Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill

Bill Number 65-

Regulatory Impact Statements

1. Taxation of the gig and sharing economy: GST (25 May 2022)
2. Taxation of the gig and sharing economy: Information reporting and exchange (25 May 2022)
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Regulatory Impact Statement: Taxation of the gig and sharing economy: GST

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing final Cabinet decisions
Advising agencies:	Inland Revenue
Proposing Ministers:	Minister of Revenue
Date finalised:	25 May 2022

Problem Definition

Digital platforms in the gig and sharing economy facilitate income earning opportunities for small-scale operators on a large scale. Because many of these supplies occur below New Zealand's GST registration threshold, they are not subject to GST. This has given rise to two policy problems that these proposals seek to address:

- **Competitive distortion:** A competitive distortion arises between traditional suppliers of these services who charge GST, and services undertaken through digital platforms, which are generally not subject to GST.
- **Sustainability of the GST base:** The ability of digital platforms to facilitate income earning opportunities for individuals on such a large scale and generally below the GST registration threshold (and the growth in activity on these digital platforms) has the potential to erode the GST base over time unless these services enabled by digital platforms are taxed in the same way as supplies of the same services made by other means.

Executive Summary

Overview

The gig and sharing economy refers to economic activity facilitated through digital platforms (commonly referred to as mobile apps) that connect buyers with sellers who share their skills, labour, and assets. Common examples include ridesharing services, short-stay accommodation, and food and beverage delivery services. The gig and sharing economy is growing in popularity as it offers flexible working arrangements and an easy way to connect buyers and sellers.

There are no special tax rules for sellers in the gig and sharing economy. They are not employees, so have costs associated with complying with their tax obligations. These include being required to keep records of income and expenses, potentially paying provisional tax, and being required to account for GST. In this regard they are considered self-employed for tax purposes.

The proposals being considered by this project on the 'Taxation of the gig and sharing economy' cover two main areas. This Regulatory Impact Statement (RIS) explores options relating to GST. Another RIS has been prepared which covers information reporting and exchange for the gig and sharing economy.

How GST should apply in the context of the gig and sharing economy

GST applies to the broadest possible range of goods and services in New Zealand. This keeps GST fair, simple and efficient. New Zealand's GST system operates with a $60,000 GST registration threshold which is intended to recognise there are trade-offs between a broad-based GST system and the compliance and administration costs associated with GST registration.

These compliance and administration costs potentially fall away (or are significantly reduced) in the context of the gig and sharing economy where transactions are facilitated by large and sophisticated digital platforms with the ability to process millions of transactions on a regular basis. Many sellers who currently operate through digital platforms expect to earn below the GST registration threshold so are not registered for GST. The policy question is whether GST should apply to these supplies and, if so, how best to apply it.

Options considered

The Government released a discussion document in March 2022[1] which considered two main options: lowering the GST registration threshold for sellers in the gig and sharing economy or extending current electronic marketplace rules to require digital platforms in the gig and sharing economy to collect GST. Although these were the only options formally consulted on in the discussion document, officials have considered a wider range of options, some of which arose out of the consultation process. Briefly, the options considered were as follows:

Options not involving digital platforms

1. The status quo
2. Lowering the GST registration threshold for all taxpayers
3. Requiring mandatory GST registration for "listed services" (which are specific gig and sharing economy activities)

Options involving digital platforms

4. Extended electronic marketplace rules that would require digital platforms to collect GST in respect of "listed services".[2]

If Option 4 is the preferred solution, there are several other sub-decisions that need to be made from a detailed policy design perspective that inform how the proposals would work in practice. These are:

- **Defining "listed services":** If digital platforms are required to collect GST in respect of activities undertaken by sellers through their digital platforms, it would need to be determined which activities were "listed services" and therefore subject to GST collection by the digital platforms. Two options are considered here:
    1. An approach that focused on the sectors the gig and sharing economy that create the most urgent GST pressures at this time (accommodation, transportation, and food and beverage delivery services).

[1] The role of digital platforms in the taxation of the gig and sharing economy. (2022). Available at: http://taxpolicy.ird.govt.nz/publications/2022/2022-dd-digital-platforms-gig-sharing-economy

[2] A variation of this option would allow sellers that are registered for GST to continue to return GST to Inland Revenue on supplies of services they make through digital platforms, but this is not supported by officials for integrity reasons.

2. A wider approach (which, in addition to those sectors outlined in option 1 also includes a wide range of personal and professional services).

- **Options to allow sellers to claim GST on their costs:** If digital platforms are required to charge GST on supplies made through them, sellers would need a method for claiming back GST on their costs. Three options are considered here:

1. Standard GST registration where sellers would register for GST and provide GST returns in the same way as any other business or self-employed person
2. A flat rate scheme where digital platforms collect GST at the standard rate, and return a portion of this to Inland Revenue, with the remaining amount being paid to the seller in recognition of the GST component of their costs
3. Refunding GST on sellers' costs as part of the annual income tax return process.

The preferred option

Option 4 is the preferred option. Under this option, digital platforms will be required to return GST on supplies of "listed services" as if the digital platform itself had made the supply, even though the services were performed by the seller through the digital platform. For integrity reasons and to reduce complexity with the design and implementation of the rules, this will apply to all supplies of "listed services" made through the digital platform, irrespective of whether the underlying seller was registered for GST or not.

Under the preferred option, "listed services" are transportation services (which includes ridesharing and food and beverage delivery) and taxable accommodation. These sectors were identified by the OECD as the most significant in terms of the gig and sharing economy currently. Also included in "listed services" are other services closely connected with these services. Existing rules for determining when an electronic marketplace is a supplier for the purposes of the remote services rules will be leveraged to achieve this.

Sellers would be able to recover GST on their costs associated with making supplies through digital platforms through either:

- The standard GST registration: This involves registering for GST and claiming GST deductions in the same way as any other business or self-employed person. In all cases where a seller is registered for GST, the output tax is still returned by the platform.
- The digital platform applying a flat rate of GST: Under a flat rate system, GST is still charged on the supply at a standard rate of 15%. However, only a proportion of this is returned to Inland Revenue, with the remainder given to the underlying seller as a proxy for their GST costs. This amount recognises the seller would otherwise be over-taxed through not having a mechanism to recover GST on costs associated with making supplies through digital platforms. The flat rate would be set at 6.5%, with the remaining 8.5% to be returned to the underlying seller as a proxy for their costs. This amount has been arrived at through an analysis of sellers' costs in these industries. Sellers with turnover greater than $60,000 would still be required to register for GST and would not be able to use the proposed flat rate scheme, however digital platforms would still be responsible for collecting and paying GST to Inland Revenue.

The preferred option would impact the following stakeholders in the following ways:

- **Digital platforms:** They would be required to collect GST on sales made by sellers through their platforms and pay this to Inland Revenue. Digital platforms would need to account for this additional tax which could reduce their competitive advantage currently held over traditional suppliers of the same services that generally have been collecting and paying GST already.

- **Sellers on digital platforms:** Sellers on digital platforms that are registered for GST would no longer be required to return output tax, as this would be collected by digital platforms on their behalf. GST registered sellers would continue to claim GST on their expenses in the usual way. Sellers operating through digital platforms that are not registered for GST would be subject to a flat rate of GST at a reduced rate to account for the otherwise unrecoverable GST on their expenses.
- **Inland Revenue:** As a result of requiring digital platforms to collect GST in respect of "listed services" through digital platforms, Inland Revenue would potentially have to monitor and police a large influx of GST registered sellers seeking to claim GST on their expenses (to the extent they elected to register over a flat rate scheme). Inland Revenue would also have to undertake monitoring to ensure compliance with the rules. This would require Inland Revenue resource and therefore have administration costs.

Consultation

There were 13 submitters on the discussion document: Airbnb, the Asia Internet Coalition, Baker McKenzie, Booking.com, Chartered Accountants Australia and New Zealand, the Corporate Taxpayers Group, Delivereasy, EY, KPMG, the New Zealand Law Society, PwC, Trade Me, and Uber NZ. Submitters did not support implementing extended electronic marketplace rules for activities in the gig and sharing economy noting the complexities involved and the lack of evidence available to suggest that the absence of GST on most supplies of services through gig and sharing economy digital platforms is distorting consumer decisions.

Limitations and Constraints on Analysis

The main constraint or limitation on the analysis is that the gig and sharing economy is difficult to measure. This problem is international and not specific to New Zealand.

While the OECD's extended model rules for information reporting and exchange might start to provide information on the size of the gig and sharing economy in New Zealand, the information exchange will take some time to implement and for the information to be flowing.

The number of sellers that operate in the gig and sharing economy in New Zealand in the sectors of short-stay accommodation, transportation, and food and beverage delivery services is expected to be in the 10s of thousands, but it has been difficult to verify this with any degree of certainty.

This still represents a significant amount of economic activity that is not subject to GST and in officials' views waiting for more information on the size of the gig and sharing economy will not influence the outcomes of the thinking that has been done to date.

There were no other significant constraints or limitations on the analysis in this statement.

Responsible Manager	
Graeme Morrison Policy Lead Policy and Regulatory Stewardship Inland Revenue 25 May 2022	
Quality Assurance	
Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance panel at Inland Revenue has reviewed the *Taxation of the gig and sharing economy: GST* Regulatory Impact Statement prepared by Inland Revenue and considers that the information and analysis summarised in the Regulatory Impact Statement **meets** the quality assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

GST is designed to apply to the broadest possible range of goods and services supplied in New Zealand. This keeps GST fair, simple and efficient. New Zealand has a GST registration threshold of $60,000 and suppliers with turnover under this threshold are not required to (but still can choose to) register for GST. GST registered persons need to add GST to their supplies of goods and services (unless they are exempt supplies) and can claim a credit for the GST on the costs they incur in producing those supplies.

Recent years have seen the rapid development of digital platforms and electronic marketplaces which quickly and easily connect a product or service provider with potential buyers. This is driven by modern technologies (such as mobile phone applications and online websites) that enable digital platforms to facilitate transactions between sellers and buyers. Many sellers operating through gig and sharing economy digital platforms are small suppliers who are not required to be registered for GST, but viewed collectively, facilitate hundreds of millions of dollars of sales through digital platforms that are not subject to GST (or where GST applies to a small component – the facilitation services from the digital platforms to the underlying sellers – instead of the overall transaction).

A study of the major global markets placed the size of the gig and sharing economy at US$204 billion in 2018, with that size projected to reach US$455 billion by 2023.[3] The estimated size of the gig and sharing economy in New Zealand is $1.9 Billion excluding GST.

What is the policy problem or opportunity?

The proliferation of the gig and sharing economy and this unique business model gives rise to two key policy considerations. The first is that a competitive distortion arises between traditional suppliers who compete with digital platforms and who generally do charge GST, and digital platforms which generally do not charge GST on services provided through them, and therefore have a competitive advantage. This problem arises particularly in the context of the gig and sharing economy because large digital platforms facilitate an income earning opportunity for small economic actors on a large scale. This means that, viewed collectively, sellers in the gig and sharing economy have a large and disruptive effect on traditional industries that provide the same services.

The second key policy issue is that the large-scale nature of the gig and sharing economy has the potential to erode the NZ GST base as more people switch to this way of working and away from other more traditional business models that do charge GST. It is therefore important from a tax policy perspective to consider whether current GST policy settings are appropriate in light of the growth of the gig and sharing economy to ensure the sustainability of the GST base going forward.

New Zealand's GST system has been expanded in the last decade to apply to offshore suppliers of remote services and low value imported goods. A key feature of these recent changes is the role of digital platforms and electronic marketplaces. Special rules treat electronic marketplaces as the supplier of goods or services provided through their platforms

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[3] https://newsroom.mastercard.com/wp-content/uploads/2019/05/Gig-Economy-White-Paper-May-2019.pdf. (This study was conducted prior to COVID-19. It is unclear what impact COVID-19 will have on the global gig and sharing economy long term.)

instead of the underlying suppliers who include the likes of software developers and goods sellers. These electronic marketplaces have similar characteristics to the digital platforms that facilitate activity in the gig and sharing economy. One view is that the existence of these digital platforms reduces the compliance and administration costs associated with collecting GST revenues for tax authorities. This is because digital platforms have a business model which necessitates them being able to deal with thousands of transactions on an on-going basis, and most digital platforms will already be registered for GST in New Zealand because of the remote services rules.

If the status quo continues there is a risk of erosion of the GST base as the gig and sharing economy continues to grow and the disruptive effect that gig and sharing economy platforms have on traditional business models will continue. Changes are therefore necessary to ensure the sustainability of the GST base and a level playing field with traditional business models.

What objectives are sought in relation to the policy problem?

The objectives are to:

- Address issues relating to competitive neutrality caused by the GST system by ensuring that supplies of services provided through digital platforms have a similar GST treatment to supplies of the same kind of services made through other means.
- Protect the long-term sustainability of the GST base in New Zealand by maintaining a broad-based GST system that is responsive to emerging trends and technologies.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

The criteria that have been used to assess the options are:

- **Fairness**: Is the preferred option effective at ensuring that those in the same position pay the same amount of tax (horizontal equity)? Fairness refers to traditional suppliers and sellers in the gig and sharing economy facing similar GST rules.
- **Efficiency**: Do the preferred options minimise impediments to economic growth? Do the options avoid distortions to taxpayer decisions?
- **Coherence**: Do the preferred options make sense in the context of the entire tax system and New Zealand's international tax relations? Are the preferred options consistent with New Zealand's broad-base low-rate framework?
- **Compliance costs**: Do the preferred options encourage sellers in the gig and sharing economy to comply with their tax obligations with low compliance costs? (Regarding options to claim input tax credits.) Does the preferred option impose disproportionate compliance costs on digital platforms?
- **Administration**: Are the preferred options possible for Inland Revenue to implement and administer without substantial ongoing administration costs?
- **Sustainability**: Is the preferred option future-proofed? Is it scalable for other activities in the future? Will the preferred option protect the sustainability of the GST base going forward?
- **Administration**: Are the preferred options possible for Inland Revenue to implement and administer without substantial ongoing administration costs?

What scope will options be considered within?

The scope of options was initially informed by the work completed by the Organisation for Economic Cooperation and Development in a report on "The impact of the growth of the sharing and gig economy on VAT/GST policy and administration". New Zealand specific proposals were developed and consulted on in the discussion document *The role of digital platforms in the taxation of the gig and sharing economy* which was published in March 2022.

The discussion document canvassed the relevant experiences of other countries in this area, and this informed the scope of options which were consulted on (for example, Canada implemented reforms to require digital platforms to return GST on supplies of short-stay accommodation made through them; and Mexico implemented a flat rate of GST to account for sellers' costs which was consulted on in a New Zealand context).

There are no non-regulatory options (being options that do not involve the amending of New Zealand's legislation) that would achieve the policy objectives. This is because the existing law, and the $60,000 GST registration threshold, means many sellers in the gig and sharing economy are not required to charge GST on their supplies. Non-regulatory options would not achieve the stated objectives which, given their nature, would require amendments to New Zealand's GST legislation.

Stakeholder views

Submitters did not support extending the electronic marketplace rules for remote services and low value goods to also apply to supplies of short-stay accommodation and personal services facilitated through digital platforms in the gig and sharing economy because:

- Doing so would introduce additional complexity to New Zealand's GST system. This includes increasing compliance costs on digital platforms and underlying sellers who would need to comply with any new GST rules.
- The discussion document did not contain economic modelling or analysis that suggested the lack of GST on many services in the gig and sharing economy resulted in distortions.
- It would be inconsistent with the approach taken by many other OECD countries, where the focus was on implementing the OECD's information reporting and exchange framework and using that information to improve compliance with existing GST rules.

What options are being considered?

Option One – Status quo

Individual sellers in the gig and sharing economy will only be required to register, and collect, GST on supplies they make provided they exceed the registration threshold of $60,000 in a 12-month period.

Digital platforms are not responsible for collecting GST on supplies made through them.

As the gig and sharing economy is dominated by small operators operating below the GST registration threshold, the status quo would not achieve the policy objectives of treating supplies of the same or similar services in the same way for GST purposes and ensuring the sustainability of the GST base.

Option Two – Lowering the GST registration threshold across the board

New Zealand's GST registration threshold of $60,000 could be lowered so that more sellers were required to be registered for GST, including those who operate in the gig and sharing economy.

The advantage of this approach over the status quo is that it would help achieve the stated policy objective of treating supplies of the same or similar services in the same way for GST purposes and promotes the objective of ensuring the sustainability of the GST base.

The disadvantages of this option are that any general changes to the GST registration threshold would have a broad impact across all sectors of the economy. This option also does not eliminate the competitive distortion problem. This is because digital platforms would still be facilitating income earning opportunities for many people beneath the new registration threshold in direct competition with traditional businesses that were subject to GST. Similarly, this option does not ensure the sustainability of the GST base into the future, as it would depend on where the new registration threshold was set. There could still be a considerable number of "smaller" sellers beneath the threshold that would have a disruptive effect on these sectors of the economy. It is also noted that lowering the GST registration threshold would create a different set of issues in terms of ensuring sellers were compliant with their GST obligations. The option fails to recognise the role that large digital platforms with oversight of transactions running through them could have to support the policy objectives more effectively.

Option 3 – Requiring sellers in specified industries to be registered for GST

This option would require GST registration of sellers that provided specifically prescribed activities, for example short-stay accommodation, transportation/ridesharing, and food and beverage delivery services. This would result in a targeted reduction of the GST registration threshold for specific areas of the economy.

This option could achieve the stated policy objectives, but it would result in significant compliance costs for sellers in specific areas of the economy who would be required to register for GST. This also has administrative implications for Inland Revenue as there would be an increase in the number of GST registered persons in the system, which has corresponding administrative implications, for example the processing of GST returns and registrations and general support which would be required.

Option 4 – Extended electronic marketplace rules that require digital platforms to collect GST on listed services

Digital platforms (which are currently recognised in the GST Act as “electronic marketplaces”) in the gig and sharing economy would be responsible for collecting GST as if the digital platform itself had made the supply, even though the services were provided by the seller on the digital platform.

To minimise the disruptive effect of any proposals on large commercial operators who are already complying with GST obligations, we recommend that the proposals include a way for digital platforms and large commercial operators to agree to allow large commercial operators to continue returning GST themselves. This is consistent with the general purpose of the proposals, which is to minimise compliance costs to the extent possible while ensuring GST applies to activities in the gig and sharing economy.

Why a solution that involves digital platforms?

The policy rationale for the GST registration threshold is to recognise that there is a trade-off between having a broad GST base that minimises distortions against the compliance and administration costs associated with GST registration.

Looked at individually, many sellers in the gig and sharing economy operate below the GST registration threshold of $60,000 in a 12-month period and the compliance and administration costs associated with GST registration outweighs the benefits of GST registration. Looked at collectively, however, digital platforms facilitate a considerable proportion of economic activity which is not currently subject to full GST.[4] This is counter to the principle of maintaining a broad GST base that minimises distortions.

These compliance and administration considerations are largely mitigated in the context of the gig and sharing economy where a large platform with the ability to manage hundreds of thousands of transactions on an on-going basis and facilitates and has oversight over all the activity of the underlying seller through that platform. By placing the compliance costs on the platform of collecting and returning GST, this option reduces compliance costs that may be faced by the underlying sellers themselves if they had to comply with GST registration and return filing obligations.

Like many other countries, New Zealand has implemented expansions to its GST rules in the last decade to require digital platforms/electronic marketplaces to return GST on supplies of remote services and low value imported goods. These rules treat electronic marketplaces as the supplier of goods or services provided through their platforms instead of the underlying suppliers, who include the likes of software developers and goods sellers.

These rules are working well and have shown that the GST system can adapt to new technologies and in cross-border situations. They have also improved the fairness of the GST system by treating supplies of similar goods and services in the same way. The natural next step is that the involvement of digital platforms in the gig and sharing economy be examined in the same way, as collecting GST from digital platforms helps minimise compliance costs for sellers and simultaneously addresses the desired policy objectives of a sustainable GST system that minimises distortions.

Another advantage of requiring the digital platforms to collect GST rather than the individual sellers themselves is that it reduces opportunities for non-compliance. This is because GST is collected and returned by the platform directly.

Option 4: Sub-decision: What services would be in scope of extended electronic marketplace rules?

If digital platforms were required to collect GST on activities undertaken by sellers through platform, the activities that were “listed services” would need to be determined. There are two options for determining what activities would be in scope of extended electronic marketplace rules:

1. **Focused approach:** This focuses on the sectors the gig and sharing economy that create the most urgent GST pressures. These are currently short-stay accommodation, transportation/ridesharing, and food and beverage delivery services.

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[4] Digital platforms will generally charge and collect GST on the facilitation services they provide to sellers in the gig and sharing economy under the GST rules for remote services. This is a small proportion of the overall transaction.

2. **Broad approach:** In addition to those sectors in option 1, this also includes a broader range of personal services which includes other professional services such as freelancing, translation services, web, and graphic design, etc.

The focused approach is the preferred approach. This is because it accounts for sectors in the gig and sharing economy that are already well developed and create the most urgent pressures from a GST perspective.

While the broad approach brings in a broader range of economic activity that should, prima facie, be subject to GST in light of this analysis, it is not supported. This is because GST is already collected on many personal services through the remote services rules and bringing personal services in scope would result in additional complexity and cross-over with the remote services rules which officials consider are working well.

While tax policy officials consider there are good arguments for including a broad range of personal services in the GST system where those services are facilitated through digital platforms, additional time is needed to develop proposals that minimise complexity. As the gig and sharing economy is expected to continue to grow over time, as new and emerging business models gain in popularity, any solution that is implemented now should be scalable in the future. The preferred option therefore includes the ability to add additional activities that would be subject to the same rules as are proposed for supplies of taxable accommodation, transportation, and food and beverage delivery services. This approach would allow the GST Act to be amended in the future as the gig and sharing economy develops.

Option 4: Sub-decision: GST on sellers' costs

The decision to implement electronic marketplace rules for remote services and low value imported goods did not give rise to how GST on sellers' costs might be recovered. This is because the underlying suppliers in these circumstances would generally be unlikely to have New Zealand GST embedded in the costs associated with producing these types of supplies.

This is not the case for the gig and sharing economy where the underlying suppliers (sellers) will have New Zealand GST on the costs they incur in producing the supplies in New Zealand through digital platforms.

The discussion document considered three different methods for enabling sellers to recover GST on their costs. The discussion document also noted that there was no obvious solution and that all options recognise there are trade-offs between accuracy, compliance and administration costs.

The three options to address this issue were:

1. **Standard GST registration:** Sellers could register for GST and complete GST returns in the usual way to claim credits for the GST on their expenses. Sellers would only be required to account for GST on sales made for other supplies they make outside of the digital platform to Inland Revenue. The advantage of this option is it allows sellers to claim the GST component of their actual costs as a credit (the same as any other self-employed person who is registered for GST), but this increases compliance costs for sellers who otherwise would not have an incentive to register for GST. There was mixed support from submitters for this option on the discussion document.

2. **Flat-rate scheme:** GST would be collected by digital platforms at the standard rate of 15 percent, but 6.5 percent would be returned to Inland Revenue as GST with the difference (8.5 percent) being returned to the seller in recognition of the GST component of their

costs.[5] Sellers would not be able to claim actual GST deductions for expenses incurred in making their supplies as the reduced GST rate would be a proxy for recognising the GST costs on their expenses. This option reduces sellers' compliance costs but the amount a seller receives back to account for their GST costs is an approximation only. There was also mixed support from submitters for this option on the discussion document.

3. **Refunding GST on costs as part of the annual income tax return process:** This option would allow sellers who were not registered for GST to claim back GST on their costs by providing them with a refundable tax credit when they provided their annual income tax return. In theory, this method reduces compliance costs relative to Option 1 (because sellers will always have to provide an annual income tax return) and would be more accurate than the flat rate scheme in Option 2 because it provides an opportunity for GST on actual costs incurred (rather than applying a proxy) but it is complex. It also means that sellers would only get the tax credit annually (as opposed to more frequently compared with Options 1 and 2) and could be confusing because it incorporates GST in the income tax return process in a novel way. This option was not supported by submitters on the discussion document.

The preferred option is a combination of Options 1 and 2: optional **GST registration with a flat rate scheme applying for sellers that choose not to register for GST**. Under the preferred option, sellers could choose to register for GST in the usual way and claim back any GST on their expenses. Sellers with turnover greater than $60,000 would be required to register for GST and would not be able to use the flat rate (the platform would still return their output tax).

If sellers with turnover under $60,000 chose not to register for GST, the flat rate would apply and the digital platforms would apply a flat rate treatment where GST was returned to Inland Revenue at a 6.5% instead of the standard rate, with the 8.5% difference being passed on to the sellers by the platform. This option was suggested by several submitters on the discussion document.

This option is preferred because it provides sellers with flexibility to claim GST on their actual costs if they choose to, but it also ensures that those who are not registered for GST are recognised in some way without needing to increase their compliance costs through GST registration.

At the margins, this option also has administrative benefits for Inland Revenue as it should reduce the incentive to be registered for GST for those who operate through digital platforms.

Financial implications of preferred option (Extended electronic marketplace rules that require digital platforms to collect GST on listed services)

The preferred option is expected to raise approximately $47 million per annum. This fiscal estimate was arrived at using a 'bottom up' approach. Digital platforms currently return GST on their facilitation fees. GST returns of specific digital platforms who provided "listed services" were analysed to determine the amount of GST paid on their facilitation fees. This amount was then grossed up to impute the underlying sales to the customer of the service and then scaled appropriately.

[5] The specific percent split ascribed to the flat rate of GST (6.5%) and the amount returned to sellers to account for GST on their expenses/inputs (8.5%) was not covered in the discussion document. This was determined after this option was chosen through an analysis of sellers' costs as included in GST returns for the relevant sectors of the gig and sharing economy.

The fiscal estimate then accounted for the GST component of sellers' costs, with the projections accounting for both GST registered sellers and those that would be subject to the 6.5% flat rate. Once sellers' costs were taken into consideration, this resulted in an estimate of $47 million revenue gain per annum from these proposals. This estimate does not account for any future growth in the gig and sharing economy and assumes all sellers who would be better off registering for GST than under a flat rate elect to do so (some will not due to inertia which would result in a greater revenue gain than the forecast amount).

Example key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

How do the options compare to the status quo/counterfactual?

	Option One – Status quo	Option Two – Lowering the GST registration threshold across the board	Option 3 – Requiring sellers in specified industries to be registered for GST	Option 4 –Extended electronic marketplace rules that require digital platforms to collect GST on listed services
Fairness	0	--	+	++
Compliance costs	0	-	-	0
Admin costs	0	--	-	-
Efficiency	0	0	+	++
Coherence	0	-	0	+
Sustainability	0	+	+	++
Overall assessment	0	--	+	++

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

The option that is most likely to achieve the policy objectives outlined in this statement is Option 4.

By requiring digital platforms to collect GST, Option 4 ensures that compliance costs are reduced for sellers and that GST will be reliably collected on supplies made through them. This model applies to a set of listed services, being activities that are well developed in the gig and sharing economy and for which there is a strong evidence base for urgent pressures from a GST perspective. For sellers to recover the GST on the costs, the combination of an optional GST registration and the flat rate scheme for GST unregistered persons to enable sellers to claim a credit for the GST on their costs ensures fairness and reduced compliance costs for sellers.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Regulated groups (Sellers in the gig and sharing economy that provide listed services)	Sellers may face a marginal increase in their compliance costs to the extent that they choose to register for GST. Supplies of listed will now be subject to GST. Although it is likely that digital platforms would raise their prices to account for GST, this could result in some drop in demand. This would impact sellers' incomes.	Low	Medium
People who purchase listed services through digital platforms in the gig and sharing economy	If GST is required to be collected by digital platforms on these services, it is assumed this will be passed on fully to consumers. This will increase the cost to consumers of purchases made through digital platforms by up to 15 percent.	Medium/High	Medium/High
Digital platforms	Would have to start collecting GST on supplies of listed services made through them. This would have pricing implications and systems implications. .	High	High

Regulators (Inland Revenue)	Inland Revenue would be required to administer a flat rate of GST and monitor compliance for an increased number of GST registered platform sellers	There is an up-front system build cost of $0.3 million. There are also ongoing administration costs for Inland Revenue.[6]	High
Total monetised costs		Medium/High	High
Non-monetised costs		Medium	High
Additional benefits of the preferred option compared to taking no action			
Regulated groups (platform sellers)	Increased certainty regarding their tax obligations due to platform intervention	n/a	n/a
Regulators (Inland Revenue)	Improved tax compliance as GST collected by platform. Improved sustainability of the GST base by virtue of GST being collected on supplies of listed services through digital platforms	Refer to column below	High
Others (Government)	Will receive additional GST revenue collected by digital platforms in respect of listed services undertaken by sellers on these platforms	$47 million per annum	Medium – this amount has been forecast based on the current size of the "listed services" sectors of the gig and sharing economy and is a conservative estimate.
Total monetised benefits		$105.75 million across the forecast period.	
Non-monetised benefits		*Low to Medium*	

[6] The estimated costs are up to $2 million (excluding depreciation and capital charge), which includes $0.3 million for the capital system building and $1.7 million for administration costs over the forecast period.

Section 3: Delivering an option

How will the new arrangements be implemented?

The preferred option (Option 4 – extended electronic marketplace rules that require digital platforms to collect GST on listed services) would require amendments to the Goods and Services Tax Act 1985 and the Tax Administration Act 1994.

Inland Revenue would be responsible for the implementation and administration of the new rules. Inland Revenue will provide guidance to digital platforms and sellers affected by any changes to ensure there is an understanding of the new rules. This would include supporting digital platforms through ongoing discussions with them.

The usual guidance would be published on the changes on Inland Revenue's website and in a *Tax Information Bulletin* shortly after any changes were enacted into law.

Submitters on the discussion document noted the importance of development time to make the necessary changes to their systems. It was noted that a period of 12 months following enactment of any changes and the publication of clear guidance was generally necessary. Officials' advice on the effective date of any proposals would therefore take this into account.

How will the new arrangements be monitored, evaluated, and reviewed?

Inland Revenue would seek funding for additional resource to monitor the estimated increase in GST registrations and additional contacts from taxpayers because of these changes. Inland Revenue would also undertake increased compliance activity for unfiled returns, other general non-compliance (such as debt collection), and complaints. The GST proposals discussed in this RIS are alongside a proposal on information reporting and exchange (which is discussed in a separate RIS) that, if implemented, will result in Inland Revenue having better information about sellers' activities on digital platforms in the gig and sharing economy. There is an obvious synergy here in that the receipt of these information flows would further help to bolster compliance initiatives for the GST proposals.

More generally, policy officials would also maintain strong communication channels with stakeholders in the tax advisory community and these stakeholders will be able to correspond with officials about the operation of the new rules at any time. If problems emerge, they will be dealt with either operationally, or by way of legislative amendment if agreed by Parliament.

Regulatory Impact Statement: Taxation of the gig and sharing economy: Information reporting and exchange

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing final Cabinet decisions
Advising agencies:	Inland Revenue
Proposing Ministers:	Minister of Revenue
Date finalised:	25 May 2022

Problem Definition

The policy problem this proposal seeks to address is to improve Inland Revenue's visibility over income earned through digital platforms in the gig and sharing economy. Having access to timely income information will help drive tax compliance (because Inland Revenue can use this information to ensure that sellers are reporting the income they earn on digital platforms in the gig and sharing economy) and could make it easier for individuals to comply with their tax obligations.

Executive Summary

Overview

The gig and sharing economy refers to economic activity facilitated through digital platforms (commonly referred to as mobile apps) that connect buyers with sellers who share their skills, labour, and assets. Common examples include ridesharing services, short-stay accommodation, food delivery, and freelance services. The gig and sharing economy is growing in popularity as it offers flexible working arrangements and an easy way to connect buyers and sellers.

There are no special tax rules for sellers in the gig and sharing economy. They are not employees, so have costs associated with complying with their tax obligations. These include being required to keep records of income and expenses, and potentially paying provisional tax and being required to account for GST. In this regard they are considered self-employed for tax purposes.

The proposals being considered by this project on the 'Taxation of the gig and sharing economy' cover two main areas. This Regulatory Impact Statement (RIS) deals with information reporting and exchange. Another RIS has been prepared which explores GST options for the gig and sharing economy.

Information reporting and exchange

Inland Revenue does not receive regular income information for sharing and gig economy workers (like it does from banks or employers in respect of investment income or salary and wage income for example). This lack of income information creates a tax compliance risk and makes it harder for individual taxpayers working in the gig and sharing economy to fulfil their tax obligations. As part of our policy thinking in this space, we are looking to improve Inland Revenue’s access to information held by digital platforms in the sharing and gig economy platforms, which receive a great deal of income information about sellers. This will make it easier for individuals to comply with their income tax obligations and support income tax compliance.

The two proposals that were consulted on in the discussion document *The role of digital platforms in the taxation of the gig and sharing economy* which was released in March 2022 are: implementing rules designed by the Organisation for Economic Co-operation and Development (the OECD) that would see the automatic exchange of information between tax authorities of income information from digital platforms in the gig and sharing economy, or designing rules that are bespoke to New Zealand’s tax system.

Option 1 – The OECD solution

The OECD developed a set of model reporting rules with digital platforms in the gig and sharing economy which require digital platforms to provide information to tax authorities about sellers who operate on their platforms. This information includes identifying information about the sellers and detail of income earned through the digital platforms. There are two variations of this option. The first requires information to be provided by platforms that facilitate the sale of personal services and rental of immovable property. The second option is an extended version of the model rules which also applies to the sale of goods and vehicle rental.[1] These will be discussed at greater length in the options section of this RIS.

If New Zealand implemented an OECD based solution, this would help improve Inland Revenue's visibility over income earned through digital platforms and could be used in various ways to support tax compliance, such as through prompting sellers to file returns or pre-populating income tax returns (it is noted that pre-population would not be considered until at least year 4 to allow information sharing between jurisdictions time to properly bed in).

The way these rules operate requires jurisdictions who implement the rules to collect certain information about the activities of sellers on digital platforms that are tax resident in their country. Information must be shared by tax authorities that collect information from digital platforms that are tax resident in their jurisdiction with other tax authorities of other jurisdictions to the extent that the information relates to tax residents in their jurisdiction, and where that jurisdiction has also implemented the OECD’s rules.

Advantages of the OECD solution

One clear advantage of this OECD led solution is that it promotes a standardised schema with significant buy in and consultation having been undertaken with the digital platforms themselves. This standardised schema reduces compliance costs for platforms. If jurisdictions designed their own rules, the variations between jurisdictions would result in increased compliance costs for digital platforms that had to design their information systems to satisfy the requirements of multiple bespoke rules. This solution leverages existing technological frameworks that have been implemented by tax authorities worldwide for the automatic exchange of information of financial account information.

[1] Ridesharing falls under ‘personal services’. Vehicle rental refers to when the seller themselves provides a vehicle for rent through a platform.

Not only does an OECD led solution reduce compliance costs for platforms, but it is also sustainable for the long term as its received widespread buy-in from platforms and provides good quality information to jurisdictions.

Disadvantages of the OECD solution

The OECD model rules follow a prescribed schema that provides information exchange on a calendar year basis. This means that if the information were to be later used for pre-population of income tax returns an alteration would need to be made to account for our tax year (which is 1 April to 31 March), such as by deeming the income earned on a calendar year to have been earned for a tax year or only pre-populating 9 months of income information.

The success of the information flows from model rules is also dependent on other countries signing up for improved information flows. This is because information will only be shared among tax authorities whose countries have implemented the rules (that is, if New Zealand implemented the rules, Inland Revenue would only receive information from other tax authorities that were also subject to the rules).

Option 2 – Bespoke rules

The second option considered is for the Government to design and implement its own rules for information collection and reporting in New Zealand as opposed to implementing the OECD schema.

Advantages of bespoke rules

One clear advantage of developing bespoke rules is that we could prescribe the data we wanted to collect from platforms along with the frequency and timing of this information, which would allow for easier pre-population of income information.

Disadvantages of bespoke rules

A bespoke solution for NZ would increase compliance costs for digital platforms and could result in reduced appetite for them to operate in New Zealand. It would also take much longer to implement as more extensive consultation would need to be taken with digital platforms (noting under the OECD solution a lot of this has been done).

Another disadvantage of a bespoke solution is that it would be more difficult for New Zealand to collect data from non-resident digital platforms with NZ sellers. This is because our domestic law would have no legal effect, and our information requests would be sitting outside the internationally agreed OECD framework which has received a large degree of buy-in across many jurisdictions. Platforms are less likely to comply with requests that sit outside the standardised OECD schema due to increased compliance costs as previously mentioned.

Option 1 is the preferred option, with officials preferring the extended version of the model rules over the more limited version.

Impact of the preferred option

The driver of the OECD's model rules is to create a standardised information reporting and exchange framework that minimises compliance costs on digital platforms (by ensuring they only need to report information to one tax authority as opposed to several) while improving tax authorities' access to information about income earned by sellers on those digital platforms, which is useful for tax administration purposes.

The information that Inland Revenue would receive from other tax authorities under the OECD's information reporting and exchange framework will reduce sellers' abilities to conceal or under-report income they earn in the gig and sharing economy. This information could be used by Inland Revenue to ensure that those who earn income from the gig and sharing economy are paying the correct amount of tax (Inland Revenue could use this information to support compliance initiatives or, after information flows mature, pre-populate income tax returns.

It is noted that pre-population of income tax returns is undertaken on a gross basis and not a net basis. This means that Inland Revenue would still be reliant on sellers to record deductions for expenses incurred in deriving income. If taxpayers did not record their expenses, they would effectively be overtaxed. Although income tax is ultimately a self-assessment regime irrespective of pre-population, this consideration around sellers' expenses does not apply to the same extent in the employment and investment income context.[2] All considered, pre-population is still an improvement over the status-quo as it ensures income generated through the gig and sharing economy is captured in sellers tax returns. In some circumstances standard cost deductions are available to support sellers to arrive at their profits in their income tax returns with minimal compliance costs.

In terms of specific impacts, the following parties are affected in the following ways:

- **Digital platforms:** Limited impact on platforms as they have already indicated approval to adopt the standardised OECD schema approach through consultation with OECD. Platforms will need to provide information in respect of sellers on their platforms. This will require platforms to develop the necessary systems, however they will already be doing so anyway as other countries move to adopt the OECD rules.
- **Sellers operating in the gig and sharing economy:** Reduced opportunities to conceal or under-report their income from activities in the gig and sharing economy as income information will be reported by a third party and/or through other tax authorities. At the margins, there may be a decrease in sellers' compliance costs because they may be able to see the information that Inland Revenue holds on income earned through digital platforms (consistent with income earned from investments and employment). Sellers will still need to track their expenses and claim deductions for these to ensure that income tax was only paid on their profits from these activities.
- **Inland Revenue:** Changes will be required to Inland Revenue's START system to ensure that the information received from digital platforms and other tax authorities is aligned with the OECD's schema. There will be additional ongoing administration costs to support the information exchange with other tax authorities (ensuring the data meets appropriate data quality standards). Changing the START system to show the income information received from digital platforms and/or other tax authorities for sellers will also be required in the future, and after several years of the information exchange having run to address any issues around data integrity that may arise.

Consultation

These proposals were included in the discussion document. There were 13 submitters on the discussion document: Airbnb, the Asia Internet Coalition, Baker McKenzie,

[2] Taxpayers are not able to claim expenses incurred in deriving employment income. Although taxpayers are able to claim expenses incurred in deriving investment income, these are typically less extensive compared to expenses incurred in deriving gig and sharing economy income.

Booking.com, Chartered Accountants Australia and New Zealand, the Corporate Taxpayers Group, Delivereasy, EY, KPMG, the New Zealand Law Society, PwC, Trade Me, and Uber NZ.

Submitters understood the need for Inland Revenue to have better access to information about sellers' activities on digital platforms in the gig and sharing economy and all supported implementation of the OECD's model rules to address the current information gap. Submitters had mixed views on how the information should be used in the context of pre-populating sellers' income tax returns. Some noted that it could result in an incomplete representation of sellers' income from all sources overall and could result in confusion for sellers if particular income sources were missing. It was also noted that it would not be possible to pre-populate expenses for sellers.

As was noted in the discussion document, the mismatch between calendar year reporting under the OECD's rules and the New Zealand tax year, which ends 31 March, would cause further problems. For these reasons, and that the data quality in the first few years of the information exchange is not expected to be of a high enough quality to enable pre-population, officials do not recommend the information is used for pre-population purposes at this stage. After the first few years of the information exchange having been in operation, pre-population can be considered.

Limitations and Constraints on Analysis

There were no constraints or limitations on the analysis in this statement.

Responsible Manager

Graeme Morrison

Policy Lead

Policy and Regulatory Stewardship

Inland Revenue

25 May 2022

Quality Assurance

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance panel at Inland Revenue has reviewed the *Taxation of the gig and sharing economy: Information reporting and exchange* Regulatory Impact Statement prepared by Inland Revenue, and considers that the information and analysis summarised in the Regulatory Impact Statement **meets** the quality assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

Inland Revenue does not regularly or systematically receive information about sellers' income earned through digital platforms in the gig and sharing economy. The Commissioner of Inland Revenue has statutory information gathering powers and could require information be provided on an ad-hoc basis, but this imposes compliance costs on the provider of the information and would lack the regularity necessary to be useful on a yearly basis.

This information would be useful for Inland Revenue to ensure that people in the gig and sharing economy are paying the right amount of tax.

Inland Revenue receives regular employment and investment income information from employers and banks, and this is generally used to pre-populate income tax returns. Taxpayers in these circumstances will typically confirm that the information that is pre-populated in their income tax returns is correct and can make adjustments if necessary. This reduces their compliance costs as they do not need to collate information about their income earned from various sources and can instead rely on information that has already been provided to Inland Revenue.

Digital platforms are like employers, banks, and other third parties that hold information that would be useful for tax administration purposes. This includes information about the income sellers on their platforms earn. This information would be useful for Inland Revenue if it were available on a regular basis: it could be used to ensure that sellers were declaring the income they earn in their income tax returns, and eventually, in the pre-population of sellers' income tax returns in a similar way that employment and investment income information is currently. As previously noted, Inland Revenue would still be reliant on sellers to record deductions for expenses incurred in deriving their income to ensure these sellers are not overtaxed, as pre-population would only prefill gross income amounts.

Given the increasing popularity of the gig and sharing economy it is appropriate that the Government consider whether its current tax settings are appropriate for:

- **Sellers on digital platforms.** This is because they are treated in the same way as self-employed persons who are responsible for tracking their income and expenditure and completing end of year income tax returns.
- **Inland Revenue.** This is because Inland Revenue is responsible for the administration of the tax system, which includes ensuring and promoting taxpayer compliance with tax laws.

Digital platforms are generally sophisticated and have business models which result in them having a significant amount of information that is valuable in a tax administration context. Because digital platforms operate in many different countries it is desirable from their perspective that any requirement to provide tax authorities with information about sellers that use their platform is simple to understand and comply with, and in a low-cost way.

The OECD have undertaken work on developing a set of model rules that jurisdictions can implement. These rules will enable information reporting and exchange in respect of income earned by sellers through digital platforms.

Digital platforms have been involved in this consultation and support the OECD model rules schema and the standardisation it brings. Standardisation is important to digital platforms from a compliance perspective as it means they do not have to devote resources complying with hugely varied domestic rules.

What is the policy problem or opportunity?

The policy problem this proposal seeks to address is to improve visibility over incomes earned through the gig and sharing economy. Having access to timely income information will help drive tax compliance by reducing opportunities for sellers to conceal or under-declare their income and may also make it easier for individuals to comply with their tax obligations (through pre-population of income sources in income tax returns).

The proposals would affect:

- **Foreign and domestic digital platforms:** These platforms would have reporting obligations to tax authorities about sellers' income earned on their platforms. This includes compiling reports with identifying information about sellers and their incomes.
- **Sellers on digital platforms:** Inland Revenue would have improved visibility over sellers' incomes earned on digital platforms. This information could be used by Inland Revenue to support sellers comply with their tax obligations. In the knowledge that Inland Revenue has access to information, this may reduce possibilities for motivated sellers to conceal from Inland Revenue details about the income they earn. Information reported by New Zealand digital platforms to Inland Revenue that related to non-resident sellers' activities could also be shared with that sellers' tax authority (if the OECD rules option were selected).

  A study of the major global markets placed the size of the gig and sharing economy at US$204 billion in 2018, with that size projected to reach US$455 billion by 2023.[3] The estimated size of the gig and sharing economy in New Zealand is $1.9 Billion excluding GST.
- **Inland Revenue:** Under both the OECD rules and a bespoke regime, Inland Revenue would receive income information from digital platforms about sellers operating on these platforms that it could use in its tax administration functions.

One reason the lack of visibility that tax authorities have over sellers' incomes in the gig and sharing economy has not been addressed in the past is that it requires information gathering by digital platforms. The rise of the gig and sharing economy in recent years and the proliferation of individuals who have switched to this method of working provided the OECD with the impetus to examine these issues. Historic analysis undertaken by Inland Revenue on self-employed persons suggest that they underestimate their incomes by an average of 20 percent. The work undertaken by the OECD has been significant in analysing the policy problem, potential solutions and receiving buy-in from jurisdictions and large digital platforms for a set of model rules that promote standardisation.

What objectives are sought in relation to the policy problem?

The objective is to improve visibility over incomes earned through the gig and sharing economy. Inland Revenue having access to timely income information will help drive the tax compliance of sellers and may make it easier for individuals to comply with their tax obligations.

[3] https://newsroom.mastercard.com/wp-content/uploads/2019/05/Gig-Economy-White-Paper-May-2019.pdf (This study was conducted prior to COVID-19. It is unclear what impact COVID-19 will have on the global gig and sharing economy long term.)

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

The critiera that have been used to assess the options are:

- **Fairness**: Is the option effective at facilitating the payment of the correct amount of tax by taxpayers? This is often described as horizontal equity: the idea that people in the same position should pay the same amount of tax. Tax should not be easier to avoid just because someone works in a different industry or sector.
- **Compliance costs**: Do the preferred options encourage sellers in the gig and sharing economy to comply with their tax obligations with low compliance costs?
- **Administration**: Are the preferred options possible for Inland Revenue to implement and administer without substantial ongoing administration costs?
- **Efficiency**: Do the preferred options minimise impediments to economic growth? Do the options avoid distortions to taxpayer decisions?
- **Coherence**: Do the preferred options make sense in the context of the entire tax system and New Zealand's international tax relations? Are the preferred options consistent with New Zealand's broad-base low-rate framework?
- **Sustainability**: Are the preferred options future-proofed? Will the options be able to apply and extend to future developments in the gig and sharing economy space without the need for further regulatory change?

What are the scope of options?

In order to improve visibility over sellers' incomes in the gig and sharing economy, it follows that Inland Revenue will need access to income information. The only feasible option to improve these information flows is to require digital platforms to provide this income information to Inland Revenue in some way or another. There is scope in terms of the exact categories of information to be collected and the timing and frequency of this information.

The options were consulted on in a public consultation paper which also asked for submissions on any alternative options, but no additional options were identified by submitters.

What options are being considered?

Option One – Status quo

Individuals who earn incomes through the gig and sharing economy are responsible for filing their own tax returns. This means that these individuals are required to accurately account for their income and expenses and, where necessary, are required to navigate more complex areas of tax such as apportionment rules and provisional tax. Although the digital platforms through which these individuals work hold a lot of information about incomes earnt through the platform, this information is not regularly provided to Inland Revenue to assist in tax compliance.

Many of those who enter the gig and sharing economy are unsophisticated taxpayers who often have limited or no prior experience in managing their tax obligations (they may have previously been employees, for example, where tax is withheld at source and subject to the PAYE system). This means that their participation in the gig and sharing economy is often the first time more complex tax rules fall on them. As a result, most individuals will need access to complex software products, accountants, or other tax advisors to assist individuals to manage their tax affairs. This presents these sellers with further compliance costs.

Under the status quo, Inland Revenue will continue to have limited visibility over incomes earned through digital platforms and platform sellers will continue to have high compliance costs associated with complying with their tax obligations.

Option Two – The OECD's extended model reporting rules

Under the extended model rules, Inland Revenue would receive information about sellers' incomes earned through digital platforms in respect of four categories. These are:

- personal services
- accommodation rental
- the sale of goods, and
- vehicle rental.

The way in which Inland Revenue would receive income information under the model rules is through an information sharing arrangement with other jurisdictions. Jurisdictions which implement the rules are required to collect certain information about the activities of sellers on digital platforms that are tax resident in their country. This information must then be shared with tax authorities of other countries that have also implemented the rules to the extent that the information relates to persons resident in that jurisdiction. Tax authorities will also receive information from other jurisdictions' tax authorities where the rules have been implemented. The model rules provide a standardised reporting framework and information exchange.

To comply with the OECD schema and other reporting standards that European countries may adopt (for example, the DAC7 directive in Europe)[4], Inland Revenue would need to apply the model reporting rules to all four categories of information as set out above. If New Zealand did not adopt the extended model rules, Inland Revenue would not be entitled to receive information from European jurisdictions about New Zealand sellers operating on platforms resident in Europe. For example, even if New Zealand adopted the personal services and accommodation rental modules, it would still not receive information from European based jurisdictions in respect of these two categories if it did not adopt the wider model rules.

The way that the extended model rules would work in the New Zealand context is that NZ resident digital platforms would be required to provide Inland Revenue with income information for New Zealand resident sellers operating on their platforms for personal services and accommodation rental only. NZ platforms would be required to provide Inland Revenue with income information in respect of non-resident sellers operating through their platforms for all four categories of information. This is because sale of goods and vehicle rental information is required in respect of non-resident sellers under DAC7 and will therefore also be required under NZ rules to ensure we have rules of equivalence with Europe.

Inland Revenue could seek to use the information about **accommodation rental** and **personal services** in sellers' income tax returns once the information flows mature over the coming years. The incomes earned through digital platforms in these circumstances would generally be amounts that needed to be declared by sellers themselves for income tax

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[4] DAC7 refers to the Council Directive (EU) 2021/514 adopted by the Council of the European Union on 22 March 2021. It is very similar in form and function to the OECD model rules but does not need to be discussed at length for the purposes of this RIS.

purposes. That is, sellers are required to declare this income in their income tax returns and pay tax on any profits they make for these activities.

As previously noted, one key component of New Zealand's implementation of the extended model rules is that NZ resident platforms would not be required to provide Inland Revenue with income information for NZ resident sellers operating on their platforms for sale of goods or vehicle rental. The **sale of goods** and **vehicle rental** are not traditional gig and sharing economy activity types. For the sale of goods, this is because it does not involve the sharing of assets, skills, or labour. It would also be unclear from a platform perspective whether the sale of goods was part of a business or other income earning activity of the seller or merely the sale of personal items that would not give rise to income for income tax purposes. For vehicle rental, it is the digital platform that is the seller. This would be different if a digital platform offered a service of vehicle rental, with the vehicles themselves being provided by a third-party seller. In this situation, the seller would be sharing an asset, and this would be a reportable activity. It is for these reasons that this proposal only requires NZ-resident platforms to provide sale of goods and vehicle rental information to Inland Revenue in respect of non-resident sellers. Requiring NZ resident platforms to provide this information in respect of NZ resident sellers would levy undue compliance costs on these platforms in light of the more limited usefulness of this information.

One disadvantage of implementing the OECD model rules generally (this applies to both the extended and base model rules) is that the information would be received on a calendar year basis. This means that it would not neatly align with our tax year (1 April to 31 March) for the purposes of pre-filling income tax returns. If Inland Revenue decided to use the information to pre-populate income tax returns, it would have to either deem the income earned to a calendar year to apply in respect of a tax year, or only pre-populate 9 months of income information.

Based on experience with OECD information exchanges in other areas, it is expected that it will take a few years to address data integrity issues with the initial information exchanges. One example of a data integrity issue that may arise is an incorrect or incomplete tax identification number which could make aligning income derived with a specific taxpayer difficult. This may make pre-population of income tax returns as proposed in the discussion document difficult until these issues have been resolved. For this reason, officials' preferred option is that pre-population be phased in over time and initially Inland Revenue would use the information from the exchange to prompt sellers about their return filing obligations.

When compared to the status quo this option presents significant advantages. Adopting the OECD model rules will ensure Inland Revenue receives high quality income information in respect of sellers' activities on digital platforms. This information could be used to support tax compliance and make it easier for sellers to comply with their tax obligations. The OECD model rules are also a sustainable and coherent solution given that they have received international buy in from multiple jurisdictions and digital platforms. The standardised schema of the OECD model rules also lowers compliance costs for platforms for ease of implementation.

Option Three – OECD's base model rules

In contrast to the extended model rules, the base model rules would require digital platforms to provide Inland Revenue with information about sellers' incomes earned through the platforms in respect of two categories. These are personal services and accommodation rental.

This means that digital platforms would not be required to provide information in respect of the sale of goods or vehicle rental.

On the face of it, this seems like an attractive option. Given the previous limitations of vehicle rental and sale of goods income information, one view is that these modules should be left off New Zealand's reporting framework altogether.

The primary reason that officials prefer the extended model rules over base rules is that New Zealand would need to have rules of equivalence with Europe (who are implementing the broad DAC7 directive) to receive information from platforms headquartered in Europe. This means that if New Zealand did not adopt the extended model rules, Inland Revenue would not receive information from European platforms about NZ sellers operating on their platforms (this would apply even in respect of accommodating sharing and personal services).

As the DAC7 directive is mandated in Europe, any New Zealand platforms with European sellers would be required to provide information on the sale of goods and vehicle rental to these jurisdictions directly anyway. By adopting the extended model rules, this ensures that New Zealand platforms will not need to provide information on their European sellers to the relevant European jurisdictions individually but can instead provide the information directly to Inland Revenue. This results in a reduction of compliance costs for NZ resident platforms with European sellers for the sale of goods or vehicle rental.

Option Four – Bespoke reporting regime

An alternative solution would be to implement bespoke information reporting requirements in New Zealand's domestic legislation. Under this option, Inland Revenue would receive information about sellers' incomes earned through digital platforms. The difference between this option and the OECD model rules is that Inland Revenue could prescribe what categories of information, along with timing and frequency of information that it receives from digital platforms.

Just like Option 2 and 3, this option would provide Inland Revenue with income information to support tax compliance and make it easier for sellers to comply with their tax obligations. As Inland Revenue could prescribe the frequency and timing of information, this would allow for easier pre-population to our 1 April – 31 March tax year. There is a risk that this option would not be sustainable long term and there is a risk that digital platforms may choose not to operate in NZ if the requirements placed on them were too onerous. A bespoke regime would not be in line with internationally agreed standards developed by the OECD and by DAC7. A lot of digital platforms are based in Europe and to ensure exchange of information with these platforms NZ would need to implement rules of equivalence with Europe.

The other problem with this approach is that it increases compliance costs for digital platforms which would need to implement bespoke system changes to comply with New Zealand's domestic legislation. This could increase the likelihood of non-compliance, and could result in Inland Revenue not receiving any income information. There are also potential practical issues that could arise in attempts to enforce New Zealand laws on foreign digital platforms.

How do the options compare to the status quo?

	Option 1: Status Quo	Option 2: Extended OECD model rules	Option 3: Base OECD model rules	Option 4: Bespoke Regime
Fairness	0	++	++	++
Compliance costs	0	+	+	+
Administration costs	0	-	-	-
Efficiency	0	+	+	+
Coherence	0	++	+	-
Sustainability	0	++	+	-
Overall assessment	0	++	+	+

Example key for qualitative judgements:	
++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

The option that is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits is implementing the OECD's extended model rules (Option 2). This option will achieve the policy objective of ensuring Inland Revenue has visibility over sellers' incomes in the gig and sharing economy. Access to this information will help drive tax compliance and could also make it easier for individuals to comply with their tax obligations (moderate reduction in compliance costs through pre-population of income profiles, though its noted sellers will still need to manually include their deductions).

This option has clear benefits over Option 4 (bespoke rules). Firstly, by adopting a standardised OECD schema this reduces compliance costs for digital platforms. The OECD model rules are also a more sustainable solution given they have buy-in from many multinational digital platforms and jurisdictions. Although a bespoke regime would save on administration costs for Inland Revenue by being better tailored to the NZ tax year, these administrative savings would be offset by the fact that a bespoke regime would need to be implemented by NZ from scratch – and would not be piggybacking off the schema developed and agreed at the OECD.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Regulated groups *(sellers in the gig and sharing economy, particularly sellers on personal services and accommodation digital platforms)*	As Inland Revenue will receive more information about sellers' activities through digital platforms, it will be harder for motivated sellers to avoid paying tax.	n/a	Medium
Regulators (Inland Revenue)	Will be required to utilise income information received on platform sellers for compliance purposes.	There is an up-front system build cost of $13.7 million. There are also ongoing administration costs for Inland Revenue.[5]	High
Others (digital platforms)	New Zealand digital platforms would need to provide Inland Revenue with information about sellers on their platforms, with that information then being shared with other tax authorities. Foreign digital platforms in jurisdictions that had also implemented the OECD's rules would then share information with Inland Revenue, saving them from	Low to Medium (Digital platforms would face lower compliance costs if information provided through the standardised OECD schema. Complying with a bespoke regime will have greater costs for platforms.	High

[5] The estimated costs are up to $19.3 million over the forecast period (excluding depreciation and capital charge) which includes $13.7 million for the capital system building and $5.6 million for administration costs.

	having multiple reporting obligations.		
Total monetised costs	*n/a*	$16.5m	High
Non-monetised costs		*Low*	*Medium*
Additional benefits of the preferred option compared to taking no action			
Sellers on digital platforms that are reporting income information	There will be minor/marginal benefits in the event income information received from digital platforms (and other tax authorities) will be pre-filled in sellers' income tax returns.	Low	High
Regulators	Improved information about sellers' income earned on digital platforms where those digital platforms are reporting that information to a tax authority that is exchanging information.	$11 million per annum	Medium
Others (eg, wider govt, consumers, etc.)	n/a	n/a	n/a
Total monetised benefits	n/a	$27.5 million over the forecast period	Medium
Non-monetised benefits		Low	Medium

The total monetised benefits of $11 million per annum are based on the information received under the model rules being used by Inland Revenue for general compliance initiatives, such as to prompt individuals to file their income tax returns.

This monetised benefit has been forecasted for using a macro approach that estimates the total size of the gig and sharing economy in New Zealand (removing the facilitation fee component charged by platforms) and then layers that with assumptions. These assumptions include estimating how much income is underreported on average by platform sellers based on existing data regarding self-employed income, and how much of an uplift in compliance would be achieved through Inland Revenue utilising the income information received from platforms (for example by prompting individuals to file), while also accounting for expenses claimed.

As this RIS has already noted, pre-population of income tax returns would not be attempted until at least year 4 to give information flows time to bed in. As such, the monetised costs outlined in the table above do not include any costs to modify Inland Revenue's existing pre-population functionality in START to apply to gig and sharing economy income. This would come at an additional cost. The current monetised costs forecasts are based on building START functionality to enable the exchange of information and general administrative funding to ensure that the information is effectively used to support tax compliance. Likewise, the table above also does not account for the uplift in revenue gain expected by pre-populating tax returns.

In terms of the non-monetised costs and benefits, these have been determined through public consultation, discussions with tax advisors who represent some of the affected groups, and work undertaken by the OECD.

Section 3: Delivering an option

How will the new arrangements be implemented?

Inland Revenue will be responsible for the implementation and ongoing administration of the new rules. Inland Revenue will provide information to increase awareness regarding the new rules. This will include producing a relevant Tax Information Bulletin item and updating guidance on Inland Revenue's website along with relevant press releases to advise platform sellers of changes (particularly in respect of tranche 2 of these proposals on GST).

Implementing these proposals would require legislative change. If the OECD's extended model rules were chosen as the preferred option, then legislative change would be simpler. Similar to how FATCA/CRS was adopted, a legislative change could be made to state that the OECD model rules schema and user guide had force in NZ's domestic legislation. Greater legislative change would be required for a bespoke regime.

From an Inland Revenue systems perspective, there would be a sizeable upfront cost to build functionality within START (Inland Revenue's computer system) to enable for the sharing and receiving of income information with other jurisdictions. As previously mentioned, further changes would also need to be made to ensure Inland Revenue could best utilise the information (for example, to pre-populate income tax returns) which would come at an additional cost to be sought at a later date. If the OECD rules were implemented, this could require greater change if income information received on a calendar year basis was deemed to apply to the NZ tax year.

The preferred option is that the OECD's extended model rules are implemented with the 2024 calendar year being the first year that information is required to be collected by digital platforms in New Zealand affected by the rules. This means that:

- New Zealand digital platforms that enable the rental of short-stay accommodation, and personal services for NZ resident sellers would need to collect information during the 2024 calendar year and report that to Inland Revenue in 2025.
- New Zealand digital platforms that enable the rental of short-stay accommodation, personal services, the sale of goods and the rental of transportation for non-resident sellers would need to collect information during the 2024 calendar year and report that to Inland Revenue in 2025.
- Inland Revenue would need to exchange the information with other countries, to the extent that the information held related to foreign tax residents in jurisdictions that had also implemented the OECD's extended model rules.
- Inland Revenue would use the information it received to support New Zealand sellers comply with their tax obligations. Pre-population of income tax returns will not be implemented until there is confidence in the quality of data received in the information exchange will facilitate this.

The first year of operation for digital platforms in Europe of the DAC7 directive is 2023. If New Zealand implements the OECD's extended model rules for 2024 Inland Revenue would not receive information from European tax authorities about New Zealand sellers on European digital platforms for that calendar year. This is the cost of implementing the OECD's extended model rules for the 2024 calendar year; but implementing the rules in the 2023 calendar year will require retrospective legislation and would (when compared with a 2024 implementation timeline) reduce the time available for New Zealand digital platforms to develop their systems to become compliant with the changes.

How will the new arrangements be monitored, evaluated, and reviewed?

If the OECD rules were implemented, it is noted that the OECD will be able to allocate resources to making any changes to the model reporting rules where necessary. Any changes to the OECD schema and rules can then be reflected into domestic legislation in NZ. Given the likely widespread buy-in from jurisdictions, this ensures a more enduring and sustainable policy reform.

Inland Revenue would also allocate resource to compliance initiatives to ensure that the information received was effectively utilised to support sellers in the gig and sharing economy to pay the correct amount of tax.

Inland Revenue regularly reviews tax settings on an ongoing basis and provides advice and updates to the Government accordingly. Policy officials maintain strong communication channels with stakeholders in the tax advisory community and these stakeholders will be able to correspond with officials about the operation of the new rules at any time. If problems emerge, they will be dealt with either operationally, or by way of legislative amendment if agreed by Parliament.

3.

Regulatory Impact Statement: GST on management services supplied to managed funds

Coversheet

Purpose of Document	
Decision sought:	*Analysis produced for the purpose of informing: final Cabinet decisions on the GST treatment of management services supplied to managed funds*
Advising agencies:	*Inland Revenue*
Proposing Ministers:	*Minister of Revenue*
Date finalised:	*25 May 2022*

Problem Definition

The current Goods and Services (GST) treatment for different types of management services supplied to managed funds is complex and inconsistent. The status quo can distort competitive behaviour by favouring certain types of managed funds, business structures, based on the taxpayer's interpretation of the existing GST rules.

Executive Summary

GST is a tax on the supply of goods and services in New Zealand. However, there are types of goods and services that are deemed to be 'exempt' from GST, that is, GST is not imposed on these supplies. One form of exempt supply is financial services (such as the services managed funds supply to their investors).

However, there is uncertainty and a range of different commercial practices for the GST treatment of fund manager services and investment manager services supplied to managed funds.

There are two main issues with this:

- The GST treatment varies across the industry and that inconsistency may create an uneven playing field which distorts competition; and
- The uncertainty and range of different practices on managed funds imposes compliance costs of having to identify and determine the GST treatment of different types of services. It also increases the risk of errors such as incorrectly classifying the type of service provided, or incorrectly charging GST, or incorrectly claiming GST deductions on inputs.

Four options were considered including the counterfactual (no policy change and enforcement of the current GST law). These options were consulted on in both public consultation and in meetings with GST advisors and industry representative groups. While the counterfactual is not supported by stakeholders, stakeholders have different views on the preferred policy solution.

Inland Revenue's preferred option, which is also recommended in the Cabinet paper, is option two – make all fees subject to 15% GST as well as repealing the existing GST exemption for the management of a retirement scheme.

Option two is being recommended because it will provide certainty and consistency in the GST treatment for management services supplied to managed funds and simplify GST compliance. Compared to the other options which involve an exemption, the preferred option is more likely to remain consistent or sustainable over time, including in retirement savings vehicles such as KiwiSaver schemes.

Option two would collect additional GST of approximately $225 million per annum from 1 April 2026, with the GST collected per annum increasing at an assumed growth rate of 10% per annum. It is assumed this cost will largely flow through to retail investors in the form of higher fees. If investor fees are increased, this will reduce after-fee returns and therefore the total amounts that are reinvested and saved over time.

Stakeholders have advised that while some fund managers would incur no material transition costs (the boutique fund managers that are currently applying 15% GST to their fees), other fund managers (such as the larger fund managers) may incur significant transition costs. Option two is the preferred option of the boutique fund managers, but the least preferred option of the larger fund managers who prefer option one - legislating to allow the current inconsistent GST practices to continue.

The preferred option proposes to mitigate the compliance and transition costs incurred by establishing a transition period of 36 months between enactment and when the rules will apply, to allow affected taxpayers to amend their IT systems, commercial contracts and investor disclosure statements to the new rules.

Limitations and Constraints on Analysis

The impacts of increased GST revenues and increased fees charged to investors are sensitive to the assumptions used, particularly assumptions of fee growth as estimates based on 2021 data have been projected to 2026 (the year the proposed reforms would apply from).

An assumption is that the dollar value of the manager's basic fees will grow by 5% for 2022 and 10% per annum thereafter. This assumption is supported by the manager's basic fees growing by an annualised average of 20% for the three years between 31 December 2018 and 31 December 2021. A more conservative 10% assumption is used as the last three years have had historically high investment returns and a lower 5% growth rate for 2022, to reflect that managed funds have generally experienced strongly negative investment returns for the first four months of 2022.

Another assumption is that a manager currently incurs taxable inputs of 20% of the value of the management services they provide to the managed funds. Under the proposal, it is anticipated that a manager could claim the additional GST input deductions on their expenses and offset these deductions against the GST charged on their fees, reducing additional GST collected. This assumption was informed by financial information from the 2021 annual report of the Guardians of the New Zealand Superannuation.

A key assumption on the impact of the changes is that the additional GST cost will largely flow through to the fees charged by managed funds to retail investors, resulting in higher fund fees.

The scope of the options is limited to measures the fund manager and investment manager industry could implement and administer. The options were consulted on in a public consultation paper which also asked for submissions on any alternative options which led to option four (legislating to allow the current GST practices to continue) being submitted as the preferred option for one group of stakeholders.

Responsible Manager(s) (completed by relevant manager)

Graeme Morrison

Policy Lead

Indirect policy team

Inland Revenue Department

s9(2)(a)

25 May 2022

Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance reviewer at Inland Revenue has reviewed the *GST on management services supplied to managed funds* Impact Summary and considers that the information and analysis summarised in it meets the quality criteria of the Regulatory Impact Analysis framework. This issue has been subjected to wide consultation, including through a public issues paper. As identified in the Key Limitations or Constraints on Analysis section, a difficulty with assessing the revenue implications of the various options has been establishing the managed funds' likely responses/behavioural changes to GST changes, and the extent to which deductions are currently being claimed on the various input costs associated with providing management services to the managed funds.

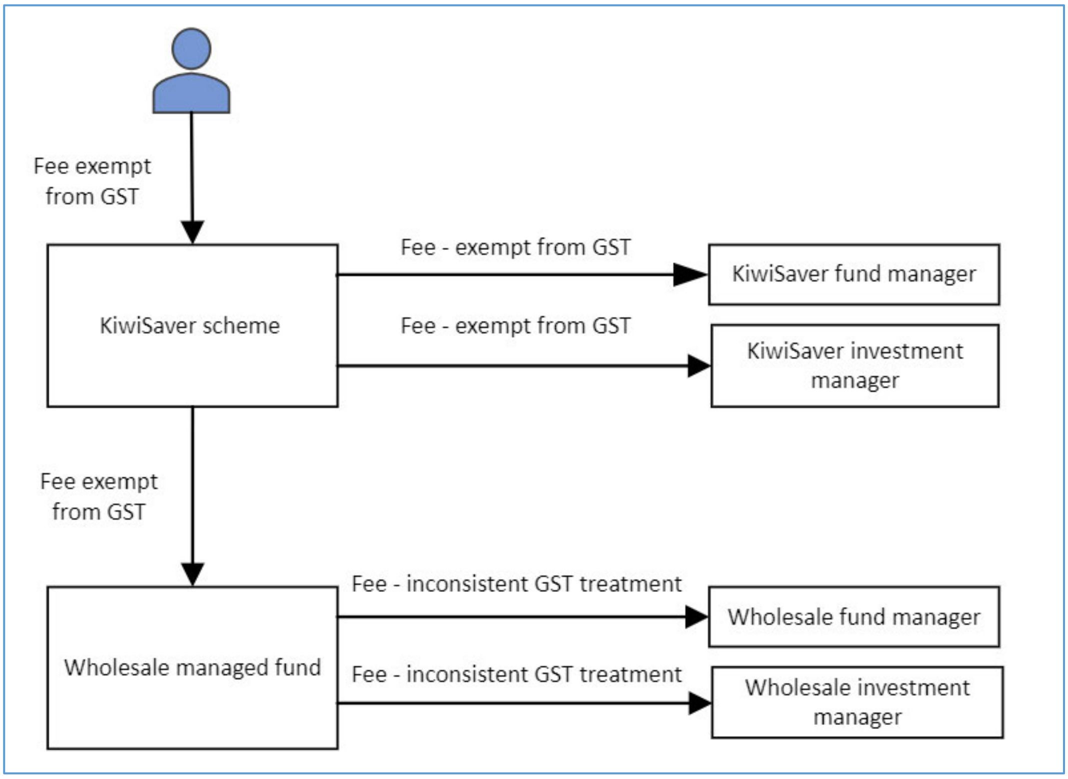
Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. Goods and Services Tax (GST) is a 15% consumption tax on goods and services supplied to consumers in New Zealand by GST-registered persons (such as businesses). A GST-registered person can deduct GST paid on their purchases (such as buildings and utilities) that they use in their business, to ensure GST is ultimately borne by the end-consumer.
2. However, some goods and services are exempt from GST, meaning GST is not charged on the good or service, but also the business cannot claim back GST paid on their costs incurred to supply that exempt good or service.
3. One of these exempt services is *financial services*. This exemption includes services that involve arranging a financial product and the management of a retirement scheme. Non-financial services such as providing "advice" on potential investment opportunities or administrative services are subject to 15% GST.
4. The rationale for the financial services exemption is that GST should not be imposed on savings but should be imposed on services such as financial advice. However, for

many savings products, such as bank accounts, it is difficult to value the financial services as it is combined with the return on savings. These valuation issues do not arise for manager and investment manager services provided to managed funds, as these services are charged to the fund as a separate fee.

5. An example of these fees charged is a KiwiSaver scheme that invests into several underlying wholesale funds that hold different types of investments (such as US shares or New Zealand fixed interest). Each of these funds has a manager and investment manager. The KiwiSaver scheme will buy services from a KiwiSaver manager, and for each wholesale fund they invest into they will be charged for services supplied by managers and investment managers. There are over 1,000 funds offered to retail investors.[1]



6. KiwiSaver funds and other types of managed funds purchase three main types of services from third parties:
   a. Manager services. A fund manager has overall responsibility for managing the fund. This includes offering and issuing units in the fund to investors, managing the fund's investments, reporting to investors, and procuring services from an investment manager and various administration service providers.
   b. Investment manager services. An investment manager recommends which assets (shares, bonds, cash) or other funds the fund invests into. When reporting to investors, manager services and investment manager services are both reported as "management fees" which are set as a small percentage (typically between 0.2% and 2%) of the funds under management.
   c. Various administrative services such as legal, accounting, ICT (information and communications technology) or reporting services.

[1] 331 KiwiSaver funds (operated by 39 KiwiSaver schemes) and 758 non-KiwiSaver managed funds.

7. The current GST treatment of different types of services supplied to managed funds is complex and inconsistent, leading to a range of differing GST practices and an uneven playing field across the industry. The industry applies the following GST practices:
    - GST exempt. There is a GST exemption which applies when management services are provided directly to a retirement scheme (such as a manager providing services directly to a KiwiSaver scheme). However, this exemption does not apply to most structures, where a retirement scheme invests into a variety of underlying wholesale funds (NZ fixed interest, international shares etc.) as the managers and investment managers will be providing their services to the wholesale fund rather than to the retirement scheme.
8. For fund manager and investment manager services provided to other types of managed fund (including wholesale funds which other funds invest into) there are two different GST practices:
    - 90% exempt. The largest fund managers and investment managers typically treat 10% of their services as being subject to 15% GST and the remaining 90% as exempt from GST (because they consider their services are mostly “arranging” the buying and selling of investment products and so should qualify for the GST exemption for financial services). This may allow them to charge lower fees to the wholesale funds (as they effectively only charge 1.5% GST on their management fees).
    - GST on all fees. A group of boutique fund managers and investment managers apply 15% GST to all of their services (as in their view their services are providing investment “advice” or other types of services that are subject to 15% GST). This simplifies GST compliance and allows the fund manager or investment manager to claim GST deductions (refunds) on their purchases such as commercial rent, market research, software, ICT and administrative services etc.
9. The practice of applying a 90% exempt ratio was first accepted by Inland Revenue from 2001, as part of an operational agreement s9(2)(ba)(i) [redacted] which established that it was acceptable to exempt 90% of unit trust manager[2] fees from GST, with the remaining 10% being subject to 15% GST (meaning 10% of their GST inputs could be claimed back). Although this operational agreement did not actually apply to investment manager’s fees, it has been found that some investment managers have also been treating 90% of their fees as exempt. This agreement expired in 2014.
10. In 2017, Inland Revenue formally considered how the GST would apply to two types of managed fund fees under existing law– *unit trust manager fees* and *investment manager fees*. The draft conclusion was that the unit trust manager fees should be fully exempt – as they are considered to be arranging financial products, which falls within the financial services exemption, whereas the investment manager fees should be subject to 15% as they are considered to be providing advice on investment opportunities and therefore sits sufficiently outside the financial services exemption.
11. Fees can have a large impact on the financial wellbeing of investors as they directly contribute to the level of accumulated savings, including retirement savings for retirement schemes such as KiwiSaver. Generally, fees as a proportion of funds under management should decrease over time through economies of scale as the amount of funds under management grow and the benefits are passed onto consumers. For this reason, the Government (through the KiwiSaver default provider appointment process)

[2] Provides similar services to a fund manager.

and the Financial Markets Authority have focussed in recent years on ensuring KiwiSaver members receive value for money.

What is the policy problem or opportunity?

12. There are two main issues with how GST applies to services supplied to managed funds.
13. The first issue is the inconsistency in the GST treatment on manager and investment manager fees. Because different types of fund manager and investment manager services can have complex and differing GST treatments, the current GST rules can distort competition by favouring certain types of managed funds, business structures, or judgements about how the supplier may choose to interpret the GST rules.
14. The inconsistent GST practices may have allowed some fund managers to structure themselves in order to develop a competitive advantage over others, though there is limited evidence of this.
15. Additionally, some stakeholders have experienced the issue of funds 'shopping around' potential fund managers and enquiring about the particular GST treatment they would be subject to. If the particular fund manager cannot match the most favourable treatment, they may not be chosen as the service supplier.
16. The second issue is the uncertainty has resulted in additional compliance costs to fund managers. For example, professional advice may need to be sought to determine the GST treatment of different types of management services or to correct any tax positions previously taken.
17. There is no data available on the level of additional cost borne by fund managers because of the uncertainty, inefficiencies, and competitive distortion. However, several fund managers have indicated the status quo is having a material impact on their ability to compete in the marketplace.

What objectives are sought in relation to the policy problem?

Consistency of industry practices and fair competition

18. The main objective is to resolve the issues outlined above, by providing certainty and consistency to the managed funds industry.
19. The current GST rules may distort commercial competition by favouring certain types of managed funds, business structures, or judgements for how the supplier may choose to interpret the GST rules. This approach can impose its own costs as fund managers invest in themselves to pursue favoured tax advantages. This suggests it may be important for all fund managers and investment managers to apply the same GST treatment.
20. However, requiring fund managers and investment managers to implement a new GST treatment could have a large impact on the fees charged to funds and retail investors (such as KiwiSaver members) as well as impose transition and compliance costs and, so this Regulatory Impact Statement also considers an option of legislating to allow the current inconsistent GST practices to continue (see option 1 below).

Minimising any significant biases that GST may create

21. It is important that any policy solution does not provide a significant bias towards certain types of savings products, managed funds, business structures or larger funds over others. This includes creating a potential bias for in-sourcing costs, given that

outsourcing may be more commercially efficient or more consistent with financial market regulations.

22. In particular, the policy solution needs to consider the existing exemption for the management of a retirement scheme, as there could be a bias for managed funds to invest into specialist retirement funds, rather than more general funds. This bias can be removed by applying the same GST treatment to retirement schemes as other types of managed funds, particularly as most retirement schemes invest into general wholesale funds.

Minimise compliance costs

23. Transitional and compliance costs should be minimised. This includes providing impacted taxpayers a reasonable time period to amend their IT systems, commercial contracts, and investor disclosure documents.
24. Where possible, the new rules should align with existing industry definitions (such as those used by the Financial Markets Authority) and commercial practices. The rules should be easily understood and simple to apply to various commercial arrangements.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

25. The following criteria was used to assess the options:
    - Certainty. The GST treatment of a particular service is clear and it becomes easier to correctly apply GST.
    - Consistency of GST practices across the industry. The option does not provide a tax-advantage for some service providers compared to similar service providers.
    - Impact on managed fund fees. The impact of a particular GST treatment when applied to the manager's fees charged to a managed fund, that consequently imposes an unrecoverable GST cost on a managed fund. Effectively, the managed funds are likely to pass through these GST costs to retail investors, such as KiwiSaver members by charging higher fees. To the extent that fees increase, this will reduce after-fee returns and therefore the total amounts that are reinvested and saved over time.
    - Compliance costs and transition costs. Compliance costs should be minimised as much as possible. The option should be easy for the affected parties to understand and apply.
    - Sustainability of the rules. The option is less likely to require amendments in the future due to on-going uncertainty or to address unintended consequences or future developments.
    - GST base integrity. The GST system is designed to collect tax revenues on all goods and services supplied to consumers in New Zealand. Some of the options will collect materially more or less GST than other options.

What scope will options be considered within?

26. The scope of the options is limited to measures the managed funds industry could implement and administer. Options two, three and four were consulted on in a public consultation paper which also asked for submissions on alternative options which led to option one (legislating to allow the current GST practices to continue) being submitted as the preferred option for one group of stakeholders.

What options are being considered?

Option One – Legislate to allow the current inconsistent GST practices to continue

27. Under this option, managed funds will be able to choose between one of three GST treatments. These three approaches represent the current practices undertaken by the industry:
    a. Fully exempt. This option includes retaining a GST exemption for when management services are directly provided to a retirement scheme (such as a manager providing services directly to a KiwiSaver scheme); or
    b. 90% exempt. Treating 90% of their services as exempt and effectively charging 1.5% GST on their fees (15% GST on 10% of their fees). This practice is applied by most retail managed funds and wholesale funds that other funds such as retirement schemes invest into; or
    c. Full GST. Charging 15% GST on all their services. This practice is applied by a small number of boutique funds.

28. One of the main stakeholders, the Financial Services Council[3], which represents the largest managed funds, has expressed a preference for legislating to effectively allow the current GST practices to be able to continue.
29. It is necessary to legislate to achieve this outcome because most of the current industry practices are not consistent with current GST legislation, which is unclear and largely depends on the type of service being supplied.
30. As this option is intended to align with current industry practice it would have no significant impact on the amount of GST collected, the fees charged to retail investors and the net returns on investments. Consequently, this option will avoid reductions in future balances (including retirement balances) that an increase in GST costs would cause.
31. The main advantage of this option, over the other options, is it will not impact on fees charged to investors of managed funds, including KiwiSaver members.
32. This option does not impose transition costs on the managed funds industry at a time when they are dealing with other significant regulatory changes[4]. However, officials consider that any change costs from the other policy reform options can be mitigated by a gradual transition, so the reforms only become mandatory 36 months after the legislation is enacted – this allows a reasonable time period to renew or renegotiate contracts, update systems and issue new disclosures about fee changes to the funds and retail investors.
33. The main disadvantages of legislating the status quo are that it entrenches the complexity and inconsistency of the current practices and the associated impacts on uneven competition and compliance costs.
34. It would also introduce new integrity risks such as ‘cherry-picking” whereby a manager may choose a taxable GST treatment to maximise GST deductions when they are in a start-up phase and to later switch to an exempt treatment to minimise the GST they charge once they are larger and produce a large amount of fee revenue.
35. This option would also involve two different exemption rules – a full exemption for management of retirement schemes and an optional 90% exemption for managers and investment managers which provide services to other types of funds (including the wholesale funds that most retirement schemes invest into). These differing exemptions could be complex to apply which increases the risks of inconsistency, errors, and disputes.
36. There is also a risk that these exemptions would not be consistent or sustainable over time. For example, some service providers may consider that administrative services, which are generally subject to GST, qualify for the exemption, particularly if these services are bundled with exempt management services. This behaviour would have the effect of broadening the boundary of the GST exemption beyond the policy intent and could require future legislative changes to address.
37. Because this option aligns with the current GST positions in the revenue baselines, it would be fiscally neutral.

Option Two – Make the fees subject to 15% GST (100% taxable)

38. Under this option, all manager and investment fees will be subject to 15% GST.

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[3] Non-profit member organisation with members in the life insurance and managed funds industry (including KiwiSaver and workplace savings schemes).

[4] Mandatory climate-related disclosure regime (The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021), Conduct of Financial Institutions regime and changes to the anti-money laundering rules.

39. The boutique funds prefer this option. This is because it provides a level playing field with other funds and reduces some compliance costs. This is the least preferred option for the larger fund managers. The fund managers and investment managers that are currently charging 15% GST on their fees (many which supply services to boutique funds) would not be impacted by this option.
40. This option would be consistent with the policy rationale that the financial services exemption should generally be limited to cases where there are valuation issues.
41. As part of this option, the GST exemption for retirement schemes would be removed and these manager fees would also be subject to 15% GST. This is because if the exemption was retained, it could create a stronger bias for investing through retirement funds rather than other types of managed funds, as well as providing a tax incentive for retirement schemes to be structured so they receive their manager services directly, rather than indirectly through investment in other funds.
42. The main advantage of this option is that it would provide consistency across the managed funds industry, and reduces concerns that GST practices could be distorting competition.
43. Applying 15% GST to all services provided by fund managers and investment managers would simplify GST compliance as they would be able to claim deductions for GST on their external costs (such as commercial rent, ICT services).
44. However, because the services that funds provide to investors would still be exempt from GST, applying GST to the manager's fees charged to funds would impose an unrecoverable GST cost on managed funds.
45. The main disadvantage of this option is that the additional GST collected will lead to higher fees for retail investors, such as KiwiSaver members. The extent to which GST will lead to higher fees for retail investors is uncertain. Some of the GST cost may be absorbed by the fund manager or investment manager, instead of being passed on as higher fees to managed funds. As well, under this option fund managers and investment managers can claim back more of their GST inputs, whereas previously some of the inputs may have been unclaimed and consequently passed on in higher fees.
46. To the extent that fees increase, this will reduce after-fee returns and therefore the total amounts that are reinvested and the available balances at future dates (e.g., KiwiSaver members would have less available when they withdraw funds to purchase a first home, or at retirement).
47. Feedback from stakeholders was mixed regarding how much they expected fees would increase. The boutique funds advised that the additional GST costs may have little impact on fees charged to retail investors due to increasing pressures to compete on fees and the proposed transition period which would allow time to adjust. In contrast, other stakeholders (such as the Financial Services Council) considered the full impact of the GST cost would be passed through to retail investors.
48. The Financial Markets Authority has advised that overall, fees for KiwiSaver schemes have fallen by 0.15% or 15 basis points over the past two years. Their view is the increased costs of GST will be passed onto members in the form of increased fees.
49. Modelling by the Financial Markets Authority shows that this option will lead to KiwiSaver fund balances being reduced by $103 billion by 2070 (KiwiSaver balances of $2,196.9 billion), while fund balances for non-KiwiSaver managed funds would be lower by $83 billion (fund balances of 1,757.05 billion).
50. Stakeholders have advised that while some fund managers would incur no material transition costs (the boutique fund managers that are currently applying 15% GST to their fees), other fund managers (such as the larger fund managers) may incur significant transition costs. Officials from both the Ministry of Business, Innovation and

Employment and the Financial Markets Authority have supported a 36-month transition period.

51. This option would collect additional GST of approximately $225 million per annum from 1 April 2026 onwards, with the GST collected per annum increasing at an assumed growth rate of 10% per annum. It is assumed that most of the additional GST would flow through to retail investors, such as KiwiSaver members, in the form of higher fees. To the extent that fees increase, this will reduce after-fee returns and therefore the total amounts that are reinvested and saved over time, including savings in retirement schemes such as KiwiSaver.

Illustrative examples of potential upper-limit impacts on fees and future balances

Assume the fund is purchasing management services which are currently treated as being 90% exempt, 10% subject to GST (GST is effectively 1.5% on management services) and that management fees comprise 90% of the fund's total fees (the other 10% are administration fees).

Also assume the retail investor's balance grows by 5% in 2022 and 10% each year thereafter (before fees) as they continue to regularly contribute funds and reinvest returns.

Investor with $37,500 in a fund with a 0.8% annual fee

A retail investor with $37,500 invested in a fund that charged a 0.8% fee under the status quo (option 1) would currently pay a $300 annual fee. Under the proposed reform (option 2), and assuming the GST costs were fully passed through to the retail investor, their fee could increase by up to $29, to become $359 for the first year after the reform.

After 25 years of regular contributions and reinvesting, the investor would have had a $338,530 balance under the status quo and a $332,040 balance under the proposed reform, a reduction of $6,490.

Investor with $100,000 in a fund with a 1% annual fee

A retail investor with $100,000 invested in a fund that charges a 1% fee would pay a $1,000 annual fee under the status quo. Under the proposed reform, their annual fee could increase by up to $96, to become $1,194 for the first year after the reform.

After 25 years of regular contributions and reinvesting, the investor would have had a $862,308 balance under the status quo and a $841,128 balance under the proposed reform, a reduction of $21,179.

Option Three – Make the fees GST exempt (100% exempt)

52. Under this option, all fund manager and investment manager fees would be exempt from GST. This option would be inconsistent with the policy rationale that the financial services exemption should generally be limited to cases where there are valuation issues.
53. The main advantage of this option is that it could improve certainty and consistency as all management and investment management services provided to the funds would be exempt. This option would not impact on fees charged to investors of managed funds, including KiwiSaver members.
54. The main disadvantage of this option is that a GST exemption would reduce costs for funds but would increase costs for fund managers and investment managers as they

would no longer be able to claim any GST input tax deductions in respect of their purchases of outsourced costs (such as commercial rent, ICT, legal and accounting services). This option would therefore establish a strong bias towards in-sourcing costs. The impact of this option on a particular fund manager and investment manager depends on their current GST treatment of their manager fees charged to managed funds - fully exempt (not materially impacted), 90% exempt / 10% taxable (comparatively small impact) or 100% taxable (significantly impacted).

55. Submitters expressed mixed views on whether an exemption would lead to lower fees for retail investors. It seems likely that any cost savings from an exemption would be relatively small and may not be passed through to retail investors.

56. Stakeholders have advised that fund managers and investment managers would incur compliance or transition costs. The transition costs would not be borne equally, that is the transition costs imposed on the larger fund managers and investment managers (that are currently applying 90% GST exempt, 10% taxable) would be less than the boutique fund managers and investment managers (that are currently charging 100% taxable). This is because the boutique fund managers and investment managers would need to adjust from 100% taxable to 100% exempt and consequently could no longer claim GST deductions for outsourced costs.

57. Compared to the status quo / option one, this option would result in a total reduction in GST of approximately $22 million per annum from 1 April 2026 onwards, with the amount of GST forgone increasing at an assumed growth rate of 10% per annum. The estimated revenue depends on the proposed application date and estimated values of the affected managed fund assets and fees at that time. When compared to expected total management fees of approximately $2.1 billion in 2026, it seems unlikely that these reduced GST costs will have a material impact on the overall fees that funds charge retail investors.

58. The main risk with this option is whether the exemption would remain consistent and sustainable over time. This is because an exemption could create boundary issues in determining whether a service was a management service or another type of service (depending on how the relevant services are defined). For example, there could be incentives to bundle or reclassify some other types of services as being management services to further reduce GST costs for managed funds. This has been the experience in European Union countries where case law has found that the “management” of an investment fund has a broad meaning for European Union VAT purposes and can include administrative services and advice.

59. Providing an exemption for management services would lead to policy arguments that other types of services provided to managed funds should also be made exempt from GST in order to further reduce GST costs for managed funds. There does not appear be a good policy rationale for treating management services charged to funds differently to administrative services charged to funds, as both types of service are necessary inputs into the providing a managed fund product to investors. The administrative services are subject to 15% GST. Removing GST on management fees could lead to pressure to reduce GST on administrative services supplied to managed funds as well as similar outsourced services which are used as inputs by online trading platforms or bank savings products.

Option Four – No policy change and enforcement of current law (counterfactual)

60. Under this option, the law remains unchanged and Inland Revenue’s draft interpretations of the existing law will be finalised, resulting in manager fees becoming exempt and investment manager fees becoming subject to 15% GST.

61. The GST exemption for retirement schemes would be retained. The differing GST treatment of management services supplied to retirement schemes, compared to

similar services supplied to other types of funds (including wholesale funds which retirement schemes invest into), would impose compliance costs, and create a bias for certain business structures.

62. There are no clear advantages to this option.

63. The main disadvantages include the risk that this option could lead to some of the affected fund managers or investment managers restructuring their services or commercial contracts, or potentially disputing Inland Revenue's interpretations to mitigate the additional GST costs imposed by this option. This could prolong the uncertainty and inconsistency and result in some fund managers or investment managers applying inaccurate tax positions.

64. The current GST rules for fund manager services and investment manager services are unclear, which has imposed uncertainty, unintended consequences, and increased compliance costs on taxpayers. These issues are further described in the problem definition section.

65. Stakeholders have advised that they would incur significant costs to implement Inland Revenue's interpretation of the existing law. In particular, some investment manager services would incur a significant increase in GST paid (moving from 90% exempt to 100% taxable).

66. Of the two types of fees impacted, the investment manager fees are higher than the fund manager fees, so the counterfactual is estimated to lead to an overall increase in GST collected of approximately $135 million per annum from 1 April 2026 onwards, with the GST collected per annum increasing at an assumed growth rate of 10% per annum. The estimated revenue depends on the proposed application date and estimated values of the affected managed fund assets and fees at that time. This estimate assumes that investment manager fees comprise about 60% of the total amount of fund manager and investment manager fees. It is assumed this GST cost will flow through to retail investors in the form of higher fees which would reduce after-fee returns and therefore the total amounts that are reinvested and saved over time.

How do the options compare to the status quo (current GST practices)?

	Option One – Legislate to allow current inconsistent GST practices to continue	Option Two – Make the fees subject to 15% GST	Option Three - Make the fees GST exempt	Option Four – No policy change and enforcement of the current law
Certainty	0	++	+	- -
Consistency	-[5]	++	+	- -
Impact on managed fund fees	0	- -	0	-
Compliance and transition costs	0	- -	-	- -
Sustainability	-[6]	+	-	- -
GST base integrity	0	++	-	+
Overall assessment	0	+	0	- -

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

67. The preferred option is option two – make the fees subject to 15% GST.

[5] Officials are concerned this option will likely further entrench the inconsistent GST treatments over time. This option could also result in the affected parties switching to a different GST treatment depending on their particular commercial preferences.

[6] Officials are concerned that over time, other fees and services may be unintentionally captured and incorrectly classified as GST-exempt, effectively broadening the boundary of the GST exemption beyond its legislated settings.

68. The preferred option is consistent with the policy rationale of the financial services exemption, removes the distortion created by the exemption for retirement scheme funds, results in consistency across the managed funds industry and reduces concerns about the GST rules driving commercial behaviour in the industry.
69. The preferred option will likely increase the fees charged to managed fund investors, resulting in reduced returns for savers and consequently reduce the future balances in KiwiSaver and other managed funds.
70. The preferred option will impose transition costs for managed funds that are not already subjecting their manager fees to 15% GST.
71. This preferred option seeks to reduce the compliance and transition costs incurred by establishing a transition period of 36 months between enactment and when the rules will apply, to allow affected taxpayers to amend their IT systems, commercial contracts, and investor disclosure statements, to align with the new rules.
72. This option would collect additional GST of approximately $225 million per annum from 1 April 2026 onwards, with the GST collected per annum increasing at an assumed growth rate of 10% per annum. It is assumed that most of the additional GST would flow through to retail investors, such as KiwiSaver members, in the form of higher fees.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment** *nature of cost or benefit (e.g., ongoing, one-off), evidence and assumption (e.g., compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Regulated groups *(GST registered businesses that supply manager services to managed funds and retirement schemes)*	One-off cost in amending their systems and commercial contracts to align with the changes.	Medium	Medium
Regulators *(Inland Revenue)*	One-off cost in providing education and guidance on the changes.	Low	High
Others (e.g., wider govt, consumers, etc.)	Investors (including KiwiSaver members) that invest in managed funds. Additional GST costs and corresponding increases in fees paid by retail investors. The available data is from 2021 so the estimates for 2026 and future years are sensitive to the assumptions used, particularly about fee growth.	Medium Approximately $225 million per annum from 1 April 2026 onwards, increasing 10% per annum (based on an assumption the relevant fees will increase 10% each year).	Medium Low
Total monetised costs	Additional GST costs and corresponding increases in fees paid by retail investors.	$225 million per annum in 2026 and growing by 10% each subsequent year.	
Non-monetised costs	N/A	*Medium*	*Medium*
Additional benefits of the preferred option compared to taking no action			
Regulated groups *(GST registered businesses that supply manager services to managed funds and retirement schemes)*	Ongoing reduction in compliance costs in determining the GST treatment of manager fees to managed funds.	Low	Medium

	Reduced competitive advantage due to GST treatment.		
Regulators *(Inland Revenue)*	Reduced need to amend GST positions of affected businesses as the new rules should be easier to apply.	Low	Medium
Others (e.g., wider govt, consumers, etc.)			
Crown finances	Additional GST tax revenues.	$225 million per annum from 1 April 2026 onwards, increasing 10% per annum (based on an assumption the relevant fees will increase 10% each year).	Low
Total monetised benefits	Additional GST revenue collected.	$225 million per annum from 1 April 2026 and growing by 10% each subsequent year.	Low
Non-monetised benefits	*N/A*	*Low*	*Medium*

73. The impacts of the non-monetised costs and benefits have been determined through public consultation and discussions with interested managed funds and tax advisors who work with the managed funds industry.
74. A key assumption is that all, or nearly all, of the additional GST cost will ultimately increase the fees charged by managed funds to retail investors. The extent to which the added GST will lead to higher fees for retail investors (such as KiwiSaver investors) is uncertain. The economic literature[7] for other types of GST increases and decreases has found they are more likely to affect the prices paid by consumers (in this case, retail investors) in more competitive markets and if the GST reform is broader. Increases in GST are more likely to be passed through than reductions.
75. The boutique funds submitted that the additional GST costs would have little impact on fees charged to retail investors due to competitive pressure to reduce fees and the proposed transition period, while the larger funds considered the change would increase the overall fees that managed funds and KiwiSaver schemes charge investors and therefore reduce returns from savings.
76. There is a risk that some funds may restructure to reduce the impact of GST applying to NZ managers and NZ investment managers such as by shifting more assets into offshore domiciled funds which use offshore managers. This could reduce the additional GST revenues collected from the preferred option.
77. The monetised costs and benefits are based on 2021 data published by the Financial Markets Authority about the manager's basic fee for each KiwiSaver and non-

[7] IHS (2011), "The Effect of VAT on Price-Setting Behaviour" in IFS et al., A retrospective evaluation of elements of the EU VAT system, Report prepared for the European Commission, TAXUD/2010/DE/328.

KiwiSaver fund multiplied by the value of the funds under management as of 31 December 2021.

78. The impacts of increased GST revenues and increased fees charged to investors are sensitive to the assumptions used, particularly assumptions of fee growth as estimates based on 2021 data have been projected to 2026 (the year the proposed reforms would apply from).
79. The fiscal costs are sensitive to the growth assumption as the model projects the 2021 calculations to future years using this assumed growth rate. The growth assumption is based on the dollar value of the basic manager's fees multiplied by funds under management growing by 20% p.a. during the three years between the quarter ending on 31 December 2018 and the quarter ending on 31 December 2021.
80. A conservative growth rate assumption of 5% for 2022 and 10% for later years is used as:
    - The period between 2018 and 2021 had historically high investment returns, and the first 4 months of 2022 had negative investment returns.
    - The data used does not reflect recent reductions in fees from new lower fee default KiwiSaver providers being appointed and having assets transferred to them during December 2021.
    - Net contributions to KiwiSaver and other retirement schemes may reduce in future years as more of the population of investors reaches retirement age.
    - There is a potential risk that some funds may restructure offshore to reduce the impact of GST (as described in paragraph 76 above).
81. An assumption has been made that a manager currently incurs acquired taxable inputs of 20% of the value of the management services they provide[8]. When a manager's fees become 100% taxable, the manager could claim the additional GST input deductions on their expenses and offset these deductions against the GST charged on manager fees, resulting in less GST paid to the Crown. Given the limited data available, financial information within the Guardians of the New Zealand Superannuation's 2021 annual report was used to inform this assumption whereby the cost of their non-employee expenses was 23% and 24% of the value of the Guardians expenses. A 20% value was used for the assumption in order to provide a profit margin to the fund manager or investment manager.
82. The above assumptions do not consider any other second-order effects.

[8] Consequently, fund managers and investment managers only claim a proportion of the GST incurred on their costs (as most of the fees charged are GST exempt), with the remaining unclaimed GST being incurred as a business cost.

Section 3: Delivering an option

How will the new arrangements be implemented?

83. Inland Revenue will be responsible for the implementation and ongoing administration of the preferred option.
84. Following Cabinet approval, the preferred option will require amendments to the Goods and Services Act 1985 which could be included in the next available omnibus tax bill expected to be introduced in August 2022. The proposals are intended to apply from 1 April 2026.
85. Inland Revenue will provide information to increase awareness and support taxpayers and the managed funds industry to comply with the proposed rules. This will include producing a relevant Tax Information Bulletin item and updating guidance on Inland Revenue's website.
86. The preferred option seeks to reduce the compliance and transition costs incurred by establishing a transition period of three years between enactment and when the rules will apply, to allow affected taxpayers to amend their IT systems and commercial contracts to align with the new rules. Essentially, this would be grandparenting existing contracts that were agreed before the new rules were enacted.

How will the new arrangements be monitored, evaluated, and reviewed?

87. Inland Revenue regularly reviews tax settings on an ongoing basis and provides advice and updates to the Government accordingly. Policy officials consulted with groups of interested fund manager and managed funds when developing the policy options and will continue to engage with them to monitor the impacts of the policy changes.
88. In addition, Inland Revenue maintains strong communication channels with stakeholders in the tax advisory community and these stakeholders will be able to correspond with officials about the operation of the new rules at any time. If problems emerge, they will be dealt with either operationally, or by way of legislative amendment if agreed by Parliament.

4.

Regulatory Impact Statement: GST status of statutory and regulatory charges

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing final Cabinet decisions
Advising agencies:	Inland Revenue
Proposing Ministers:	Hon David Parker, Minister of Revenue
Date finalised:	26 May 2022

Problem Definition
The GST treatment of statutory and regulatory charges (being amounts payable under any enactments or regulations) can at times be unclear, and/or does not always align with intended GST policy outcomes because of a deficiency with the Goods and Services Tax Act 1985 (the GST Act).

Executive Summary

GST applies to the broadest possible range of goods and services supplied in New Zealand. This keeps the tax fair, simple, and efficient. Because of this principle, determining whether GST applies to specific statutory and regulatory charges (being any amount payable under an enactment or a regulation) is often straightforward. For example, fees paid for licencing, registration, and permits are usually unambiguously subject to GST.

For some statutory and regulatory charges, however, the GST treatment can be unclear, or the general GST rules do not result in outcomes which are desirable from a GST policy perspective. In these situations, the approach taken to date has been for the GST Act to be amended with piecemeal provisions that apply in respect of specific statutory and regulatory charges. This approach lacks transparency, results in further uncertainty, and exacerbates the existing inconsistent and incoherent approach to GST and statutory and regulatory charges.

The preferred solution should resolve these inconsistencies and provide transparency and certainty as to the GST status of statutory and regulatory charges in the future. This should, where applicable, decrease compliance and administration costs on government agencies with administrative responsibility for statutory and regulatory charges, and for Inland Revenue and the Treasury who typically advise on the GST implications of statutory and regulatory charges.

The preferred approach is to enact a specific legislative provision (the “default rule”) that deems all statutory and regulatory charges (excluding fines, penalties, interest, and general taxes) to be consideration for a supply of goods and services from the recipient of the charge. This would apply to all new (and renewed) statutory and regulatory charges that come into force after a fixed future date. It would also apply to all statutory and regulatory charges that had not otherwise been renewed in three years' time, to ensure consistency.

The rationale for excluding fines, penalties, and interest is because these amounts do not typically correspond to the supply of any goods and services and therefore should not be subject to GST. In the case of general taxes, while they may be used to fund goods and services, it is not proposed that GST apply to these.

The default rule would mirror existing deeming provisions for specific statutory and regulatory charges that have been included in the GST Act such as those for rates payable to local authorities, the waste minimisation levy, the levy payable under the Infrastructure Funding and Financing Act, fuel excise, road user charges, etc.

It is also proposed that a schedule of non-taxable statutory and regulatory charges is included in the GST Act. Where the GST treatment under the default rule is not considered appropriate from a GST policy perspective, the Minister of Revenue (during a transitional period, through an Order in Council process) or Parliament could amend the schedule which would result in GST not applying to those specific charges contained on the schedule.

Most common charges paid under enactments and regulations are currently subject to GST, so this is expected to have no impact on most of the population. For those who are affected, it is expected that there will be only minor and limited impacts.

To the extent that it results in GST applying to statutory or regulatory charges where GST is not currently collected:

- government agencies and their Ministers will need to ensure they are compliant with the new rules on renewal of statutory and regulatory charges that come into force once the default rule applies.
- persons paying the charges should notice a cost increase (to account for GST) if they are not registered for GST; or, if they are registered for GST and the charges are paid as part of their taxable activity, there should be no material change (as a GST credit will be available).

Inland Revenue officials consulted on the issue and the proposed solution with the Treasury, the Parliamentary Counsel Office, and GST experts at Deloitte, KPMG, and PwC. To understand the impact of the changes, officials also consulted with the Ministry for Primary Industries, the Ministry of Business, Innovation and Employment, the Ministry of Transport, the Ministry of Justice, and the Department of Internal Affairs.[1] No substantive issues that affect the analysis in this statement were identified during these discussions.

Most common charges paid under enactments and regulations are currently subject to GST, so the default rule approach discussed in this statement is expected to have only a limited or minor impact on both those paying statutory and regulatory charges, and those responsible for the administration of them.

[1] These government agencies are have administrative responsibility for the largest number of statutory and regulatory charges.

Limitations and Constraints on Analysis

It has not been possible to review the GST treatment of all statutory and regulatory charges that exist currently, or which are in the early stages of policy development. Even if this were possible, it is not expected that this would change the preferred option in this statement.

There were no other limitations or constraints on the analysis in this statement.

Responsible Manager (signature and date):

Graeme Morrison

Policy Lead

Policy and Regulatory Stewardship

Inland Revenue

s9(2)(a)

2 June 2022

Quality Assurance

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance reviewer at Inland Revenue has reviewed the *GST status of statutory and regulatory charge*s Regulatory Impact Statement prepared by Inland Revenue, and considers that the information and analysis summarised in the Regulatory Impact Statement **meets** the quality assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

The GST treatment of many statutory and regulatory charges (being any amount payable under an enactment or a regulation) is clear under existing principles in New Zealand's GST laws. For a subset of statutory and regulatory charges, however, the GST treatment is not so clear.

This has led to specific amendments being made to the Goods and Services Tax Act 1985 (the GST Act) which ensure GST applies to statutory and regulatory charges which are collected for specific government objectives or purposes. This generally occurs when officials at Inland Revenue and the Treasury become aware of new statutory and regulatory charges and are involved in the early stages of policy development.

The problem with this approach is that:

- it requires piecemeal amendments be made to the GST Act every time a new statutory or regulatory charge is being developed (which is generally the position of Inland Revenue and the Treasury when they are engaged in the policy development process on the GST implications)
- it can result in uncertainty (that is, if there is no specific provision in the GST Act that shows GST applies, is it not always clear whether the charge is subject to GST under the general GST rules or is not subject to GST at all), and
- it can result in statutory and regulatory charges that are not subject to GST, because under the existing law, GST would not apply (even though, from a GST policy perspective it should apply).

This leads to an incoherent and inconsistent approach to GST and statutory and regulatory charges. There are over 250 statutory and regulatory charges across New Zealand's Acts and regulations, and it is important for the integrity of the GST system that the GST treatment of these charges follows a consistent and coherent framework.

These problems will continue unless a different approach is taken to address the issue that gives rise to them.

What is the policy problem or opportunity?

The current rules in the GST Act do not always result in the appropriate GST policy outcome in respect of some statutory and regulatory charges.

This has resulted in piecemeal amendments being made to the GST Act to ensure that GST does apply to statutory and regulatory charges that are used for specific government objectives or purposes, or which are used to recover the costs associated with performing the functions of bodies within specific regulatory systems.

The problems with this approach could be addressed if the GST Act contained rules which made the GST treatment of all statutory and regulatory charges clear.

This would ensure that government agencies with administrative responsibility for statutory and regulatory charges had clarity on the GST treatment of new and existing charges which could help minimise their compliance costs.

Stakeholder views

Inland Revenue officials consulted with the Treasury and the Parliamentary Counsel Office, and GST experts at Deloitte, KPMG, and PwC on the issue and the potential solutions. The Treasury and the Parliamentary Counsel Office support the preferred option (the introduction of a new default rule). GST experts at Deloitte and KPMG acknowledged the proposal made sense in the context of New Zealand's GST system which included within the base the activities of government agencies and the Crown. GST experts at PwC disagreed with the preferred solution and considered that deemed supplies in the GST Act should generally be avoided.

Officials consider the preferred option an improvement over the status quo, where there is a mixed GST treatment of statutory and regulatory charges which is caused by a lack of certainty about how GST should apply to them. Repealing the current deeming provisions would come at a fiscal cost, would be disruptive in circumstances where GST was being collected, and would be inconsistent with New Zealand's broad based GST system.

To understand the impact of the proposal on existing statutory and regulatory charges, Inland Revenue officials consulted with the Ministry for Primary Industries, the Ministry of Business, Innovation and Employment, the Ministry of Transport, the Ministry of Justice, and the Department of Internal Affairs. No material issues were identified during this consultation.

What objectives are sought in relation to the policy problem?

The GST treatment of statutory and regulatory charges should be clear for government agencies with administrative responsibility for them (as they will need to know whether GST applies or not) and for those who have to pay them.

To address the problems with the current approach and ensure consistency and greater clarity in the future, it is necessary for changes to be made to the GST Act that apply broadly.

Section 2: Deciding upon an option to address the policy problem

The criteria that will be used to assess the options are:

- **Certainty and transparency:** Does the preferred option result in greater certainty and transparency in relation to the GST treatment of statutory and regulatory charges?
- **Consistency and coherence:** Does the preferred option make sense in the context of New Zealand's GST system? Is the preferred option consistent with the broad-base low-rate tax framework?
- **Compliance costs:** Does the preferred option minimise compliance costs for those with administrative responsibility for statutory and regulatory charges (including both new and existing charges)?
- **Administration costs:** Does the preferred option reduce the administration costs associated with ensuring appropriate GST policy outcomes are achieved for Inland Revenue and the Treasury?

What are the scope of options?

The scope of feasible options has not been limited by Ministers or stakeholders.

Non-regulatory solutions (such as providing guidance and education to government agencies with administrative responsibility for statutory and regulatory charges) have been considered and will continue in the future where appropriate.

A regulatory solution is required to directly address the issues identified with the status quo because the GST Act does not always produce outcomes which are considered correct or desirable from a GST policy perspective.

What options are being considered?

Option One – status quo

Inland Revenue and the Treasury will advise government agencies on the GST treatment of newly developed statutory and regulatory charges and will often advise specific amendments to the GST Act are necessary to ensure appropriate GST policy outcomes are achieved.

This approach:

- still requires regulatory changes (being specific amendments to the GST Act for each new statutory or regulatory charge where, under existing rules in the GST Act, GST would likely not apply)
- may result in GST outcomes not being considered where Inland Revenue and the Treasury are not engaged in the policy development process, and
- does not address the GST treatment of existing statutory and regulatory charges where no GST is currently being collected.

Option Two – Require Inland Revenue and the Treasury consultation on all new and renewed statutory and regulatory charges

A new requirement that government agencies with administrative responsibility for statutory and regulatory charges consult with Inland Revenue and the Treasury on the GST implications of any new statutory or regulatory charges could be introduced. Consultation could then be required on the GST treatment of any new, amended, or renewed statutory and regulatory charges, on a case-by-case basis.

This would ensure that Inland Revenue and the Treasury can provide advice on the appropriate GST policy outcomes.

This option would likely still require amendments be made to the GST Act. These amendments would be required for specific statutory and regulatory charges that, under existing GST legislation, would not be subject to GST.

Option Three – Amend the GST Act to add a default rule

The GST Act could be amended to include a default rule that applied to all statutory and regulatory charges (excluding amounts in the nature of fines, penalties, interest, and general taxes). This rule would make it clear that statutory and regulatory charges were deemed to be consideration for the supply of goods and services from the recipient. This would put the GST treatment of these charges beyond doubt.

Recognising this default rule may not be appropriate for all future statutory and regulatory charges, therefore this option would include adding a schedule of non-taxable statutory and regulatory charges to the GST Act. This schedule could contain a list of charges to which the default rule would not apply and could be amended through primary legislation if necessary.

The default rule would apply to all new (and renewed) statutory and regulatory charges that come into force on or after a date in the future. To ensure consistency, the default rule would also apply to all statutory and regulatory charges after a three-year transition period. This transition period should provide government agencies and Ministers with sufficient time to make the necessary changes to any statutory and regulatory charges which may be affected by the default rule.

Inland Revenue and the Treasury would continue to support government agencies to understand the GST implications of their statutory and regulatory charges. The default rule would also make it easier for Inland Revenue and the Treasury to provide this assistance and guidance (as the deficiency with the current law would be addressed).

How do the options compare to the status quo?

	Option One: Status quo	Option Two: Require consultation with Inland Revenue and the Treasury	Option Three: Amend the GST Act to add a default rule	Comments
Certainty and transparency	0	+	++	Under Option Three, GST would apply to statutory and regulatory charges by default which would make the GST treatment clear from the early stages of policy development.
Consistency and coherence	0	+	+	GST currently applies to many statutory and regulatory charges because of specific provisions in the GST Act. The lack of specific provisions in the GST Act could suggest that GST should not apply to other statutory and regulatory charges which is not intended. Option Three would bring about greater consistency and coherence through creating a default starting position for all charges.
Compliance costs	0	-	+	Option Two would add to the policy development timeframe by requiring government agencies to consult with Inland Revenue and the Treasury on new statutory and regulatory charges. Option Three should reduce compliance costs associated with determining the appropriate GST treatment of statutory and regulatory charges.
Administration costs	0	-	+	Option Three should marginally reduce administration costs for Inland Revenue as no further piecemeal amendments to the GST Act would be required to ensure appropriate GST policy outcomes are achieved.
Overall assessment	0	+	++	

Example key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual	-	worse than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual	- -	much worse than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual		

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

Introducing a new default rule that applies to all statutory and regulatory charges is the preferred option as, compared with the status quo, it ensures:

- a consistent and coherent approach to the GST treatment of statutory and regulatory charges in the future
- greater certainty and transparency as to the GST treatment of statutory and regulatory charges in the future, and
- reduced compliance and administration costs for government agencies with administrative responsibility for statutory and regulatory charges, and Inland Revenue and the Treasury who provide guidance on the tax implications of them.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Government agencies with administrative responsibility for statutory and regulatory charges (and other entities that collect statutory and regulatory charges)	May need to update charges to be compliant with the new rule. This has regulatory implications and potential systems and billing implications. There will be no changes required for agencies with charges that GST apply to (where GST should apply).	Medium	Medium
GST registered payers of statutory and regulatory charges	For charges paid that relate to their taxable activity, and where no GST was previously payable, these payers would now need to claim a GST deduction like for any other expenses incurred.	Low	High

Payers of statutory and regulatory charges who are not registered for GST, or those who are paying charges outside of their taxable activity	May experience an increase in statutory and regulatory charges they pay if they are not already subject to GST. Most charges are already subject to GST so there should be an insignificant impact.	Low	Medium
Total monetised costs	Potentially higher costs for anyone paying charges that are not currently subject to GST that would, under the proposal, result in GST being payable.	Low	Medium
Non-monetised costs	n/a	Low	Medium
Additional benefits of the preferred option compared to taking no action			
Government agencies with administrative responsibility for statutory and regulatory charges	Greater certainty of the GST treatment of statutory and regulatory charges due to clear legislative authority.	Medium	Medium
Inland Revenue and the Treasury	Will be able to better support government agencies understand the GST implications of statutory and regulatory charges without the need for piecemeal regulatory changes. An expected reduction in demand for binding rulings and other administrative support from Inland Revenue on the GST status of future charges.	Medium	Medium
Total monetised benefits		n/a	n/a
Non-monetised benefits		Medium	Medium

Section 3: Delivering an option

How will the new arrangements be implemented?

The preferred option – enacting a default rule for all statutory and regulatory charges which makes the GST status clear – would require changes to the Goods and Services Tax Act 1985. These changes could be included in an omnibus taxation bill.

To provide government agencies with administrative responsibility for statutory and regulatory charges sufficient time to make any changes that may be required as a result of the default rule, a three-year transitional period is proposed.

Any new statutory or regulatory charge that comes into force (including those that are amended through updated regulations) after the date that the default rule applies from would need to be compliant with it. Any existing statutory and regulatory charges that are not otherwise renewed within a three-year period would need to be compliant with the default rule from the beginning of the fourth year after the default rule came into force.

To the extent that there are statutory and regulatory charges where the default rule results in an inappropriate GST policy outcome, these could be included on the proposed schedule of non-taxable statutory and regulatory charges included in the GST Act.

During the transitional period, the Minister of Revenue could recommend an Order in Council to add specific charges to this schedule. This Order in Council mechanism would help support an expedient carve-out from the effect of the default rule.

If the default rule became law, there are various rules in the GST Act that would no longer be required. These rules would be identified as part of the drafting of the Bill and should be repealed following introduction of the default rule.

Inland Revenue would communicate the changes to other government agencies if the default rule became law. It would also communicate the changes in its publications (for example, in a *Tax Information Bulletin*) to improve general awareness.

How will the new arrangements be monitored, evaluated, and reviewed?

Inland Revenue would continue to monitor the outcomes of the default rule pursuant to the Generic Tax Policy Process ("GTPP") to confirm that it met the policy objectives. The GTPP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995.

We do not expect extensive monitoring to be necessary as the proposed option should result in reduced confusion about the GST status of statutory and regulatory charges. The proposed default rule will help make working through the GST implications of new statutory and regulatory charges easier.

5.

Regulatory Impact Statement: GST apportionment and adjustment rules

Coversheet

Purpose of Document	
Decision sought:	*Analysis produced for the purpose of informing final Cabinet decisions on reforms to simplify the GST apportionment and adjustment rules*
Advising agencies:	*Inland Revenue*
Proposing Ministers:	*Revenue*
Date finalised:	*26 May 2022*

Problem Definition

The current GST apportionment and adjustment rules are complex and have high compliance costs, including unexpected liabilities for private assets such as vehicles and houses which have a small amount of business use.

Executive Summary

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):

- The rules are complex and have high compliance costs; and
- Unexpected tax 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.

Seven options were considered including the status quo and a non-regulatory option of Inland Revenue providing increased education and guidance about the current rules.

Inland Revenue's preference which is also recommended in the Cabinet paper is a reform package of options 3, 4, 6 and 7. These options were consulted on in a public consultation document and through meetings with GST advisors and are supported by submitters.

A package of measures is recommended because each separate option has some gaps and weaknesses. Using a package of options allows the other options to fill in such gaps. It reduces the number of businesses who are required to apportion GST on their business or private assets and reduces compliance costs in those cases where apportionment is still required.

Limitations and Constraints on Analysis

A key assumption is that for most of the affected businesses the proposed options will align with their current practices. This assumption leads to the non-monetised impacts being low as only a small number of businesses would have to consider or change their current practices. This assumption was checked as part of the consultation and is considered reasonable by Inland Revenue and other stakeholders.

There is limited information about the affected population of GST-registered persons who use assets for both business and private (or exempt) use, so assumptions were required to estimate monetised impacts and the non-monetised impacts of the options were informed by consultation.

The scope of the options is limited to measures Inland Revenue could implement and administer. The options were consulted on in a public consultation paper which also asked for submissions on any alternative options.

Responsible Manager

Graeme Morrison

Policy Lead

Indirect tax

Inland Revenue

s9(2)(a)

26 May 2022

Quality Assurance

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The reviewer considers that the information and analysis summarised in the regulatory impact statement meets the quality assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

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).
2. A GST-registered person can deduct GST paid on purchases of assets (such as buildings and vehicles) that they use in their business.
3. Two issues arise where an asset is used both for business use and for private use.
4. The first issue arises where an asset has mostly business use, such as a van delivering packages during the week, with some minor private use, such as recreational use of the van in the weekend (or making exempt supplies). In such cases, complex apportionments and adjustments are required. The taxpayer must apportion (by way of a percentage) the total deduction, based on their estimate of the percentage of business use. This is to ensure GST is collected on the portion of the asset's private use. They are then required to monitor their actual business 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.

5. The second issue arises when a GST-registered person acquires an asset mostly for private use but later makes some business use of the asset. For example, a GST-registered person acquires a dwelling to live in but uses one room of the dwelling as a home office, or they acquire a dwelling to be used as a holiday home, but also hire it out occasionally as guest accommodation. The GST system does not tax most private sales of assets, such as dwellings. This is because they are not part of a registered person's taxable activity (that is, their business). However, where a GST-registered person makes some business use of a mostly private asset, the use, and disposal, of that asset may be subject to GST. This can lead to a GST liability or adjustment if the asset is sold. The GST liability arises even if the person did not claim an input tax credit when they acquired the asset. The GST liability on a dwelling or land can also be significant as land is a high value, appreciating asset that is often held for long periods before disposal.

What is the policy problem or opportunity?

6. There are two key 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).
7. 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 a change of use. Due to the compliance costs and complexity of the current rules, Inland Revenue and other stakeholders consider the level of compliance by affected GST-registered businesses with the current rules is likely to be very low.
8. Second, in the mostly private use case, the tax liabilities and compliance costs that can arise will usually be unexpected. We understand that many GST-registered persons are unaware that GST consequences can arise if their dwelling is partly used to make taxable supplies. Consequently, we expect that non-compliance is high and that many people are not accounting for GST on their dwelling on its disposal.
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 is 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.
10. There is limited information about the affected population of GST-registered persons who use assets for both business and private (or exempt) use. Some of the main groups potentially affected are farmers who sell their farmhouse, self-employed persons who sell a home office or vehicle with a mix of private and business use, holiday home accommodation providers and property developers who rent out residential houses prior to selling them.
11. 1,781 farms were sold in the 12 months to March 2022, but we do not know how many farms include a farmhouse (as opposed to just land). 1,006 GST-registered persons are registered with the business industry code "holiday homes and flat accommodation", and 7,881 GST-registered persons have registered with the code for "residential property development". The number of houses sold by these GST-registered persons (and whether there was private or exempt use of such houses) is unknown.

12. There is no data on self-employed persons who sell a home office or vehicle with a mix of private and business use. Based on discussions and submissions from GST advisors we have assumed that such persons are typically taking GST positions that their house is a non-taxable private asset, and their vehicle is a fully taxable business asset for GST purposes, consistent with the GST rules that operated prior to 2011.

What objectives are sought in relation to the policy problem?

13. The objective is to mitigate the problems described above. This could be achieved by targeting the application of the apportionment and adjustment rules, so they apply to fewer assets. This would remove compliance costs and reduce the risk of unexpected liabilities. Other options consider how to simplify the rules, so they impose lower compliance costs in those cases where apportionment and adjustment is still required.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options?

14. The following criteria was used to assess the options:

- Fairness. The option does not significantly over-tax or under-tax the non-business use of the relevant asset. It also provides similar GST outcomes for the affected taxpayers compared to other taxpayers who have similar circumstances.

- Compliance costs. Compliance costs should be minimised as much as reasonably possible. The option should be easy for the affected parties to understand and apply.

- Tax collection and compliance. The option should reduce the fiscal risks associated with incorrect GST practices. The option should be practical for the affected businesses to comply with, so that they are more likely to apply consistent and correct GST practices.

What options are being considered?

15. 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. This suggests some rules would 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.

16. Therefore, the option of repealing (rather than reforming) the apportionment and adjustment rules has not been further analysed. The scope of the options is also limited to measures Inland Revenue could implement and administer. The options were consulted on in a public consultation paper which also asked for submissions on any alternative options.

Option One – Status Quo

17. The current GST apportionment and adjustment rules may create uncertainty, complexity, unintended consequences, and undue compliance costs. These issues are further described in the problem definition section.

18. The status quo can result in unfair outcomes where some taxpayers will face higher and unexpected GST costs compared to other taxpayers in similar situations. It imposes high compliance costs from complex and unclear rules requiring annual adjustments. It is unlikely to be fair in practice as the current rules are often not applied by the affected taxpayers. The small number of compliant taxpayers may be disadvantaged by facing higher compliance costs and liabilities than taxpayers that do not comply.

Option two – *Improved education and guidance on current law / rules*

19. This option involves continuing with the current GST rules but with Inland Revenue providing additional education and guidance to improve the affected taxpayers' understanding of the rules.

20. This option is unlikely to reduce compliance costs. There is a large population of potentially affected small businesses who will be difficult to reach with guidance or education, especially as they will often not have tax advisors. As the current rules are compulsory and inflexible, there is a limited ability for published guidance to provide alternatives to apportionment or simpler methods for the affected taxpayers to use.

21. Raising awareness of the current issues is likely to create more pressure for policy reforms. Some of the issues with the current rules were identified because of Inland Revenue developing guidance on how these rules apply to particular situations such as business use of dwellings.

22. Submissions noted the importance of providing guidance materials and training if policy reforms were implemented.

Option Three – *Election method*

23. Option three would allow businesses, at the time of purchase, to elect to treat certain assets which are mainly used privately (or to make exempt supplies), such as a house with a home office, or a vehicle, as though they only had private or exempt use. If so, no GST deduction is claimed on purchase and GST will not apply if the asset is later sold.

24. This could ensure GST-registered sole traders are not disadvantaged compared to other types of ownership structures where private assets are usually held by a different person to the entity which is GST-registered. In both cases, the owner of the private asset would have a choice as to whether or not it was considered as part of the businesses' assets for GST purposes.

25. The option is expected to be effective at reducing compliance costs for the second issue involving appreciating and mostly private assets such as dwellings and land. However, it will not solve the first issue involving mostly business assets. Moreover, for cashflow reasons, GST-registered businesses may still choose to claim GST deductions for depreciating assets such as vehicles, even if they have only a small amount of business use. This option would therefore be less likely to reduce compliance costs from applying apportionment rules to those assets.

26. Submissions agreed that the election option would be an effective way to reduce compliance costs for dwellings and would align the GST rules with current taxpayer practices for dwellings.

Option Four – *Principal purpose test*

27. Option four would introduce a principal purpose test where an asset's dominant use at the time of purchase will determine the GST treatment. A similar rule previously applied prior to 2011 and Inland Revenue and other stakeholders consider that a lot of the affected taxpayers are continuing to take GST positions on this basis.

28. A principal purpose test would reduce compliance costs for taxpayers by eliminating the need for the apportionment and adjustment rules. However, 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.

29. For this reason, Inland Revenue consulted on a proposal that the principal purpose test would only apply to assets purchased for $5,000 or less (GST exclusive).

30. Submissions supported this option but argued that a higher threshold should be used such as $10,000 or $50,000, or alternatively that the apportionment rules be replaced with a principal purpose test for all assets (as was the case prior to 2011). The pre-2011 rules required complex adjustments for private use of the asset which would greatly reduce the compliance cost benefits of this proposed option. However, applying a principal purpose test to high value assets (such as land) in the absence of any adjustment rules would undermine fairness and tax collection.

31. In response to submissions, Inland Revenue recommends applying a principal purpose test to assets purchased for $10,000 or less (GST exclusive). While a higher threshold could reduce compliance costs for more assets, it would reduce fairness and tax collection. In particular, a higher threshold could create an unintended incentive for businesses to prefer to buy vehicles valued below the threshold as, unlike higher cost vehicles or vehicles provided to employees, GST would not be imposed on the private use of lower-value vehicles principally used for work, if the proposed simple principal purpose test could be applied to them.

Option Five – *Rounding based rules*

32. This option involves simplifying the GST apportionment rules with two components:

    - a rounding rule where assets with high (80% or more) or low (20% or less) business use will be deemed to have sole business or private use (rounding-based rules).

    - a percentage-based threshold (such as 20%), that would allow a modest change in the business or private use without requiring a GST adjustment to be made.

33. These proposals are expected to remove most partly business and partly private assets from the apportionment rules and reduce the need to make annual adjustments, which will reduce compliance costs. Some assets (with less than 80% business or private use) would continue to incur compliance costs, but these costs would be lower than the current rules as adjustments would only be required if there was a significant (more than 20 percent) change in use, which would usually be a planned, deliberate change.

34. Some submissions considered this option would be an effective way to reduce GST compliance costs for assets such as certain work vehicles which would generally have 80-99% business use. Such assets would be treated as having 100% business use, removing the need to apportion the vehicle cost or make annual adjustments.

35. However, other submissions considered that this option would not result in a significant reduction in compliance costs as they thought it may only reduce the need to make annual adjustments. They considered other compliance costs would remain such as the need to formulate a method for apportioning business and non-business use of the asset (such as value of the supplies, time or space allocated) and then monitor this to check the relevant threshold is not exceeded. In addition, the business use of a mainly private asset such as a dwelling may exceed 20 percent, so this option would not be effective at removing GST compliance costs or unexpected liabilities on such assets. It would also create cliff face issues where large costly adjustments would become required if the business use of the asset changed so as to exceed the relevant allowable threshold (e.g. if land went from 80% business use, to less than 80%, GST would need to be paid on 20% of the purchase price of the land).

Option Six – *Integrity measures*

36. The issues paper consulted on a package of integrity measures that will improve Inland Revenue's ability to collect GST owing on the sale of assets by a GST-registered business that claimed business use of the asset when they originally acquired the asset.

37. This could include a new requirement for certain GST-registered businesses to provide basic information to Inland Revenue about high-value land, pleasure craft (yachts or launches) or aircraft that they have purchased and intend to use in their business activity.

38. This information would help Inland Revenue identify and improve tax compliance in situations where a large GST refund (or cost saving from acquiring zero-rated land) was originally claimed on acquisition of the asset, but there has been a failure to continue to use the asset in a business activity or properly account for GST if the asset is later sold (e.g., because the business never commences trading or has closed down).

39. A new deeming rule is also proposed to clarify that in these situations (business use claimed on acquisition), GST is properly accounted for if the asset is sold, even though the person's business activity may have since ceased.

40. Other proposed measures ensure that a wash-up calculation that applies when there has been a permanent change to the percentage of business or private use, cannot be unintentionally exploited to avoid tax.

41. The integrity measures would improve fairness by removing opportunities for non-compliant taxpayers to exploit unintended GST subsidies which are not available to compliant taxpayers or to private consumers. However, it would increase compliance costs by requiring the businesses to provide certain information to Inland Revenue when they purchase land, high-value land, pleasure craft (yachts or launches) or aircraft.

Option Seven – *Simplifying existing apportionment rules*

42. This option involves several minor improvements to the existing apportionment rules that would slightly reduce compliance costs for GST-registered businesses. The improvements were strongly supported by submitters and include:

- Reducing the number of years GST-registered businesses need to monitor their actual business use of assets and make annual GST adjustments (this ranges from no subsequent adjustments for low-value assets, to 10 years of adjustments for high-value assets and land);

- Expanding the ability to use a wash-up rule which provides a final adjustment (rather than ongoing adjustments) when there has been permanent change of use. The proposal will allow this rule to be used for any permanent change in use (rather than just a change to fully business, or fully non-taxable use) and to be applied 12 months earlier; and

- Allowing Inland Revenue to approve a wider range of apportionment methods that are more practical for taxpayers to apply and consequentially repealing some complex formula in the legislation which apply to specific and uncommon scenarios.

43. Compared to the status quo, these improvements would reduce the number of annual adjustments and allow a wider range of methods. However, compared to options 3, 4 or 5 above which would remove certain assets from needing to be apportioned when purchased, this option would be less effective at reducing compliance costs for these assets.

How do the options compare to the status quo?

	Option One –Status Quo	*Option Two – improved education / guidance on current law*	*Option Three – Election method*	*Option Four – Principal purpose test*	*Option Five – Rounding based rules*	*Option Six – Integrity measures*	*Option Seven – simplifying existing apportionment rules*
Fairness	0	0	+	-	-	+	0
Compliance costs	0	0	+	++	0	-	+
Tax collection and compliance	0	+	-	- (if limited to low value assets) - - (if all assets)	- -	+	-
Overall assessment	0	+	+	+	-	+	+

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

44. The proposal is a reform package consisting of options 3, 4, 6 and 7.

45. This is because each separate option has some gaps and weaknesses. For example, the principal purpose test would be too inaccurate leading to unfair outcomes for high-value assets so is proposed to be limited to assets acquired for $10,000 or less (GST exclusive).

46. Using a package of options allows the other options to address gaps and weaknesses. For example, the election option (option 3) is likely to be most relevant for land and dwellings and not applied by the affected taxpayers to other types of assets, so options 4 and 7 are recommended in order to reduce compliance costs for other assets.

47. In this way, implementing a reform package reduces the number of businesses who are required to apportion GST on their business or private assets and reduces compliance costs in those cases where apportionment is still required.

Key for qualitative judgements:

++	much better than the status quo
+	better than the status quo
0	about the same as the status quo
-	worse than the status quo
- -	much worse than the status quo

What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated group *(GST-registered businesses with assets with a mix of business and private or exempt use and their tax advisors)*	One-off costs of understanding and responding to changes, although for most affected businesses, the proposals should align with their current practices.	Low	Medium
Regulators *(Inland Revenue)*	One-off costs of implementing and providing education and guidance on changes.	Low	High
Others *(Crown Revenue)*	Fiscal cost of less GST being collected on some affected assets, but as we do not have relevant data, we had to use assumptions to estimate this cost	Estimated $4m per annum reduction in GST collected each year	Low
Total monetised costs	n/a	Estimated $4m per annum reduction in GST collected each year	Low
Non-monetised costs		*Low*	*Medium*
Additional benefits of the preferred option compared to taking no action			
Regulated group *(GST-registered businesses with assets with a mix of business and private or exempt use and their tax advisors)*	Ongoing reduction in compliance costs as majority of partly business and partly private assets will no longer need to apply the apportionment rules or make annual adjustments. However, for most affected businesses, the proposals should align with their current practices. Some options may lead to a small reduction in overall GST returned but as we do not have relevant data, we had to use assumptions to estimate this cost	Low Estimated $4m per annum reduction in GST paid each year	Medium Low
Regulators *(Inland Revenue)*	Reduced need to amend GST positions of affected businesses as new rules should be easier to apply correctly. Integrity measures will improve Inland Revenue's ability to collect GST	Low	Medium
Others	No identified benefits	n/a	Low

Total monetised benefits	n/a	Estimated $4m per annum reduction in GST collected each year	Low
Non-monetised benefits		*Low*	*Medium*

48. The impacts of the non-monetised costs and benefits have been determined through public consultation and discussions with tax advisors who work with the affected group.

49. A key assumption is that for most of the affected businesses the proposed options will align with their current practices. This assumption leads to the non-monetised impacts being low as only a small number of businesses would have to consider or change their current GST practices in response to the reforms being implemented. This assumption also means that the monetised impact of the proposed reform options is considered to be nil for nearly all the affected assets (by value) as the GST outcomes provided by the reform options would align with these businesses' existing GST practices so would not result in any less GST being collected. This assumption was checked as part of the consultation and is considered reasonable by Inland Revenue and other stakeholders.

50. As Inland Revenue does not have relevant GST data on assets acquired by businesses and their private or exempt use, the estimated reductions in GST collected from the affected group of GST-registered businesses are very uncertain and based entirely on assumptions. This included the key assumption about current GST practices (noted above), and assumptions about the number and value of affected assets which may be complying with the current rules and which would potentially apply different GST positions as a result of the proposed reforms.

Section 3: Delivering an option

How will the new arrangements be implemented?

51. Inland Revenue will be responsible for the implementation and ongoing administration of the new rules. Inland Revenue will provide information to increase awareness and support taxpayers to comply with the new rules. This will include producing a relevant Tax Information Bulletin item and updating guidance on Inland Revenue's website.

52. One of the proposed integrity measures would require Inland Revenue to implement a new information disclosure for GST-registered persons who claim a large GST deduction (or cost saving from zero-rating) for business use, at the time they acquire land, aircraft, or high-value boats. Similar information disclosures already apply to persons with interests in foreign companies for income tax purposes.

53. The implementation risks are considered low as the preferred option is expected to make the GST rules easier to apply for the affected businesses and is also anticipated to align with the tax positions already taken by most of the affected businesses in respect of these assets.

How will the new arrangements be monitored, evaluated, and reviewed?

54. The proposed reform package potentially includes a new information disclosure by GST-registered persons who are claiming GST deductions in respect of land, aircraft and high-value boats. This information will assist Inland Revenue to monitor some of the affected assets which involve the highest level of tax compliance and collection risk.

55. Inland Revenue regularly reviews tax settings on an ongoing basis and provides advice and updates to the Government accordingly. Policy officials maintain strong communication channels with stakeholders in the tax advisory community and these stakeholders will be able to correspond with officials about the operation of the new rules at any time. If problems emerge, they will be dealt with either operationally, or by way of legislative amendment if agreed by Parliament.

6.

Regulatory Impact Statement: Cross-border workers tax reform

Coversheet

Purpose of Document	
Decision sought:	Final Cabinet decision
Advising agencies:	Inland Revenue
Proposing Ministers:	Minister of Revenue
Date finalised:	25 May 2022

Problem Definition
New Zealand's employment-related tax rules are strict, with the result that they do not recognise the different compliance circumstances which arise in the context of cross-border working arrangements. There is an opportunity to modernise these rules which will minimise compliance costs and provide greater certainty for employers and payers of non-resident contractors.

Executive Summary
Cross-border work arrangements have been an issue of importance to employers and businesses for many years. New Zealand has a need to import specialist skills from abroad. In addition, traditional labour practices are changing, and improved technology has enabled remote working. The employment-related tax rules (Pay As You Earn (PAYE), Fringe Benefit Tax (FBT), Employers' Superannuation Contributions Tax (ESCT) and Non-resident Contractor's Tax) are precise. These rules do not adequately recognise the different compliance circumstances of employers and payers of cross-border workers. As a result, the employer or payer may be non-compliant despite their best endeavours to comply. They seek greater flexibility and certainty from the tax system. In addition, it is not always clear when a non-resident employer has a PAYE, FBT or ESCT obligation. Where the employer does not have a PAYE obligation, the current rules pass the obligation to the employee. No corresponding rules exist for FBT and ESCT. This needs to be addressed to support the integrity of the employment-related tax rules. Over time, private sector businesses have raised concerns with the rules with Inland Revenue. As a result, a review of the tax rules applying to cross-border workers was included on the Tax Policy Work Programme. An officials' issues paper *Cross-border workers: issues and options for reform* was published in October 2021. Public consultation indicates that the structural settings are sound. As such, the proposals do not change the rate of tax payable or the circumstances in which tax is payable. However, there is an opportunity to ensure that the rules better fit the specific circumstances which apply to the employers of cross-border employees and the payers of non-resident contractors. A package of improvements is proposed which: • Improve the flexibility of, and/or clarify, the PAYE, FBT and ESCT and NRCT rules, and

- Support the integrity of the PAYE, FBT and ESCT rules.
- Make a number of remedial amendments.

These changes are broadly intended to modernise the rules to better reflect the issues that arise in connection with cross-border work and to reduce compliance costs.

The proposals will affect employers of cross-border employees, payers of non-resident contractors and the individual workers. Recognised seasonal employees are outside the scope of these reforms.

Final design of the proposals has taken stakeholder views into consideration where possible. Three proposals received feedback consistent across a number of submitters:

- The private sector sought a longer time period to correct the tax position for the employer or payer and the affected individual(s). We have increased the period from 28 days to 60 days.
- The proposal for a PAYE, FBT and ESCT threshold to support the 'sufficient presence' test for these obligations was not seen as helpful. Some submitters favoured a safe harbour and we have adopted this approach.
- The proposal to introduce an NRCT reporting requirement was viewed by the private sector as imposing a compliance cost and potentially onerous. Nevertheless, officials see this proposal as part of the overall package of NRCT reforms which will simplify the rules for payers and assist Inland Revenue to police the rules. As such, we intend to proceed with this proposal.

It is expected that some administrative systems changes are required. The changes proposed will be supported by the publication of updated guidance.

Limitations and Constraints on Analysis

Currently, the system does not distinguish between New Zealand based employees and cross-border workers – whether employees or non-resident contractors. As a result, direct sources of data are limited. However, discussions with Inland Revenue operations and private sectors businesses have been used to scope the problem and develop solutions and to provide qualitative assessments of the costs and benefits.

Responsible Manager(s) (completed by relevant manager)

Sam Rowe

Policy Lead, International

Policy and Regulatory Stewardship

Inland Revenue

s9(2)(a)

[redacted]

15 June 2022

Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The reviewer considers that the information and analysis summarised in the regulatory impact statement meets the quality assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. New Zealand introduced tax obligations relating to the employment in the latter half of the 20th century. The Income Tax Act 2007 and the Tax Administration Act 1994 impose obligations on persons who make payments subject to Pay As You Earn (PAYE) withholding tax, Fringe Benefit Tax (FBT), Employer's Superannuation Contribution Tax (ESCT) or non-resident contractors' tax (NRCT).

2. The introduction of the PAYE system streamlined the collection of taxes from individuals' salaries or wages and ensured that the amount collected is broadly accurate. The obligation to comply with PAYE requirements falls on the payer of the income. As a result, individual taxpayers who only earn employment income do not normally need to pay a substantial amount of tax on their gross income after the end of the tax year. Further taxes have since been applied to other components of employee remuneration:

   - Fringe Benefit Tax (FBT) applies to specified benefits provided by an employer to an employee, such as private use of a vehicle, contributions to a superannuation scheme or private medical insurance, or a loan.

   - Employer's Superannuation Contribution Tax (ESCT) applies where the employer makes cash contributions to a superannuation fund or KiwiSaver scheme for the benefit of its employee(s).

3. The latter two taxes ensure that all elements of employee remuneration are taxed on an equivalent basis.

4. Where the payee is a non-resident contractor, the person who pays the income is required to withhold non-resident contractors' tax (NRCT), a schedular tax, from the contract payment. The withholding obligation does not arise if the contract payment is below the NRCT threshold or subject to a certificate of exemption. While NRCT is included in the PAYE system, it can apply to contracts in which both payer and contractor are non-resident and only the activity takes place in New Zealand.

5. NRCT serves a different policy purpose to PAYE, FBT and ESCT. NRCT was introduced and expanded to manage "flight risk" – contractors who departed New Zealand having completed their work and collected payment but having not paid the New Zealand tax due. It addresses specific concerns about the integrity of the New Zealand tax base, whereas employment-related PAYE obligations serve a range of purposes. NRCT is intended to be a robust withholding obligation, not minimum or final tax. The non-resident contractor has its own tax filing requirement that gives effect to the final tax position.

6. The overarching objectives of the Government include accelerating New Zealand's economic recovery and laying the foundations for a better future. As New Zealand is a small economy, to advance these objectives it is likely there will be increased demand from businesses based in New Zealand to obtain workers with specialist skills from

abroad. The tax arrangements for internationally mobile workers can be complex and impose compliance costs on businesses and/or the individual worker.

7. The COVID-19 pandemic has highlighted the role of technology in enabling cross-border and remote work arrangements. The pandemic has accelerated existing trends towards more flexible and more remote work. For example, New Zealanders returning to New Zealand while working remotely for an overseas firm with no connection to New Zealand.

8. Given the changes in where and how people work, and the concerns raised with Inland Revenue about the rules, a review of the rules was added to the Tax Policy Work Programme.

9. If left unaddressed, it is expected that the issues faced by employers, payers and workers will continue, though they may worsen. The current rules are hard to comply with, even where the employer, payer or individual worker is trying to get it right. If flows of workers into New Zealand increase, the cost of compliance will increase. Further, leaving the problems unaddressed may make New Zealand a less desirable place for cross-border workers. In the long run, this may disadvantage New Zealand and hinder the government's economic objectives.

10. No interactions with other work programmes or regulatory systems have been identified.

What is the policy problem or opportunity?

Problem

11. New Zealand's employment-related tax rules are strict, meaning that they are narrow and inflexible when applied to cross-border working arrangements. There is an opportunity to modernise these rules which will minimise compliance costs and provide greater certainty for employers and payers of non-resident contractors.

12. The problems can be broken into three broad categories of issues:

- PAYE, FBT and ESCT are inflexible withholding obligations and do not adequately cater for the complexities of cross-border employment arrangements. For example, where the employer or payer expected an employee to benefit from an exemption from New Zealand tax, for example under the terms of a double taxation agreement, a project delay may result in the need to pay New Zealand tax. Similarly, it is not always possible to gather and process compensation data from global sources in time to meet New Zealand's reporting and payment dates.

- PAYE, FBT and ESCT obligations have been differently interpreted by employers, tax advisors and Inland Revenue. A recent operational statement *Non-resident employers' obligations to deduct PAYE, FBT and ESCT in cross-border employment situations* (OS 21/04) (the Operational Statement) has clarified that the obligations arise for an employer with a sufficient presence in New Zealand. Under the current rules, if there is no presence in New Zealand, an employee should pay PAYE directly to Inland Revenue. However, no equivalent rule exists for FBT and ESCT.

- NRCT withholding obligations are inflexible and require modernisation. In addition to the issues which arise for employers, specific issues exist for payers of non-resident contractors. These relate to exemption from the NRCT withholding obligation. Breaches of the thresholds and/or delays in the exemption process may result in a cost borne by New Zealand businesses.

13. Strictly, breaches of the rules require a voluntary disclosure to report the underpaid tax to Inland Revenue and correct the tax position for each affected employer, payer and/or individual. Voluntary disclosures are time-consuming and costly to prepare and from an administrative perspective are time-consuming to process and resolve.

Affected population

14. The key groups affected by the proposal are the employers of cross-border employees and payers of non-resident contractors. These are most likely to be medium and large enterprises. There may also be impacts for individual cross-border workers.

15. While the population affected by the cross-border worker rules is not currently quantifiable, we assume it is small as a proportion of total employees working in New Zealand. Based on stakeholder conversations, businesses and entities which make use of highly-skilled cross-border workers are typically medium or large enterprises. The data available indicates that the numbers of workers potentially affected by the proposal are in the low tens of thousands.

16. Employers and employees in the Recognised Seasonal Employer scheme are out of scope of these reforms.

17. No specific population groups will be disproportionately affected by the changes proposed.

Consultation

18. An officials' issues paper *Cross-border workers: issues and options for reform* was published in October 2021. Following written submissions, stakeholders were offered

the opportunity for follow up discussion and meetings were held to better understand the submissions. Submissions resulted in adjustments to some, but not all, proposals

19. Feedback from the Public consultation indicates that the structural settings are sound. As such, the proposals do not change the rate of tax payable or the circumstances in which tax is payable. However, there is an opportunity ensure that the rules better fit the specific circumstances which apply to the employers of cross-border employees and the payers of non-resident contractors. Feedback from consultation was used to produce a package of improvements is proposed which:

- Improve the flexibility of, and/or clarify, the PAYE, FBT and ESCT and NRCT rules, and
- Support the integrity of the PAYE, FBT and ESCT rules.
- Make a number of remedial amendments.

20. These changes are broadly intended to modernise the rules to better reflect the issues that arise in connection with cross-border work and to reduce compliance costs.

21. By addressing these issues, we can increase the flexibility and clarity of the system for taxpayers. As the changes proposed are largely administrative or timing changes, the fiscal impact is expected to be minimal.

What objectives are sought in relation to the policy problem?

22. The objectives of the review are to reduce compliance costs and modernise the rules.

23. Measures to simplify tax rules often face a trade-off between the accuracy of the rules in question and reduced compliance costs. This main review has focused on ensuring that tax compliance is supported by reducing the focus on the strict requirements of current tax administration. It is expected that this will reduce compliance costs with limited impacts on the amount of tax collected.

24. An additional focus of the review has been to seek to improve and modernise tax data. This will enable Inland Revenue to better police the tax rules for cross-border workers. This is particularly relevant in the context of non-resident contractors, where the burden of assessing the schedular payment thresholds is on the payer; although the payer may not have, or be easily able to obtain, the relevant information. The provision of improved data to Inland Revenue enables a simplification of the threshold test.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

1. Given our objectives, our criteria include:

   - *Flexibility:* flexibility should be provided where possible.
   - *Compliance:* compliance costs should be minimised as far as possible.
   - *Administration:* proposals should fit within existing administrative and operational systems. Administration costs should be minimised.
   - *Clarity & Certainty:* the proposal should increase the clarity of the law to improve certainty for taxpayers.
   - *Fiscal impact:* fiscal costs to the government should be minimised.
   - *Stakeholder support:* changes should be broadly supported by stakeholders.

2. There may be trade-offs between increasing flexibility and improving the integrity of the tax base and decreasing compliance and administration costs. To provide flexibility will require operational changes, for example to systems and guidance. For stakeholders there may be changes to their systems and processes. In particular, new reporting requirements may increase compliance costs.

What scope will options be considered within?

3. Prior to the release of the officials' issues paper, a range of issues had been raised with Inland Revenue across a broad range of cross-border working scenarios. Some of these issues were policy-based, others operational. Informal discussions with the stakeholders who raised concerns were held to assist in scoping the officials' issues paper. Through this process it became clear that most issues, and the most important issues to stakeholders, related to inbound cross-border workers (i.e. those working in New Zealand).

4. We considered whether further guidance would resolve the issues raised, but based on discussions with stakeholders, it became apparent that while guidance would be welcome, it would not be sufficient to resolve the concern around the inflexibility of the current rules and the relatively high compliance costs incurred. In addition, the Operational Statement highlighted an integrity issue which could only be addressed by legislation.

5. Work undertaken in developing the issues paper indicated that the fundamental policy settings are sound. No clear case for more radical reform was established. Adjustments to the existing rules to recognise the particular compliance circumstances of employers, payers and individual cross-border workers within the existing framework will meet the objectives above.

6. A number of operational matters were raised in the informal discussions, mostly around Inland Revenue's processes. Operational matters were excluded from the officials' issues paper which focused on policy and legislative matters. Following the legislative changes, operational support will be required to embed the new rules.

What options are being considered?
Option One – Status quo

7. Option one is the status quo. The population affected by these rules is assumed to be small when viewed as part of the total number of persons working in New Zealand.

8. However, the status quo means that identified problems would remain unresolved and pressure for change would continue. Employers and payers are eager to see reform in this area. Moreover, the current rules do not recognise the compliance circumstances which arise for cross-border workers.

9. *Flexibility:* stakeholders find the lack of flexibility in the system challenging, and as the nature of work becomes increasingly mobile and demands for cross-border workers increase, this could become increasingly problematic.

10. *Compliance:* compliance costs will remain high for employers and payers. If numbers of cross-border workers increase the associated costs will also rise.

11. *Administration:* there is an administrative burden for Inland Revenue in processing and resolving voluntary disclosures. A lack of reform in this area will continue to be a draw on organisational resource. There is also a lack of information which hinders Inland Revenue's ability to monitor the system.

12. *Clarity & Certainty:* leaving known problems unclarified will allow uncertainty to persist in the system, adding to compliance difficulties for taxpayers. This would be contrary to Inland Revenue's objectives for an easy to get right, hard to get wrong tax system.

13. *Fiscal impacts:* under this option there would be no fiscal impact, besides the potential for unintentional non-compliance due to the lack of reform.

Option Two – Reform package

14. Option two is to make a number of tax technical legislative changes to support the objectives of reducing compliance costs and modernising the rules to better fit employers and payers of cross-border workers, as well as those workers themselves.

15. The officials' issues paper proposed a package of reforms:

- PAYE, FBT and ESCT flexibility. Flexibility will permit a period for catch-up payments of underpaid tax to be made via existing systems. It is intended that where a catch-up payment is made, a voluntary disclosure will not be required. In addition, the package confirms that a variety of options for compliance is appropriate, for example a related New Zealand company may discharge the non-resident employer's employment-related tax obligations.

  Submissions indicated stakeholders favoured flexibility. A longer catch-up period was preferred – this has been accommodated in the new rules by extending the period from 28 to 60 days. Further, the category of employees has been extended from those on a shadow payroll to other cases where appropriate, such as those who pay via the IR 56 mechanism.

- PAYE integrity: Integrity measures will support and clarify the existing PAYE, FBT and ESCT obligations. In particular, while existing rules transfer a PAYE obligation to an employee where the employer does not withhold, this is not the case for FBT and ESCT. A corresponding mechanism will therefore be introduced for FBT and ESCT to support the integrity of the rules.

  Stakeholders appreciated the intention to bring further clarity to the application of the PAYE, FBT and ESCT rules in cross-border employment arrangements. However, the threshold approach proposed drew limited support. Other mechanisms were favoured, and a safe harbour approach is now proposed.

Concerns were raised about the transfer of FBT and ESCT obligations to employees causing a possible cashflow disadvantage to the affected employee. This could arise where the employer does not fund the payment of the tax or take advantage of other flexibility measures. The affected population is unquantifiable but is likely to be small. As this measure is required to support tax integrity, it is included in the final package.

- NRCT flexibility: The NRCT package will simplify the threshold tests for NRCT by requiring the payer to consider their only contract with the non-resident contractor. Related to this measure, reporting of non-resident contractor details to Inland Revenue is required. The package contains a catch-up payment option for breaches of the NRCT rules, a nominated taxpayer approach to establishing a compliance history and discharging tax obligations and provides for broader and retroactive certificates of exemption in specified circumstances.

  Stakeholders supported the flexibility particularly with regards to certificates of exemption, although many submitters favoured further reforms in that direction. Given that the policy intent of NRCT is to support the integrity of the New Zealand tax base via managing the basis for exemption from withholding tax, we have not enhanced the proposals following consultation.

  In addition, some NRCT proposals which drew a degree of support from submitters, such as the establishment of a register of exempt non-resident contractors, we do not intend to proceed with at present. It was unclear whether the benefits of establishing such a register were likely to outweigh the costs.

  Finally, submitters appreciated the proposed simplified approach to the NRCT thresholds, but felt that the reporting requirement proposed was likely to impose compliance costs. One submitter felt the costs would be potentially significant, due to the number of payments made, the different systems in which the payment details are recorded and the proposal to make reporting monthly. It is likely that the costs involved will differ between payers. Other submitters felt that reporting would be reasonable, provided the information required was kept to a minimum and reporting was not required monthly.

  Reporting allows Inland Revenue to introduce greater simplicity and flexibility in the rules, in exchange for data which enables Inland Revenue to police the rules more effectively. The intention is to base the report on information commonly obtained by the payer as part of contractual due diligence. As such, reporting has been retained in the package of proposed reforms. Compliance costs will be minimised as far as possible in the design of the requirement. The reporting requirement and associated changes will be introduced from 1 April 2024 to enable time to prepare systems and processes.

16. In addition, four remedial changes are included in the package. These changes aim to improve the clarity and coherence of the rules.

How do the options compare to the status quo/counterfactual?

	Option One – [*Status Quo*	**Option Two – Reforms package**	**Option Two - comment**
Flexibility	0	++	Flexibility is greatly enhanced by the proposals. This is largely achieved through timing changes for tax payments and simpler administrative processes. These reforms better reflect the realities faced by cross-border workers than the status quo.
Compliance costs	0	+	More flexible processes and greater clarity in the system is expected to mean that overall compliance costs are reduced compared to the status quo. Removing the need for voluntary disclosures in specified cases will reduce costs for employers and payers of cross-border workers and enable easier compliance. The introduction of a reporting requirement for NRCT will increase compliance costs for payers. It is clear that the reporting requirement will impose higher costs on those taxpayers who use a greater number of non-resident contractors and may entail systems changes.
Administration	0	+	For the most part, Inland Revenue will use existing systems to support the proposals. Inland Revenue's administration costs may increase due to the new reporting requirements, although costs incurred in administering voluntary disclosures are expected to reduce.
Clarity & Certainty	0	++	The proposals improve the clarity and certainty of employment-related taxes for cross-border workers. Unclear rules creating uncertainty as to when employment-related tax obligations arise are a key issue with the status quo. Resolving this helps stakeholders to understand their responsibilities and contributes to Inland Revenue managing a tax system that makes tax easy to get right.
Fiscal impacts	0	0	In line with our objectives, the fiscal impacts are minimal. Most reforms change administrative requirements or propose timing changes for the payment of tax. The

			PAYE, FBT and ESCT integrity measures may result in a small fiscal increase.
Stakeholder support	0	+	Generally, stakeholders support the direction of the proposals. Some stakeholders would have liked us to go further or to make reforms in areas which were scoped out of the officials' issues paper. Following written submissions, stakeholders were offered the opportunity for follow up discussion and meetings were held to better understand the submissions. Submissions resulted in adjustments to some, but not all, proposals.
Overall assessment	0	+	Compared to the status quo, the package of reforms supports the objectives of reducing compliance cost and modernising the rules.

Option Two Reform package

	Flexibility	Compliance	Administration	Clarity & Certainty	Fiscal impacts	Stakeholder support	Overall rating
PAYE Flexibility	++	++	++	0	0	++	++
PAYE integrity	+	+	+	+	0	++	+
NRCT flexibility	+	+	+	+	0	+	+

Example key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

17. Option two is better than the status quo. The proposals are broadly in line with the objectives of reducing compliance costs and modernising the rules to achieve a better fit for employers, payers and cross-border workers. When viewed as a package there are clear benefits for both stakeholders and Inland Revenue. Although some proposals

may impose a cost on an employer, payer or cross-border worker, the concerns raised will be taken into account to the extent possible when finalising the design.

What are the marginal costs and benefits of the option?

Affected groups	**Comment** *nature of cost or benefit (e.g., ongoing, one-off), evidence and assumption (e.g., compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Regulated groups (It is expected that this is a small group of taxpayers consisting of larger businesses and entities, and workers whose non-resident employer permits remote working.)	Ongoing. The NRCT reporting requirement would be regular and may require changes to processes or systems for some payers.	Low	Low
Regulators (Inland Revenue)	One-off costs will include systems changes to support the new rules and the production of guidance. Ongoing costs will include monitoring the reports and other compliance activity.	Low	Low
Others (e.g., wider govt, consumers, etc.)	N/A	N/A	N/A
Total monetised costs	**Ongoing**	**N/A**	**N/A**
Non-monetised costs	**Ongoing**	**Low**	**Low**
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Ongoing. Employers and payers are expected to benefit from increased certainty and flexibility which supports reduced compliance costs.	Low	Low
Regulators	Ongoing. The costs of system changes and processing reports may be offset by the expected reduction in the number of voluntary disclosures.	Low	Low

Others (e.g., wider govt, consumers, etc.)	N/A	N/A	N/A
Total monetised benefits	**Ongoing**	**N/A**	**N/A**
Non-monetised benefits	**Ongoing**	**Low**	**Low**

Example key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

18. Both costs and benefits to this proposal are likely to be ongoing. The changes seek to make the rules clearer and easier to apply and to make it easier to comply. This enables ongoing compliance and administrative benefits.

19. The fiscal impact is expected to be small, as the proposals seek to change how and when tax is paid, rather than the amounts paid. To the extent tax integrity is improved there may be a small fiscal gain and it is possible that the simplification of NRCT thresholds may result in a small fiscal loss. Losses and gains are expected to balance.

20. Current Inland Revenue sources of direct information on cross-border workers are limited. This makes it difficult to quantify the costs and benefits. Instead a qualitative assessment has been made. Most insights into the nature of the problem and the potential solutions were gained from Inland Revenue operational staff and private sector stakeholders.

Section 3: Delivering an option

How will the new arrangements be implemented?

1. The proposals are included in the 2022 omnibus taxation bill. The PAYE integrity measures will apply from 1 April 2023. The PAYE and NRCT flexibility measures are intended to apply from 1 April 2024. The latter date allows time for taxpayers to prepare for systems changes, particularly to support the reporting requirement.
2. Inland Revenue will be responsible for producing guidance to support the changes and for the administration of the rules as part of its normal operational activity.

How will the new arrangements be monitored, evaluated, and reviewed?

3. Inland Revenue would monitor the effectiveness of the proposed reforms on an ongoing basis, through normal use of data analytics and compliance activity. The new data obtained by reporting requirements will assist with analysing whether the new rules are functioning well or if further reforms are necessary.

7.

Regulatory Impact Statement: Fringe benefit tax exemption for public transport

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing: final Cabinet decisions on a fringe benefit tax exemption for public transport
Advising agencies:	Inland Revenue
Proposing Ministers:	Minister of Finance, Minister of Revenue
Date finalised:	31 May 2022

Problem Definition

The current fringe benefit tax (FBT) exemption for on-premise car parking does not align with the general principle that tax should be applied neutrally to avoid biasing economic decision-making. Employers may choose how to remunerate their employees, and the current FBT rules may encourage employers to choose providing their employees with private car parks on their premises over providing them with public transport fringe benefits, thereby creating a bias towards less environmentally friendly modes of transport. The current FBT rules can also encourage the provision of car parking in lieu of a portion of taxable salary and wages.

Executive Summary

In principle, anything that an employer provides to an employee that is salary or wages, or is a substitute for salary or wages, should be taxed, subject to the practicality of doing so. To ensure this is the case, most non-cash benefits received because of employment are treated as fringe benefits and are subject to FBT on a broadly comparable basis to salary and wages. FBT should, like taxes in general, be neutral in its application, including its impact on environmental outcomes.

Currently, contributions an employer makes to their employees' public transport costs, for example subsidies in the form of a voucher or a loaded electronic ticketing card, will generally trigger FBT.

In contrast, when an employer provides free car parking to an employee on the employer's premises FBT does not apply in many instances. This extends to car parks leased from a car park provider. This exemption is not car park specific but rather is part of a general FBT exemption for benefits provided "on-premises", to reduce taxpayer compliance costs.

The car park exemption can be a sizeable benefit to employees (currently $2,500-$6,000 per annum) where parking charges are material, such as in central Auckland and Wellington. This does not align with the general approach that tax should be applied neutrally to avoid biasing economic decision-making. It can encourage the provision of car parking in lieu of a portion of taxable salary and wages. It may also encourage the use of private cars for transport to workplaces with free car parking over the use of public transport, which can have an environmental impact.

Applying FBT to valuable on-premise car parking would best improve wider tax and environmental neutrality and achieve a more equitable tax treatment across employees. However, this has been attempted on several occasions, particularly in 2012, and has proved to be problematic, partly because of practical valuation and compliance cost concerns, and therefore did not proceed. These difficulties compromise the feasibility of this option, which the Tax Working Group acknowledged and instead recommended exempting employer subsidised public transport from FBT.[1]

From an environmental neutrality perspective, widening the FBT exemptions to also include a public transport exemption could achieve small environmental improvements. It would remove the current bias towards the environmentally unfriendlier mode of transport by car that employers face when considering how to remunerate their employees. The trade-off being that it would also create a new economic distortion in the FBT rules. Further, tax policy officials consider that such an exemption is unlikely to result in significant behavioural change. Its application would be limited to situations where public transport options are readily available to employers' locations, and by employers' preparedness to offer the benefit to their employees.

The fiscal impact of such an FBT exemption for employer subsidised public transport is an estimated $9 million[2] reduction in tax revenue per year. This is based on exempting subsidised use of buses, trains and trams, but not air travel.

Feedback from targeted consultation in 2021 indicated that stakeholders largely supported an FBT exemption for employer subsidised public transport and that it would make more employers likely to consider public transport fringe benefits as an option. However, employers who have attempted to provide public transport benefits in the past had encountered significant compliance costs in relation to being billed for employees' use of public transport. Therefore, a simple system for paying the transport provider would be crucial. A number of the larger employers consulted have remote work sites and stated a public transport FBT exemption would not be of much help for their employees.

Limitations and Constraints on Analysis

Data limitations

Inland Revenue does not hold detailed information on public transport fringe benefits currently provided by employers and the amount of FBT paid on these benefits. In an FBT return, an employer is only required to provide Inland Revenue with the aggregate amount of their fringe benefits provided to its employees. Therefore, Inland Revenue does not have a sense of what proportion of FBT is related to subsidised public transport. There is some limited historical data. Up to 2001 Inland Revenue collected fringe benefit category data, including goods, services and subsidised transport which accounted for 13% of FBT revenue at the time. Anecdotally, much of the FBT returned under this category was from subsidised goods.

Similarly, Inland Revenue does not hold information on car parking benefits currently provided by employers.

While the proposal to exempt employer subsidised public transport benefits from FBT has the potential to result in a small reduction in emissions as compared to the current rules, it

[1] *Future of Tax*, Final Report Volume I, Recommendations, Tax Working Group, Te Awheawhe Tāke, paragraph 126, page 53.

[2] This estimate is based on FBT data for the fiscal year ended 30 June 2021.

is not clear what level of behavioural response would result from such an exemption. It is likely to be relatively small and it is not an impact that can be quantified with ease in terms of carbon reduction.

These data limitations have meant that any fiscal estimates have needed to be very high-level. The financial impact of an FBT exemption for employer subsidised public transport has been made based on the historic New Zealand data, Australian data and feedback from some employer representative groups on public transport fringe benefits. We estimate the fiscal cost of exempting public transport from FBT to be around $9 million per year. This represents an estimate of the amount currently paid under the status quo rules that would potentially be forgone with an exemption. It does not attempt to model a behavioural shift in the future.

Option limitations

Given the past difficulties in achieving a change in the tax laws to include more car parks within the FBT net, Ministers indicated that this option should not be further explored. It is however, included in the options discussed later in this paper for comparative purposes.

The scope of the policy project is limited to exploring how the neutrality of the FBT rules could be improved in light of the car parking exemption. It does not extend to similar considerations in relation to direct cash payments that would be covered instead under the pay-as-you-earn (PAYE) tax rules applied to salary and wages. This is because both direct employer payments to cover employee car parking costs and employee public transport use are taxed, so there is not the same non-neutrality issue.

We have not investigated applying the $9 million annual funding instead to the Government's general subsidisation of public transport.

Responsible Manager(s) (completed by relevant manager)

Graeme Morrison

Policy Lead

Policy and Regulatory Stewardship

Inland Revenue

s9(2)(a)

31 May 2022

Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue RIA Panel
Panel Assessment & Comment:	The Inland Revenue Quality Assurance Panel has reviewed the Regulatory Impact Statement (RIS) *Fringe benefit tax exemption for public transport* prepared by Inland Revenue and considers the information and analysis summarised in the RIS **meets** the quality assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. Since the mid-1980s, New Zealand's tax system has been based around a broad-base framework. This means that taxes are applied neutrally with few exemptions and subsidies. In respect of employee income, anything an employer provides to an employee that is salary or wages, or is a substitute for salary or wages, should be taxed, subject to the practicality of doing so. To ensure this is the case, most non-cash benefits received because of employment are treated as fringe benefits and are subject to FBT on a broadly comparable basis to salary and wages.
2. Specifically, the FBT that an employer calculates and pays is designed to equate with the PAYE tax that is applied to salary and wages. This promotes fairness between employees (whether they are paid in cash or in kind) and helps preserve the integrity of the base that taxes income from employment. It reduces incentives for employers to provide employees with non-cash benefits rather than pay them salary and wages.
3. As with the taxation of salary and wages and taxes in general, FBT coverage is intended to be broad with exemptions from FBT being limited to situations where compliance costs make it impracticable to apply FBT. For example, benefits provided on an employer's premises are exempt from FBT. The purpose of this general on-premises exemption is for taxpayer compliance costs reasons.
4. The on-premises concession means that when an employer provides free car parking to an employee on the employer's premises, FBT does not apply in many instances, including car parks leased from a car park provider.
5. In contrast, any contributions an employer makes to their employees' public transport costs, for example in the form of a voucher or a loaded electronic ticketing card, triggers FBT unless they fall below the standard de minimis[3]. Any cash contributions to an employee's public transport costs are taxed like salary and wages under the PAYE rules and do not attract FBT.

[3] Miscellaneous benefits are exempt from FBT when the taxable value provided to each employee is $300 or less per quarter and the total taxable value of all unclassified benefits provided by the employer to all employees over the past four quarters is $22,500 or less. There is also a longstanding concessional FBT treatment when an employer who is in the business of providing public transport allows an employee to travel on that transport for less than fares charged to the public, but this covers relatively few employees.

What is the policy problem or opportunity?

6. The current FBT exemption for on-premise car parking does not align with the general principle that tax should be applied neutrally to avoid biasing economic decision-making. For example, it may encourage the use of private cars for transport to workplaces with free car parking over the use of environmentally friendlier modes of transport, in particular public transport, and can also encourage the provision of car parking in lieu of a portion of taxable salary and wages.
7. A key principle of tax policy is horizontal equity – ideally a tax should apply equally to people on the same effective income. The car park exemption can be a sizeable benefit to employees ($2,500-$6,000 per annum) where parking charges are material, such as in central Auckland and Wellington. This gives rise to horizontal equity concerns when the untaxed car parking benefit is provided as a substitute for a portion of the employee's salary and wages. The employee in this case receives a tax saving over other employees who are not able to structure their remuneration package to include this benefit. There may also be, to a lesser extent, some vertical equity considerations, as the car parking exemption is more likely to favour overall high-income earners.
8. In addition, FBT, like other tax rules, should be applied neutrally, including considering its impact on environmental outcomes. Taxes should avoid biasing economic decision-making and should not encourage environmentally damaging behaviour. Current FBT settings may encourage the use of private cars for transport to workplaces with free car parking over the use of public transport, which is likely to have a negative environmental impact.
9. Applying FBT to more on-premises car parking has been considered on several occasions, particularly in 2012. However, the reform proved to be contentious, partly because of valuation and compliance cost concerns, and did not proceed.
10. The Tax Working Group (the Group)[4] identified the environmental neutrality issue around car parking and the practical difficulties associated with applying FBT to a wider range of on-premise car-parking and stated the different FBT treatment of car parks and public transport has the perverse effect of discouraging the use of public transport. The Group recommended in its 2018 final report[5] that the Government consider, for environmental reasons, allowing employers to subsidise their employees' public transport use without incurring FBT given the practical difficulties associated with applying FBT to a wider range of car parks.
11. Stakeholders are employers, employees, public transport providers, and the wider community, particularly those in urban areas. For example, employers have an interest in that they may currently be discouraged from providing public transport fringe benefits to their employees when compared with car parking.
12. Employees have an interest as the FBT rules encourage their take-up of tax free car parking (where available) in lieu of a portion of taxable salary and wages over travel to and from work by public transport. Public transport providers are affected in that the current bias may reduce public transport use. Therefore, the incentive to develop low-cost solutions for employer-subsidised public transport may be reduced.
13. The wider community is affected in that the current FBT rules may encourage behaviour that increases overall emissions and traffic congestion.

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[4] The Tax Working Group was established in November 2017 by the Government at the time to consider the future of tax and provide recommendations to Government that would improve the fairness, balance and structure of the tax system over the next 10 years.

[5] https://taxworkinggroup.govt.nz/resources/future-tax-final-report.html

14. Given the lack of data for on-premise car parking and public transport fringe benefits currently provided by employers, it is difficult to determine the scale of the issue.

What objectives are sought in relation to the policy problem?

15. The objectives are to:
    a. Enhance neutrality of the wider tax system, particularly removing or reducing the bias towards the use of private cars.
    b. Improve equity as taxpayers with similar levels of income should pay similar levels of tax (horizontal equity) and that taxpayers on higher incomes should pay higher levels of income tax in a way that reflects the Government's objectives of increasing the progressivity of the tax system (vertical equity).
    c. Improve environmental neutrality of the FBT rules, in particular reduce the current bias towards the environmentally unfriendlier mode of transport by car employers face when considering how to remunerate their employees.
    d. Minimise compliance costs on employers.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

16. The options will be assessed against the objectives previously stated. As stated in the limitations, they only consider changes to FBT, not PAYE or government expenditure options.
17. In addition, consideration is given to the Government's climate change priority and to its commitment to reduce New Zealand's greenhouse gas emissions to net zero by 2050.

What options are being considered?

Option One – *Status Quo*

18. Under the status quo, employer-provided on-premise car parking is exempt from FBT, whereas other more environmentally friendly modes of transport, such as employer subsidised public transport, attract FBT.
19. Pros:
    a. Maintains consistency and neutrality between public transport and other fringe benefits.
    b. Maintains lower compliance costs for employers providing car parking for their employees compared with option two.
20. Cons:
    a. Car parks are subsidised when provided by employers which encourages salary substitution.
    b. Car park subsidy encourages travel to and from work in private cars rather than other modes of transport, in particular public transport.
    c. Current negative environmental bias is maintained.

Option Two – Apply FBT to (more) on-premise car-parking

21. Under this option FBT would be applied to all or more (for example in areas where the benefit is greatest) employer-provided car parks on the employers' premises.
22. Pros:
    a. Improves wider tax neutrality and horizontal equity.
    b. Improves environmental neutrality by removing the incentive to use private cars over other modes of transport for travel between home and work, in particular public transport.
23. Cons:
    a. Increases administrative complexity for Inland Revenue and employers and increases compliance complexity and costs for employers providing car parking to employees.
    b. Given previous experience, it is unlikely that this option will be able to proceed and be implemented.

Option Three – Exempting employer subsidised public transport from FBT

24. Under this option FBT would not apply when employers subsidise employees' use of public transport for the purposes of travel between home and work, for example by providing a voucher or loaded electronic ticketing card. Public transport would cover buses, trains and trams.
25. Pros:
    a. Provides a more balanced treatment between the use of private cars and car parking and public transport. It improves horizontal equity.
    b. Improves, in principle, the environmental neutrality of the FBT rules by removing the incentive to use private cars over public transport. Some employers are likely to shift to providing subsidised public transport benefits. However, tax officials believe that uptake will likely not be significant enough to materially change employees' behaviour in respect of their between work and home travel.
26. Cons:
    a. Does not remove overall tax distortion.
    b. Creates an additional economic distortion relative to other fringe benefits.
    c. An exemption would in practice be limited to situations where public transport fringe benefits are relevant to employers' location (urban areas with sufficient public transport infrastructure) and employers' preparedness to offer such benefits to their employees (administrative complexity and compliance costs for employers of providing vouchers or topping up electronic ticketing cards may limit uptake by employers).
    d. Could incentivise calls for other FBT exemptions, adding further distortion and undermining the integrity of the tax system.

Consultation

27. Officials undertook targeted consultation through meetings, emails, and surveys in 2021 with three public transport providers, one public transport planner and employers through two representative Groups. It suggested that there are very few employers currently providing public transport fringe benefits. They noted the challenges were the differing circumstances of employees which meant it may or may not be a useful benefit and consideration of whether other fringe benefits, such as health insurance, might be of equal or more value to employees.
28. Stakeholders largely supported an FBT exemption for employer subsidised public transport and stated that it would make more employers likely to consider public

transport fringe benefits as an option. Those members who have attempted providing public transport benefits in the past had encountered significant compliance costs in setting up and operating processes that enabled them to top up employees' electronic travel cards or be billed directly by public transport providers. Accordingly, they stated that for an exemption to be successful, public transport providers will need to have some type of simple approach that employers can use. A number of the larger employers consulted have remote work sites and stated a public transport FBT exemption would not be of much help for their employees.

29. Some, mainly large, employers also provided details of car parks they have available and stated that, as a generalisation, other than remote sites, the provision of car parks is often restricted to being available for employees who need to park work vehicles in them or need to have a vehicle available for work related travel.

30. The public transport providers and the planner confirmed that they have been involved with only a few employers who were providing, or looking to provide, public transport benefits. One transport provider had been running a small-scale pilot scheme with a few employers for partially subsidising employees' transport costs. At the time of consultation, this pilot was not ready or intended to be scaled up.

How do the options compare to the status quo?

	Option One – Status *Quo*	Option Two – *Apply FBT to (more) on-premise car-parking*	Option Three - *Exempting employer subsidised public transport from FBT*
Enhance neutrality of the wider tax system	0	+ *Reduces an economic distortion in the tax system.*	- *Creates an additional economic distortion relative to other fringe benefits.*
Equity	0	+ *Employees provided with on-premise car parking no longer receive a tax free benefit means more equitable treatment across employees receiving fringe benefits.*	+ *Provides a more balanced treatment between private cars/car parking and public transport. Employers are not biased in their choice of whether to provide public transport to their employees relative to car-parking.* - *Less equitable in relation to employees receiving other fringe benefits that are taxed or cash subsidies/reimbursements.*
Improve environmental neutrality of the FBT rules	0	++ *Removes the bias towards employers providing car-parking and therefore employees using private cars for between home and work travel. This creates neutrality across all modes of travel between home and work.*	+ *Removes the bias towards employers providing car-parking over subsidised public transport.*

Minimise compliance costs	0	- *Employers providing on-premise car-parking to their employees have increased compliance complexity and costs, but employers may have option of not providing such parking.*	- *Providing public transport benefits may increase employers' compliance costs depending on billing/administrative arrangements. However, providing the benefit is voluntary.* + *Compliance costs of those employers already providing public transport fringe benefits are reduced because they no longer need to calculate and pay FBT on these benefits.*
Overall assessment	0	++	0

Example key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

31. From a pure tax policy perspective, option two – apply FBT to (more) on-premise car parking would be officials' preferred option, as it would improve wider tax neutrality and horizontal equity as well as environmental neutrality. However, this option would increase complexity and compliance costs for employers providing on-premise car parking. Earlier attempts pointed to stakeholders raising practical difficulties which could not be readily resolved at the time. It is unlikely that perceptions have changed.
32. Our view is that the status quo would be preferable to exempting employer-subsidised public transport fringe benefits from FBT. While an exemption would improve environmental neutrality in relation to private cars, it creates an additional economic distortion relative to other fringe benefits, including other modes of travel such as employer-provided e-bikes. Officials believe that an exemption would result in limited behavioural change. Its application would be restricted to situations where employers are located near public transport routes that their employees can readily access, including the availability of those services when the employees need them, and employers' preparedness to offer the benefit to their employees. We also note that with exemptions there is an incentive to salary sacrifice and associated costs that come with that choice.
33. Environmental neutrality is a priority given the Government's emissions reduction commitments. In that context, widening the FBT exemptions to also include a public transport exemption would potentially achieve an improvement despite creating an additional economic distortion in the FBT rules. The current bias towards the environmentally unfriendlier mode of transport by car employers face when considering how to remunerate their employees is removed. Limiting the exemption to between home and work travel would best achieve removing the existing bias between car-parking on the employer's premises and public transport. However, this may be practically difficult (for example, when an employee uses a monthly train pass), so an exemption would need to focus on situations where the subsidy is provided primarily for that purpose and accept that some incidental other private travel would likely be subsidised too.

What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of option three compared to taking no action			
Regulated groups (employers)	Taxpayer friendly and voluntary.	No cost	High
Regulators (Inland Revenue	This change will bring a small administrative cost to Inland Revenue for providing guidance to employers about the new rules to raise awareness and understanding, and to promote compliance.	Low	High
Wider government	Exempting employer subsidised public transport benefits from FBT will result in a lower FBT take for the Government. There may also be some salary substitution which would mean a decrease in PAYE.	Around $9 million forgone revenue per year	Low, given the lack of FBT specific detailed data.
Others (employees – if receiving public transport benefits)	Not applicable	Not applicable	Not applicable
Total monetised costs	Fiscal cost	Around $ 9 million forgone revenue per year	Low
Non-monetised costs		Low	
Additional benefits of option three compared to taking no action			
Regulated groups (employers)	Employers are able to provide public transport fringe benefits without attracting FBT.	Medium	High
Employees	There is likely to be an increase in employees receiving employer subsidised public transport benefits.	Low	Medium
Regulators	N/A	N/A	N/A

Wider government	Some behavioural change towards using public transport between home and work, which should reduce overall emissions and traffic congestion.	Low	Medium
Total monetised benefits	N/A	N/A	N/A
Non-monetised benefits		Low	Low

34. An FBT exemption for public transport would generally apply to all employers. However, in practice it would largely be relevant for employers with workplaces in urban areas with sufficient public transport networks. The level of uptake will also depend on the availability of low compliance cost options for employers.

Section 3: Delivering an option

How will the new arrangements be implemented?

35. Should the Government decide to proceed with an exemption, it will require an amendment to the Income Tax Act 2007. The proposed legislative amendments would take effect from 1 April after the proposed bill receives Royal Assent. There is already a public transport provision in the FBT rules but that relates only to valuing the benefit where it has been provided by an employer who is a public transport provider.
36. Inland Revenue would be responsible for the implementation and ongoing administration of the new rules. Inland Revenue will publish guidance material to raise awareness and explain how the exemption works. This would include producing a relevant Tax Information Bulletin item and updating guidance on Inland Revenue's website. Overall, Inland Revenue expects that only very minor alterations to systems and operations will be needed.

How will the new arrangements be monitored, evaluated, and reviewed?

37. **Monitoring**: Should the Government decide to proceed with an FBT exemption for employer subsidised public transport fringe benefits, the proposal is taxpayer friendly, uptake will be voluntary, and enforcement and extensive monitoring is not necessary. In practice, it will be difficult to evaluate the effect the proposed measure will have on employers' and employees' behaviour. A reduction in FBT collected may indicate the level at which public transport benefits are currently provided.
38. **Review**: Should the Government proceed with an exemption for public transport, there are no plans for a specific review of this change, as it is taxpayer friendly.
39. Inland Revenue regularly reviews tax settings on an ongoing basis and provides advice and updates to the Government accordingly. Policy officials maintain strong communication channels with stakeholders in the tax advisory community, including through the generic tax policy process, and these stakeholders will be able to correspond with officials about the operation of the new rules at any time. If problems emerge, they will be dealt with either operationally, or by way of legislative amendment if agreed by Parliament.

8.

Regulatory Impact Statement: Comparing options to support build-to-rent

Coversheet

Purpose of Document	
Decision sought:	*Analysis produced to inform Cabinet decisions on whether to provide support to the build-to-rent sector by allowing an in-perpetuity exemption from interest limitation or introduce depreciation deductions, or to retain the status quo.*
Advising agencies:	*Inland Revenue*
Proposing Ministers:	*Minister of Revenue* *Minister of Housing*
Date finalised:	*29 June 2022*

Problem Definition

There is a shortage of good quality, affordable rental properties in New Zealand. The interest limitation rules were introduced to discourage investment in residential property, and in doing so may have exacerbated this supply issue. The question is whether build-to-rent assets should be exempt from the interest limitation rules, if alternative support should be provided through depreciation deductions, or if the status quo should be retained.

Executive Summary

Problem definition

The Government's three key housing objectives are to:

a) Ensure every New Zealander has a safe, warm, dry and affordable home to call their own – whether they are renters or owners.
b) Support more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers.
c) Create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well planned and well regulated.

The interest limitation rules that apply from 1 October 2021 are aimed at addressing objective B by dampening investor demand. The rules address the demand-side housing objective by denying interest deductions for residential investment property. However, the rules include exemptions for new builds so as to not disincentivise investment in new housing supply, in keeping with objectives A and C above.

The current under-supply of adequate housing stock has led to a shortage of affordable rental accommodation. The build-to-rent (BTR) sector has the potential to enable significant dedicated rental supply, including the most-needed rental typologies (i.e., one- and two-bedroom units), in areas of high demand.

Possible options

Officials have been asked to compare two options to provide support to the BTR sector using the tax system.

The following options have been compared:

1. Option 1: provide an in-perpetuity exemption from interest limitation for BTR assets; or
2. Option 2: reintroduce depreciation deductions for BTR assets at a rate of 1.4%[1] diminishing value (DV).

If Cabinet decide to go with either of the above options, BTR must be defined as an asset class.

Cabinet has already agreed to a partial definition of a BTR asset class (SWC-21-MIN-0228 refers), including the following components:

a. 20 or more dwellings in a single building or multiple buildings that comprise a single development;

b. the dwellings are owned by a single owner;

c. the building/buildings that contain the dwellings may contain other dwellings or commercial premises that do not form part of the build-to-rent asset;

d. the dwellings offer tenants benefits in relation to tenure and/or rights that are greater than those provided for under the Residential Tenancies Act 1986;

e. the development includes dwellings where tenants are offered lifetime tenancies;

f. the dwellings have continuously been used as a build-to-rent since they were constructed.

There are two outstanding issues in defining the asset class - minimum tenure length requirement, and application to new or existing assets.

Inland Revenue's preferred option

<u>Recommended option – the status quo</u>

Inland Revenue recommends the status quo, for the following reasons:

- There is nothing inherent in BTR that makes it different from other residential rental property, apart from scale.

- While the interest limitation rules will make BTRs less attractive, the rules currently apply equally to all residential property. Inland Revenue previously advised against the introduction of the interest limitation rules, however, further exemptions for specific investment would undermine the purpose of the rules.

- The development and new build exemptions already significantly mitigate the negative impact of the interest limitation rules for newly built BTRs (completed after 27 March 2020). As with all new builds, the exemptions would apply while new BTRs are being constructed, and then for 20 years after they are completed. The new build

[1] The depreciation rate of 1.4% was chosen based on the Bureau of Economic Analysis (BEA) economic depreciation rate set for multi-use residential buildings (MURBs).

exemption would apply to the initial owner of a BTR development, as well as to any subsequent owners of the BTR during the 20-year period for which the exemption applies.

- An in-perpetuity exemption for BTRs (option 1) could be viewed as inequitable, because it would benefit large investors but provide no relief for smaller investors who hold similar properties.

- An in-perpetuity exemption would also incentivise BTRs to only ever be used as rental properties. This is contrary to the objective of the interest limitation rule, which is to tilt the playing field away from investors to first home buyers and owner-occupiers.

- Reintroducing depreciation deductions only for BTRs (options 2) would reduce fairness and efficiency within the tax system, as well as the overall coherence of the tax system. Additionally, some (but not all) BTRs are multi-unit residential buildings (MURBs). MURBs are long lived assets that in reality depreciate at a slower rate than commercial and industrial buildings.

<u>Second preference – an exemption from interest limitation (option 1)</u>

If Ministers decide to provide support to the BTR sector through the tax system, Inland Revenue recommends option 1, which would involve introducing an in-perpetuity exemption from interest limitation for BTR assets. Inland Revenue prefers option 1 as it provides a similar benefit to BTR assets as option 2, but is simpler from both a compliance and administrative perspective.

Potential impact of option 1

Of the options, option 1 is likely to provide a slightly lower net present value (NPV) tax benefit for BTR when a particular set of assumptions is applied. The NPV is based on the following assumptions:

1 the investor has a new BTR asset which is initially worth $15m

2 the investor holds the BTR asset for 50 years

3 all future deductions are discounted at a rate of 5%

4 the investor borrows 50% of the cost of the BTR asset

5 the investor pays interest of 6% per annum.

The NPV tax benefit of the extra interest deductions (beyond the benefit of the 20 year new build exemption) would be **$730,008**. The size of the NPV tax benefit of option 1, relative to the initial value of the BTR in this example, is 4.87%.

In comparison, the NPV benefit of allowing the investor to claim depreciation deductions at a rate of 1.4% (diminishing value) over the same time period would be **$879,161**. The size of the NPV tax benefit of option 2, relative to the initial value of the BTR in this example is 5.86%.

Regardless of the assumptions applied, the benefit of option 1 is relatively low. The NPV analysis for both options is also sensitive to changes in the debt ratio. For example, where the debt level is 70%, rather than 50%, the NPV of interest deductions is greater than that of depreciation deductions.

Views from consultation with stakeholders and general public

Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development

Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development recommends option 1: an in-perpetuity exemption for BTR developments from interest limitation rules.

The purpose of the change to interest limitation was to reduce investor demand for existing housing and improve housing affordability for first home buyers. As well as being supported by this policy, objective B is supported by other recent changes made by the Government including to the First Home Products (supports first home buyers to overcome the deposit barrier to home ownership). The Government is also addressing urban density through speeding up implementation of the National Policy Statement on Urban Development and including medium density residential standards in district plans.

The initial policy (for interest limitation) did not take into full account the diversity of residential property supply, and was mostly built around standalone properties. Emerging residential models such as BTR were not captured in this model. Subsequently, the impact on BTR and its tenants were not considered. The 20-year new build exemption is not sufficient to encourage investment in BTR, and this is likely to have a negative impact on rental supply and the experiences of New Zealanders who rent. Exempting BTR developments will support housing objectives A and C (outline above in the problem definition), in conjunction with other measures to support objective B.

The Treasury

The Treasury does not recommend an exemption for build-to-rent assets. The sector will largely be comprised of new build developments that will already receive a 20-year exemption, and there is little evidence that the sector requires additional financial support via the tax system. The sector continues to expand in full knowledge of the tax changes, and several public funding-streams are available to directly support its continued development without the complexity outlined in this paper.

Stakeholders

Some submissions to the Finance and Expenditure Committee on the interest limitation proposals were in favour of a specific exemption for BTR assets. Submitters argued that when compared with regular residential rental accommodation, BTR assets provide greater tenure security to tenants, do not compete with first home buyers and are more comparable to commercial assets (such as student accommodation or retirement villages). Additionally, they stressed that the industry will not grow without an in-perpetuity exemption from interest limitation.

Te Tūāpapa Kura Kāinga - Ministry of Housing and Urban Development convened a BTR reference group throughout 2021. This group provided input into the BTR asset class definition and an extension to the interest deductibility exemption:

- Depreciation deductibility was identified as a potential incentive to developing BTRs. Deductibility of depreciation for BTRs would be more consistent with the treatment of commercial property.

- Denying or limiting interest deductibility was characterised as a barrier to BTR development. BTR stakeholders have also been consulted in one-to-one discussions. Feedback from some institutional investors was that interest deductibility effectively determines whether investing in domestic BTR is viable, compared to international opportunities.

Limitations and Constraints on Analysis

Officials were directed to compare two options for providing support to the BTR sector using the tax system. Analysis is therefore limited to these two options and does not consider other options to support the sector.

Components of the definition of a BTR asset had already been agreed to [SWC-21-MIN-0228 refers]. There are two outstanding issues in defining the asset class (minimum tenure length requirement, and application to new or existing assets).

The impacts and costs of each option are uncertain as there is little available data on BTR in New Zealand, and limited projections on how the sector may develop. As such, it is difficult to estimate the how the sector may be impacted if support is not introduced.

Responsible Manager

Chris Gillion

Policy Lead

Policy and Regulatory Stewardship

Inland Revenue

s9(2)(a)
[redacted]

29 June 2022

Quality Assurance

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance panel at Inland Revenue has reviewed the *Comparing Options to Support Build-to-Rent* Regulatory Impact Assessment prepared by Inland Revenue and considers that the information and analysis summarised in the Regulatory Impact Assessment **meets** the quality assurance criteria.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

2. **Housing affordability – supply-side issues**: Supply-side restrictions have resulted in a housing market that has not kept up with increased demand over the last 40 years. Regulatory barriers, the increased cost of building and insufficient long-term infrastructure planning makes it difficult to increase housing supply in the short term. The increased cost of building has been further exacerbated by building material shortages caused by COVID-19.

3. **Housing affordability – demand-side issues**: Demand side factors are also putting upward pressure on prices. Falling interest rates resulted in an increase in house prices, creating capital gains for existing property owners but worsening the position of prospective first-home buyers. The removal of loan-to-value ratio (LVR) restrictions by the Reserve Bank of New Zealand in response to COVID-19 allowed highly-leveraged investors to re-enter the market, thereby exacerbating price pressures. However, these have since been reinstated. High population growth has also increased demand for housing over recent decades. While tax settings are not the primary driver of housing affordability, current tax settings incentivise investment in housing. In the context of constrained supply, lightly taxing housing relative to other forms of income will lead to higher property prices than would otherwise be expected.

4. **Government objectives:** The Government currently has three key housing objectives-

    a. Ensure every New Zealander has a safe, warm, dry and affordable home to call their own – whether they are renters or owners.
    b. Support more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers.
    c. Create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well-planned and well regulated.

5. A barrier to achieving objectives A and C is a shortage of rental accommodation driven by an under-supply of housing stock. The build-to-rent (BTR) sector has the potential to enable dedicated rental supply, including needed rental typologies (i.e., one- and two-bedroom units), in areas of high demand.

6. **Status quo**: BTR assets are treated the same as any other residential investment property. Interest deductions are being phased out from 1 October 2021 for existing residential investment properties. New builds will have an exemption from the interest limitation rules for 20 years from their date of completion. This exemption will apply to new BTR assets. Depreciation deductions are not currently available for any residential property including BTR assets.

7. **Impact of status quo on the BTR sector:** Limits to available data make it hard to predict how the sector will be impacted if no tax support is introduced for BTR. The view from the sector is that that some developments have been put on hold or deferred indefinitely as a result of the interest limitation rules. However, there are many factors at play that are making it difficult for the BTR sector to emerge at scale in New Zealand.

8. The introduction of the interest limitation rules from 1 October 2021 is seen by the BTR industry as a barrier to its expansion in New Zealand. BTR stakeholders raised concerns that without an extended interest limitation exemption, the rules would

seriously harm the feasibility of commercially delivered BTR developments. Stakeholders have indicated that they are investing elsewhere (including overseas) because of the introduction of interest limitation rules.

9. The sector has provided two arguments why interest limitation may limit the industry:

   a. First, it increases taxation and reduces cashflow for rentals. Noting that this issue is partially solved for new BTR assets, as the new build exemption will apply for the first 20 years of the asset's life.

   b. Second, it affects future sales. If a BTR asset needs to be sold, the lack of interest deductibility may affect asset value in the BTR market. BTR investors may see development in New Zealand as riskier than overseas options, or developments exempt from the interest limitation rules (such as retirement villages). Additionally, BTR assets that do go ahead may be split up and sold off as individual units after 20 years (once the new build exemption ceases) which could displace tenants.

What is the policy problem or opportunity?

10. The key policy problem is availability of rental accommodation in New Zealand. Housing costs tend to be a greater burden for renters than owner-occupiers.[2] In 2019, approximately one third of households were renters.[3] A greater proportion of lower-income households were renters, including nearly half of all households in the lowest income decile.[4] In 2020, 45 percent of renters spent 30 percent or more of their income on housing costs compared to 25 percent for owner-occupiers.[5] This high ratio of rents to incomes has been steady nationally for more than a decade.[6] However, rents have grown much faster than incomes for some groups, including renters in major centres (such as Auckland and Wellington).[7] Several factors explain increasing rent prices, including the cost of supplying rentals and increased incomes.

11. BTR provides a potential opportunity to further the Government's objectives A and C by increasing supply of long-term affordable rental accommodation. Therefore, two options for support are being considered: an in-perpetuity exemption from interest limitation, or reintroducing depreciation deductions.

12. Treatment of BTR assets would need to balance the objectives of providing new housing (objectives A and C) while not undermining the intended purpose of the interest limitation rules in terms of dampening investor demand (objective B). As BTR is an emerging industry, neither of the options are expected to provide significant financial benefit the industry, as illustrated by the NPV analysis above. However, the makeup of

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2 Stats NZ, Housing in Aotearoa: 2020, Figure 33. https://www.stats.govt.nz/assets/Uploads/Reports/Housing-in-Aotearoa-2020/Download-data/housing-in-aotearoa-2020.pdf.

3 Stats NZ, Housing in Aotearoa: 2020, p 36. https://www.stats.govt.nz/assets/Uploads/Reports/Housing-in-Aotearoa-2020/Download-data/housing-in-aotearoa-2020.pdf.

4 Stats NZ, Housing in Aotearoa: 2020, p 46. https://www.stats.govt.nz/assets/Uploads/Reports/Housing-in-Aotearoa-2020/Download-data/housing-in-aotearoa-2020.pdf.

5 Stats NZ, Housing in Aotearoa: 2020. https://www.stats.govt.nz/assets/Uploads/Reports/Housing-in-Aotearoa-2020/Download-data/housing-in-aotearoa-2020.pdf.

6 Stats NZ, Housing in Aotearoa: 2020, p 46. https://www.stats.govt.nz/assets/Uploads/Reports/Housing-in-Aotearoa-2020/Download-data/housing-in-aotearoa-2020.pdf.

7 Stats NZ, Housing in Aotearoa: 2020, Figure 34. https://www.stats.govt.nz/assets/Uploads/Reports/Housing-in-Aotearoa-2020/Download-data/housing-in-aotearoa-2020.pdf.

BTR investors tend to be large institutional investors, so it could be seen as unfair to provide support that is not available for smaller investors who own individual residential rental properties.

What objectives are sought in relation to the policy problem?

13. As noted on 8 March 2021 (CAB-21-MIN-0045 Amended refers), Cabinet's policy objectives for the housing market are to:

   a. Ensure every New Zealander has a safe, warm, dry and affordable home to call their own – whether they are renters or owners.
   b. Support more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers.
   c. Create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well-planned and well regulated.

14. The options presented in this Regulatory Impact Statement seek primarily to address supply-side housing objectives in support of objectives A and C. Specifically, to ensure that renters have a safe, warm, dry and affordable home to call their own. However, the options will also be considered in terms how they impact objective B.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

15. The options will be assessed against the three housing objectives:

    a. Ensure every New Zealander has a safe, warm, dry and affordable home to call their own – whether they are renters or owners.

    b. Support more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers.

    c. Create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well-planned and well regulated.

16. The options will also be evaluated against traditional tax policy criteria including:

    a. **Compliance costs**: options should be as simple and as low cost as possible for taxpayers to comply with.

    b. **Administrative costs:** administrative costs imposed on Inland Revenue should be appropriate for the issue.

    c. **Economic impact:** taxes should be efficient and minimise as far as possible impediments to economic growth. Options should avoid unnecessarily distorting the use of resources (that is, causing biases toward one form of investment versus another) and imposing heavy costs on individuals and firms.

    d. **Revenue impact:** options for reform should be appropriate given fiscal constraints.

    e. **Sustainability and coherence of the tax system:** options should collect the revenue required in a transparent and timely manner while not leading to tax driven outcomes, or opportunities for tax avoidance and arbitrage. Options for reform should make sense in the context of the entire tax system.

    f. **Fairness and equity:** The tax system should be fair. Options should, to the extent possible, seek to treat similar taxpayers in similar circumstances in a similar way. Consider the demographic impact where relevant, for example: on the young, poor, old, etc.

What scope will options be considered within?

Decisions by Cabinet

Options for comparison

17. Officials were directed to compare two specific options to provide support to the BTR sector using the tax system [SWC-21-MIN-0228 refers]. The first option is to provide an in-perpetuity exemption from interest limitation for BTR assets. The second option is to reintroduce depreciation deductions for BTR assets.

Definition of a build-to-rent asset

18. Cabinet has agreed to a partial definition of a BTR asset class (SWC-21-MIN-0228 refers), including the following components:

    a. 20 or more dwellings in a single building or multiple buildings that comprise a single development;

    b. the dwellings are owned by a single owner;

    c. the building/buildings that contain the dwellings may contain other dwellings or commercial premises that do not form part of the build-to-rent asset;

    d. the dwellings offer tenants benefits in relation to tenure and/or rights that are greater than those provided for under the Residential Tenancies Act 1986;

    e. the development includes dwellings where tenants are offered lifetime tenancies;

    f. the dwellings have continuously been used as a build-to-rent since they were constructed.

19. Cabinet is yet to agree on a minimum tenure length requirement to be included as part of the build-to-rent asset class definition, and whether the definition would apply to existing or new BTRs.

What options are being considered?

20. Two options are being considered in addition to the status quo:

    a. Option 1: provide an in-perpetuity exemption from interest limitation for BTR assets.

    b. Option 2: reintroduce depreciation deductions for BTR assets at a rate of 1.4%[8] diminishing value.

21. The assessment is limited to these two options. It does not analyse any other avenues of support the tax system could provide, or the other programmes that address Government housing objectives.

Status quo

22. Currently, depreciation is disallowed for BTR units (as it is for all residential buildings). Interest deductions are also being phased out over approximately four years for existing BTR assets, and interest will eventually be completely denied in relation to borrowing for BTR assets by 2025/26. BTR assets that receive their code compliance certificates on or after 27 March 2020 will be considered new builds and could qualify for the new build exemption from interest limitation for 20 years from the date they receive their code compliance certificate.

23. **Objective:** This option would not achieve objectives A and C as it provides no additional support to BTR assets, so it does not support the supply-side objectives. However, new BTR assets would still have access to the new build exemption. The status quo best achieves objective B as it does not further incentivise investor demand in residential property.

24. **Compliance costs:** This option would impose no further compliance costs.

25. **Administrative costs:** This option would impose no further administrative costs.

26. **Economic impact:** This option would have no further economic impact.

27. **Revenue impact:** This option would have no revenue impact over the forecast period.

28. **Sustainability and coherence of the tax system:** This option would be best for the overall sustainability of the tax system, as it creates no new opportunities for tax driven behaviour, avoidance, or arbitrage. It is the most coherent option in terms of the tax system.

29. **Fairness and equity:** This option has no impact on fairness and equity.

Option One – provide an in-perpetuity exemption from interest limitation for BTR assets

30. The interest limitation rules apply from 1 October 2021 to limit the ability for residential property investors to deduct interest on loans relating to residential property. Option 1 would provide an in-perpetuity exemption from interest limitation for BTR assets. The

[8] The depreciation rate of 1.4% was chosen based on the Bureau of Economic Analysis (BEA) economic depreciation rate set for multi-use residential buildings (MURBs).

exemption would allow interest incurred in relation to BTR assets to continue to be deducted indefinitely.

31. **Objective:** Option 1 would support objectives A and C. However, for most BTR assets there will be no additional tax benefit for 20 years, as the new build exemption already applies over the first 20 years of a new BTR asset's life. It would not support objective B, as it would provide a further exemption from the interest limitation rules that aim to dampen investor demand.

32. **Compliance costs:** The compliance costs associated with option 1 are low. The interest limitation rules are complex, however, most taxpayers with BTR assets will already be interacting with the rules and applying exemptions. Taxpayers that own BTR assets would be able to continue to deduct interest costs. Taxpayers would have to determine whether they satisfy the definition of BTR as an asset class and will have to provide proof of this to the relevant government agency.[9] Taxpayers would have to consider whether their BTR assets continue to meet the definition and report any changes to their eligibility to the relevant government agency.

33. **Administrative costs:** Option 1 would have low administrative costs. It would be straightforward to administer a new exemption from interest limitation, as similar exemptions (such as the new build exemption) already exist.

34. Adding a new exemption reason to tax return forms going forward would be simple, and it should be relatively easy to collect any data required for reporting purposes.

35. There should be limited additional administrative costs for Inland Revenue associated with checking that taxpayers qualify for the BTR asset class exemption, as the relevant government agency will be providing the details of eligible taxpayers to Inland Revenue.

36. **Economic impact:** Option 1 would create a bias towards investment in BTR assets compared with other residential property. However, it would reduce the current bias against investing in BTR compared with other investments (such as commercial property), by restoring interest deductions.

37. The NPV tax benefit (when applying the assumptions set out in the executive summary) of the extra interest deductions would be $730,008. The size of the NPV tax benefit of option 1, relative to the initial value of the BTR in this example, is 4.87%.This analysis assumes the investor has an interest only mortgage with a constant debt level of 50%.

38. **Revenue impact:**

39. <u>New BTR assets:</u> This option would have no revenue impact for first 20 years after a new BTR asset receives its code compliance certificate, because the existing new build exemption would apply.

40. <u>Existing BTR assets:</u> HUD estimates there may be up to 500 existing dwellings that would not qualify for the new build exemption (existing BTR assets). If these existing BTR assets were to qualify for a BTR-specific exemption from interest limitation, this would have an estimated cost of $2.1m over the 2021/22 to 2025/26 period. Those

[9] The relevant government agency that will hold and monitor the asset class register has not yet been determined.

BTR that do not qualify for the new build exemption will be subject to the four-year phasing out of interest deductions. This means the costing for option 1 will only account for the portion of interest that would otherwise have been phased out for existing BTR.

41. After the 20-year new build exemption expires: BTR assets would continue to have interest deductions under option 1 in perpetuity from year 21. The extent to which option 1 provides a greater benefit than option 2 depends upon a number of factors, in particular the interest rate and the level of borrowing to fund the BTR asset. There is no forecast revenue impact because the reduction in revenue occurs well after the forecast period.

42. **Sustainability and coherence of the tax system:** Option 1 is better for the overall sustainability of the tax system than option 2, because it would be easier to collect data on the amount of support this option would provide to BTR assets. This better access to data would also make it more likely that Inland Revenue would be able to identify and prevent tax avoidance and arbitrage. Option 1 is less coherent than the status quo, but more coherent than option 2. There are already a number of exemptions from the interest limitation rules which provides a precedent for a BTR exemption.

43. **Fairness and equity:** Option 1 is less equitable than the status quo, but more equitable than option 2, because it provides BTR assets with an advantage over other investors in non-BTR residential properties. However, new BTR properties would qualify for the new build exemption already, so providing an explicit BTR exemption would not provide any greater advantage to new BTR assets for 20 years (at which point the new build exemption would expire).

Option Two – reintroduce depreciation deductions for BTR assets at a rate of 1.4% diminishing value

44. This would apply to both existing and new build dwellings that meet the BTR asset class definition. The rate of 1.4% is based on the Bureau of Economic Analysis (BEA) economic depreciation rate of a multi-unit residential building (MURB). Depreciation would be deductible for the life of the asset. If the asset is eventually sold for less than its depreciated value, the loss can be deducted. However, if the asset is sold for more than its depreciated value (which is more likely for residential property) the excess deductions will be included as income. This is known as depreciation clawback (or depreciation recovery income) and is an existing feature of the tax depreciation rules.

45. **Objective**: This option would support objectives A and C more than option 1. This is because most BTR assets would qualify for the new build exemption and would therefore enjoy the benefit of depreciation deductions as well as the new build exemption from interest limitation for 20 years. However, any benefit provided by allowing depreciation deductions would be reduced to the extent to which depreciation deductions are clawed back when a BTR asset is sold, so the actual benefit could be quite small. It would not further objective B as it could incentivise greater investment in residential property.

46. **Compliance costs:** The compliance costs associated with option 2 would be greater than option 1 as taxpayers would have to apply the depreciation rate. For option 1, taxpayers would just continue to deduct interest.

47. Taxpayers will have to keep accurate records of their depreciated BTR assets, so that they can calculate whether there is a depreciation loss or depreciation recovery income

when they sell their BTR asset. Taxpayers will have to ensure that any amounts of loss or income are returned, and any resulting tax liability satisfied if they sell a BTR asset.

48. Similar to option 1, taxpayers would have to determine whether they satisfy the definition of BTR as an asset class, and will have to provide proof that they satisfy the definition to the relevant government agency. Taxpayers would have to consider whether their BTR assets continue to meet the definition, and report any changes to their eligibility to the relevant governmment agency.

49. **Administrative costs:** Option 2 could have high administration costs, depending on what data needs to be collected from taxpayers.

50. If data needs to be captured on the amount of depreciation deductions claimed in relation to BTR assets, this would impose high administrative costs, because this level of information about depreciation deductions is not currently captured.

51. Similar to option 1, there should be limited additional administrative costs for Inland Revenue associated with checking that taxpayers qualify for the BTR asset class exemption, as the relevant government agency will be providing the details of eligible taxpayers to Inland Revenue.

52. **Economic impact**: Option 2 would create a bias towards BTR assets compared with other residential property, by allowing depreciation deductions for BTR when these deductions are denied for other residential buildings. However, it would reduce the bias towards investment in commercial buildings, which are able to be depreciated.

53. From year 21, interest deductions would cease because the new build exemption would expire. Depreciation deductions alone, especially taking into account any potential clawback/depreciation recovery income on sale, would provide a similar NPV tax benefit than an exemption from interest limitation.

54. The NPV benefit of allowing the investor to claim depreciation deductions at a rate of 1.4% (diminishing value) over the same time period would be $879,161. The size of the NPV tax benefit of option 2, relative to the initial value of the BTR in this example is 5.86%.

55. **Revenue impact:**

56. <u>While the new build exemption applies:</u> The revenue impact of option 2 over the forecast period, and while the new build exemption applies to new BTR assets, would be greater than the revenue impact of option 1.

57. <u>After the new build exemption expires:</u> In the longer-term, option 2 would likely have less of a revenue impact than option 1. However, the fiscal impact over the 2021/22 to 2025/26 period is estimated to be $21.2milion. The fiscal impact is greater than option 1, despite having a similar economic impact. This is because under option 1 the new build exemption applies to most BTR, and interest deductions are phased out over four years for existing BTR. This means the cost over the forecast period for option 1 only takes into account the portion of interest that is denied for existing BTR.

58. **Sustainability and coherence of the tax system:** Option 2 is worse for the overall sustainability of the tax system, as Inland Revenue does not currently collect detailed data on depreciation deductions claimed by taxpayers. Collecting additional data on depreciation would impose a high administrative burden, and absent this data it would be difficult to determine whether the depreciation rules for BTR as an asset are being applied correctly (or whether there is any tax avoidance or arbitrage occurring). Option

2 is the less coherent option, because it would involve amending the depreciation rules just to provide support for a particular type of residential investment/asset. The aim of the tax depreciation rules is to ensure that a tax deduction is available each year for the amount by which the value of an asset declines over time, not to provide incentives so that taxpayers have extra support for investments in certain types of assets.

59. **Fairness and equity**: This option is less equitable, because it provides BTR assets with depreciation deductions, and these are not available for any other residential buildings. Some (but not all) BTR assets are MURBs. MURBs are long lived assets and in reality, depreciate at a slower rate than commercial and industrial buildings.

How do the options compare to the status quo/counterfactual?

	Status Quo	**Option One – *Exemption from interest limitation***	**Option 2 – *Depreciation deductions***
Supply-side objective	0	+	+
Demand-side objective	0	- -	-
Compliance costs	0	0	-
Administrative costs	0	-	- -
Economic impact	0	+	+
Revenue impact	0	-	- -
Sustainability and Coherence	0	-	- -
Fairness and equity	0	-	- -
Overall assessment	0	-	- -

60. Under option 1 there would be fewer compliance and administrative costs than under option 2. Option 1 is also more coherent, equitable, and efficient, and would likely be better for the overall sustainability of the tax system. There are already exemptions from interest limitation, such as the new build exemption, and amending future tax returns forms to account for the additional exemption would be straightforward.

61. Any administrative or compliance costs associated with the BTR asset class definition would be the same for both options 1 and 2.

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

62. The status quo best meets the stated objectives overall. It promotes objective B by retaining the scope of the interest limitation rules. It also results in the most coherent and equitable tax system of all the options.

63. Inland Revenue considers that there is no inherent difference between BTR assets and regular residential property, apart from scale. To provide BTR investors with concessionary treatment would be inequitable if the same concessions are not also provided to smaller investors. Options 1 and 2 would potentially meet objectives A and C, however, there is not enough available information to conclude that either of these options would make a considerable difference to the viability of the sector.

64. Te Tūāpapa Kura Kāinga – Ministry for Housing and Urban Development considers option 1 best addresses the problem, provides the highest net benefits over the long run and that policy objective B is better met through direct support for first home buyers. It is important that Government interventions address needs for all New Zealanders, including renters.

What are the marginal costs and benefits of the option?

65. As the preferred option is to retain the status quo, there would be no additional costs or benefits of the preferred option.

66. The proposal for Cabinet (option 1 - exemption from interest limitation) would also have no extra costs or benefits to most of the sector as the new build exemption will apply to new BTR assets. The revenue impact over the forecast period would be $2.1 million if existing BTR assets were to qualify for an exemption from interest limitation.

Section 3: Delivering an option

How will the new arrangements be implemented?

68. The recommended option is to retain the status quo. This will require no implementation. The interest limitation rules have already been enacted and educational material is available.

Implementation of option 1

69. If Cabinet agrees to implement option 1, the relevant government agency would determine whether a taxpayer satisfies the BTR definition and keep a register of all qualifying taxpayers. This register will be accessible by Inland Revenue each tax year, so that Inland Revenue is aware of which taxpayers can be claiming interest or depreciation deductions for BTR assets, when these taxpayers first satisfied the criteria, and if these taxpayers cease to meet the criteria.

Implementation of option 2

70. As with option 1, a relevant government agency will need to keep a register BTR assets the meet the required definition. This would be provided to Inland Revenue who would then allow depreciation deductions for qualifying taxpayers.

71. There would be an additional complexity with implementing option 2 if data is captured on the amount of depreciation deductions claimed in relation to BTR assets. This level of information about depreciation deductions is not currently captured.

How will the new arrangements be monitored, evaluated, and reviewed?

72. There are no new arrangements recommended. However, Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development will be monitoring the impact of the interest limitation rules on the BTR sector through regular consultation.