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GST - Current issues
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Our ref Submission - GST - Current issues

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Dear Sir

KPMG submission on GST - Current issues

We appreciate the opportunity to make a submission on the Officials Issues Paper – *GST – Current issues* (the "Issues Paper").

We outline below the summary of our submissions:

Summary of submission

We generally support the Officials' analysis and the corresponding suggested solutions on various current GST issues as outlined in the Issues Paper. The suggested solutions to these issues aim to align the GST rules more closely with the underlying policy principle, making the system more equitable particularly to businesses, both residents and non-residents.

Chapter 2	We agree with the suggested solution but recommend that Inland Revenue explores whether a commencement date prior to 1 April 2017 is possible.
Chapter 5	We accept the need to align the interpretation of the "directly in connection with land" test with OECD Guidelines and common international approaches, but recommend that any amendments are not more restrictive than these other approaches.
Chapter 7	*Goods moved offshore by GST-registered non-residents* The suggested solution should make it clear that the supply is zero-rated in order to achieve the intended outcome. *Non-resident registration rules* We support the recommended changes regarding section 54B of the GST Act. In addition, we suggest some additional changes which are summarised below.

Chapter 8	*Notification that a refund is being withheld see comment below, proposal is to change the law* The suggested solution is inconsistent within the GST legislation itself and creates unfair disadvantages to taxpayers.

In addition to the items discussed in the Issues Paper, we would like to bring to the Officials' attention the following issues which the Officials should also seek to address as part of the remedial amendments:

Section 5(25) of the GST Act	We recommend that Officials review the policy intention of section 5(25) of the GST Act and either provide further clarifications on the application of this section, or amend the section to reflect the actual intention and provide greater certainty.
Additional changes to section 54B of the GST Act	*Head Office registration under section 54B* Clarifications should be provided to confirm whether a Head Office can register under section 54B of the GST Act to recover Head Office costs incurred in New Zealand if it has a New Zealand branch registered under section 51 of the GST Act. *Requirement to have a bank account for registration under section 54B* Changes introduced by the Taxation (Land Information and Offshore Persons Information) Act mean that non-residents applying for registration to claim a GST refund must have a New Zealand bank account. We recommend that this requirement is reconsidered in the context of GST registration since it places a significant compliance obstacle to non-residents, particularly where a refund may be a one-off payment. *Carrying on a taxable activity under section 54B* We have seen an interpretation adopted by Inland Revenue which denies registration for a non-resident under section 54B of the GST Act on the basis that the applicant is carrying on a taxable activity in New Zealand, but cannot register under section 51 of the GST Act because it is not making taxable supplies in New Zealand. This interpretation is clearly contrary to the policy outcomes sought by allowing registration under section 54B. Clarifying legislation should be introduced to prevent such an interpretation.

General comment	These and other issues suggest to us that Inland Revenue officers do not appreciate that GST should not be a tax on business. We recommend that further training be undertaken, particularly, for those parts of Inland Revenue that should be regularly providing refunds to businesses.

We have provided in the attached Appendix a more detailed discussion and analysis of our submissions.

Further information

Should you wish to discuss further with us any aspect of our submissions or require any further information, please do not hesitate to contact us.

Yours sincerely

Peter Scott
Partner

John Cantin
Partner

Appendix: Submission on Officials Issues Paper – GST – Current issues

1 Chapter 2 – Financial services

Capital raising

We support the suggested solution to allow input tax credits on capital raising costs to the extent of the proportion of the registered person's business being to make taxable supplies. The suggested solution allows a more equitable GST position to be achieved for businesses making taxable supplies.

Given Officials' recognition that capital raising costs may be currently absorbed by a business or passed on to consumers, and should instead relate to a business's broader taxable activity, we suggest that Officials consider whether the legislative process will allow application prior to 1 April 2017.

We note that some care will need to be taken with the drafting so that financial services previously supplied are appropriately taken into account. The particular example is of a registered person who has raised capital through a share issue previously. This prior share raising should not be counted as part of the person's taxable percentage for a subsequent capital raising.

Mortgagee costs

Inland Revenue has recently published a view that mortgagee costs do not generate input tax for either the mortgagee or the mortgagor. This means that input tax which is properly referable to taxable supplies is unable to be claimed.

Mortgagee costs can be viewed either as a cost of the mortgagor disposing of the property or as a cost of the mortgagee recovering the loan. In either case, this will by definition be related to the making of taxable supplies. For the mortgagor, because if GST applies, it is sold in the course of its taxable activity. For the mortgagee, because it relates to the making of a zero-rated financial service B2B supply (if section 17 applies and that the mortgagor is GST registered).

We submit that mortgagee costs be legislated as input tax either against the GST payable on the section 17 supply or in the mortgagee's GST return. Either approach is consistent with the correct policy outcome. We suggest that the choice be determined by practical implementation considerations.

2 Chapter 5 – Services directly in connection with land

We note the comments made regarding the GST treatment of services supplied to non-residents which are directly in connection with land situated in New Zealand. In particular, we recognise the need to amend the application of these provisions so that they are consistent with the OECD International VAT / GST Guidelines (April 2014), and interpretation in other jurisdictions such as Australia and the EU.

However, we submit that the following are taken into account when making any amendments:

- Clear practical guidance accompanies any legislative changes, to provide certainty to taxpayers of IR's view;
- Any changes should not go beyond the OECD Guidelines, and approaches overseas. For example, paragraph 3.125 of the OECD Guidelines states that legal services should only be regarded as directly in connection with land where they are specific to a transfer of title. Therefore, other legal services (including those connected to contracts, per Article 31a (3)(h) of the Council Implementing Regulation (EU) No 282/2100), and tax advice even in respect of particular goods or property (per paragraph 44 of Australian Tax Office Ruling GSTR 2003/7) should not be regarded as directly in connection with land.
- Furthermore, paragraph 3.124 of the OECD Guidelines states that the connection with immovable property must be at the heart of the supply, and must constitute its predominant characteristic. This appears to be a narrower application than that envisaged in paragraph 5.27 of the Issues Paper, with the latter referring to a "direct relationship between the purpose or objective of the service and land". We therefore repeat our submission that any changes should not be more restrictive than OECD Guidelines and other common international approaches.
- IR considers the impact such changes will have on non-resident businesses which will suffer a GST impost, but should be able to claim a refund of this GST under section 54B of the GST Act. Such an amendment to the "directly in connection with land" provisions should be GST neutral for businesses eligible to register under section 54B. However, as explained under our additional submissions in section 5 below, there are considerable compliance obstacles to such a registration. We therefore submit that these obstacles are addressed along with any changes to the "directly in connection with land" provisions.

3 Chapter 7 – Miscellaneous issues

Goods moved offshore by GST-registered non-residents (7.42 – 7.52)

We support the Officials' analysis, the conclusion that the current rules are inconsistent with the purpose of GST and the suggested solution to deem supplies made by non-residents registered under the ordinary registration rule to be made and received in New Zealand.

While this may be implied in the suggested solution, we would like to emphasize to Officials that such supplies will need to be zero-rated in order to achieve the intended result of removing the GST impost on suppliers making taxable supplies. We recommend that this is confirmed in legislation and commentary.

4 Chapter 8 – Administration

Notification that a refund is being withheld (8.16 – 8.21)

We note the view in the Issues Paper that treating "time of issue" as the time of notice will provide the Commissioner with greater certainty and better consistency between the GST Act

and the TAA. However, in our view, the proposals will create an inconsistency and will likely unfairly disadvantage taxpayers.

The dispute resolution process in the TAA requires both the Commissioner and the taxpayer to issue/respond to notices within a timeframe determined by referencing to the previous date of issue. For example, sections 89AB(3) and 89D(5) of the TAA provide that taxpayers must issue a notice of proposed adjustment ("NOPA") in relation to a notice of assessment within a 4-month period from the date of issue of the notice of assessment. Section 89AB(2) of the TAA provides that a notice of response ("NOR") to be issued within a 2-month period from the date when the NOPA was issued.

In all instances in the disputes provisions of the TAA, regardless of whether the notices/responses are to be issued by the Commissioner or the taxpayer, the relevant timing is determined by reference to the date of issue, and, therefore, is consistent. Both parties are also able to determine with certainty when were the notifications provided. There is a date of issue consistency between the two items being measured.

The current section 46 reference to the date of receipt (or when the notice would have ordinarily been received under normal circumstances) is also consistent: GST returns are deemed to be furnished when they are received by the Commissioner under section 40 of the TAA. There is a date of receipt consistency in the two items being measured. (As the delivery time via the postal system can vary due to various reasons (e.g. delivery time to urban addresses is generally shorter than to rural addresses), "date of receipt" inevitably creates some uncertainty which, under the current rules, are borne by both the taxpayer and Inland Revenue.)

The proposed amendment (i.e. date of issue of the Commissioner's notification) would create a mismatch between the rules applicable to taxpayers and the rules applicable to Inland Revenue. The commencement of the 15-day period is the later of the two alternatives (i.e. date of receipt) where the taxpayer bears the uncertainty of the postal system. On the other hand, the cut-off point for Inland Revenue is the earlier of the two alternatives (i.e. date of issue) which Inland Revenue enjoys the certainty of.

We submit that Officials reconsider the proposal to confirm that the apparent consistency with the TAA notice period rules is actually justified given the internal inconsistency that would arise if the proposal was implemented.

We acknowledge that the timing difference will be negated where notices are communicated via electronic means e.g. online GST lodgements and secure mails via myIR. However, given that not all communications are conducted via electronic means, there will be taxpayers who are unfairly affected by the proposed changes.

5 Additional submissions

While the Officials are considering various remedial issues in the current GST rules, we believe that the Officials should also take this opportunity to address the following issues not already discussed in this Issues Paper:

5.1 Late payments and non-payments

Generally speaking, no GST arises where a payment is made for "no supply". Compensation payments are an example of this. In our experience, many businesses impose both late payment fees as well as non-payment or default fees. A late payment fee is typically imposed when a customer pays but is late in paying an amount. A non-payment or default fee is charged where no payment is ever made, or possibly payment is made but then reversed or dishonoured by the customer.

Section 5(25) of the GST Act modifies the principle above and specifically provides that an amount charged for the late payment of an account is consideration for a supply of services in the course or furtherance of a taxable activity. Consequently, GST should be accounted for on late payment penalties subject to section 5(25)(a) and (b).

The term "late payment" for the purpose of section 5(25) is not defined in the GST Act. Its ordinary meaning refers to a payment made after the relevant due date, hence, late payment. A "late payment" can be distinguished from a "non-payment" where a payment has never been made (as opposed to a payment being made but after the due date) and, therefore, does not fall within the scope of section 5(25).

We would appreciate further clarification on the GST treatment of penalties for non-payment from Officials and that, where the current legislation leads to unintended or undesirable outcomes, appropriate amendments be implemented.

5.2 Head Office registration under section 54B of the GST Act

Overseas companies ("Head Office") carrying on a taxable activity in New Zealand through a fixed or permanent place ("Branch") are treated as residents for GST purposes to the extent of the New Zealand taxable activity. It is, therefore, common for overseas companies operating via a branch structure (as opposed to, for example, a separate incorporated company) to register for New Zealand GST solely for their branch activities.

In the event where the Head Office, being a non-resident of New Zealand and a non-registered person, incurs costs in New Zealand, it is unable to recover the GST on these costs on the basis that the Head Office does not carry on a taxable activity in New Zealand and that the costs incurred are not in connection with making taxable supplies.

The Head Office should be allowed to separately register under section 54B. This is consistent with the fundamental principle that GST should be borne by the final consumer. Where the overseas Head Office which is carrying on a taxable activity overseas and is registered for an overseas equivalent of GST, is not allowed to register under section 54B, the Head Office which is unlikely to be the final consumer in most instances will bear the GST cost.

It is unclear, however, whether the Head Office can register under section 54B as a separately registered person if it has a New Zealand Branch which is registered under section 51 of the GST Act. The issue is that the Head Office and the Branch are the same legal entity. The branch registration rules in section 55 suggest that a branch is a separate registered person. Inland Revenue has argued that it is therefore a different registered person in correspondence with

KPMG. However, Inland Revenue does not appear to take the same view for section 54B purposes.

The GST Act should explicitly provide that an unrelated branch registration is a separate person so that section 54B can apply as intended.

5.3 Requirement to have a bank account for registration under section 54B of the GST Act

The Taxation (Land Information and Offshore Persons Information) Act introduced section 24BA of the Tax Administration Act 1994. This requires non-residents to have a New Zealand bank account in order to be granted a New Zealand tax file number, which is in turn required for registration under section 54B of the GST Act. This provision applies with effect from 1 October 2015.

The bank account requirement in the Taxation (Land Information and Offshore Persons Information) Act was introduced principally for the purpose of identifying non-resident property purchasers and sellers, as confirmed in paragraphs 27 – 33 of the first Regulatory Impact Statement on the bill. We submit that the requirement to have a New Zealand bank account in order to register for GST under section 54B is unduly onerous, and a barrier to the cross-border business neutrality which section 54B was intended to achieve. Whilst we recognise the need to verify that refunds are only paid in genuine circumstances, the requirement to have a New Zealand bank account, particularly where a GST refund may be a one-off payment, is a time-consuming and complex exercise due to the anti-money laundering (AML) requirements, and may be disproportionate to the refund cash-flow. This is particularly so when the IRD process to register already involves providing significant details or such things as passport information for directors, and their home addresses, as well as typically involving an audit by the IRD of the refund being sought.

We note that an applicant registering under the equivalent regime in Australia does not require an Australian bank account. Registering under that equivalent regime only requires a GST and not ATO number, and the following link confirms this position:

https://www.ato.gov.au/Business/Business-activity-statements-(BAS)/Lodging-and-paying-your-BAS/Expecting-a-refund-/

Furthermore, should the requirement to have a New Zealand bank account remain in order to receive a refund under section 54B of the GST Act, we submit that the identification requirements, particularly for company directors, for registration under section 54B should be relaxed. Whilst we recognise the need to protect the tax base through only paying out genuine refunds, the stringent AML identification requirements remove the need to have further identification checks under the tax application process.

We therefore submit that either:

- The requirement to have a New Zealand bank account to register under section 54B is removed (recognising the need to maintain this requirement for other tax reasons), or
- The director identification requirements contained in form IR564 are removed.

5.4 Carrying on a taxable activity in New Zealand under section 54B of the GST Act

We have an seen a further Inland Revenue approach which contradicts the aim of the non-resident refund rules to prevent GST from being a real fiscal cost to non-resident businesses.

The approach we have seen in practice is that Inland Revenue has argued that:

- A non-resident business carried on a taxable activity in NZ under section 54B(1)(d)(i) of the GST Act, thereby preventing registration under section 54B. The non-resident received consideration from overseas from that taxable activity, even though the non-resident received no New Zealand income from the taxable activity; and

- Even though the non-resident is carrying on a taxable activity in New Zealand, the non-resident is unable to register under section 51 of the GST Act because it is not making any taxable supplies in NZ (because all supplies from that taxable activity were made outside of New Zealand).

We consider that the words "carrying on a taxable activity in New Zealand" in paragraph (d)(i) of section 54B(1) must require the non-resident to be **making taxable supplies in New Zealand,** as opposed to where the activity in New Zealand does not involve making any taxable supplies in New Zealand.

This properly reflects the policy behind section 54B which is to ensure that GST is not a cost for non-resident businesses.

We submit that section 54B should be clarified to confirm that the carrying on of a taxable activity in New Zealand must involve making taxable supplies in New Zealand before a non-resident is prevented from registering.

6 General comment

A number of our submissions go to the policy of a GST: the consumer and not the business supplier should bear the GST. This means that refunds of input tax are an expected part of the tax.

This does not appear to be appreciated by Inland Revenue officers. The approach that they take denies input tax for a taxable business is contrary to the policy of a GST. This suggests to us that Inland Revenue's GST training is lacking.

We recommend that the Commissioner reinforce the GST policy, particularly, with those officers who can be expected to regularly consider claims for GST refunds.

For completeness, we acknowledge that Inland Revenue has a proper interest in confirming that input tax has been paid. Our concern is that where input tax is paid, the deduction is denied so that it is a cost to the business.