapter 6, we propose that some special rules be introduced for land developed by residential property developers. These rules would replace the concurrent use of land rule for property developers, as they would be able to claim a full input tax deduction for the purchase of land once they commenced developing the property.
- 7.16 Accordingly, we propose that the concurrent use of land rules in section 21E of the GST Act could be repealed, as other situations where land is used to make both taxable and non-taxable supplies by a registered person are usually able to be apportioned on a time and/or space basis. Alternatively, such registered persons could apply to Inland Revenue for approval to use a more practical alternative apportionment method (as discussed in the next section below).
- 7.17 If the concurrent use of land rules were repealed, thought would need to be given to how GST-registered persons who are currently using this calculation method would transition into the new rules. One option would be to allow such registered persons to apply the proposed special rules for residential property developers that would allow a 100 percent deduction for land that is being developed but generally requires the land to be sold within 36 months of claiming the full deduction. If those rules were not applicable because, for example, the registered person's taxable use of the land did not involve developing and selling the land (for example, they could be in the process of converting a residential property into a commercial building or clearing it to build / widen a road), they would also be able to apply to the Commissioner of Inland Revenue to agree an alternative apportionment method.
- 7.18 In addition, we are interested in submitters' views on whether grandparenting provisions would potentially be required for land that the concurrent use of land rules currently apply to, and if so, what period for grandparenting would be appropriate?

Allowing a wider range of approved apportionment methods

- 7.19 Sections 20(3EB) and 21(4B) of the GST Act allow registered persons to apply to the Commissioner of Inland Revenue to approve an alternative

apportionment method. This is intended to reduce compliance costs, as an alternative apportionment method could produce similar GST outcomes to the default apportionment rules but with much lower compliance costs.

- 7.20 Currently, any alternative apportionment method is required to have regard to the tenor of the default apportionment rules and formula in the relevant sections 21A to 21H. This requirement may limit alternative methods to those methods that are based on the default rules and formula rather than other methods that may be more practical and provide a fair and reasonable method of apportionment but that use a different methodology.
- 7.21 For example, where residential rental income is received for a limited period and is incidental to a much larger taxable use of the land, it could be more practical for the registered person to return (but not charge) GST output tax on consideration received for an exempt supply of accommodation in a dwelling. They would then claim full input tax deductions for associated expenses, rather than making annual adjustments under the default apportionment rules and formula.
- 7.22 To accommodate a wider range of methods, we propose removal of the requirement that the alternative method has to “have regard to the tenor of” the default apportionment rules and formula. We would retain the more general requirement that the alternative method simply provides “a fair and reasonable method” of apportionment.
- 7.23 This proposed change would be complementary to an existing proposal included in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill to remove the current \$24 million turnover threshold in section 21(4B). If enacted, that proposal will allow all GST-registered persons to apply to the Commissioner to use an alternative apportionment method.

Application date

- 7.24 If the proposed options discussed in this chapter were implemented, they would apply prospectively from a specified date after the new rules have been enacted, such as 1 April 2023.

Questions for submitters

- What are the potential impacts of reducing the number of adjustment periods for assets acquired for less than \$20,000 and for land?
- What are the potential impacts of expanding eligibility for the wash-up calculation? Are there other options we should consider instead?
- Should the mixed-use asset rules for GST be repealed? What are the potential impacts of this?
- Should the concurrent use of land rules be repealed and replaced with rules for property developers? What are the potential impacts of this?
- If the concurrent use of land rules were repealed, how should GST-registered persons who are currently using this calculation method transition into the new rules?
- Are there other ways of simplifying the current apportionment rules we should consider?