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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.ird.govt.nz** (search keywords: public consultation).

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Office of the Chief Tax Counsel
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PO Box 2198
Wellington 6140

You can also subscribe at **www.ird.govt.nz/public-consultation** to receive regular email updates when we publish new draft items for comment.

Ref	Draft type	Title	Comment deadline
ED0217	Operational statement	Employer-provided travel from home to a distant workplace – income tax (PAYE) and fringe benefit tax	6 September 2019
PUB00345	Interpretation statement	Income tax – distributions from foreign trusts	10 September 2019
ED0219	Determination	Employee use of telecommunications tools and usage plans in their employment	20 September 2019
ED0209	Standard practice statement	Options for relief from child support debt	16 September 2019

IN SUMMARY

New legislation

Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 2

The new Act sets the annual rates for income tax for the 2018–19 tax year and introduces new rules to enable the collection of GST on low value imported goods. It also introduces ring fencing of rental losses and expands the care and management powers of the Commissioner of Inland Revenue. It also contains smaller policy changes and a number of technical changes to ensure the tax rules work as intended.

Social Assistance Legislation (Budget 2019 Welfare Package) Amendment Act 2019 103

The Budget 2019 Welfare Package was designed to increase the incomes of low-income individuals and families and to support a sustained reduction in child poverty. It contains a number of improvements to the child support regime.

Binding rulings

BR Pub 19/03: Income tax – employer issued crypto-assets provided to an employee 105

This Ruling follows on from two Public Rulings that were issued recently: *BR Pub 19/01: Income tax – salary and wages paid in crypto-assets* and *BR Pub 19/02: Income tax – bonuses paid in crypto-assets*. It considers how FBT applies where cryptocurrency issued by an employer is provided to an employee.

Operational position

Commissioner's Operational Position - New section HC 27(6) – treatment of a beneficiary as a settlor in certain circumstances 113

This operational position addresses new section HC 27(6) of the Income Tax Act 2007 and the position the CIR will take until the section comes into effect on 1 April 2020.

Legal decisions – case notes

High Court considers whether a geothermal turbine hall is a building for depreciation purposes under the Income Tax Act 2007 114

Mercury challenged the 2012 – 2015 income years to determine whether the turbine halls at its Kawerau and Nga Awa Purua geothermal powerstations ("powerstations") were buildings and therefore subject to a depreciation rate of 0%.

Mercury asserted that the turbine halls were to be treated as part of the gantry cranes which are situated within the turbine halls, and therefore were depreciable at a rate of 9.6%.

The Court found in favour of the Commissioner.

NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

GST on low-value imported goods

Sections 2, 4B, 8(3)(ab), 8(4B), 8(4E), 8(4F), 8BB, 10(7C), 10(7D), 10(7E), 10B, 10C, 11(1)(jb), 11A(1D), 12(1B), 12(1C), 12B, 20(3)(dd), 20(3L), 20(4C), 20(4D), 24BAB, 24BAC, 25AA, 25(1)(aab), 25(1)(bb), 26AA, 51(1B), 60(1A), 60(1C), 60C, 60D, 60E, 60F, 60G, 77(3), 77(4), 77(5), 85C

1. The Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 amends the Goods and Services Tax Act 1985 by applying goods and services tax (GST) to "distantly taxable" goods supplied by non-resident merchants, operators of marketplaces and redeliverers to consumers in New Zealand.
2. "Distantly taxable" goods are generally imported goods valued at or below NZ$1,000 (such as books, clothing, cosmetics, shoes, sporting equipment and small electronic items) that are imported from offshore merchants by consumers in New Zealand. The new rules will require non-resident merchants, operators of electronic marketplaces and redeliverers (referred to collectively as "suppliers") to register and return GST on these supplies if they exceed, or are expected to exceed, NZ$60,000 in total over a 12-month period.
3. The new rules apply from 1 December 2019 and non-resident suppliers will be able to apply to be registered from 1 September 2019, with the registration taking effect from 1 December 2019. The registration form and information about registering for GST will be located on the Inland Revenue website **www.ird.govt.nz** (search keywords: non-resident GST). For general enquiries, or to apply for the Commissioner of Inland Revenue (the Commissioner) to exercise various discretions included in the rules, email **info.lvg@ird.govt.nz**.
4. The new legislation is broadly consistent with the GST rules that have applied to supplies of remote services since 1 October 2016. A special report from May 2016 contains detailed guidance on the GST on remote services rules and is available online at **taxpolicy.ird.govt.nz/publications/2016-sr-gst-cross-border-supplies/overview**.
5. Legislation references are to the Goods and Services Tax Act 1985 (the GST Act) unless stated otherwise.

Background

6. In principle, GST should apply to all consumption that occurs in New Zealand, as this ensures that the system is fair, efficient and simple. Under the current rules, however, GST is not typically collected on imported goods below the customs de minimis of NZ$60 of duty owing (this typically equates to a parcel with a value of NZ$400 if GST is the only applicable duty).
7. When GST was introduced in 1986, few New Zealand consumers purchased goods from offshore suppliers, and online shopping did not exist. At that time, the compliance and administrative costs that would have been involved in taxing imported goods under the de minimis outweighed the benefits of taxation.
8. The growth of e-commerce means the volume of imported goods on which GST is not collected is becoming increasingly significant. Many are concerned that the current tax settings place New Zealand suppliers of low-value goods at a competitive disadvantage relative to offshore suppliers. The non-collection of GST on low-value imported goods has also resulted in a growing gap in New Zealand's GST revenue base (estimated to be around NZ$130 million in 2017–18).
9. The new rules are intended to maintain the broad base of New Zealand's GST system and from a GST perspective create a level playing field between domestic and offshore suppliers of low-value goods. The effect will be to reduce the extent to which differences in GST treatment distort consumers' purchasing decisions.
10. On 1 July 2018 Australia introduced rules requiring offshore suppliers to register and return GST on their supplies of low-value imported goods to Australian consumers. The amendments broadly follow Australia's recently introduced rules.

Key features

Scope of the new GST rules

11. From 1 December 2019, GST will apply to "distantly taxable goods" – generally low-value imported goods supplied by non-resident merchants to New Zealand consumers. The new rules will require non-resident merchants, operators of electronic marketplaces and redeliverers to register and return GST on these supplies if the supplies in aggregate exceed, or are expected to exceed, NZ$60,000 in a 12-month period.
12. The new rules apply GST to a wide range of "distantly taxable" goods,[1] consistent with New Zealand's broad-based GST system. "Distantly taxable" goods are generally defined as goods that:
    - individually have a value of NZ$1,000 or less;
    - are outside New Zealand at the time of supply;
    - are supplied by a non-resident; and
    - are delivered to New Zealand.
13. Suppliers may have the option to also charge GST on their supplies of goods valued over NZ$1,000 to consumers in New Zealand.
14. The New Zealand Customs Service (Customs) will continue to collect GST, as well as other duties and cost recovery charges, on consignments with a total value in excess of NZ$1,000.

Distantly taxable goods supplied to GST-registered businesses

15. Non-resident suppliers will not be required to return GST on supplies to New Zealand GST-registered businesses, nor will they be required to provide tax invoices.
16. A rule requires non-resident suppliers to presume that a New Zealand customer is not a GST-registered business unless the customer has provided their GST registration number or New Zealand Business Number, or otherwise notified the supplier of their status as a GST-registered business.
17. The Commissioner can also prescribe or agree to an alternative method of determining whether the supply is made to a GST-registered person. The Commissioner will consider the following matters as an indication that the goods are generally only supplied to registered businesses:
    - The nature of the supply (for example, a product that would only ever be purchased by a business for the purpose of carrying on its taxable activity).
    - The value of the supply (for example, the supply is of a value that would be expected to be received only by a GST-registered person in the course or furtherance of its taxable activity, such as a supply of a very large quantity of low-value goods).
    - The terms and conditions related to the provision of the goods (for example, whether the supply is of goods that may be licensed for use by a GST-registered person).
18. When a GST-registered recipient is inadvertently charged GST, they will have to seek a refund from the non-resident supplier. The non-resident supplier may make an adjustment in their GST return when it is apparent that a mistake has been made. Alternatively, if the value of the supply (excluding GST) is NZ$1,000 or less, a non-resident supplier will have the option to provide a tax invoice to the purchaser to allow them to claim a deduction, rather than refunding the GST charged and making an adjustment in their GST return.

Special rules for certain businesses

Electronic marketplaces

19. When certain conditions are satisfied, an operator of an online marketplace may be required to register and return GST on supplies of distantly taxable goods made through the marketplace, instead of the underlying supplier.
20. The rules require the operator of an "electronic marketplace", rather than the non-resident underlying supplier, to register and return GST. An "electronic marketplace" is a marketplace operated by electronic means through which a person (the underlying supplier) makes a supply of remote services by electronic means, or a supply of distantly taxable goods, through another person (the operator of the marketplace) to a third person (the recipient).
21. Operators of "non-electronic marketplaces" may also register and return GST on behalf of their underlying suppliers, but this requires an agreement with the Commissioner.

[1] Goods that are already exempt (such as supplies of fine metal) retain their current treatment under the new rules.

Redeliverers

22. In some situations, a "redeliverer" may be used to deliver or assist in the delivery of goods to New Zealand, as opposed to the merchant who sold the goods or an operator of a marketplace. When this occurs, the redeliverer may be required to register and return GST on the goods.
23. A redeliverer is required to return GST when, under an arrangement with the recipient, the redeliverer does one or more of the following:
    - provides the use of an address outside New Zealand to which the goods are delivered;
    - arranges or assists the use of an address outside New Zealand to which the goods are delivered;
    - purchases the goods outside New Zealand as an agent of the recipient;
    - arranges or assists the purchase of the goods outside New Zealand.

New Zealand agents

24. An amendment to an existing agency rule provides agents acting for non-resident suppliers of distantly taxable goods the ability to agree with the supplier to treat the agent (and not the principal) as making the supply.

Preventing double taxation

25. Special rules apply to prevent double taxation from arising on distantly taxable goods imported into New Zealand with a combined value in excess of NZ$1,000. Since Customs will collect GST and other duties on consignments valued above NZ$1,000, suppliers are required to take reasonable steps to ensure tax information is included on relevant import documents in order for Customs to identify these goods at the border. The following information should be included on import documents:
    - The name and registration number of the supplier.
    - Which particular goods in the consignment GST has already been collected on.
    - Which particular goods in the consignment GST has not been collected on.
26. Suppliers would also need to provide a receipt to consumers if they have charged the consumer GST on some or all of the goods in the transaction.[2] This receipt can then be used as evidence to Customs that GST has already been charged on the goods. The information required to be included on the receipt consists of:
    - the name and registration number of the supplier;
    - the date of the supply;
    - the date of issue of the receipt (if different from the date of the supply);
    - a description of the goods supplied;
    - the consideration for the supply and the amount of GST included;
    - which goods GST has been charged on; and
    - information indicating the goods for which the amount of GST charged is zero.
27. A special non-double taxation rule also allows a deduction against the supplier's liability for New Zealand GST to the extent that the same supply is subject to consumption tax in another jurisdiction.

Vouchers

28. The GST rules for vouchers have been amended to clarify that the seller of a face value voucher[3] may treat GST as applying on the redemption of the voucher, if the voucher is (or could be) redeemed for remote services or distantly taxable goods.
29. A further amendment clarifies that if GST is payable on the redemption of a voucher, the person redeeming the voucher for goods and services is liable for GST.

Converting foreign currency amounts to New Zealand dollars

30. Non-resident suppliers of distantly taxable goods will be able to choose from a range of exchange rates when converting foreign currency amounts to New Zealand dollars.

[2] The requirement to provide a receipt applies even if the combined value of the goods supplied in the transaction is below NZ$1,000. One reason for this is that goods sold in a foreign currency could have a value of NZ$1,000 or less at the time of supply (so the supplier charges GST) and a value above NZ$1,000 at the time the goods are imported, due to exchange rate movements.

[3] A face value voucher entitles the holder to use the voucher to purchase goods and services up to a set monetary value.

Currency conversion to determine whether GST applies to a supply of goods

31. For the purpose of determining whether goods are individually valued at or below NZ$1,000 (and, therefore, whether GST should be returned), a supplier may use any one of the following exchange rates:
    - the rate published by Customs;
    - the Reserve Bank of New Zealand (RBNZ) rate, or a reference rate published by another central bank;
    - an exchange rate provided by a foreign exchange organisation or foreign exchange data vendor.
32. Other than the requirement that a supplier's chosen exchange rate be used consistently (discussed later at [230]), there are no restrictions on the specific type of exchange rate (sell NZD, buy NZD, or midpoint rate) that suppliers may use for converting foreign currency amounts. This means that suppliers can choose a sell NZD rate, a buy NZD rate or a midpoint rate when converting foreign currency amounts to establish whether GST applies (as well as for the purpose of calculating the amount of GST required to be returned in New Zealand dollars).

Currency conversion when determining the amount of GST payable

33. When converting to New Zealand dollars for determining the amount of GST required to be returned, the supplier can use the conversion rate at:
    - the time of supply;
    - the end of each taxable period;
    - the time of filing the return (or at the due date for filing, if the return is filed past the due date); or
    - another time as agreed with the Commissioner.
34. Once the supplier chooses a method other than expressing amounts in New Zealand currency at the time of supply, they may not change their method for a period of 24 months, unless they agree otherwise with the Commissioner.

Reverse charge (GST-registered recipient of distantly taxable goods returns the GST)

35. To ensure that supplies of distantly taxable goods acquired by GST-registered businesses for a purpose other than making taxable supplies are taxed, the reverse charge has been extended. The reverse charge requires the GST-registered business to return the GST if the percentage intended or actual taxable use of the services is less than 95 percent of the total use.

Administration of the non-resident registration system

Registration

36. The new rules will require non-resident suppliers to register and return GST on distantly taxable goods supplied to consumers if these supplies exceed, or are expected to exceed, NZ$60,000 in a 12-month period. Some New Zealand-resident businesses will also be required to return GST on distantly taxable goods that they are deemed to supply.
37. Non-resident suppliers are able to use a fair and reasonable method of converting foreign currency amounts to New Zealand currency to determine whether the registration threshold has been exceeded.
38. Non-resident suppliers may apply to be registered from 1 September 2019 (an application form will be available on that date) with the registration coming into force on 1 December 2019. The registration form will be located on the Inland Revenue website **www.ird.govt.nz** (search keywords: non-resident GST). The application form will ask for the applicant's name, contact details, country of residence (including any existing tax identification numbers), a description of the business activity and website address.
39. If a supplier (whether resident or non-resident) is already registered for GST because they make taxable supplies under existing GST rules, they do not need to register separately for any distantly taxable goods they supply. Instead, these suppliers should continue to file their usual GST returns and include their supplies of distantly taxable goods.

Filing GST returns

40. Applicants who indicate on the registration form that they will only return GST and not claim expenses will file a simplified "pay only" GST return. The simplified return would only include fields relevant to returning GST, such as the amount of supplies to New Zealand customers and the amount of GST required to be returned.
41. For the period from 1 December 2019 to 31 March 2020, non-resident suppliers of distantly taxable goods that become liable to be registered between 1 December and 31 December 2019 will have a taxable period of four months. After this transitional period, these suppliers will have mandatory quarterly taxable periods beginning on 1 April 2020.

42. A GST return must be provided setting out the tax payable for the taxable period by the 28th of the month following the end of the taxable period.[4] The end of each taxable period is the last day of the month at the end of the taxable period. The quarterly taxable periods end on 31 March, 30 June, 30 September and 31 December.
43. Applicants who indicate that they intend to return GST and claim GST may be asked to provide further information about their business during the registration process to better confirm their identity. These applicants will be required to file a full GST return.
44. Both types of GST return will be able to be filed online using Inland Revenue's myIR. For GST payments, myIR displays payment options available to registrants, and provides links and instructions on how to make payments. Information on how to file returns online and make payments will be available to non-resident suppliers when they apply to register for New Zealand GST.

Methods for electronic marketplaces and redeliverers to determine GST treatment of supplies

45. As discussed above at [19] to [23], in certain circumstances the special rules applying to electronic marketplaces and redeliverers would, for GST purposes, treat these businesses as suppliers of distantly taxable goods. This means electronic marketplace operators and redeliverers will need to rely on information provided by merchants or by customers to determine the GST treatment of these supplies.
46. The new legislation includes some default rules (based on objective proxies) that electronic marketplace operators and redeliverers can use to determine how much GST they are required to return on distantly taxable goods. The new rules also provide the Commissioner with discretion to prescribe or agree to alternative methods for electronic marketplace operators and redeliverers to determine if they are treated as making a supply of distantly taxable goods and the amount of GST payable.
47. This is intended to minimise compliance costs in situations where it may not be possible to precisely determine the GST treatment of a supply due to insufficient commercially available information.

Consumers and underlying suppliers providing false or misleading information

48. The Commissioner will have the discretion to require a person to register and pay the GST if that person provides false or misleading information about themselves resulting in an underpayment of GST, if the GST amount involved is substantial or the behaviour is repeated.
49. Existing "knowledge offences" rules may also apply when a person (being a consumer, or an underlying supplier selling goods through a marketplace) deliberately supplies incorrect information to a supplier by misrepresenting themselves as a GST-registered business or as a resident of another country. This is a criminal penalty and a person convicted of a knowledge offence is liable for a fine of up to NZ$25,000 for a first-time offence, or NZ$50,000 for repeated offences.

Optional rules aimed at reducing costs for suppliers

Claiming GST deductions for New Zealand expenses

50. An amendment to a pre-existing deduction rule will allow non-resident suppliers of distantly taxable goods and/or remote services to claim GST deductions for New Zealand expenses. Deductions are available regardless of whether the relevant business inputs are used for (or available for use in) making supplies to consumers in New Zealand. This is only available to those suppliers that have registered under the standard registration system as a "pay and claim" registrant.

Option to charge GST on high-value goods

51. Suppliers of distantly taxable goods may elect to charge GST on goods valued above NZ$1,000 ("high-value goods") if those goods are supplied to consumers in New Zealand. This option is available if at least 75 percent of the total value of goods that they supply to customers in New Zealand in the 12-month period starting on the date the election is intended to be effective for are individually valued at NZ$1,000 or less.
52. Alternatively, a supplier will be able to charge GST on its supplies of high-value goods to consumers if the Commissioner considers that allowing the supplier to do so will not result in a risk to the integrity of the tax system.

Option to charge GST on low-value supplies to GST-registered businesses

53. If certain conditions are met, a non-resident supplier is able to choose to charge GST on a supply of distantly taxable goods to a GST-registered business and proactively issue the recipient with a tax invoice. This applies when:
    - the value of the supply (excluding GST) is NZ$1,000 or less; and

[4] The exceptions to this being when the month following the end of the taxable period is December (in which case the filing and payment due date is 15 January) or April (filing and payment due date of 7 May).

- the supplier reasonably expects that in the 12 months after the supply is made, more than 50 percent of their supplies to customers in New Zealand will be to persons that are not registered for GST.

54. If a non-resident supplier opts to charge GST on a supply to a GST-registered business they are able to issue a single document that qualifies both as a full tax invoice and as a receipt that the recipient may provide to Customs to prevent any double taxation.

Transitional rule for fixed-term contracts entered into before 1 December

55. A transitional provision is provided in the new rules for fixed-term contracts entered into before 1 December 2019 and when the consideration for the supply is set or reviewed for periods of 396 days or less during the term of the agreement.
56. The transitional provision allows suppliers to treat periodic payments under the contract as not being successive supplies, and therefore, payments made after 1 December 2019 are not subject to GST. This transitional rule only applies for the term of the agreement or up to 396 days from the date the contract was entered into, whichever is earlier.

Application date

57. The new GST rules come into force on 1 December 2019.

Detailed analysis

Key terms

58. There are a number of terms that have a specific meaning in respect of these new rules.
59. **Supplier** – The term "supplier" is used to refer to the person who is the supplier of the goods for GST purposes (that is, required to return and pay GST on the supply to Inland Revenue). The supplier will be the merchant unless another person (such as an electronic marketplace operator, redeliverer or agent) is treated as the supplier of the goods under a specific provision.
60. **Merchant** – The term "merchant" is used to refer to the person who actually supplies the goods. A merchant may sell independently – for example, via their own website or by mail order – or they may sell their goods on a marketplace.
61. **Marketplace** – Refers to a third-party medium that allows consumers and merchants to interact to facilitate the sale and purchase of goods or services. The definitions of "marketplace" and "electronic marketplace" are discussed at [134].
62. **Redeliverer** – Refers to a person who delivers goods (or arranges or assists delivery) to New Zealand under an arrangement with the recipient of the goods, and does one or more of the following:
    - provides the use of an address outside New Zealand to which the goods are delivered;
    - arranges or assists the use of an address outside New Zealand to which the goods are delivered;
    - purchases the goods outside New Zealand as an agent of the recipient; or
    - arranges or assists the purchase of the goods outside New Zealand.
63. **Consignment** – The term "consignment" generally means a single package or parcel of imported goods. However, in some instances, Customs will treat two or more packages arriving on the same day, from the same consignor (supplier) and addressed to the same consignee (importer or recipient) as one consignment.
64. **De minimis** – Refers to the threshold below which Customs will not collect GST and other duty on a consignment of imported goods. From 1 December 2019, imported consignments valued at NZ$1,000 or less will not have GST and other duty collected at the border (unless a specific exception to the de minimis applies, such as for alcohol and tobacco).
65. **Customs value** – Refers to the value of imported goods as determined under Schedule 4 of the Customs and Excise Act 2018. This is the valuation that Customs uses when determining whether a consignment of imported goods is above the de minimis, and therefore whether Customs collects duty on the goods.
66. **Estimated customs value** – Refers to the value of an item of goods as determined in accordance with new section 10B of the Goods and Services Tax Act 1985, discussed later at [83]. This valuation (which approximates the customs value of an individual item of goods) is used for the purposes of determining whether a given item of goods is valued at NZ$1,000 or less, and therefore whether GST is required to be charged on the supply of the item.
67. **Value of supply** – Refers to the (GST-exclusive) value of a supply of goods and services. This is the valuation used for the purpose of calculating the amount of GST, and is determined by reference to the amount of consideration for the supply of goods and services (generally the total price or amount paid by the recipient of the supply of goods and services).

Scope of the new GST rules

(Sections 2, 4B, 8(3)(ab), 10(7E), 10B, 51(1B) and 77(5))

Place of supply rules

68. The GST Act imposes GST on goods and services supplied in New Zealand. The Act adopts a broad set of rules to determine whether a good or service is considered to be supplied in New Zealand in the first instance. The place of supply rules are accompanied by a range of exclusions that determine whether the supply is zero-rated or exempt rather than taxed at the normal 15% rate.

69. If a non-resident person supplies goods, the starting point is that the supply will be treated as having been made outside New Zealand, and therefore not subject to GST. However, under section 8(3)(a), goods are treated as having been supplied in New Zealand if the goods are in New Zealand at the time of supply. Section 8(4) provides that if a supply is made to a GST-registered business for the purposes of carrying on its taxable activity, the goods are considered to be supplied outside New Zealand, and therefore are not subject to GST, unless the parties agree that GST will apply.

Distantly taxable goods supplied by non-residents

70. New section 8(3)(ab) has been inserted into the place of supply rules, which treats supplies of "distantly taxable goods" (as defined) supplied by a non-resident to a person providing a delivery address in New Zealand as a supply made in New Zealand, and therefore subject to GST.

71. Like section 8(4), new section 8(4E) provides that if distantly taxable goods are supplied to a GST-registered business for the purposes of carrying on its taxable activity, the goods are treated as having been supplied outside New Zealand. The goods are therefore not subject to GST, unless the non-resident supplier chooses to treat the goods as being supplied in New Zealand. More information on this option is provided later at [310] to [317].

Distantly taxable goods supplied by New Zealand residents

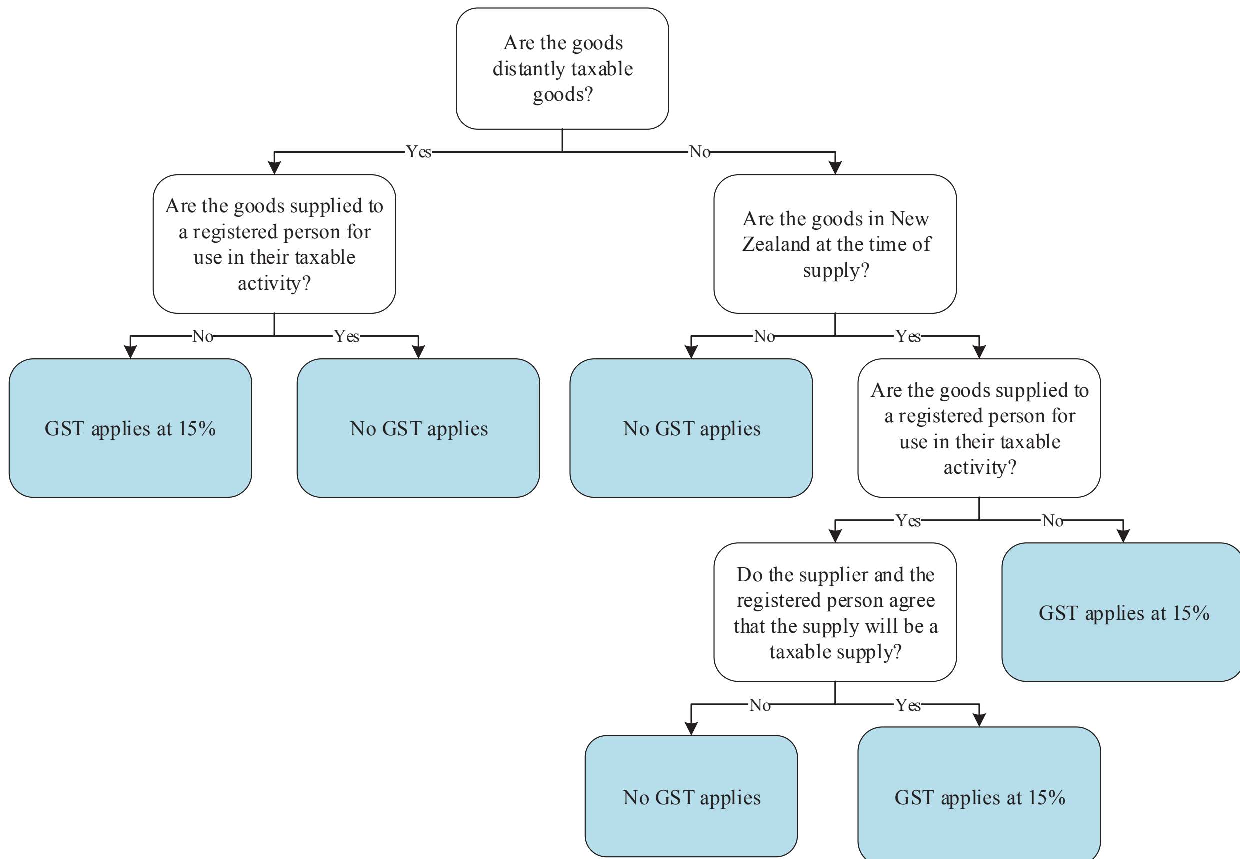
72. Goods treated as having been supplied by a New Zealand-resident person, such as an electronic marketplace operator, redeliverer or agent domiciled in New Zealand, would be treated as supplied in New Zealand by existing section 8(2). This treatment would apply even if the goods are supplied to a GST-registered business for the purposes of carrying on its taxable activity.

73. A comprehensive explanation of the special rules applying to electronic marketplaces, redeliverers and New Zealand-resident agents is provided later, with each section beginning at [133], [167] and [182], respectively.

Exempt and zero-rated supplies

74. Supplies of goods that are already exempt from GST (such as supplies of fine metal), or zero-rated under a specific rule, would retain that treatment under the new rules.

Summary of the new place of supply rules for non-resident suppliers of goods



Definition of "distantly taxable goods"

75. Under the GST Act, "goods" are defined as all kinds of real or personal property; but do not include choses in action, money or a product that is transmitted by means of a wire, cable, radio, optical or other electromagnetic system or by means of a similar technical system.

76. New section 4B sets out that "distantly taxable goods" would generally be defined as goods that:

- are supplied by a non-resident;
- are outside New Zealand at the time of supply;
- are delivered to a place in New Zealand by the supplier, or the supplier arranges or assists the delivery of the goods to a place in New Zealand; and
- are low-value goods (that is, individually have an estimated customs value of NZ$1,000 or less).

77. As discussed later, the definition of distantly taxable goods also includes goods treated by section 60C, 60D or 60E as being supplied by a marketplace operator or redeliverer, regardless of the residency of the marketplace operator or redeliverer.

78. Alcoholic beverages, tobacco and tobacco products that are exempted from regulations made under section 406(1) of the Customs and Excise Act 2018 are not distantly taxable goods. At present, Customs collects GST and other duty including excise-equivalent taxes on these goods. This will not change.

Goods outside New Zealand at the time of supply

79. A non-resident merchant supplying low-value goods that are delivered to an address in New Zealand will be considered to have made a supply of distantly taxable goods if the goods are outside New Zealand at the time of supply.

80. The time of supply for distantly taxable goods will be determined by the general rule in section 9(1), which sets out that the time of supply is the earlier of any payment being received by the supplier or an invoice being issued by the supplier. In the case of goods purchased online by consumers, this will generally be the same as the time the consumer purchases the goods.

81. If either a redeliverer or an operator of a marketplace is treated by section 60C, 60D or 60E as the supplier of the goods, the location of the goods at the time of supply will not be relevant for determining if the goods are distantly taxable goods.

Any goods that are treated by one of those sections as having been supplied by a marketplace operator or a redeliverer will be distantly taxable goods, regardless of where the goods are located at the time of supply.[5]

Goods individually having an estimated customs value of NZ$1,000 or less

82. In order for an "item of goods" to be distantly taxable, it must have an estimated customs value of NZ$1,000 or less. Suppliers will be required to determine a reasonable estimate of the item's customs value using information available to them at the time of supply (new section 10B(3)).

83. For the sole purpose of determining whether an item is an item of distantly taxable goods (and, therefore, whether GST is charged on the supply of the item), section 10B(2) provides that the value of an item will be the amount of consideration[6], less any amounts included in the consideration for:

- GST charged on the supply of the item under section 8;
- any duty payable by the supplier under the Customs and Excise Act 2018[7]; and
- the cost of transport and insurance of the item between leaving its country of export and being delivered in New Zealand. Any amounts charged for transport and insurance of the item which relate to domestic transport and insurance within the country of export should not be subtracted from the amount of consideration. Suppliers may make a reasonable estimate of the amount relating to transport and insurance within the country of export for this purpose.

84. This is broadly consistent with the valuation that Customs will use (the "customs value") when determining if a consignment of imported goods is above or below the NZ$1,000 de minimis. However, as explained below at [93] to [95], the approximation of the customs value outlined above is different to the valuation that is used for calculating the amount of GST required to be returned on distantly taxable goods.

85. Note that "an item of goods" may be a single good or multiple goods, depending on how the "item" is presented for sale. For example, an item of goods could be one pair of socks or a pack of ten pairs of socks.

Example 1 – high value item shipped in two different boxes for assembly by the recipient

Kathryn, a consumer in New Zealand, buys a bicycle from a merchant in China for NZ$1,200 (excluding GST and delivery). For ease of packaging and handling and to minimise the risk of damage in transit, the bicycle parts are shipped to Kathryn in two separate boxes to be assembled when Kathryn receives the packages.

It is clear from the advertisement on the Chinese merchant's website that the nature of what is being supplied is a single item of goods (being an unassembled bicycle) and not multiple items. On this basis, the Chinese merchant does not charge Kathryn GST on the supply of the bicycle, as the bicycle is not considered distantly taxable (the estimated customs value of the bicycle is NZ$1,200, exceeding the de minimis of NZ$1,000.)

The two boxes arrive in New Zealand on the same flight and are treated by Customs as a single consignment. Assuming that the customs value of the consignment is above NZ$1,000 at the time of importation, Customs will charge Kathryn GST, along with the Import Entry Transaction Fee and Biosecurity System Entry Levy and any other duties.

Example 2 – learn to play electric guitar starter pack

Jared decides that he wants to learn to play guitar and orders a 'learn to play electric guitar starter pack' from an online music retailer based in Japan for NZ$1,500 (excluding GST and delivery). The starter pack has everything that Jared needs to get started, including a lead, strap, tuner, guitar bag, amplifier, picks, whammy bar and an instructional DVD.

It is clear from the advertisement on the Japanese merchant's website that what is being offered for sale is a package for a single price of NZ$1,500. Although Jared provides a delivery address in New Zealand at the online checkout, he is not charged GST because the goods are outside New Zealand at the time of supply and the goods are not distantly taxable goods (as the estimated customs value of the item, being the starter pack, is NZ$1,500).

[5] While not necessarily likely, it is possible that the time of supply for imported goods could be after the goods are already in New Zealand. As discussed later, goods that are not imported but are actually sourced from within New Zealand are distantly taxable goods if they are supplied through a marketplace by a non-resident merchant and the marketplace operator is treated by section 60C or 60D as the supplier.

[6] "Consideration" is a term commonly used in contract law to refer to what a party to a contract agrees to provide under the contract. In the case of a supply of goods and services by a business to a consumer, the consideration for the supply will typically be a sum of money that the consumer pays to the supplier in order to receive the goods and services.

[7] A merchant may include an amount in the price of an item to cover any duty payable under the Customs and Excise Act 2018 if it is selling goods on a delivered-duty-paid basis (that is, will pay the customs duties to Customs on behalf of the recipient).

86. Under the rules for electronic marketplaces and "approved" marketplaces, some distantly taxable goods may not actually be imported into New Zealand by the recipient, but may instead be sourced from within New Zealand.[8] This would occur when a non-resident uses an electronic marketplace to sell low-value goods that are already in New Zealand to a customer providing a New Zealand delivery address. In this situation, the value of an item of goods would be the amount of consideration the item is sold for, less any amounts included in the consideration for:
    - GST charged on the supply of the item under section 8; and
    - the cost of transport and insurance of the item.[9]

Currency conversion to determine the estimated customs value

87. To determine whether an item has an estimated customs value of NZ$1,000 or less, currency conversion to New Zealand dollars may be required if the item is sold in a currency other than New Zealand dollars.[10] Currency conversion for this purpose will only be necessary if:
    - it is unclear whether an item of goods that is sold in another currency has an estimated customs value exceeding NZ$1,000; and
    - the supplier has not elected to treat its high-value goods as distantly taxable goods (discussed later at [292]).
88. Under new section 77(5), a supplier may convert foreign currency amounts into New Zealand dollars using either:
    - the spot exchange rate for the foreign currency applying at the time of supply; or
    - a currency conversion method approved by the Commissioner of Inland Revenue.
89. The currency conversion method approved by the Commissioner is set out later at [226] to [231].

Which goods would be included in a supply of distantly taxable goods?

90. In some cases, a single transaction will involve one or more items that each have an estimated customs value of NZ$1,000 or less and, at the same time, one or more other items that each have an estimated customs value exceeding NZ$1,000. In this situation, section 4B(2) splits the transaction into two separate supplies:
    - a supply of distantly taxable goods, consisting of all the goods that are low-value goods (that is, individually have an estimated customs value of NZ$1,000 or less); and
    - a second supply consisting of the remaining goods supplied in the transaction.
91. The supplier can however elect to treat its supplies of high-value goods as distantly taxable, in which case there will generally be a single supply of distantly taxable goods. In this situation, section 4B(2) will only split the supply into two separate supplies if some of the goods are not distantly taxable goods because they are alcoholic beverages, tobacco or tobacco products (or, if a non-resident merchant is the supplier for GST purposes, because some of the goods are in New Zealand at the time of supply).
92. Further explanation of the special rules allowing suppliers to treat their supplies of high-value goods to consumers as distantly taxable goods is provided later at [292] to [309].

Example 3 – separate supplies of distantly taxable and non-distantly taxable goods bought in the same transaction

Brenda decides to treat herself by buying a new television and home entertainment system. She orders a 50" flat screen television for NZ$800 (excluding GST and delivery), as well as a stereo/home entertainment system for NZ$1,100 from the catalogue of an Australian-based mail order company.

The Australian merchant charges Brenda GST on the television but not on the stereo/home entertainment system. This is because the estimated customs value of the television is less than NZ$1,000 (NZ$800) – meaning that the supply of the television is a taxable supply of distantly taxable goods.

However, the estimated customs value of the stereo/home entertainment system is above NZ$1,000 (NZ$1,100) and, therefore, the stereo/home entertainment system is not supplied as a taxable supply because the item is outside New Zealand at the time of supply and is not an item of distantly taxable goods.

[8] This is because whether the marketplace operator is treated as the supplier is based solely on the residency status of the merchant. This is to avoid further compliance costs for marketplace operators in determining whether the goods are already in New Zealand or will be shipped from outside New Zealand.

[9] There will be no customs duty payable as the goods are sourced from within New Zealand, rather than being imported.

[10] As the estimated customs value is worked out by using a reasonable estimate at the time of supply, the date or time of supply will be the date or time of the currency conversion (if required).

Calculating GST on distantly taxable goods

93. To calculate the amount of GST on distantly taxable goods, suppliers need to determine the value of the supply. It should be noted that the value of a supply of distantly taxable goods is not the same as the estimated customs value of distantly taxable goods (as the estimated customs value is only used for the purpose of determining whether a given item is distantly taxable).

94. Instead, the value of a supply of distantly taxable goods is determined by the amount of consideration for the supply (section 10(2))[11], which – unlike the estimated customs value – will typically include amounts paid by the recipient for related services such as freight and insurance.

95. The amount of GST required to be returned on a supply of distantly taxable goods is 15% of the value of the **supply**. For goods that are priced inclusive of GST, the amount of GST that should be returned will be equal to the amount of consideration for the supply multiplied by 3 ÷ 23. An example of how this applies is provided in **Example 4** below.

Treatment of amounts paid by the recipient for delivery and other related services

96. Under ordinary GST principles, the amount of consideration for a supply of distantly taxable goods will typically include amounts paid by the recipient for services relating to the goods, such as delivery and insurance. This is because these services are generally either:

- ancillary or integral to the supply of the goods (such as in the case of freight and insurance); or
- merely incidental to the goods, or are a means of better enjoying the goods.

97. Where this is the case, the services will typically form part of the supply of distantly taxable goods, even if a separate fee is charged for the services. This applies even if the services would be zero-rated if they were supplied separately – for example, international transportation of goods (including ancillary activities such as handling) and insurance associated with the international transportation are zero-rated.[12]

98. However, in limited situations, it is possible that there may be a separate zero-rated supply if the recipient contracts separately for the supply of these services.

99. To avoid doubt and ensure consistent treatment, new section 10(7E) provides that the consideration for a supply of distantly taxable goods includes the amount of consideration for a supply of related services to the recipient of the distantly taxable goods if:

    - the consideration for the related services is determined by reference to the items included in the supply of distantly taxable goods;[13]
    - the supply of related services is made, arranged or facilitated by the supplier of the distantly taxable goods (or by the underlying supplier, if the supplier for GST purposes is a marketplace operator);
    - the supply of related services is directly in connection with the distantly taxable goods or is of insurance of the goods;[14]
    - the supply of related services would be zero-rated in the absence of this rule; and
    - the supply of related services and the supply of distantly taxable goods do not form a single supply.

100. This means that amounts paid by the recipient for a separate zero-rated supply (such as international transportation that is contractually supplied to the recipient by a third party) may still be included as part of the consideration for a supply of distantly taxable goods that is subject to GST at the rate of 15%.

[11] Section 10(2)(a) provides that, to the extent that the consideration for a supply of goods and services is in money, the value of the supply with the addition of GST is equal to the amount of consideration in money. To the extent that the consideration for a supply of distantly taxable goods is not in money, section 10(2)(b) provides that the value of the supply with the addition of GST is equal to the open market value of the non-monetary consideration.

[12] For more information on when multiple goods and services supplied in a single transaction will form a single supply or multiple supplies, see the Interpretation Statement, *IS 18/04 Goods and Services Tax – Single supply or multiple supplie*s, available at **www.ird.govt.nz/resources/2/2/229901d1-77a8-410e-a005-933a9904455e/is1804.pdf**.

[13] For example, this means that a subscription where a consumer is paying for the transport of many supplies of goods over a period of time is excluded from the scope of the rule.

[14] The "directly in connection with" wording is intended to apply broadly to services that have a direct physical intervention with the goods, including (but not limited to) transportation and handling of the goods. For example, services such as gift-wrapping would meet the "directly in connection with" test.

Example 4 – calculating amount of output tax based on GST-inclusive price

Wendy purchases a fascinator from Wild Hats, an e-commerce business based in Australia that ships novelty party hats from its warehouse in Melbourne. Wild Hats is registered for GST in New Zealand.

The price of the fascinator is NZ$23 including GST if any. To get the hat to her address in New Zealand, Wendy also pays a shipping fee of NZ$11.50 (also inclusive of GST). Therefore, the total amount paid by Wendy including GST is NZ$34.50.

The amount of GST returned on the supply by Wild Hats is NZ$4.50 (NZ$34.50 × 3/23 = NZ$4.50). This includes the NZ$1.50 of GST included in the shipping fee.

Example 5 – calculating amount of output tax based on GST-exclusive price

Chris buys a new suit from a non-resident merchant based in Hong Kong for NZ$900 plus GST if any. The merchant charges Chris an additional NZ$50 plus GST if any for delivery to New Zealand.

The merchant charges Chris NZ$142.50 of GST (NZ$950 × 15% = NZ$142.50). The full amount paid by Chris is therefore NZ$1,092.50 (NZ$950 + NZ$142.50 in GST).

Example 6 – application of section 10(7E) to separate zero-rated supply of international transport

Jan, a consumer in New Zealand, purchases a fishing rod from an American merchant on the A Co. marketplace for NZ$20 (excluding GST).

The merchant does not provide shipping to addresses outside the United States. However, to make goods on its marketplace available to a global market, A Co. allows customers outside the United States to purchase shipping to the destination country from a freight forwarder. Using the A Co. marketplace, Jan purchases shipping of the fishing rod to her home in New Zealand for NZ$10 excluding GST.

Under the rules applying to electronic marketplaces, A Co. is treated as making the supply of the fishing rod to Jan, meaning that A Co. is responsible for GST on the supply of the fishing rod. However, neither A Co. nor the American merchant supply the shipping to Jan, as the contract for the supply is between the freight forwarder and Jan. This means that the supply of shipping is separate to the supply of the fishing rod. Consequently, the supply of shipping is zero-rated under the rules applying to international transportation.

However, section 10(7E) treats the shipping fee as part of the consideration for a taxable supply of distantly taxable goods because:

- the shipping fee is determined by reference to the supply of the fishing rod to Jan;
- the shipping was purchased by Jan through the A Co. marketplace, which is sufficient to meet the test that either A Co. or the American merchant facilitated the supply of the shipping;
- the shipping is supplied directly in connection with distantly taxable goods, as it involves the physical handling and transport of the fishing rod;
- in the absence of section 10(7E), the shipping would be zero-rated as a supply of international transportation services; and
- the supply of shipping and the supply of distantly taxable goods do not form a single supply (as mentioned above, the supply of shipping is a separate supply to the supply of the fishing rod).

This means that A Co. is required to return GST of NZ$4.50, made up of NZ$3 in GST on the fishing rod (NZ$20 × 15% = NZ$3) and NZ$1.50 in GST on the shipping (NZ$10 × 15% = NZ$1.50).

Apportionment of GST on freight and insurance charges

101. In some situations, a consumer may purchase goods that are distantly taxable goods as well as goods that are not distantly taxable goods in a single transaction. In this situation, the consumer may be charged a single delivery fee for the transportation of all the goods. Where this is the case, apportionment of GST on the amount paid for transportation will usually be required.

102. The supplier may use any fair and reasonable method of apportioning GST on delivery charges. For example, apportionment based on the weight of the distantly taxable goods relative to the weight of other goods would be a fair and reasonable apportionment method, as would apportionment based on the value of the goods. If feasible, it would be in the supplier's interest to use the same method for apportioning GST on delivery charges at the point of sale as that used to apportion delivery charges for customs purposes.

103. However, apportionment of GST on a single delivery charge relating to both distantly taxable goods and other goods will not be required if:

- the delivery services are a separate zero-rated supply; and
- section 10(7E) does not apply to treat the amount of consideration relating to delivery services as part of the consideration for the supply of distantly taxable goods (so GST will not apply at all to the amount paid for delivery).

Example 7 – apportionment of delivery fee relating to distantly taxable and non-distantly taxable goods based on value

Scott purchases a gold watch for NZ$1,100 along with two shirts at NZ$40 each (all priced excluding GST) from a merchant in Germany for delivery to his address in New Zealand.

The shirts are both distantly taxable goods – each of these items has an estimated customs value of NZ$1,000 or less – so the German merchant (who is registered for GST in New Zealand) is required to return GST on each of these items. However, the watch is not distantly taxable, as it has an estimated customs value above NZ$1,000 (NZ$1,100), so the German merchant is not required to return GST on the watch.

The merchant charges Scott an NZ$30 fee for the transportation of all the goods purchased and ships the goods to Scott in a single package. The merchant apportions the GST on the transportation fee based on the value of the respective items in the package. The apportionment ratio used by the merchant is 6.78% ((40 + 40) ÷ (40 + 40 + 1,100) = 0.06779).

The merchant charges Scott NZ$12.31 in GST, comprising NZ$12 in GST on the distantly taxable goods ((NZ$40 + NZ$40) × 15% = NZ$12) and NZ$0.31 in GST on the transportation fee (NZ$30 × 6.78% × 15% = NZ$0.31).

Example 8 – apportionment of delivery fee relating to distantly taxable and non-distantly taxable goods based on weight

Aroha purchases a number of items (all priced excluding GST) from a merchant in the United States (US) for delivery to her address in New Zealand:

- two shirts at NZ$50 each;
- a ball dress at NZ$300; and
- a wedding dress at NZ$1,200.

The shirts and ball dress are all distantly taxable goods, so the US merchant (who is registered for GST in New Zealand) is required to return GST on each of these items. However, the wedding dress is not, so the US merchant is not required to return GST on the wedding dress.

The US merchant charges Aroha an NZ$80 fee for the transportation of all the goods purchased and ships the goods to Aroha in a single package. The US merchant apportions the GST on the transportation fee based on the weight of the respective items in the package. The combined weight of the distantly taxable goods is 2kg, and the wedding dress also weighs 2kg (half the weight of the package).

The US merchant charges Aroha NZ$66 of GST, comprising NZ$60 in GST on the distantly taxable goods ((NZ$50 + NZ$50 + NZ$300) × 15% = NZ$60) and NZ$6 in GST on the transportation fee (NZ$80 ÷ 2 × 15% = NZ$6).

Special valuation rule for supplies treated as made by redeliverers

104. New section 10(7C) contains a special rule for determining the amount of output tax (GST payable) on a supply of distantly taxable goods treated by section 60E as being made by a redeliverer. The special rule is explained later at [177].

Discounts, returns and refunds

105. Section 25(1) provides a list of situations where a GST-registered supplier may return too much or too little GST as a result of either a mistake, subsequent alteration to, or cancellation of the supply. This list includes the following events:

- The supply of goods and services has been cancelled.
- The nature of the supply of goods and services had been fundamentally varied or altered.
- The previously agreed consideration for the supply of goods and services has been altered, for instance through the offer of a discount.
- The goods and services or part of the goods and services have been returned to the supplier.

106. In the situation where a merchant has returned too much or too little GST as the result of an event referred to in section 25(1) (such as the events listed above), section 25(2) provides that the merchant may make an adjustment in its GST return when it is apparent that too much or too little output tax has been returned.

Example 9 – goods returned to merchant

Aroha from the previous example decides that the ball dress she bought is too small. The US merchant agrees to provide Aroha with a full refund of the price of the dress if Aroha returns it.

The US merchant receives the returned dress and refunds the GST-inclusive amount paid for the dress of NZ$345 (NZ$300 + NZ$45 in GST). By the time that the US merchant received the returned dress, they had already filed their GST return for the taxable period in which the supply to Aroha was made. The US merchant is entitled to make a reduction of NZ$45 in their output tax in the GST return for the current taxable period.

107. A special valuation rule applies in the specific situation where an operator of a marketplace (who is treated as making a supply of distantly taxable goods or remote services by section 60C or 60D) provides a discount to the recipient of the supply. This rule is explained later at [161].

GST registration threshold

108. As a result of the changes to the place of supply rules, non-resident suppliers of distantly taxable goods will be required to register for GST if the total value of supplies in New Zealand exceeds NZ$60,000 in a 12-month period. This is equivalent to the existing registration threshold for resident suppliers, as well as non-resident suppliers of remote services.

109. As these suppliers will be subject to the rules contained in section 51, non-resident suppliers will be required to register if:

- the total value of their supplies in New Zealand in the past 12 months exceeded NZ$60,000 (unless the Commissioner of Inland Revenue is satisfied that their supplies in the next 12 months will not exceed this threshold); or
- the total value of their supplies in New Zealand in the next 12 months is expected to exceed NZ$60,000.

110. The total value of supplies in New Zealand by a non-resident includes the following:

- the total value of supplies of distantly taxable goods[15] to consumers, including amounts charged for services such as delivery and insurance;
- the total value of supplies to consumers of goods that are located in New Zealand at the time of supply (not including any distantly taxable goods);
- the total value of supplies to consumers of services physically performed in New Zealand; and
- the total value of remote services supplied to consumers (not including any services physically performed in New Zealand).

111. As goods and services supplied by a non-resident to a New Zealand GST-registered business are generally treated as not being supplied in New Zealand (and therefore not subject to GST), these supplies will not count towards the registration threshold.

112. If a non-resident makes supplies of distantly taxable goods to consumers and their total supplies in New Zealand fall below the NZ$60,000 threshold, they will be able to voluntarily register for GST.

Example 10 – non-resident supplier below the registration threshold

Jersey Co., a non-resident company based in the United States, sells clothing to customers across the world. Jersey Co. also makes and supplies businesses with staff uniforms.

Each year, Jersey Co. makes supplies valued at NZ$50,000 to New Zealand customers who are not GST-registered. It makes supplies valued at NZ$20,000 to New Zealand GST-registered customers.

Jersey Co. is not required to register and return GST on any of its supplies in New Zealand, as it has not exceeded the NZ$60,000 registration threshold.

113. Section 51(1B) allows non-resident suppliers to use a "fair and reasonable" method of converting foreign currency amounts to New Zealand currency to determine whether the registration threshold has been exceeded. This includes converting amounts to New Zealand currency as at the time of supply, using the current exchange rate at the time of testing the threshold, or using an average exchange rate over the period. Any of these methods would be regarded as fair and reasonable as long as they were used on a consistent basis.

[15] "Distantly taxable goods" in this specific context being just those items that individually have an estimated customs value of NZ$1,000 or less.

Example 11 – non-resident supplier above registration threshold

Tool Warehouse, a non-resident company, supplies power tools to New Zealand businesses and individual consumers. Over the past two years, Tool Warehouse has supplied NZ$10,000 of power tools that each individually have an estimated customs value of NZ$1,000 or less, each month, to New Zealand individual consumers and this is expected to continue into the foreseeable future.

Tool Warehouse will be expected to register for New Zealand GST from 1 December 2019 as it is reasonably expected that their supplies in New Zealand to individual consumers will exceed NZ$60,000 in the 12 months following 1 December 2019 (the date the new rules apply from).

Effect of the new legislation on suppliers' residency and income tax obligations

114. Although these amendments treat certain goods supplied by non-residents as "supplied in New Zealand", there is no intention that this will affect whether a supplier is a resident of New Zealand for GST or income tax purposes, or whether a supplier has a "permanent establishment" in New Zealand.

115. The GST Act largely adopts the Income Tax Act 2007's definition of "resident". Solely for GST purposes, a person is also considered to be a resident of New Zealand to the extent that the person carries on a taxable activity or other activity in New Zealand, and has a fixed or permanent place in New Zealand relating to that activity. The amendments do not affect the extent to which a person carries on an activity in New Zealand, despite making certain supplies taxable for GST purposes.

116. Double tax agreements (DTAs) primarily deal with whether a resident of one country is subject to income tax on income derived in another country. The concept of "permanent establishment" is used in DTAs between New Zealand and other countries. Under DTAs, a company that does not have a "permanent establishment" in New Zealand will have no New Zealand income tax. The fact that a supplier is registered for New Zealand GST under the new rules should not affect whether or not they have a "permanent establishment" in New Zealand for DTA purposes, or the application of the definition of resident used for GST purposes.

Distantly taxable goods supplied to GST-registered businesses

(Sections 8(4E), 8BB, 20(4C), (4D), 24 and 25(1)(aab) to (abb))

117. New section 8(4E) applies to supplies of distantly taxable goods by non-residents to GST-registered businesses and treats these as being made outside New Zealand (not subject to GST). However, as discussed later at [310] to [317], a limited exception will in certain circumstances allow a non-resident supplier to treat these supplies as being made in New Zealand (subject to GST).

Example 12 – business-to-business exclusion

Consider Tool Warehouse in the previous example.

If the New Zealand businesses that Tool Warehouse sells power tools to are not registered for GST, the power tools that each individually have an estimated customs value of NZ$1,000 or less will be subject to GST under section 8(3)(ab), as these power tools are distantly taxable goods that are supplied to a person providing a delivery address in New Zealand who is not a GST-registered business.

If the New Zealand business customers are registered for GST, then under section 8(4E) the power tools will be treated as being supplied outside New Zealand.

118. Section 8BB(1) requires non-resident suppliers to treat distantly taxable goods as being supplied to a consumer who is not GST-registered, unless the recipient notifies the supplier that they are GST-registered or provides their GST registration number or a New Zealand business number. GST-registered recipients of distantly taxable goods should not identify themselves as a GST-registered business, or provide their GST registration number or a New Zealand business number, if they intend to use the goods wholly for non-taxable purposes.

119. It may not be practical for all suppliers to ask for evidence that a customer is GST-registered. Therefore, to provide flexibility, section 8BB(3) allows the Commissioner to prescribe or agree an alternative method to determine whether the supply is made to a GST-registered person. Section 8BB(4) outlines the factors that the Commissioner will consider when exercising the discretion:

- The nature of the supply (for example, a product that would only ever be purchased by a business for the purpose of carrying on its taxable activity).

- The value of the supply (for example, the supply is of a value that would be expected to be received only by a GST-registered person in the course or furtherance of its taxable activity, such as a supply of a very large quantity of low-value goods).
- The terms and conditions related to the provision of the goods (for example, whether the supply is of goods and services that may be leased or licensed for use by a GST-registered person).

120. Suppliers who have already agreed an alternative method with the Commissioner for supplies of remote services may want to use the same method to determine whether supplies of distantly taxable goods are to GST-registered businesses. In this situation, the supplier should apply to the Commissioner to agree an alternative method for their supplies of distantly taxable goods. This could be as simple as requesting the Commissioner's approval for them to use their existing method for distantly taxable goods.

Example 13 – alternative method of determining supplies are to a GST-registered business

Discount Crazy is a non-resident that supplies a wide range of products to New Zealand businesses and individual consumers. Factors such as the quantity or volume of goods purchased in a single transaction and the overall value of the transaction mean that in some cases it is quite clear that low-value items are being purchased in bulk by a business and not an individual consumer. Businesses that purchase goods in bulk are likely to be GST-registered businesses.

Discount Crazy has a large number of customers and it is impractical to ask for evidence to identify their customers as GST-registered. Discount Crazy is able to apply to the Commissioner of Inland Revenue to use an alternative method for identifying whether their customers are GST-registered persons.

Evidence such as the nature of the supplies, licensing terms and other conditions could be used, as well as a sample of their customer base that supports the likelihood that future customers will be GST-registered.

GST inadvertently charged to a GST-registered recipient

121. There may be instances when a non-resident supplier inadvertently treats a GST-registered business as an individual consumer and therefore charges the business GST. In this situation, the GST-registered recipient should seek a refund from the non-resident supplier and not claim an input tax deduction for the inadvertently charged GST (see the deduction prohibition in section 20(4C)). There is, however, an exception to the deduction prohibition for supplies valued at NZ$1,000 or less[16] if the supplier has provided the recipient with a full tax invoice (discussed below).

122. Amendments to section 25(1) will allow a supplier to make adjustments to its output tax in the return in which it is apparent that the mistake has been made. This applies if the supply is treated as made in New Zealand (subject to GST) when in fact it should not have been treated as a taxable supply (see section 25(1)(aab)).

123. Note that an adjustment will be required only if the non-resident supplier has already filed a return and has accounted for an incorrect amount of output tax as a result of the mistake (see existing section 25(1)(e)). If the mistake becomes apparent before the relevant return has been filed, the mistake can be rectified before the return is filed.

124. Since non-resident suppliers are not required to provide a tax invoice under the amendment to section 24(5), they do not have to issue a credit note under section 25(4). However, if a non-resident supplier opts to charge GST on business-to-business supplies and provide a tax invoice under the special rule in new section 8(4F) (discussed later at [310] to [317]), the supplier will be required to issue a credit note if the amount of consideration for the supply is subsequently reduced or if the supply is cancelled.

Supplies of NZ$1,000 or less

125. An exception to the above rules applies when the value of the supply (excluding GST) is NZ$1,000 or less at the time of supply. In this situation, when the supplier inadvertently charges a GST-registered business GST, the supplier can choose to provide a tax invoice to the GST-registered business. This option is intended to be a compliance cost-saving measure for non-resident suppliers in relation to low-value supplies, when the compliance cost of issuing a refund may exceed the cost of issuing a tax invoice. Note that if the supplier chooses to provide a tax invoice, it must be a full tax invoice, even if the payment for the supply (including GST) is less than NZ$50 (see the amendments to section 24(4)).

126. The tax invoice must be a full invoice as set out in section 24(3), and therefore must contain the following particulars:

- the words "tax invoice" in a prominent place;
- the name and registration number of the supplier;
- the name and address of the recipient;

[16] Meaning that the value of the overall supply is NZ$1,000 or less (as opposed to all of the items in the supply each having an estimated customs value of NZ$1,000 or less).

- the date upon which the tax invoice is issued;
- a description of the goods and services supplied;
- the quantity of the goods and services supplied;
- and either:
  - the total amount of the tax charged, the consideration, excluding tax, and the consideration, inclusive of tax for the supply; or
  - where the amount of tax charged is the tax fraction of the consideration, the consideration for the supply and a statement that it includes a charge in relation to the tax.

127. The exception to the deduction prohibition in section 20(4C) (discussed above) allows the GST-registered business purchasing the goods to claim an input tax deduction under the normal deduction provisions to the extent to which the goods are used for, or available for use, in making taxable supplies.

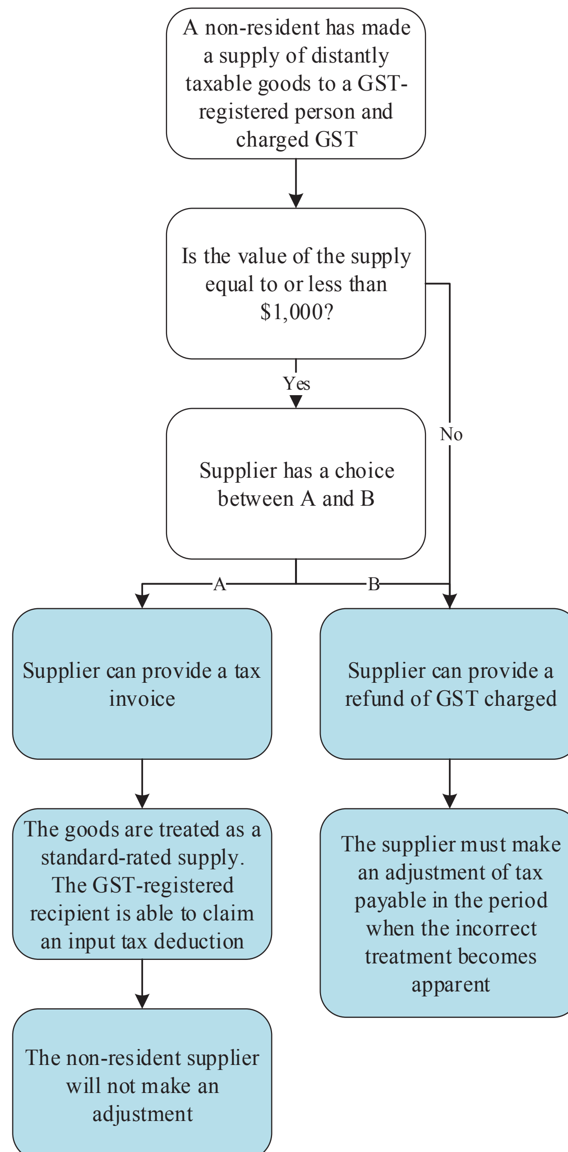
128. If the supplier chooses to provide a tax invoice:
  - the supplier is not required to make an adjustment to correct the amount of GST shown on the invoice (see section 25(1)(aab)(ii)); and
  - the supplier and recipient are treated as having agreed that the supply is made in New Zealand (and therefore subject to GST) under section 8(4).[17]

129. These provisions turn a supply that should not have been taxed into a supply that is taxed at the standard rate of 15%. In this situation, the correct amount of GST is returned by the supplier and therefore an adjustment to the supplier's GST return, under section 25, is not required.

[17] Note that the reference in section 24(5D) to the supplier and recipient being treated as agreeing that section 8(4) will not apply to the supply is incorrect (as section 8(4) would not apply in the first place if the supply is of distantly taxable goods). Officials will seek to correct this error in a future omnibus tax bill.

130. This diagram summarises how these rules will apply.

When GST is incorrectly charged



Special rules for certain businesses

(Sections 2, 10(7C), 10(7D), 11(1)(jb), 11A(1D), 26AA, 60(1A), 60(1C), 60C, 60D and 60E)

131. GST is normally payable by the merchant who sells the goods or services. However, the GST on a supply of distantly taxable goods may be payable by either an operator of a marketplace, the merchant who sold the goods, a "redeliverer" who brings the goods to New Zealand, or a New Zealand resident acting on behalf of a non-resident principal.

132. To determine who is liable to return the GST, the new legislation establishes the following hierarchy:

- if an operator of a marketplace is liable to return the GST on a supply, the merchant will not be responsible for the GST;[18]
- if an operator of a marketplace or the merchant is liable to return the GST on a supply, a redeliverer will not be responsible for the GST; and
- if a New Zealand-resident agent makes supplies of distantly taxable goods on behalf of a non-resident principal, the agent will be responsible for the GST instead of the principal if the agent and principal have an agreement to this effect.

[18] As discussed later, a limited exception to this may apply in the situation where an operator of an electronic marketplace is provided with incorrect or misleading information by the merchant, which leads the marketplace operator to conclude that it is not responsible for GST on the supply (or otherwise results in the marketplace operator underpaying GST to Inland Revenue).

Marketplaces

133. A marketplace is a medium that allows consumers and merchants to interact to facilitate the sale and purchase of goods or services. When certain conditions are satisfied, an operator of an electronic marketplace instead of the merchant (referred to as the "underlying supplier") may be required to register and return GST on supplies made through the marketplace. Under the new rules, electronic marketplaces are required to register and return GST, and non-electronic marketplaces can register subject to the Commissioner of Inland Revenue's approval.

134. The definition of "marketplace" in section 2 means an electronic marketplace or a marketplace approved under section 60D as a supplier of remote services or distantly taxable goods. An electronic marketplace is further defined under section 2 as requiring the following:
    - The marketplace enables underlying suppliers to supply goods or remote services through the marketplace to customers.
    - The marketplace is operated by electronic means, including by a website, internet portal, gateway, store, distribution platform or other similar marketplace.
    - Supplies of remote services made through the marketplace must be made by electronic means, but this requirement does not apply to supplies of tangible goods made through the marketplace.

135. Providers that solely process payments are excluded from the definition of "electronic marketplace" as these providers merely facilitate the exchange of money between the supplier and consumer, rather than the sale and purchase of the goods or services.

136. Section 2 defines an "underlying supplier" as the person that would be the supplier of the goods and services in the absence of the marketplace rules. Given that a marketplace is at the top of the hierarchy of collection entities (with a redeliverer only being responsible for GST if neither a marketplace operator nor the merchant who sold the goods is liable to return the GST), the "underlying supplier" would be the merchant who sold the goods.

Electronic marketplace rule

137. Section 60C has been amended so that it treats the operator of an electronic marketplace as making a supply of distantly taxable goods in the course or furtherance of a taxable activity when:
    - the goods are supplied by a non-resident underlying supplier;
    - the operator of the electronic marketplace or the underlying supplier makes, arranges or assists the delivery of the goods to a place in New Zealand; and
    - the goods individually have estimated customs values of NZ$1,000 or less.

138. However, the operator of the electronic marketplace will not be considered to have made the supply if they do not control any of the key elements of the supply, and the liability of the underlying supplier is made clear in the documentation relating to the transaction. Accordingly, under section 60C, an operator of an electronic marketplace would not be treated as the supplier if all the following conditions are satisfied:
    - the electronic marketplace does not authorise the charge to the recipient, or make or authorise the delivery of the supply, or directly or indirectly set any of the terms and conditions under which the supply is made;
    - the documentation provided to the recipient identifies the supply as made by the underlying supplier and not the marketplace; and
    - the underlying supplier and the operator of the marketplace have agreed that the underlying supplier is liable for GST.

139. If they are treated as making the supply, the operator of the electronic marketplace will be responsible for returning GST. The operator of the electronic marketplace will include these supplies in their turnover for the purpose of determining whether the registration threshold is exceeded and, if it is exceeded, will be liable for the GST. The operator would also make any adjustments arising from the supply, for example, when incorrectly charged GST is refunded to a GST-registered business.

Meaning of "authorise the charge for the supply to the recipient"

140. The meaning of "authorise the charge for the supply to the recipient" is broad, covering the situation where the marketplace authorises the charge on behalf of the merchant or as a processing agent for the merchant. However, as mentioned earlier, providers that only process payments are excluded from the definition of "electronic marketplace".

141. An electronic marketplace would authorise the charge to the recipient if it communicates the liability to pay to the customer, or otherwise influences whether or when the customer pays for the supply. This may be done by initiating the process through which the recipient is charged and includes situations where the marketplace connects the recipient to

a third-party payment processor who receives the marketplace operator's instruction. To authorise the charge, it is not necessary for the marketplace operator to collect or receive the payment, or that it is involved in each of the steps in the payment authorisation process.

Example 14 – marketplace that authorises the charge to the recipient

When using the A Co. marketplace to purchase goods, Virginia chooses to pay using Pay Global, a third party payment processor. A Co. connects Virginia to Pay Global's website, and provides data to Pay Global that allows them to process the payment.

A Co. authorises the charge to Virginia. This is because it has communicated Virginia's liability to pay for the goods.

Example 15 – marketplace that does not authorise the charge

Thomas is an underlying supplier who sells goods using the E-Z Trades marketplace. His profile advertises the fact that he has an active account on Pay Global, a third party payment processor. Thomas uses the messaging function to provide customers with his account details.

E-Z Trades does not communicate the customer's liability to pay, or influence whether or at what time the customer pays for the supply. It does not authorise the charge for the supply to the recipient.

Meaning of "make or authorise the delivery of the supply to the recipient"

142. An electronic marketplace makes or authorises the delivery of the supply to the recipient if the operator of the marketplace itself delivers the goods, or if the marketplace sends approval to commence delivery or instructs the underlying supplier or a third party to make the delivery.

Example 16 – marketplace that authorises delivery

Consider Virginia and A Co. in Example 14. Once A Co. receives confirmation from Pay Global that payment was made, A Co. notifies the underlying supplier, and provides delivery instructions. A Co. authorises the delivery of the supply to Virginia.

Example 17 – marketplace that does not authorise delivery

Sports Stuff is an underlying supplier selling sporting gear through Persimmon's website. Steve contacts Sports Stuff through Persimmon's messaging service and buys a set of shin guards. Sports Stuff, and not Persimmon, authorises delivery of the item, given the arrangements for the order and delivery of the goods are made directly with Sports Stuff.

Meaning of "directly or indirectly set a term or condition under which the supply is made"

143. The meaning of "directly or indirectly set a term or condition under which the supply is made" is very broad. This concept looks beyond the formal contractual relationship to the influence exercised by the marketplace operator. The marketplace operator does not need to have any direct involvement in determining the contractual arrangements between underlying suppliers and buyers using the marketplace in order to be responsible for GST on supplies.

144. A requirement for underlying suppliers to comply with the marketplace's listing policies will in many cases mean that the marketplace does (at least indirectly) set a term or condition under which the supply is made, meaning that the marketplace operator will be responsible for GST on the supply. However, this may not be true in all cases and will depend on what the marketplace's specific listing policies are.

145. For example, a requirement in a contract between the marketplace operator and the underlying supplier that goods sold on the marketplace must comply with New Zealand laws and regulations will not in itself mean that the marketplace "directly or indirectly sets a term or condition under which the supply is made". This is because the "directly or indirectly" test is a proxy for the level of control or influence the marketplace operator has over the sale and any post-sales processes, such as returns, refunds and customer complaints. A mere requirement that listings comply with New Zealand's regulatory requirements or, for example, that listings do not contain offensive language is not sufficient to meet this test.

146. However, there are several marketplace listing policies that will meet this test, including:

- the offer, acceptance, payment for the goods or delivery information is to be communicated through the marketplace;
- the underlying supplier must accept one or more specific payment methods, or shipping or delivery methods to be used in fulfilling the sale;
- the marketplace operator provides the types of packaging to be used by the underlying supplier;

- underlying suppliers will match the prices of goods which are sold cheaper elsewhere (price match guarantee);
- the marketplace operator has the right to withhold the buyer's payment from the underlying supplier until the buyer confirms they are satisfied with the product;
- use of the marketplace's grievance or dispute management procedures for underlying suppliers and buyers;
- the marketplace operator has the right to set the price for which goods are sold, such as by offering a discount through a customer loyalty programme;
- underlying suppliers are required to meet particular performance requirements, such as those relating to the quality of the goods or requiring them to maintain a particular customer rating to sell products on the marketplace; or
- underlying suppliers are required to display a rating based on stipulated behaviours relating to that underlying supplier's conduct on the marketplace.

147. In practice this means there will be very limited circumstances where an electronic marketplace operator will not be responsible for GST on sales made by a non-resident underlying supplier though the marketplace.

Example 18 – marketplace that directly or indirectly sets any of the terms and conditions

Tangerine (an electronic marketplace) offers features and imposes requirements on underlying suppliers and buyers, each of which mean that it directly or indirectly sets some of the terms and conditions under which the supplies through it are made.

Tangerine:

- requires underlying suppliers to conclude the transaction through its marketplace, and prohibits them from directly transacting with buyers outside of its marketplace. This ensures that Tangerine can collect the correct fee amount, which is based on the value of the sale;
- requires underlying suppliers to accept at least one of the specific payment methods listed on its website; and
- provides a rating of the underlying supplier's performance on the platform, using ratings from buyers. This rating system influences the underlying supplier's conduct when selling items through Tangerine.

Example 19 – marketplace that does not directly or indirectly set any of the terms and conditions

XYZ Marketplace Co. (XYZ) operates an electronic marketplace. However, the only requirements that it places on merchants and buyers using its website are that restricted or prohibited items (such as firearms) cannot be listed for sale, and that listings and other communications between merchants and buyers cannot contain offensive language.

XYZ does not directly or indirectly set any of the terms or conditions under which the supply is made.

Priority rule where multiple electronic marketplaces are involved in a supply

148. Where multiple electronic marketplaces are liable for GST on a single supply of distantly taxable goods or remote services, a priority rule in section 60C(3) provides that the first operator that authorises a charge or receives payment for the supply is treated as the supplier. If none of the marketplaces involved meet this requirement, the first operator that authorises delivery would be treated as the supplier.

Approved marketplace rule

149. Amended section 60D allows non-electronic marketplaces for goods to register as a marketplace subject to the Commissioner of Inland Revenue's approval. The operator, and not the underlying supplier, would then be treated as making the supply in the course or furtherance of a taxable activity.

150. New section 60D(2)(c) sets out that an approved marketplace for goods will be treated as making a supply in the course or furtherance of a taxable activity in circumstances where:

- the Commissioner approves an application made by the operator of the marketplace under subsection (2);
- the goods are supplied by a non-resident underlying supplier;
- the operator of the marketplace or the underlying supplier makes, arranges or assists the delivery of the goods to a place in New Zealand; and
- the goods individually have estimated customs values of NZ$1,000 or less (if the marketplace operator has not elected to charge GST on high-value goods – discussed later).

151. When exercising this discretion to approve a marketplace under section 60D, subsection (3) provides that the Commissioner may take the following into account:
    - whether the marketplace is best placed to determine whether the recipient of the supply of goods is a registered person; and
    - whether the number of non-resident underlying suppliers selling low-value goods through the marketplace means that return requirements are better satisfied by the marketplace rather than the individual underlying suppliers.

Residency of underlying suppliers

152. As mentioned above, a marketplace operator will only be treated as making a supply of distantly taxable goods if the underlying supplier of the goods is a non-resident. This is in contrast with the existing marketplace rules for remote services, which (as illustrated in Table 1) apply to supplies made by both resident and non-resident underlying suppliers.
153. The marketplace rules for goods do not require the marketplace operator to distinguish between goods that are outside New Zealand at the time of supply versus those that are already in New Zealand. This is because all goods that are treated by section 60C or 60D as supplied by a marketplace operator are included in the definition of "distantly taxable goods", regardless of where the goods are situated at the time of supply.
154. Below is a summary of the differences between the GST rules applying to goods individually valued at NZ$1,000 or less ("low-value goods") and remote services before and after 1 December 2019, in the situation where those low-value goods or remote services are supplied over a marketplace by a non-resident underlying supplier.

Table 1: Pre-1 December 2019 treatment of different types of supplies and application of the marketplace rules to these supplies from 1 December 2019

	Remote services	Low-value goods in New Zealand at the time of supply	Low-value goods outside New Zealand at the time of supply
Previous treatment	Marketplace operator is the supplier for GST purposes.	Underlying supplier is responsible for GST.	Supply not subject to GST.
New treatment	No change.	Marketplace operator is the supplier for GST purposes.	Marketplace operator is the supplier for GST purposes.

155. The existing treatment of remote services supplied through non-resident electronic marketplaces will continue to apply. This means that the non-resident marketplace operator is responsible for returning GST on these supplies, regardless of whether the underlying supplier is a New Zealand resident or a non-resident.

Specific rule for underlying suppliers

156. Non-resident underlying suppliers that sell goods and/or remote services over marketplaces may already be registered for GST under existing rules. It is also possible that some non-resident underlying suppliers may become liable to register in their own right under the new rules for distantly taxable goods if they also make non-marketplace supplies to consumers in New Zealand (for instance, through their own website or mail order).
157. Some of these underlying suppliers may incur GST on inputs purchased from New Zealand businesses for making supplies to customers in New Zealand. Amended section 60(1C) ensures that such underlying suppliers (whether they are non-resident, or resident in New Zealand) can claim input tax deductions for their expenses in making supplies through electronic marketplaces.
158. The provision allows the underlying supplier to treat the supply as two separate supplies – a supply of goods or remote services from the underlying supplier to the operator of the marketplace, and a supply of those same goods or services from the operator to the recipient. The first supply to the marketplace operator is zero-rated under either section 11A(1)(jc) or new section 11(1)(jb), thus enabling the underlying supplier to recover the GST costs incurred in making the supply.

Example 20 – zero-rated supply of remote services from underlying supplier to marketplace operator

Games Pty Ltd., an Australian app developer that is registered for GST in New Zealand, contracts with App Store Co., an operator of an app store, to distribute its smartphone games. App Store Co. collects payments from customers and authorises delivery of the app.

App Store Co. is treated as the supplier under section 60C, and is therefore responsible for GST on the supply. If, as a result of section 60C, App Store Co. makes supplies that exceed the registration threshold, it will be required to register and return GST on supplies of remote services that are made through its marketplace to New Zealand-resident consumers.

Even though section 60C means App Store Co. is treated as the supplier of the app, Games Pty Ltd. can treat its supply of the app as a zero-rated supply to App Store Co. (as a separate supply to the supply that App Store Co. is treated as making). This will allow Games Pty Ltd. to deduct its GST costs incurred in making supplies of the app through App Store Co.

Example 21 – zero-rated supply of distantly taxable goods from underlying supplier to marketplace operator

Page Turners, a US-based book seller that is registered for GST in New Zealand, uses Books Marketplace, an electronic marketplace, to advertise and sell its books to customers in New Zealand. Books Marketplace sets some terms and conditions and collects payments from customers.

Books Marketplace is treated as the supplier under section 60C, and is therefore responsible for GST on the supply. If, as a result of section 60C, Books Marketplace makes supplies that exceed the registration threshold, it will be required to register and return GST on supplies of goods that are made through its marketplace to customers with a delivery address in New Zealand.

Even though Books Marketplace is treated as the supplier, under section 60(1C) Page Turners can treat its supply as a zero-rated supply to Books Marketplace (as a separate supply to the supply that Books Marketplace is treated as making). This will allow Page Turners to deduct its GST costs incurred in making supplies of books through Books Marketplace.

Repeal of residency rule for marketplace operators

159. Sections 60C(1)(b) and 60D(1)(b), which restrict the application of the marketplace rules to marketplaces operated by non-residents, have been repealed. This means that, from 1 December 2019, the marketplace rules for distantly taxable goods and remote services will apply to marketplaces operated by residents, in addition to those operated by non-residents.[19]

Example 22 – supply of distantly taxable goods through New Zealand-resident marketplace

Frances, a non-resident merchant, sells some books to Anna over an online marketplace. The entity which operates the online marketplace, NZ Marketplace, is a New Zealand resident for tax purposes.

Because the books each individually have an estimated customs value of NZ$1,000 or less, are to be delivered to an address in New Zealand and the underlying supplier of the books (Frances) is a non-resident, NZ Marketplace is treated as making a supply of distantly taxable goods under section 60C. This means that NZ Marketplace (instead of Frances) is required to return GST on the supply to Anna.

The same outcome would also apply if NZ Marketplace was a non-resident for New Zealand tax purposes. However, if Frances was a New Zealand resident, NZ Marketplace would not be responsible for GST on the supply to Anna.

Discounts provided by marketplace operators

160. New section 10(7D) contains a special valuation rule to deal with the situation where an operator of a marketplace provides discounts for remote services or distantly taxable goods that it is treated as supplying under section 60C or 60D.

161. Section 10(7D) provides that where an operator of a marketplace is deemed to make a supply of remote services or distantly taxable goods to a recipient who accepts an offer of a discount by the operator, the supply is made for the discounted price. This means that the amount of GST that the marketplace operator would be required to return on the supply would be 3/23 of the total GST-inclusive amount paid by the recipient.

[19] An implication of this is that the electronic marketplace rules will technically apply in the situation where a resident underlying supplier makes a supply of remote services through a resident marketplace, thus having the unintended effect of affecting some domestic commercial arrangements that are already covered by existing agency rules. Officials will seek to correct this in a future omnibus tax bill, so that a New Zealand-resident operator of an electronic marketplace will only be treated by section 60C as making a supply of remote services if the underlying supplier is a non-resident. The application date of the planned amendment would be 1 December 2019.

Example 23 – marketplace provides discount for distantly taxable goods sold by underlying supplier

Trev, a non-resident supplier, sells a rugby league jersey to Mali, a consumer in New Zealand. The jersey is listed on the A Co. marketplace for NZ$50 plus GST if any with free shipping. The GST-inclusive price of the jersey is therefore NZ$57.50 (NZ$50 + NZ$7.50 in GST).

A Co. offers a discount of NZ$5 on the price of the jersey, which Mali accepts at the checkout before paying for the goods. The final (GST-inclusive) price paid by Mali is therefore NZ$52.50. However, A Co. pays for the discount, so Trev still receives the GST-exclusive price of NZ$50.

A Co. is required to calculate the amount of GST on the price paid by Mali (NZ$52.50). A Co. returns NZ$6.85 in GST on the supply (being 3 ÷ 23 × NZ$52.50).

Bad debt deduction rule

162. An operator of a marketplace may collect GST on a supply it is deemed to make in one of two ways:
    - The marketplace operator arranges for the payment from the customer to be split when the payment is processed, with the amount of GST and the marketplace's facilitation fee or commission remitted to the operator, and the sale price (net of GST and the amount of the marketplace's fee or commission on the sale) remitted to the underlying supplier of the goods or services.
    - The customer may pay the underlying supplier directly, and the marketplace operator collects the GST along with its fee or commission from the underlying supplier.

163. In the second scenario, the marketplace operator may at times be unable to collect the GST from the underlying supplier. To prevent marketplace operators in this situation from being liable for GST that they are unable to collect, new section 26AA will allow them to claim a bad debt deduction if:
    - the underlying supplier fails to pass on the GST paid to them for the supply; and
    - the operator of the marketplace has written off all amounts for the supply as a bad debt, including its fee or commission on the sale.

164. Section 26AA(1) specifies that the rule would apply to a marketplace operator that is treated by section 60C or 60D as making a taxable supply of goods or services if the underlying supplier of the goods is not an associated person, and the marketplace operator:
    - charges the underlying supplier a fee for making the supply through the marketplace;
    - accounts for GST on the supply and files a return for the taxable period during which the supply was made;
    - has an agreement with the underlying supplier under which the underlying supplier is required to pay, from the consideration the underlying supplier receives from the customer, an amount that includes the GST on the supply that the marketplace operator has accounted for; and
    - the marketplace operator writes off as a bad debt the entire amount that the underlying supplier is required to pay (along with the entire amount of the marketplace's fee, if not already included in this amount).

165. Section 26AA(2) provides that the marketplace operator may deduct input tax (or account for a reduction in its output tax, if the marketplace has registered under the simplified "pay only" system, discussed at [40]) equal to the amount of GST charged on the supply.

166. In the situation where the marketplace operator recovers an amount of the bad debt that was written off in an earlier taxable period, section 26AA(3) will require the operator to account for an amount of output tax that is a fraction of the amount of the input tax deduction (or output tax reduction) claimed earlier. This fraction would be calculated by dividing the amount recovered by the total amount written off.

Example 24 – marketplace writes off amount owed by underlying supplier as a bad debt

Derek, a consumer in New Zealand, purchases a vinyl record listed on the A Co. online marketplace from Retro Audio, a non-resident supplier. The price of the record, including shipping (but excluding GST) is NZ$40.

At the online checkout, Derek provides an address in New Zealand for the goods to be delivered. Consequently, A Co. is deemed to be the supplier of the vinyl record for GST purposes. The supply of the record is a supply of distantly taxable goods subject to GST at the rate of 15%. The GST-inclusive price of the record is therefore NZ$46 (NZ$40 + NZ$6 in GST).

Instead of paying by a method that would provide A Co. with some control over the processing of the payment (such as by credit card), Derek opts to pay Retro Audio directly by internet banking transfer. A Co. has an agreement with Retro Audio that if a customer pays Retro Audio directly, Retro Audio is required to pay A Co. the amount of GST on the sale, along with A Co.'s commission of five percent on the total sale price. The amount of the debt that Retro Audio owes A Co. is therefore NZ$8.30 (NZ$6 in GST, plus commission of NZ$46 × 5% = NZ$2.30).

Retro Audio defaults in paying the debt to A Co, so A Co. writes off the full amount of NZ$8.30 as a bad debt. As A Co. returned the NZ$6 in GST on the supply to Inland Revenue in a previous GST return, A Co. is entitled to claim a bad debt deduction of NZ$6 in its GST return.

If A Co. subsequently recovered any of the debt in a later taxable period, it would be required to return output tax in its GST return for that taxable period, to the extent of the amount of the recovery. For example, if A Co. managed to collect NZ$4.15 from Retro Audio, the fraction given by section 26AA(3) would be 4.15 ÷ 8.30 = ½. A Co. would therefore be required to return NZ$3 in output tax (½ × NZ$6 = NZ$3).

If, instead of writing off the full amount as a bad debt, A Co. only wrote off a fraction of the amount as a bad debt, A Co. would not be able to claim a bad debt deduction in relation to the supply.

Redeliverers

167. Some non-resident merchants do not provide shipping of goods to New Zealand. New Zealand consumers can, however, use a redeliverer to ship or arrange the shipment of goods to New Zealand.

168. A redeliverer may be a person that provides a "mailbox" service, meaning that they provide the use of an overseas delivery address for consumers purchasing goods from offshore suppliers. These types of redeliverers would receive or collect the goods from the overseas address and deliver the goods to the consumer's address in New Zealand, or arrange the collection and delivery of the goods to the customer in New Zealand.

169. In some instances, the definition of "redeliverer" may also cover a person that provides personal shopping services to consumers in New Zealand.

170. When consumers use a redeliverer, it is likely that the merchant (or both the merchant and the marketplace operator, if the supply is made through a marketplace) is unaware of the goods' ultimate destination, and therefore cannot be expected to return GST on the supply. The new rules therefore require redeliverers to collect and return GST in this situation.

Definition of "redeliverer"

171. The definition of "redeliverer" requires that the person who is acting as a redeliverer has an arrangement with the recipient of the goods. Under this arrangement, the person either delivers the goods to New Zealand, or arranges or assists the delivery of the goods to New Zealand, and does one or more of the following:
    - provides the use of an address outside New Zealand to which the goods are delivered;
    - arranges or assists the use of an address outside New Zealand to which the goods are delivered;
    - purchases the goods outside New Zealand as an agent of the recipient; or
    - arranges or assists the purchase of the goods outside New Zealand.

172. Personal shoppers that re-sell goods to consumers in New Zealand (as opposed to purchasing goods as an agent of the customer) are not covered by the redeliverer rules as they are considered to be merchants.

Redeliverer rule

173. New section 60E sets out that a person acting as a redeliverer will be treated as supplying distantly taxable goods in the course or furtherance of a taxable activity if all the following conditions are satisfied:
    - no operator of a marketplace is treated as the supplier of the goods;
    - the merchant who sold the goods does not deliver, nor arrange or assist the delivery of the goods to New Zealand; and

- when the redeliverer is treated as the supplier of the goods, the goods that the redeliverer is treated as supplying are distantly taxable goods (meaning that the goods individually have an estimated customs value of NZ$1,000 or less[20] or, as discussed later at [292] to [309], the redeliverer has elected under new section 10C to charge GST on items with an estimated customs value above NZ$1,000).

174. This means that a redeliverer will only be treated as the supplier if neither the merchant, nor an operator of a marketplace, delivers or assists in delivering the goods to New Zealand. If either does deliver or assist in delivering the goods to New Zealand, one of these entities will be responsible for GST on the supply instead of the redeliverer. This is consistent with the policy intent that the redeliverer provisions apply in limited circumstances, where the other entities are unaware that the goods will be sent to New Zealand.

Priority rule where multiple redeliverers are involved

175. In some circumstances, more than one person may meet the definition of a redeliverer in relation to a single supply of distantly taxable goods. This would occur when more than one redeliverer is involved in an arrangement to deliver goods to a place in New Zealand. For example, one entity acting as a redeliverer may contract with another entity to purchase the goods as an agent of the consumer.

176. Section 60E(2) contains a priority rule to deal with the situation where multiple redeliverers may be liable for GST on a supply of distantly taxable goods to a consumer in New Zealand. Under this provision, the redeliverer that first enters into an arrangement with the recipient of the goods is treated as making the supply. If no such arrangement exists, the first redeliverer to enter into an arrangement with any other person acting on the recipient's behalf is treated as the supplier and therefore responsible for GST.

Special valuation rule for redeliverers' deemed supplies of goods

177. New section 10(7C) is a special valuation rule for supplies of goods treated by section 60E as being made by a redeliverer. Section 10(7C) provides that the value of a supply of distantly taxable goods by a redeliverer equals the consideration paid by the recipient for the goods before the addition of GST.

178. This rule means that the amount of GST on the supply of goods that the redeliverer would be required to return is equal to 15% of the price paid by the recipient to the supplier for the goods. This recognises that the price charged by the supplier of the goods did not include GST.

Amendment to zero-rating rules for international transportation services

179. Under the existing rules in section 11A(1) of the GST Act, the supply of international transportation and associated insurance services is zero-rated, as are services that are supplied directly in connection with moveable personal property situated outside New Zealand at the time the services are performed. This generally means that services provided by redeliverers (which would largely consist of international transportation and handling, storage and logistics provided in relation to goods that are located offshore, or the arranging or facilitation thereof) are effectively not taxed, as the supply of these services would typically be subject to GST at the rate of 0% under existing rules.

180. New section 11A(1D) provides an exception to this general rule. Section 11A(1D) sets out that paragraphs (a), (c), (cb), (d) and (f) in section 11A(1) do not apply to a supply of services provided by a GST-registered redeliverer if those services are provided in relation to distantly taxable goods that are treated as being supplied by the redeliverer. This means that the redeliverer's services would be taxed in the same way as the goods the redeliverer brings or assists in bringing to New Zealand (as any transportation or associated facilitation services provided by the redeliverer would be taxed at the rate of 15% if they are supplied in connection with a supply by the redeliverer of distantly taxable goods).

181. The value of a supply of distantly taxable goods and related transport and facilitation services by a redeliverer will therefore be equal to:
    - the consideration paid by the recipient for the distantly taxable goods before the addition of GST (meaning that the amount of GST on the goods is 15% of the price paid by the recipient for the goods, including any additional charges by the merchant for transport and insurance); plus
    - the consideration for the supply of the redeliverer's services with the addition of GST (meaning that the amount of GST on the supply of the redeliverer's services is 3/23 of the GST-inclusive price paid by the recipient).

[20] In the situation where some of the goods in the transaction have an estimated customs value of NZ$1,000 or less while other goods in the transaction are valued above NZ$1,000, the supply would be treated as two separate supplies in the manner described at [90] if the redeliverer has not made an election to treat items valued above NZ$1,000 as distantly taxable goods.

Example 25 – redeliverer providing a mailbox service

Matt, a consumer in New Zealand, contracts a redeliverer called C Co. to pick up a laptop bag from a UK address that C Co. provided to Matt and deliver it to his home address in Wellington. Matt paid NZ$40 for the bag including the amount charged by the merchant for shipping from its retail store in London to C Co.'s UK address.

When arranging for the goods to be redelivered to his Wellington address, Matt tells C Co. that he paid NZ$40 for the goods. C Co. charges NZ$15 plus GST if any for its services as redeliverer in bringing the goods to New Zealand.

As the estimated customs value of the laptop bag is less than NZ$1,000, the laptop bag is considered distantly taxable. C Co. charges Matt NZ$23.25, comprising:

- NZ$6 in GST, which is 15% of the NZ$40 Matt paid the UK supplier for the goods;
- NZ$15 for C Co.'s redelivery services; and
- NZ$2.25 in GST, which is 15% of C Co.'s GST-exclusive fee for its services.

C Co. returns NZ$8.25 in GST to Inland Revenue when it files its GST return.

Example 26 – redeliverer providing a personal shopping service

Marie is a redeliverer who regularly purchases clothes as an agent for Carolyn. Marie facilitates the delivery of the goods into New Zealand by arranging for a freight company to deliver the clothes to Carolyn's address in Oamaru. The USA merchants that sell the clothes have no role in bringing the goods to New Zealand.

Carolyn paid NZ$720 for a dress that Marie purchased as her agent. This included NZ$20 for the cost of shipping from the USA merchants to Marie's address overseas. Marie charged Carolyn NZ$40 (exclusive of GST) for her services as a redeliverer in bringing the dress to New Zealand.

As the estimated customs value of the dress is less than NZ$1,000 (being NZ$720), the dress is an item of distantly taxable goods. Marie is registered for GST and determines the supply is a taxable supply.

Marie charges Carolyn NZ$874, made up of:

- NZ$720 to reimburse Marie for the purchase of the dress (including the NZ$20 charge for delivery to Marie's USA address);
- NZ$108 in GST, which is 15% of the NZ$720 Carolyn paid for the dress;
- NZ$40 for Marie's facilitation and delivery services; and
- NZ$6 in GST, which is 15% of Marie's NZ$40 GST-exclusive fee for her services.

Marie returns NZ$114 in GST to Inland Revenue when she files her GST return.

New Zealand-resident agents

182. Amended section 60(1A) and 60(1AB) allows New Zealand-resident agents acting for non-residents that supply distantly taxable goods to consumers to agree with the non-resident principal to treat the agent (and not the principal) as making the supply in the course and furtherance of a taxable activity carried on by them.

183. If this option is exercised, the agent would be required to register and return GST on the supplies of distantly taxable goods. Since the agent is a New Zealand resident they would be treated as any other resident supplier of goods and services and, therefore, would be required to return GST on both supplies to New Zealand consumers and GST-registered businesses.

Example 27 – New Zealand-resident agent treated as making supply of distantly taxable goods

Agent Co., a New Zealand resident, sells low-value imported goods to consumers in New Zealand on behalf of Principal Co., a non-resident merchant. Agent Co. and Principal Co. agree that Agent Co. will be treated as making the supplies of distantly taxable goods.

Assuming the supplies made by Agent Co. exceed the NZ$60,000 registration threshold, Agent Co. is now required to register and return GST on behalf of Principal Co. in relation to supplies to both New Zealand consumers and GST-registered businesses.

Preventing double taxation

(Sections 12(1B), (1C), 12B, 20(3)(dd), 24BAB, 24BAC and 25(1)(bb))

Changes to the customs de minimis

184. To simplify border processes and reduce the risk of potential double taxation occurring under the new legislation applying to distantly taxable goods, the Government is proposing changes to the Customs and Excise Regulations 1996. The changes consist of:

- increasing the de minimis (the threshold below which GST and other duties are not collected by Customs at the border) from NZ$60 of duty owing to a consignment with a customs value over NZ$1,000; and
- removing the Import Entry Transaction Fee (IETF) and associated Biosecurity System Entry Levy (BSEL) from consignments with a customs value of NZ$1,000 or less.

185. This means that from 1 December 2019, Customs will collect GST and other duties, as well as the IETF and associated BSEL on imported consignments valued above NZ$1,000, but will not collect these charges on consignments valued at or below NZ$1,000.[21]

186. However, requiring merchants, marketplaces and redeliverers to collect GST on imported goods individually having an estimated customs value of NZ$1,000 or less – while Customs collects GST on consignments valued over NZ$1,000 – nonetheless creates the potential for double taxation to occur in some situations. For example, a single consignment could be valued over NZ$1,000, but contain an item or items that, individually, have an estimated customs value of NZ$1,000 or less.

187. Double taxation could also potentially arise if goods are sold in a foreign currency and the exchange rate used by the supplier at the time of supply to determine whether the goods are distantly taxable goods differs from that used by the customs broker when completing the import entry. Rules and processes, including requirements for suppliers to provide certain information about GST, are therefore required to prevent double taxation, as well as relieve double taxation in the rare event that it occurs. This section explains how these rules and processes will operate.

Exception to the collection of GST on importation

188. Under new section 12(1B) and (1C), Customs will not collect GST on items imported in consignments with a combined value over NZ$1,000 if GST has been charged on the item at the point of sale – provided that Customs is notified that GST has already been paid. Customs will still collect other duty, such as tariff duty, and the IETF and associated BSEL on consignments over NZ$1,000 if GST has already been charged on all the goods in the consignment at the point of sale, including GST applying to the tariff duty, IETF and BSEL.

189. Section 12(1B) sets out that for Customs' purposes of collecting GST on imported goods at the border, the value of distantly taxable goods does not include the following:

- the value of the goods determined in accordance with Schedule 4 of the Customs and Excise Act 2018;
- the amount paid or payable for transport of the goods to New Zealand and associated insurance; and
- the amount of levy paid or payable on goods under the Climate Change Response Act 2002.

190. This means that if GST was charged on an item at the point of sale, Customs will not collect GST again on the value of the item or on the amount charged for freight and insurance, but will collect GST on any tariff duty applying to the item if the item is imported in a consignment valued over NZ$1,000.

191. In order for Customs to identify whether GST has already been charged on an item, the information available to Customs at the time the goods are imported needs to sufficiently identify the items in the consignment on which tax was charged at the point of sale, as well as the name and GST registration number of the registered person who is responsible for returning GST on the supply to Inland Revenue.

[21] As mentioned earlier, consignments containing alcohol and tobacco products are not subject to the de minimis, so Customs will continue to collect GST and excise taxes on these products regardless of their value.

Example 28 – consignment of distantly taxable goods with total value above NZ$1,000

Jason purchases a phone for NZ$900 and noise cancelling headphones for NZ$200 (excluding GST) from Kim's Phone Warehouse, a GST-registered non-resident supplier. As both items individually have an estimated customs value below NZ$1,000, Kim's Phone Warehouse treats the goods as distantly taxable and charges Jason GST on both the phone and the headphones.

The phone and headphones are sent to Jason in a single package with a customs value of NZ$1,100. As the consignment is over NZ$1,000, Customs will stop the consignment for revenue collection and collect the Import Entry Transaction Fee and associated Biosecurity System Entry Levy (total fees of NZ$55.71). However, provided that evidence is made available to Customs in the approved form that GST was already collected by Kim's Phone Warehouse on both the phone and the headphones, Customs will not collect GST on either of the two items in the consignment.

Example 29 – distantly taxable goods subject to tariff duty imported in consignment over NZ$1,000

Fi purchases two designer label dresses from Snazzy Dresses, a non-resident merchant offering free shipping for orders over NZ$1,000. One dress is priced at NZ$400 while the other is priced at NZ$1,100 (plus GST if any).

Snazzy Dresses is registered for GST and charges GST on the supply of the NZ$400 dress to Fi (as the supply of the NZ$400 dress is a taxable supply of distantly taxable goods, but the NZ$1,100 dress is not an item of distantly taxable goods).

The dresses are sent to Fi in a single package with a customs value of NZ$1,500. As the consignment is over NZ$1,000, Customs will stop the consignment for revenue collection and collect the Import Entry Transaction Fee and associated Biosecurity System Entry Levy of NZ$55.71. Evidence is made available to Customs in the approved form that GST was already collected by Snazzy Dresses on the NZ$400 dress, so Customs only collects GST on the NZ$1,100 dress of NZ$165 (NZ$1,100 × 15% = NZ$165).

However, because both dresses are subject to tariff duty of 5%, Customs will also collect tariff duty (including GST applying to the tariff duty) on both dresses. The amount of the tariff duty excluding GST is NZ$75 (NZ$1,500 × 5% = NZ$75) and the amount of GST applying to the tariff duty is NZ$11.25 (NZ$75 × 15% = NZ$11.25).

The total amount that Fi will pay to Customs is NZ$306.96 (NZ$55.71 in cost recovery charges + NZ$165 in GST on the NZ$1,100 dress + NZ$75 in tariff duty excluding GST + NZ$11.25 in GST on the tariff duty).

Example 30 – difference in exchange rate used by supplier and that used by Customs

Fi later purchases a 60" ultra-high definition television for AU$950 from Earl's Electronics, a non-resident merchant. At the time of sale, Earl's Electronics estimates that the customs value of the television is NZ$998.41, based on a "buy NZD" exchange rate of AU$0.9515 / NZ$1. As the estimated customs value at the time of supply is below NZ$1,000, Earl's Electronics charges Fi GST at the point of sale.

When completing the import documentation, the customs broker converts the AU$950 figure to New Zealand dollars using the exchange rate published by Customs of AU$0.9307 / NZ$1. Based on this exchange rate, the customs broker calculates the customs value to be NZ$1,020.74 and enters this as the value in the import entry.

As the customs value of the consignment is above NZ$1,000, Fi is required to pay the Import Entry Transaction Fee and associated Biosecurity System Entry Levy of NZ$55.71. However, as evidence was made available to Customs in the approved form that GST was already collected by Earl's Electronics, Customs will not collect GST.

Receipt requirement

192. New section 24BAB requires suppliers to issue receipts for supplies of distantly taxable goods if the supplier has charged GST at the rate of 15% on the supply. The purpose of this requirement is to provide the recipient of the supply with a document that they can provide to Customs as evidence that GST was charged at the point of sale, so that Customs does not collect GST again when the goods are imported into New Zealand.

193. The requirement to provide a receipt is not the sole mechanism for preventing double taxation under the new rules. Rather, it serves as a back-up safeguard against double taxation in the situation where the primary mechanism (discussed below at [203] to [210]) either fails or, in some cases, may not be feasible under current systems.

Particulars required to be included in the receipt

194. Unless alternative particulars are agreed with the Commissioner of Inland Revenue, section 24BAB requires that the receipt contains the following:

- the name and registration number of the supplier;
- the date of the supply;

- the date of issue of the receipt (if different from the date of the supply);
- a description of the goods supplied;
- the consideration for the supply and the amount of tax included;
- information indicating the items for which tax has been charged; and
- information indicating the items that have not had tax charged.[22]

195. If GST has been charged on all of the goods included on the receipt, the last two requirements can be met by including the total GST-inclusive price and stating that this price includes GST (or alternatively by including the amount of GST for each of the goods). However, if GST was charged on only some of the goods supplied, these requirements can be met by including the amount of GST for each of the goods.

196. The amounts shown on the receipt are not required to be in New Zealand dollars.

Option to issue a document that meets the requirements of both a receipt and a full tax invoice

197. Under the special rule in new section 8(4F) (explained later at [310] to [317]), some non-resident suppliers of distantly taxable goods may opt to proactively issue a full tax invoice for all supplies of distantly taxable goods that they make, regardless of whether the customer is a private consumer or a GST-registered business using the goods in its taxable activity.

198. The benefit of this is the non-resident supplier can issue a single document to its New Zealand customers that meets the requirements of both a full tax invoice and a receipt required to be issued to a consumer for a supply of distantly taxable goods, provided the conditions of section 8(4F) (including the requirement that the value of the supply is NZ$1,000 or less) are met.

199. The requirements of a full tax invoice are broadly similar to those set out in section 24BAB(2) for a receipt required to be issued to a consumer for a supply of distantly taxable goods – the main differences being the requirements for a tax invoice to include the words "tax invoice" in a prominent place, the name and address of the recipient and the quantity or volume of the goods and services supplied.

200. The table below sets out the respective requirements of a full tax invoice under section 24(3) and of a section 24BAB receipt.

	Section 24BAB receipt	Tax invoice
Words "tax invoice"	No	Yes
Name of the supplier	Yes	Yes
Registration number of the supplier	Yes	Yes
Name and address of the recipient	No	Yes
Date of supply	Yes	No
Date of issue	Yes	Yes
Description of goods	Yes	Yes
Quantity or volume of goods supplied	No	Yes
Amount of consideration	Yes	Yes
Amount of tax included	Yes – but see footnote 22	Yes – unless the total amount of tax is 3/23 of the consideration, in which case a statement that the consideration includes a charge in respect of tax is sufficient
Indication of which items had GST charged	Yes	No

10-day requirement for issue of receipt

201. Section 24BAB requires that a receipt (or combined tax invoice and receipt) as described above is issued to the recipient at the time of supply. However, if the supplier has not issued a receipt at the time of supply and the recipient requests a receipt, the supplier would be required to issue one within 10 business days after the request.

202. Under new section 143A(1)(fb) of the Tax Administration Act 1994, a supplier who knowingly fails to issue a GST receipt within ten business days of such a request commits a knowledge offence, for which penalties (both civil and criminal) may apply.

[22] Officials will seek to include an amendment in a future taxation bill so that the supplier is not required to state the amount of tax included on the receipt, as this requirement does not appear to be necessary given the last two requirements in this list. The suggested amendment would be retrospective to 1 December 2019.

GST information to be included on import documents

203. In addition to the requirement outlined above to issue GST receipts, new section 24BAC requires suppliers of distantly taxable goods to take reasonable steps to ensure that relevant GST information is available to Customs at the time of importation of the goods.

204. That information consists of:

- the name and registration number of the supplier;
- information indicating which items in the consignment have had GST charged at the point of sale at the rate of 15%, if applicable; and
- information indicating the items in the consignment for which the amount of GST is zero.

205. If GST was not charged on some items in the transaction, these items must be identified to meet the above requirements. This would allow the new rules in section 12 that prevent double taxation to operate effectively, as GST on importation will only be "switched off" if GST has been charged on the item at the point of sale.

What "reasonable steps" means for merchants and marketplaces that fulfil orders, and redeliverers

206. For non-mail items (goods brought to New Zealand through the freight channel), a supplier who is either the merchant that sold the goods, a redeliverer, or an operator of a marketplace undertaking the fulfilment[23] of the order from the customer, would meet the requirement to take reasonable steps by:

- providing the GST information listed above to the transporter or customs broker in the country of export (one way that the supplier could do this is by including the receipt or tax invoice for the goods in the commercial documentation provided to the transporter or customs broker); and
- asking the transporter or customs broker in the country of export to make sure the information is provided to the transporter or customs broker in New Zealand that will complete the import documentation on behalf of the importer.

What "reasonable steps" means for marketplaces that do not fulfil orders

207. The "reasonable steps" requirement differs somewhat for an operator of a marketplace who is treated as making a supply of distantly taxable goods in the situation where the order is fulfilled by the underlying supplier. In this situation, the marketplace operator would meet the reasonable steps requirement by including GST information on commercial documentation and instructing the underlying supplier to pass this information through the logistics chain on their behalf. As above, this requirement would only apply in relation to non-mail items.

Role of transporters and customs brokers

208. The transporter or customs broker completing the import documentation would report the GST information provided by the supplier or merchant into the Trade Single Window. Transporters and customs brokers only need to report this information into the Trade Single Window if it is provided to them. If this information is not provided, they are not required to take extra steps to source this information and will still be able to report the goods into the Trade Single Window for customs clearance.

209. A field for the supplier's GST registration number will be added into the Trade Single Window. The required format of the number is nine digits as a single string without separators.

210. The information about which goods have and have not had GST charged at the point of sale will be reported into the Trade Single Window by way of a "GST paid" indicator. The format of this indicator is a "Yes" (Y) or "No" (N) response.

Goods brought to New Zealand by international post

211. Current systems may not fully accommodate the transmission of information relating to goods delivered to New Zealand by international post. Therefore, issuing the customer a receipt (as required under section 24BAB) will be sufficient in the meantime to meet the reasonable steps requirement.[24]

[23] "Fulfilment" of an order is used here in reference to the party (merchant or marketplace operator) that ships or arranges the shipping of the goods to the customer.

[24] What will constitute reasonable steps in relation to mail items might change in the future, owing to the increased availability of electronic advance data in the international postal network that is expected to occur over the next few years.

212. In the situation where the value of the consignment is over NZ$1,000, the consumer should hire a customs broker to complete the import documentation and arrange the clearance of the goods. To ensure that GST is not paid twice on the same goods, the consumer should provide their receipt to the customs broker as evidence that GST was charged at the point of sale.[25]

Penalties for knowingly failing to take reasonable steps

213. Under new section 143A(1)(fc) of the Tax Administration Act 1994, a supplier would commit a knowledge offence if they knowingly fail to take reasonable steps to ensure that tax information is available to Customs at the time the goods are imported. Administrative penalties under the Customs and Excise Act 2018 may also apply in relation to an error or omission in an import entry that has been lodged with Customs.

Refunds when double taxation occurs

214. Where the relevant GST information is not available to Customs, GST will be collected on importation by Customs on the entire value of a consignment over NZ$1,000 (as determined in accordance with existing section 12(2)). If some or all the goods in the consignment have already had GST charged at the point of sale, the consumer will need to request a refund of the GST from the supplier.

215. If a consumer requests a refund of the GST charged by the supplier, and the supplier has received a declaration from the recipient or some other confirmation that GST was paid on importation, the supplier will be required to issue a refund of the GST that was charged on the supply (new section 12B). If the supplier complies with this requirement, new section 25(1)(bb) allows the supplier to subtract the amount of GST refunded from its output tax (GST payable) in its GST return.

Mistakes where GST has been incorrectly charged on a supply

216. New sections 12B and 25(1)(bb) would also apply in the situation where a supplier has incorrectly charged GST on a supply of imported goods that is not a supply of distantly taxable goods (for example, because the goods individually have estimated customs values above NZ$1,000). This means that a supplier in this situation will be required to refund the GST they charged if the recipient has requested a GST refund and the supplier has received a declaration from the recipient (or some other confirmation that GST was paid on the importation of the goods).

217. As above, the supplier will only be entitled to make the adjustment under section 25(1)(bb) if:

- they have reimbursed the recipient for the GST charged; and
- the supplier has received a declaration from the recipient or other confirmation that GST was paid to Customs on importation.

Non-double taxation rule

218. New section 20(3)(dd) prevents double taxation from arising on supplies of distantly taxable goods by allowing a deduction that offsets the supplier's liability for GST in New Zealand, to the extent that the supply is subject to a consumption tax in another jurisdiction.

219. Section 20(3)(dd) provides a deduction for the New Zealand GST charged when:

- there is a supply of distantly taxable goods to a person in New Zealand who is not a GST-registered person; and
- the supplier has, in relation to the supply, incurred liability for, returned and paid a consumption tax in another jurisdiction.

220. The deduction is limited to the GST paid on the supply in New Zealand (15%) and to the extent tax is returned and paid in the other country.

[25] This recommendation also applies in the situation where GST information required to be provided by the supplier in relation to goods imported by freight has not been passed on to the person completing the import documentation. In other words – assuming the consumer was charged GST by the supplier and obtained a receipt – the consumer should provide their receipt to the carrier or customs broker when they are contacted by the carrier or broker to arrange clearance of the goods to avoid paying GST twice.

Example 31 – non-double taxation rule in section 20(3)(dd)

Mike, a consumer in New Zealand imports some shirts from a supplier based in Country A, who ships the goods from its warehouse in Country A. The supplier is registered for VAT in Country A and is also registered for GST in New Zealand.

In order for the supplier to charge Country A's VAT at a rate of zero percent on the supply to Mike, VAT legislation in Country A requires the supplier to export the goods within 21 days of the date of the supply. The supplier does not manage to export the goods within this timeframe and is therefore required to charge Country A's VAT at the rate of 20%. In addition, the goods are all distantly taxable goods, so the supplier is also required to charge New Zealand GST at the rate of 15% on the supply.

The non-double taxation rule in section 20(3)(dd) allows the supplier to make an input tax deduction up to the amount of New Zealand GST returned on the supply (15%) if the supplier has returned and paid VAT to Country A.

If Country A's VAT rate was instead 10%, the supplier would only be entitled to an input tax deduction of 10%.

Vouchers

(Section 5(11G))

221. In the situation where a face value token, stamp or voucher is redeemed for distantly taxable goods or remote services, new section 5(11G)(a) clarifies that the supplier of the token, stamp or voucher may treat the supply of goods and services that the token, stamp or voucher is redeemed for as the relevant supply for GST purposes. This means that the seller of a face value voucher would have the option of treating GST as applying on the redemption of the voucher, if the voucher is (or could be) redeemed for remote services or distantly taxable goods. This option to treat the supply as arising on the redemption of the voucher would apply regardless of whether the issuer or seller of the voucher is a different person to the supplier of the goods and services that the voucher is redeemed for.

222. The introductory wording of section 5(11G) has been amended to clarify that if GST is payable on the redemption of a voucher, the party redeeming the voucher for goods and services (or treated as making the supply of goods and services) is responsible for returning the GST.

Example 32 – seller of voucher opts to use redemption basis

Wendy purchases a voucher with a face value of NZ$50 from A Co. as a gift for her son Karl who lives in Dunedin, New Zealand. The voucher can be redeemed with any merchant on the A Co. marketplace.

A Co. chooses to treat the supply for GST purposes as arising on the redemption of the voucher (instead of the sale of the voucher). This means that GST will apply when Karl redeems the voucher for goods and services, and not on the sale or issue of the voucher itself.

Karl redeems the voucher with a non-resident merchant on the A Co. marketplace by purchasing NZ$50 worth of distantly taxable goods. Because A Co is treated by section 60C as the supplier of the goods, it is required to return NZ$6.52 in GST (3 ÷ 23 × NZ$50 = NZ$6.52) on the redemption of the voucher.

If A Co. was not treated as the supplier, the underlying supplier would (if registered for GST or required to register for GST) instead be required to return GST on the supply.

Converting foreign currency amounts to New Zealand dollars

(Sections 77(2), (3) and (5))

223. Generally, the GST Act requires all amounts to be expressed in New Zealand currency at the time of supply. This means that if a supply is paid for in a foreign currency, the value of the supply must be expressed as the amount of foreign currency converted to New Zealand currency at the exchange rate applying at the time of supply.

224. Section 77(2) has been amended to provide non-resident suppliers of distantly taxable goods with the option of expressing amounts in a foreign currency at the time of supply.

Currency conversion to determine whether GST applies

225. In accordance with new section 77(5), suppliers of distantly taxable goods may use the spot exchange rate applying at the time of supply, or a currency conversion method approved by the Commissioner of Inland Revenue when determining the value of goods under section 10B. The method approved by the Commissioner for this purpose is set out below.

226. Under the approved method, a supplier may use any one of the following exchange rates:
    - the rate published by the New Zealand Customs Service;
    - the Reserve Bank of New Zealand (RBNZ) rate, or a reference rate published by another central bank;[26]
    - an exchange rate provided by a foreign exchange organisation[27] or foreign exchange data vendor.
227. "Exchange rate" for these purposes means the unit of foreign currency per New Zealand dollar, which has been published within 30 calendar days of the conversion time. If a rate other than the most recently published rate is used, the practice for sourcing the rate must be consistent.
228. Other than the requirement that a supplier's chosen exchange rate be used consistently (discussed below), there are no restrictions on the specific type of exchange rate (sell NZD, buy NZD, or midpoint rate) that suppliers may use for converting foreign currency amounts. This means that suppliers would have a choice of using a sell NZD rate, a buy NZD rate or a midpoint rate when converting foreign currency amounts to establish whether GST applies.

Currency conversion formula

229. In working out the estimated customs value of goods, suppliers can convert foreign currency to New Zealand dollars using the following formula:

    (Amount expressed in a foreign currency) ÷ (the supplier's chosen exchange rate on the conversion day)

Sourcing exchange rates and updating business systems

230. A supplier may adopt a practice of updating their business systems with the particular rate they have chosen from the source data according to a schedule set by them. This schedule must be consistent in terms of the frequency and time of setting the rate. The maximum period permitted under such a schedule is 30 calendar days. A supplier cannot test and select a more favourable exchange rate at other times, or decide not to accept the published rate at the scheduled time of setting.
231. A supplier may only change their exchange rate or their schedule for sourcing and updating the exchange rate in their systems if they have sound commercial reasons for doing so. For instance, if a supplier changes the exchange rate they use with the purpose of affecting whether goods are distantly taxable, the supplier will not have used the rate consistently and, accordingly, will not have followed the currency conversion method approved by the Commissioner. However, different exchange rates may be used for distinct parts of the supplier's business, provided the exchange rate chosen for each respective part of the business is used consistently within that part.

Example 33 – supplier using exchange rate published by New Zealand Customs

Pilko's Phones & Electronics (Pilko) is a non-resident merchant that supplies consumer electronics such as tablets and mobile phones. It prices goods in USD. Pilko is registered for GST in New Zealand under the rules applying to supplies of distantly taxable goods.

To determine the estimated customs value of an item at the time of sale, Pilko has its point of sale systems set up to convert USD to NZD using the exchange rate published by the New Zealand Customs Service.

Customs publishes its exchange rates fortnightly, 11 calendar days in advance of when they come into effect. Pilko has a practice of sourcing the most recently published exchange rate and updating the exchange rate in its point of sale systems seven days after the exchange rate was published on the Customs website.

This currency conversion method is Commissioner-approved. The schedule set by Pilko for sourcing the exchange rate and updating its systems is consistent in terms of its frequency and time of setting the rate. The time between setting the previous rate and updating the rate is 14 calendar days (within the 30-day maximum). Under Pilko's schedule, the maximum possible length of time between the publication date and the time of conversion is 21 calendar days. This is within the 30-day maximum.

[26] "Another central bank" refers to a central bank or monetary authority outside New Zealand that exercises functions that correspond with, or are similar to, the RBNZ. This would include organisations such as the Reserve Bank of Australia, the Federal Reserve and the European Central Bank.

[27] A "foreign exchange organisation" means an organisation that provides exchange rates publicly.

Example 34 – supplier using midpoint exchange rate published by retail bank

Witte Fashion Co. (Witte) is a non-resident merchant that supplies high-end clothing. It prices goods in AUD. Witte is registered for GST in New Zealand under the rules applying to supplies of distantly taxable goods.

To determine the estimated customs value of an item at the time of sale, Witte has its point of sale systems set up to convert AUD (being the currency the goods Witte sells are priced in) to NZD using a mid-point rate published by a bank.

The bank publishes the close-of-trading foreign exchange rates from the previous day each morning (except for Saturdays and Sundays). Witte has a practice of sourcing the most recently published exchange rate and updating the exchange rate in its point of sale systems once every four weeks on a Tuesday.

This currency conversion method is Commissioner-approved. The schedule set by Witte for sourcing the exchange rate and updating its systems is consistent in terms of its frequency and time of setting the rate, and the time between setting the previous rate and updating the rate is 28 calendar days (within the 30-day maximum). Under Witte's schedule, the maximum possible length of time between the publication date and the time of conversion is 28 calendar days. This is within the 30-day maximum.

Example 35 – currency conversion to determine whether goods are distantly taxable

Consider Witte Fashion Co. (Witte) in the previous example. Witte sells a suit valued at AU$880 to Gordon, plus AU$50 for shipping to Gordon's address in Wellington, New Zealand.

At the time of the sale, the midpoint exchange rate used in Witte's systems for estimating the customs value of items sold is AU$0.9270 to NZ$1. Based on this, Witte determines that the estimated customs value of the suit in New Zealand dollars is NZ$949.30 (AU$880 / AU$0.9270 = NZ$949.30).

As the estimated customs value is less than NZ$1,000, the suit is distantly taxable. Witte charges Gordon GST of AU$139.50 (AU$930 × 15%).

Currency conversion when determining the amount of GST payable

232. When converting foreign currency amounts to New Zealand dollars to determine the amount of GST required to be returned, section 77(3) provides that a supplier can use the conversion rate applying on either:
    - the last day of the relevant taxable period;
    - the date the supplier files their return for the relevant period (or the due date for filing, if the return is filed past the due date); or
    - another date as agreed with the Commissioner of Inland Revenue.

233. If the supplier elects to use an option other than expressing amounts in New Zealand currency at the time of supply, they may not change their method for a period of 24 months, unless they agree otherwise with the Commissioner.

Example 36 – currency conversion to determine amount of GST to be returned in New Zealand dollars

Consider Witte Fashion Co. (Witte) again. At the time of preparing its GST return, Witte determines that the total amount of GST it charged for the most recent taxable period is AU$9,000.

Witte has elected to use the exchange rate applying on the date that it files its GST return to determine the amount of GST to be returned to Inland Revenue in New Zealand dollars. The exchange rate applying on the date that Witte files its return is AU$0.9294 / NZ$1.

The amount of GST returned by Witte in its GST return is NZ$9,683.67 (AU$9,000 / AU$0.9294 = NZ$9,683.67).

Witte must use this method for 24 months. It must convert GST from AUD to NZD on the date it files each GST return (or the due date if a return is filed late).

Methods for electronic marketplaces and redeliverers to determine GST treatment of supplies (Sections 60F and 60G)

234. As discussed earlier at [137] and [173], new sections 60C and 60E treat operators of electronic marketplaces and redeliverers as supplying goods that are actually sold by third party merchants, but only if the goods are destined for a delivery address in New Zealand, and – in the specific case of marketplace operators – if the underlying supplier of the goods is a non-resident.

235. In some situations, an electronic marketplace operator or redeliverer may not have the precise information that is required to determine the GST treatment of a supply of goods, as this information may only be available to the underlying supplier and/or the recipient. In these situations, the electronic marketplace operator or redeliverer will need to rely on information collected from the underlying supplier or the recipient to determine the GST treatment of these supplies.

236. New section 60G sets out a range of methods for redeliverers and operators of electronic marketplaces to use when determining if they are the supplier of distantly taxable goods under section 60C, and/or the amount of GST required to be returned on a supply of distantly taxable goods. These methods (which are all based on information that may be commercially available to redeliverers or operators of electronic marketplaces) are explained below.

Electronic marketplaces – methods for determining residency of underlying suppliers

237. An operator of an electronic marketplace that does not know the residency of an underlying supplier[28] is required by section 60G(3) to treat the underlying supplier as a non-resident, unless the marketplace operator has any of the following:

- information that the underlying supplier is a company that is incorporated in New Zealand or has its centre of management in New Zealand (see section 60G(3)(b)(i));
- a New Zealand business number for the underlying supplier (see section 60G(3)(b)(ii)); or
- at least two of any of the following items of information that support the conclusion that the underlying supplier is a New Zealand resident (see section 60G(3)(b)(iii) and (6)):
  - an address of a physical location for the underlying supplier, such as a mailing or billing address;
  - a New Zealand GST registration number for the underlying supplier;
  - bank details (including the account the underlying supplier uses for making payments, or the billing address held by the bank, or the account to which the marketplace operator makes payments of amounts owed to the underlying supplier);
  - the internet protocol (IP) address of the device used by the underlying supplier or another geolocation method;
  - the mobile country code of the international mobile subscriber identity stored on the subscriber identity module (SIM) card used by the underlying supplier;
  - the location of the underlying supplier's fixed land line;
  - the location from where the goods are shipped; or
  - other commercially relevant information.

238. It might be the case that neither of the first two proxies indicate that the underlying supplier is resident in New Zealand, but the evidence under the third proxy is mixed (that is, the marketplace operator has more than one set of information listed under section 60G(6), where one set indicates that the underlying supplier is resident in New Zealand and the other set indicates that the underlying supplier is a non-resident). In this situation, the marketplace operator is required to choose the more reliable set of evidence. Which specific items of evidence are considered to be more reliable will depend on the circumstances.

[28] In some cases, a marketplace operator may already know with absolute certainty the residency status of an underlying supplier, or may otherwise have good reasons to consider that the underlying supplier is very unlikely to be a tax resident of New Zealand. In such cases, the marketplace operator will not need to take steps to determine the underlying supplier's residency status. For example, some marketplaces may only list goods offered for sale by merchants based in a particular geographic region. In other cases, the underlying supplier may be a related entity of the marketplace operator, or there may be publicly available information about the underlying supplier from which a clear conclusion about the tax residency status of the underlying supplier can be drawn (for example, the underlying supplier is a company that was incorporated in New Zealand, and therefore will be a New Zealand resident under the GST Act).

Example 37 – methods for determining residency of underlying supplier

Gardening Tools Co. sells a pair of gardening gloves to Maraina over the A Co. marketplace. Maraina provides a New Zealand delivery address at the checkout.

A Co. does not have any information that would suggest that Gardening Tools Co. is a New Zealand resident for tax purposes. The mailing and billing address, IP address and bank details that A Co. has for Gardening Tools Co. all suggest that Gardening Tools Co. is resident in the United States. A Co. also has information that the goods are shipped from China.

Without there being any information that would lead A Co. to conclude that Gardening Tools Co. is a New Zealand tax resident using any of the three proxies listed under section 60G(3), A Co. is required to treat Gardening Tools Co. as a non-resident (meaning that A Co. is responsible for returning GST on supplies made on its marketplace by Gardening Tools Co. to consumers in New Zealand, including the supply of gardening gloves to Maraina).

If A Co. had either a New Zealand business number for Gardening Tools Co. or information that Gardening Tools Co. is a New Zealand-incorporated company, A Co. would be required to treat Gardening Tools Co. as a New Zealand resident (meaning that A Co. would not be responsible for returning GST on supplies made by Gardening Tools Co). Alternatively, if Gardening Tools Co. had at least two pieces of non-contradictory information listed under section 60G(6) (such as a mailing or billing address or bank details) indicating that Gardening Tools Co. is a New Zealand resident, and did not have two or more pieces of information leading to the opposite conclusion and which are considered to be more reliable, A Co. would be required to treat Gardening Tools Co. as a New Zealand resident.

Exception to electronic marketplace rule for underlying suppliers that are both resident and non-resident

239. New section 60C(2C) contains a limited exception to the electronic marketplace rule in section 60C. Section 60C(2C) provides that an operator of an electronic marketplace will not be treated as the supplier of goods sold by a non-resident underlying supplier if all the following conditions are met:

- the underlying supplier of the goods is a non-resident for income tax purposes that has a branch in New Zealand;
- the operator of the marketplace treats the underlying supplier as a New Zealand resident in relation to the supply (meaning that the operator does not return GST on the supply); and
- in treating the underlying supplier as a New Zealand resident, the operator of the marketplace relies on a method for determining the underlying supplier's residency that is set out in section 60G, or on an alternative method agreed with or prescribed by the Commissioner under section 60G(7) (discussed at [248]).

240. This exception ensures that the underlying supplier is liable for GST where the marketplace operator has used a section 60G method to determine that it is not the supplier of the goods for GST purposes.

Example 38 – non-resident underlying supplier with New Zealand branch treated by marketplace as resident

Clothes 'N' Stuff Pty Ltd is an Australian-incorporated company that is non-resident for income tax purposes. It sells goods in New Zealand through its retail outlet in Auckland. Because it has a retail outlet in Auckland through which it carries on a taxable activity, Clothes 'N' Stuff is treated as a New Zealand resident for GST purposes to the extent of the activity carried on through the Auckland retail outlet and accordingly is registered for GST in New Zealand.

Clothes 'N' Stuff also sells goods to customers in Australia and New Zealand through the A Co. online marketplace. In most cases the goods are shipped directly from a warehouse in Sydney, but in some cases goods sold to a New Zealand customer may instead be sourced from the retail outlet in Auckland in order to provide faster delivery times.

A Co. has on record a New Zealand GST registration number for Clothes 'N' Stuff, as well as the physical address of the Auckland retail outlet and the fixed landline number for the Auckland retail outlet. On the basis of the information that it holds and in accordance with the requirements in section 60G, A Co. determines that Clothes 'N' Stuff is a New Zealand resident for GST purposes. A Co. therefore does not collect and return GST on Clothes 'N' Stuff's supplies to consumers in New Zealand.

Although Clothes 'N' Stuff is likely to be a non-resident in relation to most of the supplies it makes through the A Co. marketplace (insofar as this sales activity is unrelated to the Auckland retail outlet), the liability for New Zealand GST on any supplies of distantly taxable goods to consumers in New Zealand would remain with Clothes 'N' Stuff. This is because section 60C would not apply to treat A Co. as the supplier of the goods (owing to the exception in section 60C(2C)).

Electronic marketplaces – proxies for determining if delivery address is in New Zealand

241. While it is expected that operators of electronic marketplaces will generally have information about the delivery address for a supply of goods, there may be some instances where the recipient of the goods does not provide the delivery address through the marketplace but instead communicates with the underlying supplier through another medium. In this situation, the best that an operator of an electronic marketplace may be able to do is to rely on proxies for determining the country or territory that the recipient's delivery address is most likely to be in, based on the information that it does have.

242. Under section 60G(4) and (6), an electronic marketplace operator that does not know the address to which the goods are to be delivered is required to determine whether a supply of goods is made to the recipient at a place in New Zealand on the basis of two non-conflicting pieces of evidence (similar to the rule in section 60G(3)(b)(iii) for determining the residency of an underlying supplier and in section 8B(2) for remote services).

243. Section 60G(6) provides a list of indicators that can be used for these purposes:

- an address of a physical location for the recipient, such as a mailing or billing address;
- bank details (including the account the recipient uses for making payments, or the billing address held by the bank, or the account to which the marketplace operator makes payments of amounts owed to the recipient, if applicable);
- the internet protocol (IP) address of the device used by the recipient or another geolocation method;
- the mobile country code of the international mobile subscriber identity stored on the SIM card used by the recipient;
- the location of the recipient's fixed land line;
- other commercially relevant information.

244. Electronic marketplace operators can use one or more pieces of other commercially relevant information to determine whether a person is located in New Zealand, rather than using the specific indicators listed. This information may include the recipient's trading history (such as a previous billing address) or the product purchased if it is linked to a geographic location (for example, some vouchers may only be used in a particular country). Information provided by a third party, such as by a payment service provider, may also be used.

245. Section 60G(4)(a)(ii) contains a tie-breaker rule to address the situation where the marketplace operator has more than one set of evidence that meets this test, where one set supports the conclusion that the recipient is located in New Zealand and the other supports the opposite conclusion. In this situation, the marketplace operator is required to choose the more reliable set of evidence.

Example 39 – method for determining location of recipient

Dave purchases a GPS from an Australian merchant over the Electronic Marketplace Co platform. Dave has not provided his delivery address to the merchant through the Electronic Marketplace Co platform, but instead provided his delivery address to the merchant via email.

Electronic Marketplace Co collects two pieces of evidence that support the conclusion that Dave is located in New Zealand – his credit card information and the records of his delivery addresses from his purchase history on Electronic Marketplace Co over the past year.

Electronic Marketplace Co also has two pieces of evidence that suggest Dave is located in the United States – his IP address and a landline phone number (the latter of which has not been updated in Dave's trader profile since 2016). Section 60G(3) requires Electronic Marketplace Co to use the set of evidence that is more reliable to determine whether GST applies in New Zealand.

Electronic Marketplace Co has implemented system rules that give priority to its customers' transaction history and credit card information, as these indicators are more reliable in the context of their business. On this basis, Electronic Marketplace Co charges New Zealand GST on the supply.

Redeliverers – default method for determining estimated customs value of goods

246. Section 60G(5) contains a default rule for redeliverers to determine the estimated customs value of goods that they bring or assist in bringing to New Zealand. The default rule applies to a redeliverer who is not responsible for the purchase of goods that it brings or assists in bringing to New Zealand in its capacity as a redeliverer. This rule requires the redeliverer to:

- prior to the delivery of the goods to a place in New Zealand, obtain a declaration from the recipient of the amount paid for the goods; and
- obtain a receipt or invoice issued by the merchant or other confirmation by the merchant of the amount paid for the goods.

247. The second requirement above is not intended to require the redeliverer to have any interaction with the merchant who sold the goods. If the merchant has included an invoice in the package in which the goods were shipped to the redeliverer, checking the amount of consideration shown on the invoice against the amount declared by the recipient would be sufficient to satisfy the second requirement. Similarly, this requirement would also be met if the redeliverer requires the recipient to provide the receipt or invoice issued by the merchant.

Commissioner discretion to agree or prescribe alternative methods

248. In some instances, a redeliverer or an operator of an electronic marketplace may not have sufficient commercially available information to apply the default methods described above. In other cases, another potential method for determining the GST treatment which is not covered by the default rules may be more reliable than the default method, or may reduce compliance costs without resulting in a material under- or overpayment of GST.

249. To provide more flexibility, new section 60G(7) allows the Commissioner of Inland Revenue to prescribe or agree to methods for marketplace operators and redeliverers to make conclusions relevant to whether they are treated by section 60C or 60E as making a supply of distantly taxable goods in the course or furtherance of a taxable activity, and/or determine the amount of GST payable.

250. An agreement with the Commissioner under section 60G(7) may cover requirements for the amount of information that the marketplace operator or redeliverer is required to obtain, as well as methods for checking the accuracy of the information and the conclusions drawn from the information.

251. Allowing the Commissioner to prescribe or agree on alternative methods minimises compliance costs for marketplace operators and redeliverers while also assuring Inland Revenue that the methods used to determine the GST treatment of supplies broadly achieve the correct result. The intention is not that marketplace operators and redeliverers should have to collect extra information beyond what is already commercially available to them under their existing business processes. To the extent possible, an agreed or prescribed method should instead be based on information that is already collected by the person under existing commercial arrangements, and/or on processes that are to some extent already part of the person's existing business practices.

Information that should be included in an application for an alternative method

252. Section 60G(8) allows the Commissioner to take the following factors into account when exercising the discretion:
    - Commercially relevant information that is available to the marketplace operator or redeliverer and the reliability of this information.
    - Compliance costs of the marketplace operator or redeliverer in complying with the requirements of the default method.
    - The existing mechanisms the marketplace operator or redeliverer has to prevent and address situations where incorrect information is provided.

253. Ideally, an application for an agreed method would briefly cover all the points listed above, along with an explanation of why the proposed method is fair and reasonable. Specifically, the application would ideally outline how the proposed method reflects the outcome that would be reached under the default method – or, if the alternative method is being proposed because it is considered more reliable than the default method, why it is more reliable than the default method.

254. For example, a redeliverer may wish to rely on the value declared by the recipient rather than being required in all cases to obtain an invoice or receipt issued by the merchant to confirm the value of the goods. In this case, the application for an agreed method would ideally include some analysis showing that the outcome reached by relying on the value declared by the recipient is not materially different from the outcome that would be obtained if documentation issued by the merchant was instead used to confirm the value.

255. Alternatively, an application by a redeliverer might propose some mechanisms for preventing and (to the extent feasible) correcting any mistakes arising from undervaluation by consumers. What can feasibly be done in terms of discouraging or identifying undervaluation will be dependent on the redeliverer's business processes, which would be taken into account by the Commissioner when considering the proposed method.

Liability for GST if person has relied on a section 60G method

256. Under new section 60F, a marketplace operator or redeliverer that has relied on a default method set out in section 60G (or that has a safe harbour agreement with the Commissioner under section 60G(7)), cannot be held liable for GST that should have been returned if they have underpaid GST to Inland Revenue solely as a result of relying on incorrect or misleading information provided by another party.

257. Section 60F applies when a redeliverer or an operator of an electronic marketplace returns a deficient amount of output tax for a taxable period as a consequence of relying on inaccurate, incomplete or misleading information provided by the recipient of a supply of goods or by the merchant or underlying supplier of the goods.
258. In this situation, section 60F(2) provides that the electronic marketplace operator or redeliverer has a reduction in its total output tax allocated to the relevant taxable period that is equal to the amount of the deficiency, provided that the requirements of section 60G are met.
259. This means that in the situation where the electronic marketplace operator or redeliverer has relied on information provided by a third party and discovers there is a shortfall in the amount of output tax returned, the marketplace operator or redeliverer would not be liable to account for the output tax shortfall – provided that the reliance on information provided by a third party was in good faith and on reasonable grounds (see section 60G(1)(c)) and, if applicable, is consistent with a method prescribed in the legislation or agreed with the Commissioner.

Example 40 – agreed method for determining residency of underlying suppliers

A Co. is a marketplace operator, whose underlying suppliers may be resident in New Zealand or in other countries. A Co. agrees with the Commissioner on the method it will use to determine the residency of underlying suppliers, based on the information that is commercially available.

As part of the agreement, A Co. has governance mechanisms to prevent mistakes, which include:

- deploying technology to detect when underlying suppliers provide incorrect information relevant to their residency;
- educating underlying suppliers on the consequences of providing incorrect information (which include tax penalties that may apply);
- taking actions to remove the underlying supplier from its marketplace where incorrect information has been provided, if necessary; and
- in agreed circumstances where a significant amount of tax is at stake, providing information to the Commissioner about underlying suppliers that have provided incorrect information, to allow the Commissioner to use her powers to collect GST from the underlying supplier.

This agreement means that A Co. can rely on certain information to support conclusions that it is not responsible for GST on a supply because the underlying supplier is a New Zealand resident. If it is later discovered that the underlying supplier is not a New Zealand resident, A Co. will not be exposed to additional GST liability (as the amount of the output tax reduction given under section 60F(2) would offset the amount of output tax that should have been returned).

Example 41 – agreement allowing redeliverer to rely on value declared by recipient

Redeliverer Co. is a redeliverer which provides a US postal address to consumers in New Zealand and brings goods from US merchants to New Zealand. The US merchant is unaware that the consumer has engaged Redeliverer Co to bring the goods to New Zealand.

Redeliverer Co charges a facilitation fee to the consumer based on the weight and size of the parcel. The receipt issued by the US merchant to the recipient is generally not a piece of information that is commercially available to Redeliverer Co, unless it asks for proof of the value of the goods because the recipient is also purchasing insurance.

Rather than changing its systems to require a receipt to be submitted, Redeliverer Co agrees with the Commissioner of Inland Revenue that it can use the amount declared by the customer to determine how much GST to collect from the consumer, provided that it puts certain governance mechanisms in place to prevent mistakes.

Such mechanisms may include the following:

- Warning recipients about the consequences of undervaluing goods, including penalties that may apply under the tax legislation and under the Customs and Excise legislation.
- Using the value on a receipt from the merchant if this is commercially available (for example, where it is included with the goods when they arrive at Redeliverer Co's warehouse in the US or when provided by the recipient if they buy insurance).
- Taking a random sample of goods regularly to identify any undervaluation, and correct it if possible.
- In agreed circumstances where a significant amount of tax is at stake, providing information to the Commissioner about consumers that have underdeclared values, to allow the Commissioner to use her powers to collect GST from the consumer.

Reliance on other types of information resulting in underpayment of GST

260. In some cases, information that a marketplace operator or redeliverer might use to determine the GST treatment of a supply of goods may be completely unrelated to the residency of an underlying supplier and the delivery address for the supply (if the supply is made through an electronic marketplace) or the amount paid by the recipient for the goods (if the goods are brought to New Zealand by a redeliverer).

261. In situations where reliance on such information results in the marketplace operator or redeliverer underpaying GST, the marketplace operator or redeliverer will be relieved from the liability to return and pay the output tax that should have been paid if the reliance on information provided by the third party was in good faith and on reasonable grounds.

Example 42 – misclassification of item by underlying supplier resulting in treatment as exempt supply

An item of gold jewellery is listed for sale on the A Co. marketplace. On the basis of the classification of the item by the underlying supplier, A Co. is led to believe that the item is fine metal as defined in section 2(1), and concludes that the supply of the item is exempt from GST. However, it turns out that the item is not fine metal, and therefore GST should have been returned on the supply.

Section 60F applies to relieve A Co. from being required to return output tax on the supply, provided that A Co. has relied on the information in good faith and on reasonable grounds (meaning that A Co. did not know that the information relied on was incorrect, nor could have reasonably been expected to know the information was incorrect).

Generally speaking, a marketplace operator that does not actually have the goods could not reasonably be expected to know if the classification of an item of gold jewellery by an underlying supplier as "fine metal" is incorrect. However, if a marketplace operator was aware that a particular underlying supplier had a history of misclassifying items for sale, then this may affect whether the marketplace operator had relied on the information on reasonable grounds.

Example 43 – reliance on information by marketplace operator not on reasonable grounds

DG Book Supplies, a non-resident supplier, sells some university textbooks to Jan (a consumer providing a New Zealand delivery address) over the A Co. marketplace. DG tells A Co. that supplies of educational books are zero-rated for New Zealand GST purposes, which A Co. relies on when determining the GST treatment of the supply to Jan.

It is later discovered that the supply to Jan should have been treated as standard-rated (subject to GST at the rate of 15%) and that, as a consequence of relying on the incorrect information provided by DG, A Co. has underpaid GST to Inland Revenue. A Co. does not have a reduction in its output tax under section 60F(2), as it should have known that the information provided by DG was not reliable. A Co. is therefore required to return and pay 3/23 of the consideration for the supply as output tax to Inland Revenue.

Reverse charge (GST-registered recipient of remote services)
(Sections 8(4B), 20(4D) and 25AA)

262. An amendment to the reverse charge rule in section 8(4B) will require GST-registered recipients of distantly taxable goods (that are treated by section 8(4E) as not being supplies in New Zealand) to return output tax if the percentage of intended or actual taxable use of the goods is less than 95 percent of the total use.

263. The amendment also extends the reverse charge to business-to-business supplies of goods that are in New Zealand at the time of supply (which are treated by section 8(4) as not being supplied in New Zealand).[29]

Example 44 – application of reverse charge to distantly taxable goods

Melissa is a self-employed project manager who is registered for GST. She purchases a phone from a non-resident supplier for NZ$400. At the time of purchase, she identifies herself as a GST-registered person and therefore is not charged GST. She uses the phone fifty percent for her taxable project management services and fifty percent for private use.

Under the reverse charge, Melissa is treated as making a taxable supply to herself of NZ$400 at the 15% rate. She must return output tax of NZ$60 (NZ$400 × 15%).

If Melissa's taxable use of the phone had been 95 percent or more, she would not have been required to apply the reverse charge.

[29] As this amendment has been inadvertently drafted too widely, officials will seek to include a retrospective amendment in a future taxation bill so that the reverse charge (as it applies to goods) only applies to goods imported by the recipient of the supply in a consignment valued below NZ$1,000, where the recipient did not pay GST to Customs nor to the supplier. A savings provision to protect tax positions taken on the basis of the amendment would be optional for taxpayers to apply.

264. An exception (amended section 20(4D)) to the prohibition on input tax deductions in section 20(4C) allows a recipient of distantly taxable goods, that is required to return output tax under the reverse charge, to claim a deduction of input tax (GST paid on goods and services purchased) to the extent that the goods are used for, or available for use in, making taxable supplies.

Example 45 – input tax on goods subject to the reverse charge

Consider Example 44 where Melissa acquires a phone from a non-resident supplier for NZ$400. Melissa can claim an input tax deduction for the portion of her total use of the phone that is for taxable purposes (fifty percent). The amount of the input tax deduction is NZ$30 (NZ$60 of GST × fifty percent). Her net position in the relevant return (assuming no other supplies) is therefore an output tax liability of NZ$30 (NZ$60 output tax minus NZ$30 input tax).

Reverse charge for supplies of NZ$1,000 or less

265. There may be instances when a GST-registered recipient applies the reverse charge and the non-resident supplier also inadvertently charges the recipient GST. In this situation, GST would be returned twice on a single supply (by the non-resident supplier and the GST-registered recipient). This issue will likely be resolved if the non-resident supplier subsequently refunds the GST charged to the GST-registered recipient and makes an adjustment under section 25 as described previously. Note that an adjustment may still be necessary under section 25AA(1)(a)(iii) to ensure the correct amount of tax is accounted for under the reverse charge in section 8(4B).

266. To ensure the correct amount of tax is paid in the alternative scenario where the supplier provides a tax invoice under section 24(5B), existing section 25AA would allow the GST-registered recipient to correct the amount of output tax returned and input tax deductions claimed. The recipient would then be able to claim, in the normal manner, a deduction for the portion of the GST that was charged by the non-resident supplier, to the extent that the goods are used for, or available for use in, making taxable supplies.

Example 46 – supplier inadvertently charges GST on supply to registered person and recipient applies the reverse charge

Consider the earlier example again, where Melissa has applied the reverse charge under section 8(4B). However, she subsequently finds out that the price for the phone included GST at the standard rate of 15% (3 ÷ 23 × NZ$400 = NZ$52.17).

Melissa contacts the non-resident supplier and requests a refund for the incorrectly charged GST. Instead of providing a refund, the supplier issues Melissa with a full tax invoice, since the value of the supply is NZ$1,000 or less.

The tax invoice enables Melissa to claim an input tax deduction to the extent the phone is used for, or available for use, in making taxable supplies, which means she can deduct NZ$26.09. The non-resident supplier is also not required to make any adjustments under section 25.

Under section 25AA(1)(a)(v), Melissa makes an adjustment in the return for the taxable period in which it is discovered that a mistake has been made to correct the amount of output tax and input tax deductions claimed as a result of applying the reverse charge in section 8(4B). Melissa claims a deduction under section 20(3) for the output tax that she accounted for (NZ$60 – section 25AA(2)) and returns output tax for the input tax deduction she claimed earlier (NZ$30 – section 25AA(3)).

Administration of the supplier registration system

(Sections 5(27), (28), 15(7), 51B(7), 51B(8) and 75(3F) of the Goods and Services Tax Act 1985. Sections 24BA(1B) and 143A(1)(c) of the Tax Administration Act 1994)

Taxable periods

267. Under amended section 15(6), non-resident suppliers that only supply distantly taxable goods and/or remote services will have calendar quarterly taxable periods (1 April to 30 June, 1 July to 30 September, 1 October to 31 December, and 1 January to 31 March). This is intended to align with these suppliers' filing obligations in other jurisdictions.

268. However, for the period beginning 1 December 2019 to 31 March 2020, non-resident suppliers of distantly taxable goods will have a taxable period of four months (see new section 15(7)). This initial four-month taxable period will apply to non-resident suppliers of distantly taxable goods that become liable to register for GST in the period 1 December to 31 December 2019 – including non-residents who also supply remote services to New Zealand-resident consumers but did not register for GST before 1 December 2019 due to being below the NZ$60,000 registration threshold.

269. Section 15E(2) provides that a supplier may apply to the Commissioner of Inland Revenue to have an alternative taxable period end date. Under this provision, the Commissioner may approve an end date that is not more than seven days before or after the last day of a month.

Example 47 – alternative taxable period end date

Retro Audio is registered for GST as a non-resident supplier of distantly taxable goods and, from 1 April 2020, will be required to have quarterly taxable periods.

Retro Audio does an accounting cut off on 29 March, 28 June, 28 September and 30 December. These accounting periods are all quarters but do not end on the last day of the typical calendar quarter, and it would be expensive for Retro Audio to re-run periods outside of this accounting cycle.

The Commissioner of Inland Revenue approves Retro Audio to have an initial four-month taxable period of 1 December 2019 to 29 March 2020, and from 30 March 2020, the following quarterly taxable periods on an ongoing basis:

- 30 March to 28 June;
- 29 June to 28 September;
- 29 September to 30 December; and
- 31 December to 29 March.

Holding records outside New Zealand and in a language other than English

270. Currently, a GST-registered person must apply to the Commissioner of Inland Revenue for authorisation to keep records at a place outside New Zealand or in a language other than English. Amended section 75(3F) provides an automatic exception to this requirement for non-resident suppliers of distantly taxable goods or remote services that are subject to GST under either section 8(3)(ab) or (c).

Exception from the bank account requirement

271. Section 24BA of the Tax Administration Act 1994 generally requires an offshore person to have a fully functional New Zealand bank account in order to obtain an IRD number. However, subsection (1B) provides an exception to this requirement for a non-resident supplier who requires an IRD number solely because they are a non-resident supplier of goods and services.

Consumers and underlying suppliers providing false or misleading information

272. Sections 5(27), 5(28), 51B(7) and 51B(8) provide the Commissioner of Inland Revenue with discretion to require a person to register and pay GST that should have been charged, when:
    - the person (being the recipient of the supply or a non-resident underlying supplier) knowingly provides altered, false or misleading information which has resulted in GST being underpaid; and
    - the amount of GST is substantial or the behaviour is repeated.

273. In the situation where a consumer provides false or misleading information that results in an underpayment of GST, section 5(27) only applies if the consumer made the misrepresentation with the purpose of avoiding being charged GST or to reduce the amount of GST charged.

274. In addition to the situations where a consumer makes a misrepresentation to a non-resident merchant, marketplace operator or redeliverer, or where a non-resident underlying supplier makes a misrepresentation to a non-resident operator of an electronic marketplace, the provisions cover the situation where a consumer or a non-resident underlying supplier deliberately provides false, altered or misleading information to a New Zealand-resident resident agent, redeliverer or marketplace operator.

275. In cases where discretion is exercised by the Commissioner to require the consumer or underlying supplier to register and pay the GST shortfall, section 5(27)(b)(iii) and (28) set out that the consumer or underlying supplier would be treated as making a supply charged with GST at the rate of 15%. Under amended section 51B, the person is treated as being registered from the date on which the first supply the discretion is exercised for is made (see subsections (7) and (8)).

276. The existing "knowledge offences" also apply when a person deliberately supplies incorrect information for the purpose of avoiding GST by misrepresenting themselves as a registered business or as a resident of another country (section 143A(1)(c) and (g) of the Tax Administration Act 1994). This is a criminal penalty and a person convicted of a knowledge offence is liable for a fine of up to NZ$25,000 for a first-time offence or NZ$50,000 for repeated offences.

Example 48 – consumer makes misrepresentation that they are registered for GST

Luke purchases a number of distantly taxable goods and remote services online, including clothing, nutritional supplements, online dating services, music and movie content. Luke is not registered for GST. To avoid paying GST, Luke continually informs suppliers he is GST registered and provides suppliers with a false GST registration number.

The Commissioner of Inland Revenue exercises her discretion to register Luke from the time the first supply of goods was made or the services were physically performed (whichever is earlier), and requires him to pay the GST that was not charged, plus penalties and interest.

277. Section 5(27)(a) has been amended so that it may apply in the situation where a consumer purchasing a remote service deliberately provides false, altered or misleading information pertaining to his or her location or residency status to avoid being charged GST. Under the former drafting of section 5(27)(a), the provision only applied in the situation where a consumer made a misrepresentation that they were registered for GST in order to avoid having GST charged.

278. If a customer has provided incorrect or misleading information to access content that is geographically restricted, and this consequentially results in GST not being charged, the reverse charge rule in section 5(27) and the existing knowledge offences would not be expected to apply. However, in cases where it is clear that the person made the misrepresentation to avoid being charged GST, the amendment to section 5(27)(a) means that the Commissioner will be able to exercise her discretion to require the person to pay GST if the amount of GST at stake is substantial or the behaviour is repeated.

279. Where distantly taxable goods are treated by section 60C or 60E as having been supplied by an electronic marketplace operator or a redeliverer, the Commissioner's discretion to require the underlying supplier or the consumer to pay the GST shortfall will only apply if the marketplace operator or redeliverer used a method set out in section 60G or a method agreed with or prescribed by the Commissioner under section 60G(7).

280. This is intended to ensure there is a clear hierarchy where the marketplace operator or redeliverer is the supplier for GST purposes, and therefore incentivises the person to take reasonable precautions to prevent an incorrect GST treatment from arising.

281. Unlike section 5(27), new section 5(28) (which applies to an underlying supplier providing incorrect or misleading information to an operator of an electronic marketplace) does not require the incorrect information to have been provided for the purpose of avoiding GST applying to the supply. This is because the underlying supplier's intention may be difficult to establish in practice.

Example 49 – non-resident underlying supplier makes misrepresentation that they are resident in New Zealand

Jave Dordan, a non-resident underlying supplier on the NZ Marketplace website, deliberately provides false information about himself (including using a VPN to fake a New Zealand IP address, providing a false mailing address in New Zealand and falsely stating that the goods are shipped from New Zealand) with the intention of misleading potential customers in New Zealand. The fact that NZ Marketplace will not charge GST on the supply as a result of Jave's deception is not Jave's primary objective in making the misrepresentations, but is merely a secondary benefit from Jave's perspective.

After a crackdown on non-resident underlying suppliers misrepresenting themselves as New Zealand businesses, NZ Marketplace discovers that Jave is not a New Zealand tax resident but is in fact a non-resident. As NZ Marketplace previously had no knowledge of Jave's residency status and had relied in good faith on the information provided by Jave in accordance with the methods prescribed in section 60G(3) to determine Jave's residency status, NZ Marketplace will not be liable to return GST on supplies made by Jave to consumers in New Zealand prior to Jave's dishonesty being discovered.

NZ Marketplace has an agreement with the Commissioner of Inland Revenue that it will provide the Commissioner with the details of underlying suppliers that misrepresent their location or residency status resulting in a significant amount of tax being underpaid. NZ Marketplace provides Inland Revenue with information about Jave, including the value and volume of sales made by Jave on NZ Marketplace.

As Jave has deliberately misrepresented his residency status over a long period of time, resulting in a substantial amount of GST due not being returned to Inland Revenue, the Commissioner registers Jave for GST, makes an assessment of the GST due and requires Jave to pay the GST that should have been returned. The fact that Jave did not make the misrepresentations with the purpose of avoiding having GST charged on his sales has no impact on the Commissioner's ability to apply her discretion.

Optional rules aimed at reducing costs for suppliers (Sections 8(4F), 10C, 20(3L), 20(3LB) and 85C)

Claiming GST deductions for New Zealand expenses

282. Special rules applying to non-resident businesses that do not make any supplies in New Zealand were introduced in 2014 to allow these businesses to claim refunds of GST incurred on business expenses. For the purposes of claiming input tax (GST on purchases), a deduction rule in section 20(3L) allows non-resident businesses registered under section 54B to claim back input tax relating to their worldwide taxable activity (for example, GST incurred in sending employees to a conference in New Zealand).

283. Section 20(3L) has been amended to allow non-resident suppliers of distantly taxable goods and remote services to claim back New Zealand GST incurred on business expenses.

284. Amended section 20(3L) provides that a non-resident person who is registered under section 54B or who is a non-resident supplier of distantly taxable goods or remote services may deduct input tax to the extent to which the relevant goods and services are used for, or are available for use in, making taxable supplies, **treating all the supplies made by the person as if they were made and received in New Zealand** [emphasis added].

285. This means non-resident suppliers of distantly taxable goods and remote services that have registered under the standard GST registration system as a "pay and claim" registrant will be able to deduct GST they have paid on business inputs sourced from New Zealand suppliers, without being required to "trace" the use of these inputs to making taxable supplies to consumers in New Zealand.

286. This will generally enable these suppliers to deduct GST incurred on inputs used in making supplies to other non-residents or to GST-registered New Zealand businesses. However, input tax cannot be deducted to the extent that the relevant inputs are applied to a private (rather than business) use or are used in making supplies that would be exempt if those supplies were made and received in New Zealand (such as supplies of financial services).

287. A special "attribution rule" will apply in the situation where a non-resident supplier of distantly taxable goods or remote services imports goods into New Zealand for delivery to another person in New Zealand and pays GST to Customs on the importation of the goods. In this situation, amended section 20(3LB) provides that subsection (3LC) will treat the recipient of the goods as having paid the import GST to Customs, and the non-resident supplier as not having paid the GST to Customs. This prevents the non-resident supplier from being able to make an input tax deduction for the GST paid to Customs.

288. The attribution rule will only apply in the situation where the goods are delivered to a person in New Zealand other than the supplier. If the supplier is the person in New Zealand who receives the goods and is not delivering the goods to another person in New Zealand, the supplier will be able to make an input tax deduction for the GST paid to Customs.

Example 50 – application of the attribution rule in section 20(3LB) and (3LC) where the non-resident supplier pays the import GST

Gordon buys an NZ$1,200 bicycle from Moving Parts, a non-resident bicycle and cycling accessories shop that is registered for GST in New Zealand under the rules for distantly taxable goods. Moving Parts supply the bicycle to Gordon on delivered-duty-paid terms, so that they pay the GST to Customs on Gordon's behalf.

Under the attribution rule in section 20(3LB) and (3LC), Moving Parts is not able to claim an input tax deduction for the import GST paid to Customs.

289. The attribution rule in section 20(3LB) and (3LC) aims to prevent non-taxation, which would arise if a non-resident making a non-taxable supply of imported goods to a consumer in New Zealand claimed an input tax deduction for the GST paid on importation of the goods to Customs. The following example illustrates this scenario.

Example 51 – non-taxation where non-resident supplies high-value imported goods to consumer and pays the import GST

Consider the scenario in the previous example, except this time assume that the attribution rule in section 20(3LB) and (3LC) does not exist.

The supply of the bicycle by Moving Parts to Gordon is not a taxable supply, as the bicycle is outside New Zealand at the time of supply and is not an item of distantly taxable goods (because the estimated customs value of the bicycle is NZ$1,200 and Moving Parts has not made the election to treat its high-value goods as distantly taxable goods, discussed later).

Gordon paid NZ$50 to Moving Parts for freight and insurance of the bicycle. Moving Parts pays import GST to Customs of NZ$187.50 (15% of the full landed value of the goods, being NZ$1,250). Moving Parts claims an input tax deduction in its GST return of NZ$187.50 for the import GST under section 20(3L), resulting in non-taxation of a supply to a consumer in New Zealand.

290. Section 11A(1)(x) – which has applied since the start of the GST on remote services rules in October 2016 – currently allows non-resident suppliers to zero-rate their supplies of remote services to GST-registered New Zealand businesses. This allows non-resident remote services suppliers to claim back GST on inputs used for making supplies to GST-registered businesses.

291. Section 11A(1)(x) has been retained as a legacy provision, so that non-resident suppliers of remote services who are accustomed to zero-rating these supplies and wish to continue what they are doing at present may do so. However, if they wish to, non-resident suppliers of remote services can use the input tax deduction rule in section 20(3L) as an alternative to zero-rating their business-to-business supplies of remote services.

Option to charge GST on high-value goods

292. Distinguishing between low-value goods (items individually having an estimated customs value of NZ$1,000 or less) and high-value goods (items with an estimated customs value above NZ$1,000) may create complexity for suppliers. To minimise compliance costs, suppliers who are required under the new rules to charge GST on low-value goods supplied to consumers in New Zealand will be able to elect to treat high-value goods as distantly taxable if certain conditions are met. These requirements are outlined below.

293. New section 10C provides that a supplier (referred to in the section as the "electing supplier") may elect to treat goods that individually have an estimated customs value exceeding NZ$1,000 as distantly taxable goods if all the following conditions are met:

- the Commissioner has not before the date the election is made by the supplier cancelled a previous election by the supplier to treat high-value goods as distantly taxable goods (see subsection (1)(a));
- the supplier notifies the Commissioner of the election before the start of the first taxable period that it is intended to be effective for (see subsection (1)(b)); and
- at the time of the election, there are reasonable grounds for believing that 75 percent or more of the total value of distantly taxable goods that the supplier will supply in the 12-month period, starting on the first day that the supplier intends the election to be effective for, will consist of items having an estimated customs value of NZ$1,000 or less (see subsection (2)(a)).

294. The "reasonable grounds" test described above implicitly requires an electing supplier to firstly assume that it will have made an effective election for the initial year – meaning that for the purposes of determining whether the 75 percent threshold is met, the supplier should include high-value goods supplied to customers in New Zealand (both consumers and GST-registered businesses) in the "total value of distantly taxable goods supplied by the electing supplier to places in New Zealand".

295. Having made the above starting assumption, the test then requires the electing supplier to determine whether it is reasonable to believe that the total value of its low-value goods supplied to customers in New Zealand during the 12-month period will be at least 75 percent of the total value of the distantly taxable goods that it will supply in the initial year.

296. The reasonable grounds requirement referred to above means different things for different types of electing suppliers:

- For an electing supplier who is a merchant, or an electing supplier who is a redeliverer treated by section 60E as the supplier of low-value goods that it brings to New Zealand: The reasonable grounds requirement means the electing supplier has a reasonable belief that 75 percent or more of the total value of goods that it will bring (or assist in bringing) to New Zealand in the initial year of the election will consist of items that individually have an estimated customs value of NZ$1,000 or less.
- For an electing supplier who is an operator of a marketplace (and who is treated by either of sections 60C or 60D as the supplier of low-value goods sold through its marketplace by non-resident underlying suppliers): The reasonable grounds requirement above means the marketplace operator has a reasonable belief that 75 percent or more of the total value of goods that would be purchased on the marketplace in the initial year of the election, and supplied by non-resident underlying suppliers to customers in New Zealand, will consist of items that individually have an estimated customs value of NZ$1,000 or less.

297. In either case, the electing supplier should not include alcohol or tobacco products for the purposes of assessing whether the 75 percent test is met.

Example 52 – merchant making election under self-assessed 75 percent test

Big Ben's Bikes, an online British bike, bike parts and bike accessories store, sells and ships goods from its warehouse in London to customers around the world. Big Ben's Bikes wishes to treat its high value goods supplied to New Zealand consumers as distantly taxable from the start of their first taxable period, being 1 December 2019.

Big Ben's Bikes sold £78,000 worth of low-value imported goods to customers in New Zealand in the year 1 July 2018 to 30 June 2019. Big Ben's Bikes also sold £22,000 worth of high-value imported goods to New Zealand customers in that year. Therefore, 78 percent of the total value of goods that Big Ben's Bikes sold to customers in New Zealand that year consisted of goods individually valued at or below NZ$1,000. This percentage is typical of Big Ben's Bikes' annual sales to New Zealand customers (in previous years, Big Ben's Bikes' sales of goods valued at or below NZ$1,000 as a proportion of its total sales to New Zealand customers have been within the range of 76 percent to 80 percent).

Based on this historical information and without any information to suggest that this percentage is likely to be less than 75 percent for the 12-month period beginning 1 December 2019, it is reasonable to assume that Big Ben's Bikes meets the 75 percent test. On this basis, Big Ben's Bikes self-assesses that it is eligible to make the election and notifies Inland Revenue that they will be charging GST on supplies of high-value goods under the self-assessed test.

Example 53 – marketplace operator making election under self-assessed 75 percent test

A Co. is an operator of an electronic marketplace who wishes to make the election to charge GST on high-value goods supplied by non-residents through its marketplace. Data from previous years shows that, low-value goods make up well over 80 percent of the total value of goods sold by non-resident underlying suppliers on the A Co. marketplace to customers in New Zealand (including goods that are shipped from a location within New Zealand if A Co. has determined that the underlying supplier of the goods is a non-resident). A Co. has no reason to expect that this percentage will drop below 75 percent for the period 1 December 2019 to 30 November 2020.

On this basis, A Co. determines that they are eligible to make the election and notifies Inland Revenue that they will be charging GST on supplies of high-value goods under the self-assessed test.

Example 54 – redeliverer making election under self-assessed 75 percent test

Redeliverer Co. wishes to make the election under section 10C to charge GST on the high-value goods they bring to New Zealand from overseas. Based on data from previous years, Redeliverer Co. estimates that approximately 90 percent of the value of the goods that they brought to New Zealand in a typical year (including any amounts for freight and insurance charged by the overseas merchant) consisted of low-value goods. Redeliverer Co. has a reasonable expectation that they will easily exceed the 75 percent threshold for the 1 December 2019 to 30 November 2020 year.

Redeliverer Co determines that they are eligible to make the election and notifies Inland Revenue that they will be charging GST on high-value goods under the self-assessed test.

298. Suppliers making the election under the self-assessed test will need to notify Inland Revenue. Operators of marketplaces that decide to charge GST on their supplies of high-value goods will also need to let their underlying suppliers know (as some non-resident underlying suppliers might already be returning GST on their sales if the goods are in New Zealand at the time of supply).

299. An electing supplier who is a non-resident that is not already registered for GST in New Zealand may notify Inland Revenue of the election by answering "yes" to the question in the IR994 registration form about whether they intend to make the election to charge GST on high-value goods and meet the 75 percent test.

300. An electing supplier that is already registered for GST (under the ordinary GST rules or under the GST rules applying to remote services) may notify Inland Revenue of the election by emailing **info.lvg@ird.govt.nz** with "Election" in the subject line of the email.

301. Section 10C(2)(b) provides that the Commissioner may allow a supplier to make an election to treat its high-value goods as distantly taxable goods, even if the self-assessed 75 percent test outlined above is not met.

302. The Commissioner will exercise this discretion if she considers that doing so will not undermine the integrity of the tax system, taking the following factors into account:

- whether the electing supplier and any associated persons have a good history of previous compliance with New Zealand tax legislation and the tax laws of countries and territories outside New Zealand;

- the total value of high-value goods supplied by the electing supplier to New Zealand consumers; and
- any other relevant factors.

303. The ability for the Commissioner to allow suppliers to charge GST on high-value goods supplied to consumers recognises that the costs to a supplier in configuring their point-of-sale systems to distinguish between low-value and high-value goods may be disproportionate to any potential revenue risk from allowing the supplier to charge GST on high-value goods (effectively replacing the collection of GST on these goods by Customs), even if the 75 percent test is not met.
304. In this situation, the Commissioner may be satisfied that it is appropriate to allow the supplier to charge GST on its supplies of high-value goods to consumers if the supplier has a good tax compliance history. Alternatively, if the supplier does not have a tax compliance history that the Commissioner is aware of, the Commissioner may be satisfied that it is appropriate to exercise the discretion if the value of the supplier's sales of high-value imported goods to consumers in New Zealand is not significant.
305. In practice, there will be a general presumption in favour of exercising the discretion unless there is information available to Inland Revenue which suggests that allowing a particular supplier to charge GST on its high-value goods may result in a revenue risk.

Example 55 – exercise of Commissioner's discretion

Dapper Menswear is a non-resident supplier of designer European menswear. Dapper Menswear wishes to treat their supplies of high-value goods to consumers in New Zealand as distantly taxable, and intends that this election be effective from the start of their first taxable period, being 1 December 2019.

Dapper Menswear undertakes some analysis of the composition of their sales to customers in New Zealand over the past year. They find that they sold NZ$70,000 worth of low-value goods to customers in New Zealand in the past year. They also sold NZ$30,000 worth of high-value goods to New Zealand customers in that year. Therefore, only 70 percent of Dapper Menswear's supplies of goods in that year were low-value goods. Given that Dapper Menswear expects the composition of its sales to New Zealand customers to be much the same in the period 1 December 2019 to 30 November 2020, Dapper Menswear does not have a reasonable expectation that the 75 percent test will be met.

Dapper Menswear applies to the Commissioner to be allowed to charge GST on their supplies of high-value goods. In considering the application, the Commissioner looks at whether Dapper Menswear (including any associated entities) has a compliance history for New Zealand tax purposes and finds there is none. However, according to information that the Commissioner has obtained under double tax agreements from overseas jurisdictions that have similar rules, Dapper Menswear has registered for VAT/GST in those other jurisdictions.

There is no evidence available to the Commissioner to suggest that Dapper Menswear is not fully compliant with the tax laws in those other jurisdictions, so the Commissioner does not consider that Dapper Menswear poses any significant compliance risk. Further, the total value of supplies of high-value goods made to New Zealand customers annually by Dapper Menswear (approximately NZ$30,000) is relatively small. On this basis, the Commissioner exercises her discretion to allow Dapper Menswear to make the election to charge GST on supplies of high-value goods to consumers.

306. Under section 10C(2), an election to treat high-value goods as distantly taxable is effective from the first day of the initial taxable period that the supplier intends the election to be effective for until the election is cancelled.
307. Cancellation of an election may be initiated upon request by the supplier or, if certain conditions are met, the Commissioner may unilaterally cancel a supplier's election.
308. If a supplier who has made an election requests that the election be cancelled, new section 10C(5)(a) provides that the Commissioner may cancel the election by notifying the supplier of the date on which the election ends.
309. In the situation where the Commissioner unilaterally cancels an election by a supplier (in cases of non-compliance by the supplier), section 10C(5)(b) provides that the Commissioner is required to:
    - notify the electing supplier of the date of the proposed cancellation and the reasons for the proposed cancellation;
    - consider any arguments against the proposed cancellation that are provided by the electing supplier within 30 days from the date of notification, or within a shorter or longer period if the Commissioner considers that period is appropriate in the circumstances; and
    - notify the supplier of the date on which the election is cancelled.

Option to charge GST on low-value supplies to GST-registered businesses

310. Under new section 8(4F), a non-resident supplier will be able to elect to treat a supply of distantly taxable goods to a GST-registered business as a supply made in New Zealand, provided that:
    - at the time of the election, the non-resident supplier reasonably expects that more than 50 percent of the value of the supplies they make to customers in New Zealand during the 12-month period from the election will be made to persons who are not GST-registered; and
    - the value of the supply (excluding GST) is NZ$1,000 or less.

311. Under new section 24(5BB), a non-resident supplier is required to provide a tax invoice if the supplier has chosen to apply section 8(4F) to the supply so that the supply is treated as made in New Zealand.[30]

312. These amendments are aimed at allowing non-resident suppliers to simply charge GST on low-value supplies (regardless of the business-to-consumer or business-to-business nature of the supply) and issue a tax invoice to the customer at the time of supply or shortly after. As discussed earlier at [197] to [200], non-resident suppliers exercising this option will be able to issue a single document that meets the requirements of both a full tax invoice and a receipt required under section 24BAB to be issued to a consumer for a supply of distantly taxable goods.

313. While non-resident suppliers are able to choose to provide a tax invoice for a supply of distantly taxable goods under section 24(5B) if the value of the supply is NZ$1,000 or less, this only applies in the situation where GST is inadvertently charged on the supply – meaning that the tax invoice would be issued to the recipient following a request for a tax invoice or a refund of the GST (as opposed to the supplier being able to proactively issue the recipient with a tax invoice in anticipation of the possibility that the recipient may be GST-registered).

314. Therefore, the ability to elect to charge GST on low-value supplies to GST-registered businesses may reduce compliance costs for both non-resident suppliers of distantly taxable goods and New Zealand businesses making low-value purchases from these suppliers, as the GST-registered recipient would be able to use the tax invoice to support an input tax deduction without needing to interact with the supplier any further.

315. Given the amendments allow non-resident suppliers to charge GST on low-value supplies and issue a tax invoice to the customer at the time of supply if they decide that works best for them, there is no requirement for the non-resident supplier to inform Inland Revenue of the election or to keep records that the election was made. The amendments merely validate the supplier's treatment of a low-value supply in the situation where the supplier has charged GST and proactively issued a tax invoice, and it transpires that the supply was to a GST-registered business using the goods in its taxable activity.

316. Consistent with the rule in section 24(5B), if the value of the supply exceeds NZ$1,000, the non-resident supplier should not issue a tax invoice, and the recipient of the supply will not be entitled to make an input tax deduction. This means that, if the value of the supply is above NZ$1,000, the receipt or invoice issued to the recipient should not include the phrase "tax invoice". In this situation, the supplier's only option is to refund the GST charged, if it transpires that GST was charged on a supply to a GST-registered business using the goods and services in its taxable activity.

Example 56 – non-resident supplier elects to charge GST on low-value supplies to GST-registered businesses under section 8(4F)

Good Books is an online book retailer resident in Hong Kong. Good Books is registered for GST in New Zealand as a supplier of distantly taxable goods to consumers. Good Books' sales to customers in New Zealand total around NZ$10 million a year, excluding GST, of which it estimates that around NZ$2 million a year are to GST-registered businesses.

Based on this historical average of around 80 percent of the value of its sales to New Zealand customers being to persons who are not registered for GST (which Good Books expects will continue going forward), Good Books has a reasonable expectation that more than 50 percent of the value of the sales it will make to customers in New Zealand in the next 12 months will be to customers who are not GST-registered.

Good Books sells two books valued at NZ$40 each (excluding GST) to a customer providing a delivery address in New Zealand and charges NZ$20 plus GST for shipping. As the estimated customs value of each item (NZ$40) is less than NZ$1,000, Good Books determines that the supply is of distantly taxable goods and charges GST of NZ$15, based on the value of the supply of NZ$100 (2 books at NZ$40 each + NZ$20 shipping = NZ$100, 15% of NZ$100 = NZ$15).

[30] Although the intention is that the tax invoice issued by the supplier should meet the requirements of a full tax invoice, the legislation as enacted does not require this. Officials will seek to include an amendment to section 24(4)(g) in a future tax bill so that a tax invoice issued under new section 24(5BB) is required to be a full tax invoice, consistent with the rule in section 24(5B).

In the event that the supply is to a GST-registered business, Good Books intends that the goods are treated as supplied in New Zealand under section 8(4F) (subject to GST). Since the value of the supply excluding GST (NZ$100) is less than NZ$1,000, the treatment of the sale as a taxable supply is correct (even if the customer is a GST-registered business, as section 8(4F) will apply in this scenario).

Good Books issues the recipient with a receipt at the time of supply containing the following particulars:

- the words "tax invoice" in a prominent place (see section 24(3)(a));
- Good Books' name and GST registration number (see sections 24(3)(b) and 24BAB(2)(a));
- the name and address of the recipient (see section 24(3)(c));
- the date the receipt was issued (which in this case is the same as the date of supply – see sections 24(3)(d) and 24BAB(2)(b) and (c));
- a description of the goods and services supplied, along with the quantity or volume (see section 24(3)(e) and (f), and section 24BAB(2)(d));
- the consideration for the supply excluding tax (NZ$100), the amount of tax included (NZ$15), and the consideration inclusive of tax (NZ$115) (see sections 24(3)(g)(i) and 24BAB(2)(e); and
- information indicating the items for which the amount of tax included is zero or more than zero (in this example, GST was charged on all the items in the supply, so information indicating that tax was included for all the items will suffice – see section 24BAB(2)(f) and (g)).

The receipt meets the requirements of section 24(3) for a full tax invoice, so if the recipient of the supply is a GST-registered business intending to use the goods and services purchased for making taxable supplies, they will be able to make an input tax deduction in their GST return. The receipt also meets the requirements of section 24BAB(2) for a receipt required to be issued for the purposes of preventing double taxation on a supply of distantly taxable goods to a consumer.

Example 57 – prohibition on issuing a tax invoice for a high-value supply of distantly taxable goods

Consider Good Books in the previous example again. Good Books sell 20 items valued at NZ$50 each (excluding GST) to a recipient providing a delivery address in New Zealand and charges NZ$40 plus GST for shipping. As the estimated customs value of each item (NZ$50) is less than NZ$1,000, Good Books determines that the supply is of distantly taxable goods and charges GST of NZ$156, based on the value of the supply of NZ$1,040 (20 books at NZ$50 each + NZ$40 shipping = NZ$1,040, 15% of NZ$1,040 = NZ$156).

As the value of the supply excluding GST (NZ$1,040) is over NZ$1,000, Good Books issues a receipt to the recipient with the words "tax invoice" omitted. Because the document is not a valid tax invoice (and because of the deduction prohibition rule for supplies valued over NZ$1,000 in section 20(4C)), the recipient cannot make an input tax deduction even if they are registered for GST and will use the supply in their taxable activity.

The recipient is registered for GST and intends to use the goods wholly for making taxable supplies. However, because the document issued by Good Books is not a valid tax invoice (and because of the deduction prohibition rule for high-value supplies of distantly taxable goods by non-residents), the GST-registered recipient contacts Good Books to ask for a refund of the GST.

317. In deciding whether the election to charge GST on low-value supplies to GST-registered businesses might be a useful option, non-resident suppliers of distantly taxable goods may want to consider the following questions:
    - Is it reasonably likely that at least 50 percent of the value of the sales that you will make to New Zealand customers in the next 12 months will be to customers that are not registered for GST?
    - In the context of your business, is it likely that any given sale of goods to a customer in New Zealand will always have a value below NZ$1,000 (excluding GST)? If not, are your business systems capable of issuing different documentation for supplies valued at NZ$1,000 or less, versus supplies valued above NZ$1,000?

Transitional rule for fixed-term contracts entered into before 1 December

318. Section 85C contains a new transitional provision similar to the transitional rule under section 85B, which was provided for the introduction of GST on remote services in 2016. The new transitional provision applies:
    - to contracts for distantly taxable goods that are for a fixed term and entered into before 1 December 2019; and
    - to periodic payments made under the contract that are treated under section 9(3)(a) as successive supplies;[31] and
    - if the consideration for the supply is set or reviewed for periods of 396 days or less during the term of the agreement (this covers contracts that are entered into during a month and end a year later at the end of the month); and
    - if the non-resident supplier elects that the transitional provision applies.
319. The transitional provision allows a non-resident supplier to treat distantly taxable goods provided under the contract as not being successively supplied under section 9(3), and therefore, those payments made after 1 December 2019 would not be subject to GST. This transitional rule would only apply for the term of the agreement or up to 396 days from the date the contract was entered into, whichever is earlier. After that time, section 9(3) would usually apply and treat periodic payments as being successive supplies when the payments become due or are received, whichever is earlier.

Example 58 – contract for magazine subscription entered into before 1 December 2019

Rosalie purchases a subscription to a Canadian model train collectors' magazine for a 12-month period on 15 August 2019 and opts to pay the subscription in monthly instalments. The non-resident supplier is able to treat those monthly instalments as not being successively supplied under section 9(3) and, therefore, payments made after 1 December 2019 will not be subject to GST up until the 12-month contract ends.

[31] The transitional provision should also apply to periodic payments made under the contract that are treated under section 9(3)(aa) as successive supplies. Officials will seek to correct this cross-referencing error in a future taxation bill.

Ring-fencing of residential property deductions

Subpart EL of the Income Tax Act 2007

New subpart EL introduces rules to ring-fence deductions for residential properties to income from those properties. To the extent the deductions exceed the income, they cannot be used against income from other sources, such as salary and wages. Instead, the excess deductions will be carried forward for use against residential property income in future years.

The residential ring-fencing rules apply from the start of the 2019–20 income year.

In addition to the ring-fencing rules, new subpart EL contains former sections DB 18A and DB 18AB in rewritten form (section EL 20).

Background

Rental property investors can deduct interest and other expenses (other than capital improvements) as these expenses relate to earning taxable rental income. In many cases, these expenses exceed the rental income, so the rental activity is loss-making although the overall investment may still be profitable due to the tax-free capital gains that may be realised on the sale of the property. Most rental property investors hold their property on capital account, so the gains made on sale would not be subject to tax.

Before the introduction of these rules, loss-making investors could use the excess deductions from their rental properties to offset their income from other sources (such as salary and wages), thus reducing their income tax liability.

The Government considered that this created an uneven playing field between property investors who are buying property in anticipation of capital gains, and home buyers. Investors with loss-making rental properties were able to have part of the cost of servicing their mortgages subsidised by reduced tax on other income sources, helping them to outbid home buyers.

The new residential ring-fencing rules are aimed at making the tax system fairer, and improving housing affordability for owner-occupiers by levelling the playing field between property investors and home buyers.

Key features

Under the rules in new subpart EL of the Income Tax Act, deductions for residential properties are ring-fenced to income from those properties (including any income on disposal). This effectively means that investors are no longer able to offset residential property losses against their other income (for example, salary or wages, or business income), to reduce their tax liability. To the extent the deductions exceed the income, they will be carried forward for use against residential property income in future years.

- The rules apply to "residential land", using the same definition of "residential land" that already exists for the bright-line test.

The rules do not apply (provided criteria are met) to:

- the taxpayer's main home;
- property subject to the mixed-use asset rules;
- property that will be taxed on sale (subject to notification requirements for some taxpayers);
- property owned by companies other than close companies;
- employee accommodation; and
- Government enterprises.

The default position is that the rules apply on a portfolio basis, meaning that investors calculate their overall profit or loss across their portfolio. The income from all properties in the portfolio is offset by deductions for all properties.

However, investors are able to elect to apply the rules on a property-by-property basis if they wish. When using the property-by-property approach, each property is looked at separately and deductions for one are not able to offset income from another. If the property-by-property approach is taken, and it transpires that the sale of the property is taxed, any remaining excess deductions are released from the ring-fencing rules and used against the taxpayer's income from other sources.

Residential property deductions are allocated to an income year up to the total of the taxpayer's "residential income". This includes residential rental income and net residential land sale income from the property or portfolio (depending on which basis the rules are applied on).

To the extent the taxpayer's residential property deductions exceed their "residential income" in a year, they cannot be used as deductions in that year. The excess deductions will instead be carried forward to the next year the taxpayer derives residential income, and added to the taxpayer's deductions for the property or portfolio in that year.

There are rules to prevent interposed entities being used to circumvent the deduction ring-fencing rules. These will apply where a taxpayer has borrowed money to acquire an interest in an entity that is a "residential land-rich entity" for a particular income year. An entity will be residential land-rich if more than 50% of its assets for the income year are residential land.

Application dates

The residential ring-fencing rules apply from the start of the 2019-20 income year.

As section EL 20 is replacing previously existing bright-line provisions, it applies from the relevant dates for the 2-year and 5-year bright-line test, respectively.

Detailed analysis

Property subject to the rules

The rules apply to "residential land", using the same definition of "residential land" in section YA 1 that already exists for the bright-line test.

"Residential land" means:

- land that has a dwelling on it;
- land there is an arrangement to build a dwelling on; or
- bare land that, under the relevant operative district plan rules, may have a dwelling built on it.

However, even if one of these criteria is met, land is not residential land if it is:

- used predominantly as business premises; or
- farmland.

The business premises and farmland exclusions from the definition of "residential land" are discussed in detail in *Tax Information Bulletin* Vol 28 No 1 (February 2016, Inland Revenue).

Overseas property

The definition of "residential land" is not limited to land in New Zealand – it extends to overseas land. This was considered appropriate for the bright-line test, and the same approach is taken for the ring-fencing rules. This is because it would not be equitable for deductions for loss-making overseas residential rental investments to be able to be offset against income in New Zealand, but deductions from loss-making domestic residential rental investments not to be.

Property excluded from the rules

Main home

A taxpayer may use their home in part to earn income, so a portion of their property-related expenses may be deductible. As the focus of the rules is on loss-making rental properties, a taxpayer's main home is specifically excluded from the scope of the rules.

To qualify for the exclusion from the ring-fencing rules (in section EL 9), the property has to be used predominantly as the person's main home for most of the particular income year.

The concept of a "main home" in section EL 9 is the same as for the bright-line test. This means that a person can have only one main home. If a person has more than one house, as with the bright-line test, their main home will be the property they have the greatest connection with. There is detailed guidance in *Tax Information Bulletin* Vol 28 No 1 (February 2016, Inland Revenue) on determining which property a person has the greatest connection with.

A significant number of family homes in New Zealand are owned by family trusts. The "main home" exclusion therefore ensures that a home owned by a trust can be regarded as a main home. Like with the bright-line rules, a dwelling owned by a trust is only considered a main home (so not subject to the ring-fencing rules) if it is the main home for a beneficiary of the trust, provided that a principal settlor of the trust does not have a different main home. This restriction ensures that trust ownership cannot be used to claim multiple properties as main homes, and so not subject to the ring-fencing rules.

The criteria for the main home exclusion are generally the same as for the main home exclusion from the bright-line test. As such, Inland Revenue guidance on the bright-line main home exclusion is also relevant in determining what constitutes a main home for the purposes of the rental ring-fencing rules. However, in the context of the ring-fencing rules, the period looked at is the particular income year rather than the whole period of ownership.

Mixed-use assets

The definition of "residential land" includes holiday houses, which may be used privately and also sometimes rented out.

Many such properties would be subject to the mixed-use asset rules, which set out a specific formula for calculating deductible expenditure. Notwithstanding the way expenditure is apportioned under those rules, a mixed-use asset can still be loss-making. This is more likely to occur when the income-earning use of the asset is low. Therefore, the mixed-use assets rules quarantine (or ring-fence) deductions in excess of income from a mixed-use asset where the income-earning use of the asset is low.

Because the mixed-use asset rules already contain their own quarantine (or ring-fencing) rules, property that is an asset for the purposes of the mixed-use asset rules (defined in section DG 3) is not subject to the residential ring-fencing rules. This exclusion is provided for in section EL 12.

Property that will be taxed on sale

The ring-fencing rules will not apply to land that will be taxed on sale regardless of when it is sold. This exclusion is provided for in section EL 10.

Where land will be taxed on sale, there is not the same concern about some of the deductible expenses relating to untaxed gains, as all economic income from the investment will be taxed.

If the land will be taxed on sale under section CB 7 because it is held in a dealing, development, subdivision, or building business, there are no notification requirements for the exclusion to apply.

However, if the land will be taxed on sale under another provision (such as if it was acquired with the intention of resale), the exclusion from the ring-fencing rules is only available if the taxpayer:

- notifies the Commissioner that the land is held on revenue account; and
- is able to separately identify the deductions relating to the land (except in the situation noted below).

Where the notification to the Commissioner is required for the exclusion to apply, the notification needs to be made by the date for filing the return of income for the later of:

- the income year the land is acquired (for example, if the sale will be taxed under section CB 6);
- the income year it becomes known that the land will be taxed on sale regardless of when the sale occurs (for example, if the sale will be taxed under section CB 12 or CB 13); or
- the 2019-20 income year (for land that was held at the start of the 2019-20 income year and was on revenue account).

The requirement for the taxpayer to be able to separately identify the deductions relating to the land does not apply if all of the taxpayer's residential land (other than land within the main home, mixed-use asset or employee accommodation exclusions) was or will be subject to tax on sale, and they have notified the Commissioner that the land is on revenue account by the relevant notification date.

Property owned by companies other than close companies and Government enterprises

The ring-fencing rules do not apply to land owned by companies other than close companies (section EL 11). Close companies are, in general terms, companies with five or fewer natural persons whose total voting interests are more than 50% – with associated persons being treated as one person. For example, a typical family company.

The exclusion for companies other than close companies avoids creating compliance costs for companies that hold residential land incidentally to their business (for example, as sites for future development), where there is not the same mischief of offsetting property losses against labour or other income with the expectation of tax-free capital gains.

Similarly, the mischief the ring-fencing rules are aimed at is not present for Government enterprises. As such, the rules do not apply to the Government enterprises listed in schedule 36 of the Income Tax Act.

Employee accommodation

There is also an exclusion from the rules for residential land that a taxpayer provides to their employees or other workers for accommodation in connection with their employment or service (section EL 13).

However, the employee accommodation exclusion in section EL 13 does not apply if the employees or other workers are associated with the owner of the land, unless it is necessary to provide the accommodation due to the nature or remoteness of the owner's business.

Again, the rationale behind this exclusion is to avoid creating compliance costs for businesses where the mischief the ring-fencing rules are seeking to address is not present.

Example 1 – Accommodation provided to associated employee

Bill is a farm manager. He is provided with accommodation at a house on a nearby property (which is not farmland), given the remote location of the farm and work hours required. Other farm workers are also provided with accommodation in the area. The farming business is owned by a company, which also owns the house Bill is provided with and the other residential land with the accommodation for employees and contractors. Bill and the company are associated persons.

The accommodation is provided to the workers in connection with their employment or service. The land with the accommodation provided to the non-associated workers is therefore within the employee accommodation exclusion (section EL 13(1)).

Because Bill is associated with the company, there is a further requirement for the exclusion for employee accommodation to apply. This is that it is necessary to provide the accommodation due to the nature or remoteness of the business carried on by the company. That requirement is met because of the work hours required and the remote location of the farm.

Income residential property deductions can be used against

Residential property deductions are allocated to a particular income year up to the total of the taxpayer's "residential income" for that year. If the default portfolio basis is used, this includes:

(a) residential rental income from the portfolio;

(b) net income from the sale of residential land in the portfolio;

(c) depreciation recovery income in relation to the portfolio; and

(d) net income from residential land that is outside the rules because it is held on revenue account.

If the property-by-property basis is used, "residential income" referred to in (a) to (c) above includes only amounts from the particular property.

To the extent the taxpayer's residential property deductions exceed their "residential income", they cannot be used as a deduction for that year. The excess deductions will instead be carried forward to the next year the taxpayer derives residential income, and added to the taxpayer's deductions for the property or portfolio in that year.

What if the taxpayer is in an overall loss position, but has made a profit from their residential property?

If a taxpayer has made an overall loss in a particular income year but has made a profit on the residential rental activity, any ring-fenced residential property deductions they have from prior years would be able to be used against those profits. This is because the deductions are used against residential income, not the taxpayer's overall net income. This will have the effect of reducing the amount of deductions that are ring-fenced.

Portfolio or property-by-property basis

Applying the rules on a portfolio basis

The default position under section EL 4 is that the ring-fencing rules apply on a portfolio basis. Under this approach, investors calculate their overall profit or loss across all the properties in their portfolio. The income from all properties in the portfolio is offset by deductions for all properties.

Example 2 – Applying the rules on the default portfolio basis

Minerva owns two residential rental properties. She applies the ring-fencing rules on the default portfolio basis. In the 2019-20 income year, one property returned gross rental income of $20,000 and deductions for that property were $12,000. The second property returned $25,000 gross rental income and deductions for that property were $30,000. In her tax return, Minerva will include $45,000 gross rental income. She can use all $42,000 of the deductions for the portfolio in that year; none of the deductions are ring-fenced. Minerva will have net rental income of $3,000 from the portfolio.

Applying the rules on a property-by-property basis

Alternatively, taxpayers can elect to apply the ring-fencing rules on a property-by-property basis (section EL 6). This approach can be elected for one or more of the taxpayer's residential rental properties, even if they own other properties which are part of a portfolio.

When using the property-by-property approach, each property is looked at separately and deductions for one are not able to be offset against income from another. However, if this approach is taken, and it transpires that the sale of the property is taxed (for example, under the bright-line test), any remaining excess deductions are released from the ring-fencing rules and used against the taxpayer's income from other sources.

The election is made by the taxpayer taking a tax position in their return that reflects deductions for the particular property only being used against income from that property. Expenditure to which any deductions relate must relate solely to the particular property. So if, for example, there is some expenditure that related to more than one property (eg, interest on a loan used for two properties) the property-by-property basis could not be used.

To apply the rules on a property-by-property basis, a taxpayer needs to take a tax position consistent with this approach in their return of income for the income year in which the property becomes their residential rental property (or, for property held at the start of the 2019-20 income year, in their return for that year).

The election remains in effect so long as the taxpayer continues to take a position in their tax returns that is consistent with applying the rules on a property-by-property basis. If the taxpayer changes their tax position, the property becomes a portfolio basis property from that year.

The position a taxpayer takes in their return may be the same on both a portfolio or property-by-property approach – for example, if all of the taxpayer's properties are profitable, or if they are all non-profitable. However, if a taxpayer has had more than one property that could comprise a portfolio, and the sale of a particular property is taxed, any remaining unused excess deductions for the property would only be released from the ring-fencing rules if the taxpayer has determined the deductions allowed for the property in each year based on income, expenditure and losses that related solely to the property. The returns for all years would need to be consistent with this – for example in any year there was a mix of profitable and non-profitable properties, or if there was any expenditure that did not solely relate to the property.

Example 3 – Applying the rules on a property-by-property basis

Riley owns three residential rental properties. He applies the ring-fencing rules on the default portfolio basis for two of the properties (A and B). He elects to apply the rules on a property-by-property basis for the third property (C). Riley decided to apply the rules on a property-by-property basis for property C because he was associated with a land developer when he acquired property C, so if he ends up selling it within 10 years the sale will be taxed.

In the 2019-20 income year, the portfolio properties (A and B) returned combined gross rental income of $50,000. Deductions for those properties totalled $45,000. Property C returned gross rental income of $20,000, and deductible expenses for that property totalled $23,000.

In his 2019-20 income tax return, Riley includes net rental income of $5,000 from the two portfolio properties (A and B). He can use $20,000 of the deductions for property C. The remaining $3,000 of deductions from property C cannot be used against the income from the portfolio properties (A and B) or against any other income Riley has. The $3,000 of excess deductions from property C are carried forward to the next income year and added to the deductions for property C in that year.

If property C ends up being taxed on sale, the net profit or loss for that specific property would be known, and any ring-fenced deductions in excess of the net income from the sale will be released and used against any other income Riley has.

What basis is used when the property is owned by a look-through company (LTC) or a partnership?

LTCs

If the residential property is owned by an LTC, whatever basis the LTC has applied the ring-fencing rules on in filing its return will flow through to and be binding on the shareholders (section HB 1(6)).

So if an LTC applied the rules on a portfolio basis and the portfolio was loss-making overall, any shareholder who directly held other residential property subject to the ring-fencing rules would be able to use their share of the deductions that flow through from the LTC against their total residential income. This would include their residential income from the LTC and any other residential income they derive.

If an LTC applies the rules on a property-by-property basis, the shareholders have to also take that approach in their returns. This would mean, for example, that if residential deductions for the property exceeded the residential income from the property, the shareholder could only use their share of the deductions up to their share of the income from the property. Their excess deductions would not be able to be used against residential income from another property (eg, one they own directly).

Partnerships

This is not the case for partners in partnerships, as there is no provision equivalent to section HB 1(6) for partnerships.

If a partnership has filed a partnership return applying the rules on a particular basis, the partners do not necessarily need to apply the rules on that same basis. And different partners in the partnership may potentially apply the ring-fencing rules on different bases in respect of their share of the residential income and deductions. The position each partner takes in their tax return will either be consistent with them applying the rules on a property-by-property basis, therefore meeting the election requirement in section EL 6(4), or it will not, which would mean the property would become included in a portfolio for them (section EL 6(5)).

However, any partner applying the rules on a property-by-property basis must have determined the deductions for the property able to be used in each year based only on income, expenditure and losses that related solely to the property. If, for example, the partnership had two residential properties with intermingled expenses that related to both the properties, none of the partners could apply the ring-fencing rules on a property-by-property basis for the partnership properties.

Use of ring-fenced deductions when properties are sold

Sale of an individual basis property

There may still be unused ring-fenced deductions for a rental property after it is sold. In some circumstances these may be released from the ring-fencing rules (or unfenced), meaning they can then be used against the taxpayer's income from any source.

If a taxpayer sells a property to which they have applied the ring-fencing rules on a property-by-property basis and the sale is **not taxed**, the unused deductions would remain ring-fenced. They would be carried forward to any future year in which the taxpayer derives residential income from another property, at which point they would be treated as transferred to that property.

However, if the sale of the property was **taxed**, any remaining unused excess deductions (if not already completely used to offset the taxable income from the sale) will be unfenced (section EL 7(2)). This means the excess deductions are no longer subject to the ring-fencing rules, and will offset any income the taxpayer has from other sources in the year of the sale. If the taxpayer does not have other income, or not enough to fully utilise the deductions, they will have an overall net loss, which will be carried forward and used against any future income.

That said, if there have been unused deductions transferred to the property from a previous rental property, the amount that is unfenced will be reduced by the amount of the transferred deductions (section EL 8(2) and (3)).

Example 4 – Taxed sale of individual basis property

Nikita has three residential rental properties – two in a portfolio (properties A and B), and one which he applies the ring-fencing rules on a property-by-property basis for (property C). He also has salary income of $70,000. Property C has accumulated ring-fenced deductions of $80,000. Nikita decides to sell property C. The sale is taxed, and gives rise to a net gain of $60,000. Nikita uses $60,000 of the ring-fenced deductions against the net sale income from property C. Because Nikita has applied the ring-fencing rules on a property-by-property basis for this property, the remaining excess deductions of $20,000 are unfenced and used against Nikita's salary income.

Sale of all properties in a portfolio

Similarly, if all of the properties that have been in a taxpayer's residential portfolio are sold, there may potentially still be unused ring-fenced deductions.

If the sale of **each of the properties** that were in the portfolio was taxed, any remaining excess (if not already completely used to offset the taxable income from the sales) would be unfenced and therefore available to offset income from other sources. If any of the properties that were in the portfolio were not taxed on sale, the remaining excess deductions would remain ring-fenced. They would be carried forward to any future year in which the taxpayer derives residential income from another property, at which point they would be treated as transferred to that new rental property.

Note that the composition of a portfolio can change, with properties within it being bought and sold. A portfolio includes all residential properties a taxpayer has included in their portfolio from the beginning of the income year in which they first acquire a property that was in the portfolio until the end of the income year in which they dispose of the last of the properties included in that portfolio.

Example 5 – The composition of a portfolio changing as properties are bought and sold

Kate and David have bought and sold the following residential investment properties, and have not elected to apply the ring-fencing rules on a property-by-property basis for any of them:

Year 1 – Own property A and property B.

Year 2 – Sell property B in May. Buy property C in August.

Year 6 – Sell property A in September, buy property D in December.

Year 10 – Sell properties C and D.

Year 11 – Buy properties E and F.

Properties A, B, C and D are all part of the same portfolio. It does not matter that they were not all held at the same time. There was a portfolio of properties from Year 1 until the end of Year 10, although the composition of the portfolio changed over that time. Any excess deductions remaining after the sale of properties C and D will not be unfenced unless all of the properties in the portfolio were taxed on sale.

Properties E and F are part of a new portfolio, as when they were purchased Kate and David no longer owned any of the properties that had been part of the first portfolio.

Example 6 – Treatment of ring-fenced deductions on disposal of all properties in a portfolio

Jairus owns a portfolio of two residential properties; he has not previously owned other residential properties. In the 2019-20 income year, he sells both of his properties for a total net taxable gain of $10,000. He also has gross rental income of $20,000 from the properties in that year, rental deductions for the properties of $35,000, and a salary of $70,000.

Jairus has a total of $30,000 "residential income" from the portfolio for the year (the rental income and the net taxable gain from the sale of the properties). He can use $30,000 of the rental deductions against his residential income. Because the sales of both properties in the portfolio were taxed, the remaining $5,000 of rental deductions are unfenced and can be used against Jairus' salary income.

If the sale of only one of the properties had been taxed, any excess deductions would remain ring-fenced. The excess would not be able to be used against Jairus' salary income, but would have to be carried forward to be used against any future residential income Jairus has.

Application of the rules to close companies

The ring-fencing rules apply to close companies – in general terms, these are companies with five or fewer natural persons whose total voting interests are more than 50%, with associated persons being treated as one person.

The continuity rules

For close companies, unused excess deductions under the ring-fencing rules are subject to the existing shareholder continuity rules for companies, with the unused excess being treated as if it were an unused tax loss component. If the shareholder continuity requirements are breached, the amount of unused excess deductions that are allocated to the relevant income year may be restricted (section EL 14).

Transfers between companies in wholly-owned groups

Section EL 15 allows for some or all ring-fenced deductions to be transferred between companies in a wholly-owned group. The ability to transfer ring-fenced deductions is limited to companies in the same wholly-owned group, as the economic ownership is the same in that situation. Transferred deductions remain ring-fenced, so can only be used against "residential income" derived by the transferee company.

Interposed entities

The issue

Without rules to deal with interposed entities, some taxpayers could get around the ring-fencing rules by interposing an entity (for example, a company) to separate a loan (and interest deductions) from the residential rental property, so the interest deductions would not be subject to ring-fencing.

For example, a taxpayer could borrow money to buy shares in a company, which uses those funds to buy a residential investment property. Because the interest on the borrowings formally relates to the individual's investment in shares in the company, not to the acquisition of a residential rental property, in the absence of the interposed entity rules the individual would have been able to claim deductions for the interest even if the rental property was loss-making taking into account those deductions, and offset those deductions against income from other sources.

Sections EL 16 to EL 19 are aimed at ensuring this mechanism cannot be used to get around the ring-fencing rules, which would undermine their credibility, neutrality, and fairness.

The interposed entity rules

The interposed entity rules apply to interest expenditure on borrowings to acquire an interest in an entity, if, for a particular income year the entity is a "residential land-rich entity". An entity will be a "residential land-rich entity" where at the end of the year over 50% of its assets by value are residential land, whether owned directly or indirectly.

The interposed entity rules can apply where the entity is a close company, LTC or partnership. They can also apply to trustees of a trust if more than 50% of the trust's assets are residential land. The interposed entity rule for trusts is intended to cover off the possibility of someone borrowing to acquire a beneficial interest in a fixed trust that is not a unit trust – something not likely to occur often.

The 50% "residential land-rich entity" threshold takes into account all residential properties, not just those within the scope of the ring-fencing rules. This ensures that the interposed entity rules apply even if, for example, the main home is held in the same entity as a rental property (which would often be worth less than the main home).

Where the land-rich threshold is met, the interest on the borrowings will only be deductible in that year to the extent allowed under the interposed entity rules.

Under the rules, the amount of the interest expenditure that can be deducted in the year is calculated by reference to two factors:

- the level of the entity's capital that has been used to acquire residential property; and
- the person's "share of net residential income".

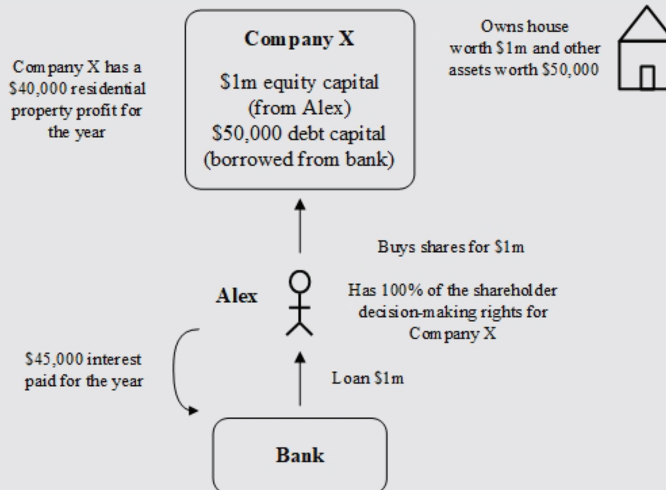
Having regard to the level of the entity's capital that has been used to acquire residential property in effect allocates the interest expenditure between the residential property and other investments of the entity. For example, if a residential land-rich company has $2,000,000 of capital and a residential property it purchased for $1,000,000, 50% of the interest expenditure in relation to shareholder's investment in the entity may potentially be subject to ring-fencing.

Having regard to the person's "share of net residential income" reflects the proportion of the total interests in the entity or property that the person has. For example, if a person who has borrowed to invest in a residential land-rich entity has 50% of the shares in the entity, they can only deduct the interest expenditure up to a maximum of 50% of the net residential income the company has.

For non-transparent entities, the person's "share of net residential income" is based on the person's interest (eg, a shareholder's voting interest in a company) and the entity's net residential income.

For transparent entities (LTCs and partnerships), the person's "share of net residential income" is the person's residential income for the income year from property held in the entity (or a particular property, if the entity has applied the ring-fencing rules on a property-by-property basis).

Example 7 – The interposed entity rules



More than fifty percent of Company X's assets are residential property, so Company X is a "residential land-rich entity".

95.24% of Company X's capital ($1,000,000 ÷ $1,050,000) was used to acquire residential rental property (this is the "applied capital percentage" in the formula in section EL 17(1)).

The "applied capital percentage" is multiplied by the interest expenditure of $45,000 Alex incurred for the year for the borrowings, under the formula in section EL 17(1). The amount calculated under that formula is therefore **$42,858** (95.24% × $45,000 interest).

Alex's voting interest in Company X is one hundred percent, as she has 100% of the shareholder decision-making rights for Company X. That interest is multiplied by Company X's net residential income ($40,000), under the formula in section EL 17(3). The amount calculated under that formula is therefore $40,000 (100% × $40,000).

Alex's interest deduction for the income year is limited under the interposed entity rules. To the extent the amount calculated under the formula in section EL 17(1) exceeds the amount calculated under the formula in section EL 17(3), the deduction is suspended for the income year. The suspended amount is carried forward to the next year and added to the amount of Alex's interest expenditure in relation to her investment in the entity for that future year.

This means that $2,858 of Alex's interest expenditure is suspended as a deduction for the year ($42,858 – $40,000 = $2,858).

For the current income year, Alex can therefore deduct $42,142 of the interest expenditure ($45,000 total interest expenditure minus $2,858 suspended deduction). The $2,858 deduction that is suspended for the year is carried forward and added to Alex's interest expenditure for the next year.

Detailed examples

The examples below provide more detailed guidance on how the rules apply in a range of situations.

Example 8 – Individual owns a portfolio of residential rental properties

Emilia is employed as a computer programmer and earns $85,000 a year. She owns three residential rental properties. She has not elected to apply the ring-fencing rules on a property-by-property basis for any of them. The rules apply to the properties on a portfolio basis.

Year 1 – Excess deductions to be carried forward

Residential income and deductions

In the 2019-20 income year, Emilia carried out some repairs on one of the properties. She derived $50,000 in rental income in total from the three properties. Her deductible expenses for all the properties totalled $60,000. Emilia's salary for the year was $85,000.

Residential rental deductions that can be claimed for the income year

Under section EL 4(2), the amount of deductions for the properties that Emilia can claim for the year is capped at the amount of income she derived from the properties. Emilia can therefore claim $50,000 of her total $60,000 deductions for the income year.

Excess deductions carried forward

The $10,000 of excess deductions relating to the properties cannot be claimed against Emilia's salary income. The excess deductions are carried forward to the next year in which Emilia derives residential income.

Year 2 – Taxable sale of a property in the portfolio

Residential income and deductions

At the end of the 2020-21 income year, Emilia sold one of her properties. The sale of the property is taxable under the bright-line test. Emilia made a net gain of $50,000 from the sale.

Emilia derived $90,000 in rental income in total from all of the properties. Residential rental deductions totalled $20,000 for the 2020-21 income year. Emilia also has $10,000 of excess deductions carried forward from the previous income year.

Residential rental deductions that can be claimed for the income year

Under section EL 4(2), the amount of deductions that Emilia can claim for the 2020-21 income year is capped at the amount of "residential income" she has derived in relation to the portfolio for the year.

Emilia's residential income comprises rental income of $90,000 and $50,000 net income from the taxed property sale.

The amount of residential rental deductions that Emilia can claim for the year is therefore capped at $140,000 ($90,000 rents + $50,000 net income from the sale of residential land).

Excess deductions carried forward

Emilia has $30,000 total residential rental deductions ($10,000 carried forward from the previous income year + $20,000 of deductions for expenses incurred in the current income year). As a result, Emilia does not have any excess residential rental deductions to carry forward to the next income year.

Example 9 – LTC owns residential properties and applies the ring-fencing rules on the default portfolio basis

Charles and Nikau are 50/50 shareholders in a look-through company (LTC). The LTC owns three residential rental properties. The LTC is applying the ring-fencing rules to the properties on the default portfolio basis. Charles owns another rental property directly. Nikau does not own any other properties.

Year 1 – Ring-fenced deductions flow through to the LTC shareholders

Residential income and deductions for the portfolio

In the 2019-20 income year, the LTC undertook renovations on the properties throughout the year, as the respective tenancies ended. The LTC derived $40,000 in residential income from the portfolio properties and incurred deductible expenses of $75,000 in relation to the portfolio.

Residential rental deductions that can be claimed for the income year for the portfolio

Under section EL 4(2), the amount of deductions relating to the portfolio that the LTC can allocate in its return to the 2019-20 income year is capped at the amount of residential income derived from the portfolio. Therefore, the total amount of deductions the LTC can allocate to the year for the portfolio is $40,000.

Income, deductions allocated to the year, and ring-fenced deductions flow through to the LTC shareholders

The LTC's tax return would reflect rental income of $40,000, deductions allocated to the 2019-20 income of $40,000, and ring-fenced deductions of $35,000. The income, deductions and ring-fenced deductions are all attributed to Charles and Nikau in proportion to their effective look-through interests.

Nikau does not have any other residential income, so his share of the ring-fenced deductions cannot be claimed against any other income he has. His share of the ring-fenced deductions are carried forward to the next year in which he derives residential income.

Charles has another rental property, so his share of the ring-fenced deductions from the LTC properties, together with the deductions from his own property, are his total deductions in relation to his portfolio. They can be used against all of his residential income from the portfolio, including from his own property.

Year 2 – Shareholders' ring-fenced deductions from prior year can be used as the portfolio is profitable

Residential income and deductions for the portfolio

In the 2020-21 income year, the LTC derived $78,000 in residential income from the portfolio properties and incurred deductible expenses of $35,000 for those properties.

Residential rental deductions that can be claimed for the income year for the portfolio

As the income from the portfolio exceeds the deductions relating to the portfolio, in its return the LTC can allocate all of the deductions to the 2020-21 income year.

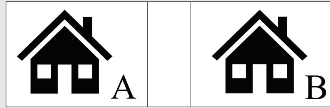
Income and deductions flow through to the LTC shareholders

The LTC's tax return would reflect rental income of $78,000, and deductions allocated to the 2020-21 income year of $35,000. There are no ring-fenced excess deductions. The income and deductions are attributed to Charles and Nikau in proportion to their effective look-through interests.

Nikau's share of the ring-fenced deductions from the previous year, together with his share of the deductions from the current year, are his total deductions in relation to his portfolio (the LTC properties). They can be used against his residential income from the portfolio for the year (his share of the income from the LTC properties).

Charles' share of the deductions from the LTC properties, together with the deductions from his own property, are his total deductions in relation to his portfolio. They can be used against all of his residential income from his portfolio (which includes the LTC properties and his own property).

Example 10 – Applying the ring-fencing rules on a property-by-property basis



Gary is a self-employed landscaper. He has two residential rental properties. He has elected to apply the ring-fencing rules to each of the properties on a property-by-property basis.

Year 1 – Taxable sale of an individual property and release of excess deductions

Residential income and deductions for property A

In the 2020-21 income year, Gary decides to undertake some repairs to property A. He commences the repairs after the tenants move out, and the house is not habitable while the repairs are being done. Gary's rental income from property A was $15,000, and he incurred $40,000 of deductible expenses for the property.

While undertaking the repairs Gary discovers there are far more significant issues than he envisaged. He is concerned the property will become a money pit, so decides to cut his losses and sell property A. It sells during the income year. The sale was taxable under the bright-line test. Gary made a net gain of $10,000 from the sale.

Residential income and deductions for property B

Gary's rental income from property B was $25,000, and he incurred $30,000 of deductible expenses for the property.

Residential rental deductions that can be claimed for the income year for property A

As the sale was taxable, the excess deductions that would otherwise be ring-fenced are released from the application of the ring-fencing rules (section EL 7(2)). This means that Gary can use the excess deductions from property A ($15,000) against his income from landscaping.

Residential rental deductions that can be claimed for the income year for property B

Under section EL 4(2), the amount of deductions for property B that Gary can claim for the year is capped at the amount of income he derived from property B. Gary can therefore claim $25,000 of the total $30,000 deductions for property B for the income year.

Excess deductions carried forward in relation to property B

This means that Gary will have $5,000 in excess deductions in relation to property B. The excess deductions cannot be used to reduce Gary's taxable income from his landscaping work.

The excess deductions are carried forward to the next year in which Gary derives income from from property B.

Year 2 – Taxable sale of remaining individual property

Residential income and deductions

Early in the 2021-22 income year, Gary decides to sell property B and go travelling. Gary's rental income for the year from property B was $10,000, and he incurred $7,000 of deductible expenses for the property. The sale was not taxable.

Gary's total residential rental deductions for property B are $12,000. This is made up of the $5,000 of excess deductions carried forward from the previous year, and the $7,000 of deductions for expenditure incurred in the current year.

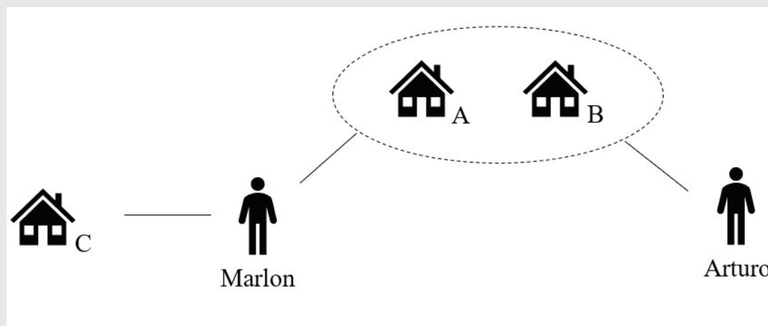
Residential rental deductions that can be claimed for the income year

Under section EL 4(2), the amount of deductions for property B that Gary can claim for the year is capped at the amount of income he derived from that property. Gary can therefore claim $10,000 of the total $12,000 deductions for property B for the income year. Because the sale of Property B was not taxable the deductions in excess of the income are not released from the ring-fencing rules.

Excess deductions carried forward

This means that Gary will have $2,000 in excess deductions that must be carried forward to a future income year in which he derives residential income. The excess deductions cannot be used to reduce Gary's taxable income from his landscaping work.

Example 11 – Partners in a partnership own residential properties and apply the ring-fencing rules on different bases



Arturo and Marlon are equal partners in a partnership with two residential rental properties. Marlon owns another rental property himself. Arturo does not own any other properties.

Residential income and deductions for the properties

In the 2019-20 income year, the income derived and deductible expenditure incurred in respect of the partnership properties were as follows:

property A	**property B**
$30,000 income	$8,000 income
$20,000 deductions	$25,000 deductions

Marlon derived $35,000 income from his property (property C), and incurred $20,000 of deductible expenses for the property.

Arturo's return

Arturo and Marlon are thinking about selling property B, and the sale may be taxed. Arturo therefore wants to apply the ring-fencing rules on a property-by-property basis. This would mean that his share of any remaining unused deductions (if there are any after being used against his share of residential income, including any net land sale income) would be unfenced and able to be used against Arturo's other income.

There are no intermingled expenses for the properties, so Arturo can apply the rules on a property by property basis.

For property A, Arturo's share of the income is $15,000, and his share of deductions is $10,000. He can therefore use all of his deductions for property A against his income from property A, leaving him with net income of $5,000 from property A.

For property B, Arturo's share of the income is $4,000, and his share of deductions is $12,500. As he is applying the rules on a property-by-property basis, the deductions for property B that Arturo can claim for the year are capped at the amount of income from property B. This means that Arturo can use $4,000 of his deductions for property B, with the remaining $8,500 being ring-fenced.

Arturo's 2019-20 return reflects that he has $14,000 of rental deductions allocated to the year ($10,000 for property A + $4,000 for property B), $8,500 of ring-fenced deductions, and $5,000 net rental income.

Marlon's return

Marlon is applying the ring-fencing rules on a portfolio basis. This is so he can use his share of the deductions from the partnership properties against his total residential income, which he wants to do as his own property (property C) is profitable.

Marlon's total residential income is $54,000 (his share from property A of $15,000 + his share from property B of $4,000 + the income from property C of $35,000). The total of his deductions for the properties is $42,500 (his share for property A of $10,000 + his share for property B of $12,500 + his deductions for property C of $20,000).

Marlon's 2019-20 return reflects that he has $42,500 of rental deductions allocated to the year, $0 of ring-fenced deductions, and $11,500 net rental income.

The Commissioner's care and management role

Sections 5B and 6A to 6G of the Tax Administration Act 1994

Background

Generally, tax law is consistent with the policy intent, but in some circumstances, the interpretation of the law when applying ordinary statutory interpretation principles does not accord with original the policy intent. When this happens, it can tie the Commissioner's and taxpayer's resources up in outcomes that are inconsistent with both parties' practice and/or expectations.

Amendments have been made to the Tax Administration Act 1994 that provide additional mechanisms, in the form of two new regulation-making powers, that can be used to address issues with tax laws that produce outcomes that are inconsistent with policy intent.

All legislative references in this part are to the Tax Administration Act 1994 (the Tax Administration Act).

Key features

The key features are two new regulation-making powers referred to in the Tax Administration Act as the "remedial powers":

- An Order in Council process which can be used to modify the application of provisions of the Inland Revenue Acts[32] on the recommendation of the Minister of Revenue.
- An administrative power of exemption for the Commissioner of Inland Revenue, which enables the Commissioner to provide legislative exemptions from provisions of the Inland Revenue Acts.

Both powers are subject to certain limitations, safeguards and processes which are intended to ensure the powers are confined to resolving issues with tax laws that produce outcomes that are inconsistent with the policy intent.

Application date

The amendments apply from 26 June 2019, the date the Bill received the Royal assent.

Detailed analysis

Amendments that do not relate to the remedial powers

New section 5B of the Tax Administration Act designates the chief executive of the Inland Revenue Department as the Commissioner of Inland Revenue. This provision was previously included in section 6A(1) of the Tax Administration Act.

Section 6 imposes an obligation on Ministers and officers of any government agencies having responsibilities under the Inland Revenue Acts to use their best endeavours to maintain the integrity of the tax system at all times (as well as defines "integrity of the tax system").

Section 6A provides that the Commissioner of Inland Revenue is charged with the care and management of the taxes covered by the Inland Revenue Acts. It recognises that the Commissioner must collect over time the highest net revenue that is practicable within the law, having regard to her limited resources, the importance of promoting compliance, and compliance costs incurred by persons. No substantive changes have been made to section 6A beyond removing the provision that designated the chief executive of the Inland Revenue Department as the Commissioner of Inland Revenue which is now in section 5B.

Section 6B enables the Governor General to issue directions in relation to the administration of the Inland Revenue Acts to the Commissioner by Order in Council. An Order made under section 6B cannot give directions to the Commissioner that concern the tax affairs of individual persons or the interpretation of tax law.

Remedial powers

New sections 6C to 6G contain remedial powers which can be used to address obvious errors, ambiguities, or inconsistencies within provisions of the Inland Revenue Acts. The remedial powers provide:

- A power of **modification** to the Governor General on the recommendation of the Minister of Revenue. The Minister of Revenue can recommend an Order in Council be made to modify the application of provisions of the Inland Revenue Acts; and
- A power of **exemption** for the Commissioner of Inland Revenue. The Commissioner can grant exemptions, that can be subject to terms and conditions, from provisions of the Inland Revenue Acts.

[32] The Inland Revenue Acts are listed in Schedule 1 to the Tax Administration Act 1994 and include the Income Tax Act 2007, the Goods and Services Tax Act 1985 and Acts that relate to social policies for which Inland Revenue has administrative responsibility as the Child Support Act 1991, the Student Loan Scheme Act 2011 and the KiwiSaver Act 2006.

The powers can be used, for example, where a drafting error means that a provision within a tax law is inconsistent with intended policy outcomes, or where a gap in the legislation is discovered that creates uncertainty about whether the legislation is consistent with the policy intent. In these situations, the powers could provide a temporary remedy where the law, interpreted using ordinary principles of statutory interpretation, does not align with intended policy outcomes. The use of the powers allows taxpayers to adopt an approach that is consistent with intended policy outcomes before amendments can be made to the relevant provision or provisions of the Inland Revenue Acts.

The new powers are in addition to the existing care and management powers contained in sections 6 and 6A.

Purpose of the remedial powers

New section 6C(2) specifies the purpose of the remedial powers. The purpose is to provide flexibility to temporarily remedy or mitigate the effect of a provision (or provisions) of the Inland Revenue Acts by making a modification or granting an exemption where it is reasonably necessary:

- due to an "obvious error";
- to give effect to the intended purpose or object of a provision or provisions;
- to resolve ambiguities;
- to reconcile inconsistencies.

Modifications and exemptions have general application unless expressly stated as applying only to a particular class of persons or circumstances. This is intended to ensure that where a modification or an exemption is made, it is available to all those affected by the issue the modification or the exemption is put in place to address.

As the effect of modifications and exemptions are that they change the application of primary legislation, an important safeguard on the use of the powers is that where modifications and exemptions are available for a person to apply, it is their decision whether or not to apply them. That is, if a person does not want to apply a modification or an exemption in relation to their circumstances, they can continue to rely on the relevant provision, or provisions, of the Inland Revenue Acts, without the effect of the modification or the exemption. The effect of such a decision also requires the Commissioner to apply the law in relation to the person as if the modification or the exemption did not exist.

Modifications made by Order in Council and exemptions granted by the Commissioner

New section 6D contains a power for the Governor General to make Orders in Council on the recommendation of the Minister of Revenue to modify the application of the Inland Revenue Acts. New section 6E provides the Commissioner with the power to grant exemptions from provisions of the Inland Revenue Acts.

The power to make modifications and exemptions, being regulations that are legislative instruments, also comes with the power to amend, revoke or replace them.[33] This means that it is possible for modifications and exemptions to be amended, revoked, or replaced if necessary. However, no modification or exemption can have its application extended beyond the three-year time limit (see *Period of application for modifications and exemptions*).

Before the Minister of Revenue recommends an Order in Council under section 6D, or the Commissioner grants an exemption under section 6E the Minister (or the Commissioner) must be satisfied that a modification or an exemption is reasonably necessary to do one or more of the following:

- Remedy or mitigate the effect of an obvious error (as defined in section 6G – see *Meaning of obvious error*) in a provision, or provisions, of the Inland Revenue Acts.
- Give effect to the intended purpose or object of a provision, or provisions, of the Inland Revenue Acts, or resolve ambiguity.
- Reconcile inconsistencies between provisions of the Inland Revenue Acts, or provisions of the Inland Revenue Acts and an administrative practice of the Commissioner.

Once satisfied that a modification or an exemption is reasonably necessary to do one or more of those things, the Minister or the Commissioner must also be satisfied that such a modification or an exemption:

- does not materially affect the intended scope or effect of the provisions to which it applies;
- is not inconsistent with the intended purpose or object of the relevant provision to which it applies; and
- is not broader than is reasonably necessary to address or resolve the issue that gave rise to it.

[33] See section 15 of the Interpretation Act 1999.

These provisions are intended to ensure that modifications and exemptions cannot be used to create new policy settings that are inconsistent with what was intended. These provisions are also intended to ensure that any modification made or exemption granted will be confined to resolving the issue that gave rise to it.

In addition to the above matters, and before recommending a modification or exemption, the Minister in the case of a modification, or the Commissioner in the case of an exemption, must also be satisfied that:

- using a modification or an exemption is the most appropriate way of resolving the issue at the time; and
- making the modification or granting an exemption does not have the effect of extending the period of application of an earlier modification or exemption made under either sections 6D or 6E.

The Minister or the Commissioner may consider that a modification is the most appropriate way of resolving the issue at the time if, for example, the matter cannot be resolved through an amendment to the corresponding provision, or provisions, of the Inland Revenue Acts in a timely manner, and there is significant uncertainty about how Inland Revenue will, or could, apply the law in the circumstances.

There may be some circumstances where neither the Minister nor the Commissioner considers it appropriate to use the remedial powers to address the issue.

Another modification or exemption cannot be used to prolong the period of application of a modification or an exemption which no longer has effect because it has expired (see *Period of application for modifications and exemptions*). For modifications and exemptions to have ongoing effect beyond the three-year limit, legislation with a corresponding amendment to the relevant provision(s) would need to be passed by Parliament.

If applicable, the Minister or the Commissioner must also be satisfied that:

- there is a reasonable opportunity for a person to choose not to apply a modification, if the modification is to be expressed as applying unless a person chooses not to apply it (see *Applying a modification or an exemption*); and
- a consultative process has taken place that meets the requirements of section 6F (see *Consultative process*) unless they consider a case of urgency exists.

For exemptions granted by the Commissioner, the Commissioner must be satisfied that the exemption would have no, or negligible, fiscal implications for the Crown. This serves to impose more of a limitation on the Commissioner's power to grant exemptions relative to the Minister's power to recommend modifications.

Content of modifications

A modification made under section 6D:

- may be made by stating an alternative means of complying with the provision or provisions to which the modification applies;
- provide the Commissioner with a discretionary power to be exercised;
- must specify the period for which the modification applies – see *Period of application for modification and exemptions*;
- must set out whether the modification applies on an "opt-in" or "opt-out" basis and set out how a person can choose to apply (or not apply) the modification – see *Applying a modification or an exemption*;
- may be subject to terms and conditions;
- may state whether the modification applies generally or is limited to a particular class of persons or circumstances; and
- may provide for transitional, savings, and related matters.

Content of exemptions

An exemption granted under section 6E:

- must specify the period for which the exemption applies – see *Period of application for modification and exemptions*;
- must set out whether the exemption applies on an "opt-in" or "opt-out" basis and set out how a person can choose to apply (or not apply) the exemption – see *Applying a modification or an exemption*;
- may state whether the exemption applies generally or is limited to a particular class of persons or circumstances;
- may provide for transitional, savings, and related matters; and
- may include terms and conditions the Commissioner thinks fit.

In circumstances where the Commissioner grants an exemption, and subject to any terms and conditions, the effect of this will be that the provision (or provisions) to which the exemption applies will no longer need to be applied (fully or in part) by those to whom the exemption is available (and to the extent that a decision is made by those people to apply the exemption).

Applying a modification or an exemption

Sections 6D(4) and 6E(5) allow modifications and exemptions to be expressed as:

- applying unless the person to whom it is available chooses not to apply it (**opt-out**); or
- applying only if the person to whom it is available chooses to apply it (**opt-in**).

Whether a modification or an exemption will be expressed on an opt-out basis or an opt-in basis will depend on the circumstances that the modification or exemption is put in place to address. For example, a modification or an exemption that relates to a person's tax position might be expressed as opt-in, and the mechanism for opting in would be taking a tax position that was consistent with the modification or the exemption. Modifications and exemptions may be expressed as opt-out where, for example, the modification or the exemption relates to the application of an Inland Revenue computer system.

How the modification or the exemption is expressed will be specified within the modification or the exemption itself.

Where a modification or an exemption is expressed on an opt-out basis, before the modification or the exemption takes effect, either the Minister of Revenue (for a modification) or the Commissioner (for an exemption) must be satisfied that people to whom the modification or exemption will be applied to have a reasonable opportunity to choose not to apply the modification or the exemption.

Period of application for modifications and exemptions

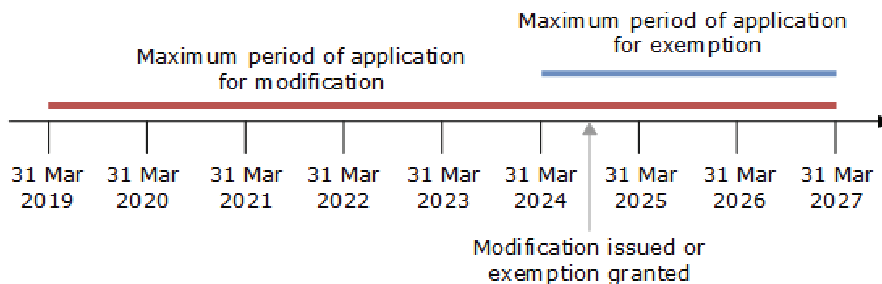
The rules for determining the period of application for modifications and exemptions are included in sections 6D(3)[33] and 6D(4)[34].

No modification or exemption can have prospective application for longer than three complete tax (or income) years, which includes the year in which the modification or the exemption comes into force.

Retrospective application is available in relation to:

- exemptions as far back as the beginning of the income year corresponding to the tax year in which the exemption comes into force;[36] and
- modifications as far back as the fifth income year before the income year corresponding to the tax year in which the modification comes into force.[37]

The following diagram shows the maximum applicable period of application for modifications and exemptions.



New section 6D(3)(c) permits modifications to have retrospective effect in relation to periods before the enactment of the remedial powers. Similarly, section 6E(4)(c) permits exemptions to be granted in respect of the 2019-20 tax (and income) year, despite the empowering provision only coming into force part way through the 2019-20 tax year.

For a modification or an exemption to have application beyond these timeframes, a legislative amendment must be made to the relevant provision (or provisions) of the Inland Revenue Acts by Parliament.

[34] For modifications made under section 6D of the Tax Administration Act 1994.

[35] For exemptions granted under section 6E of the Tax Administration Act 1994.

[36] See section 6E(4)(b) of the Tax Administration Act 1994.

[37] See section 6D(3)(b) of the Tax Administration Act 1994.

Legislative status of modifications and exemptions

Modifications made under section 6D and exemptions granted under section 6E are both legislative instruments and disallowable instruments.

This means that certain provisions of the Legislation Act 2012 apply to modifications and exemptions, in particular:

- publication requirements – modifications and exemptions will both be published electronically on the **www.legislation.govt.nz** website, as soon as practicable after having been made;
- drafting by the Parliamentary Counsel Office – modifications and exemptions, being legislative instruments, will be drafted by the Parliamentary Counsel Office; and
- disallowance procedures – modifications and exemptions are both subject to the disallowance procedures in Part 3 of the Legislation Act 2012.

The Regulations Review Committee will also review all modifications and exemptions. For more information, see Standing Orders 319 – 325 in the 2017 Standing Orders of the House of Representatives.

As modifications are given effect through an Order in Council, they will also be subject to a Cabinet process of approval before being introduced.

Additional publication requirements

When a modification is made, or an exemption is granted, the reasons for the modification or the exemption must be included alongside the modification or the exemption itself.[38] In addition to the reasons, an explanation of how the modification or exemption complies with the requirements of section 6D or 6E, as applicable, must also be published. The reasons and explanations will be included within the relevant modification or exemption (within either the Explanatory Note or Statement of reasons) and will also be communicated on Inland Revenue's website.

Consultative process

Before the Minister of Revenue recommends a modification, or the Commissioner grants an exemption, a consultative process must take place. The requirements for the consultative process are contained in section 6F.

The consultative process must include the distribution of the proposal to persons (or representatives of persons) that it is considered reasonable to consult with for the particular purpose of the modification or the exemption, with an explanation of the way in which the Minister considers the modification complies with the requirements of section 6D, or the Commissioner considers the exemption complies with the requirements of 6E.

The period of consultation must last for at least six weeks. This period can be shortened by the Minister in the case of a modification, or the Commissioner in the case of an exemption, if either consider that a case of urgency exists.

Meaning of obvious error

One of the circumstances in which a modification can be made or an exemption can be granted is to address an "obvious error" within a provision or provisions of the Inland Revenue Acts. New section 6G defines what an "obvious error" is for the purposes of subpart 2B as an error that arises in the circumstances where:

- the intended purpose or object of the relevant provision is clear; and
- the intended purpose or object cannot be carried into effect by the relevant provision; and
- the substance of the provision that Parliament would have made, had the error become known, or had the circumstances been allowed for, is clear.

Raising matters to be considered for the remedial powers

The Inland Revenue website has been updated with information about how to raise issues to be considered for the remedial powers.

The website address is: **ird.govt.nz/modification-power**

[38] See sections 6D(6) and 6E(6) of the Tax Administration Act 1994.

Social policy changes

STUDENT LOAN DEDUCTIONS FROM WITHHOLDING INCOME

Sections 4, 73, 202A and Schedule 2 of the Student Loan Scheme Act 2011

Background

The Student Loan Scheme Act 2011 contains changes to make it easier for borrowers earning schedular, casual agricultural, or election day income to meet their student loan obligations. Currently, borrowers earning these forms of income must make student loan repayments in lump sums at the end of the year, and it can be challenging for borrowers to meet this obligation. By collecting throughout the year, Inland Revenue hopes to reduce or eliminate the large student loan bills that these borrowers face at the end of the year.

Key features

The Act will allow for student loan deductions to be made from schedular income, casual agricultural employees and election day workers. Borrowers with income using a WT, CAE or EDW tax code will need to add a SL code to these forms of income. Employers will need to make additional deductions from amounts paid to these borrowers.

Unlike salary and wage payments, deductions from WT, CAE and EDW income will not be full and final and will need to be squared up at the end of the tax year. Any repayments required at this point should be considerably smaller. If a borrower has expenses that reduce their income, these will be taken into account at the end of the year, and the borrower can apply for a special deduction rate to reduce their deductions. Borrowers on WT codes will be able to take advantage of the repayment threshold. Borrowers on CAE and EDW income will have deductions made at the secondary rate of 12 percent from the first dollar they earn. They will be able to apply for a special deduction rate if they do not have primary employment that would put them above the repayment threshold.

Borrowers will be able to apply for relief under the existing provisions in the SLSA such as sections 42, 54 or 148. They could also apply for a tailored tax code for their student loan deductions under section 34.

Application date

The application date of these changes is 1 April 2020

INTEREST-FREE STUDENT LOANS

Sections 134, 135 and 137 of the Student Loan Scheme Act 2011

Background

Limitations in Inland Revenue's previous IT system meant that all student loan borrowers would be charged interest and would get it written off if they were New Zealand based. The new system does not face these limitations.

Key features

The Student Loan Scheme Act 2011 has been amended so only overseas-based borrowers are charged interest on their student loans. Instead of being charged interest and having it written off at the end of the tax year, New Zealand-based student loan borrowers will not be charged any interest on their loans. This change will make it easier for borrowers to understand their loan statements and better enacts the interest free student loan policy.

Application date

1 April 2020

STUDENT LOAN DAY COUNT TEST

Sections 22 and 23 of the Student Loan Scheme Act 2011

The act clarifies the application of the day count test and reinstates the tie-breaker provision that was inadvertently removed from the Student Loan Scheme Act when it was rewritten. For borrowers who frequently travel between New Zealand and overseas, the provision clarifies if they are overseas-based or New Zealand-based.

Background

The Student Loan Scheme Act 1992 and the Student Loan Scheme Act 2011 contain a day count test for determining if a borrower is New Zealand or Overseas-based. To qualify as a New Zealand-based borrower, the borrower must be physically in New Zealand for 183 consecutive days, with absences of no more than an aggregate 31 days in that period, and they must be in New Zealand for the first day of that 183-day period. To become Overseas-based, a borrower must be overseas for 184 consecutive days, with periods in New Zealand totalling no more than 31 days in that period. Like the New Zealand-based test, to become overseas based the 184-day period begins from the first day that they are overseas.

In cases where a borrower could qualify for either of these tests the 1992 Act contained a tiebreaker provision that required that they be treated as New Zealand-based in these situations. This provision was not carried over into the rewritten act in 2011. There was no intention to change the law. The amendment restores this act to its previous status.

Key features

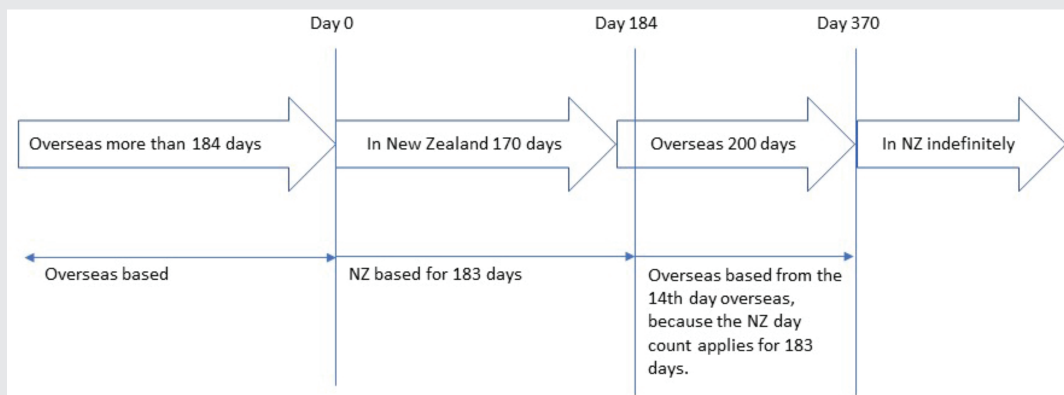
If a day could be included both in the 183-day qualifying period for becoming New Zealand-based and the 184-day period for becoming overseas-based, it is treated as being included in the 183-day period only.

Application date

The application date of this is 1 April 2012.

Example 1

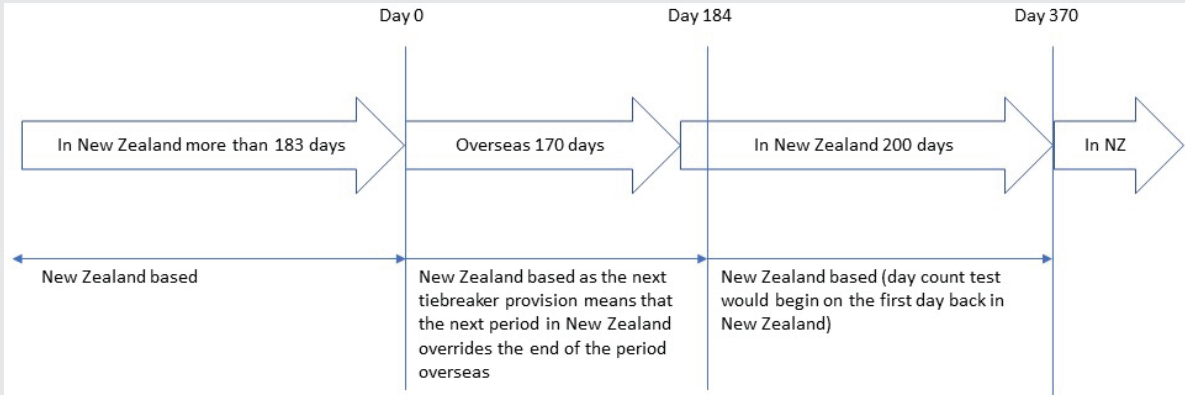
Oliver is overseas-based. He returns to New Zealand for 170 days, before heading overseas for 200 days. He then returns to New Zealand indefinitely. There is a 183-day period following his first day in New Zealand, with less than 31 days overseas. He is New Zealand based for the 170 days that he is in New Zealand, and for a further 13 days after he leaves New Zealand, due to the tiebreaker provision.



Example 2

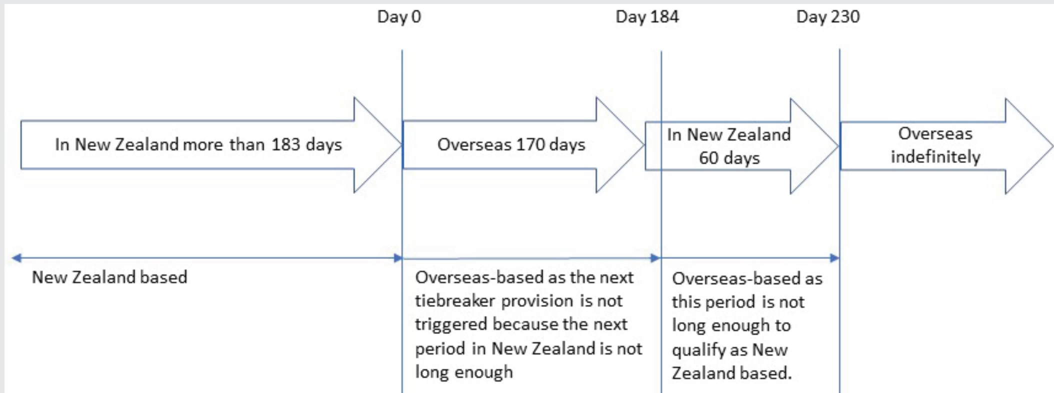
Mia is New Zealand-based. She goes overseas for 170 days. She then returns to New Zealand indefinitely. The tiebreaker provision is triggered after they have returned for 183 days, and as a result, the borrower does not become overseas based at any point in the period.

Note that Mia will be considered an overseas-based borrower until she has met the 183-day test after she returns to New Zealand. This is because at day 184 she has spent a continuous period of 184 days overseas, with less than 31 days in New Zealand in this time.



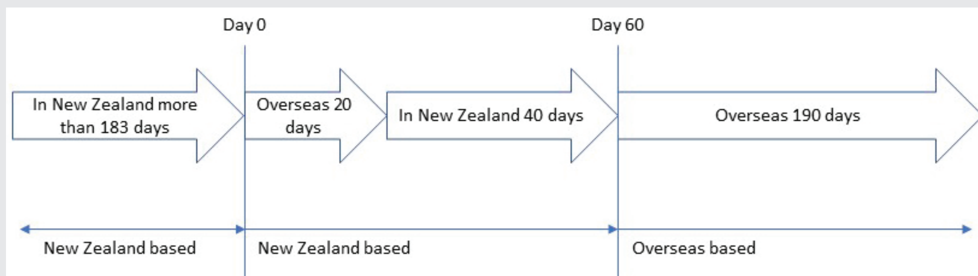
Example 3

Nikau is initially New Zealand-based. He goes overseas for 170 days. He then returns to New Zealand for 60 days, before returning overseas indefinitely. As the 60-day period in New Zealand does not meet the 183-day test, he is overseas-based from his first day overseas.



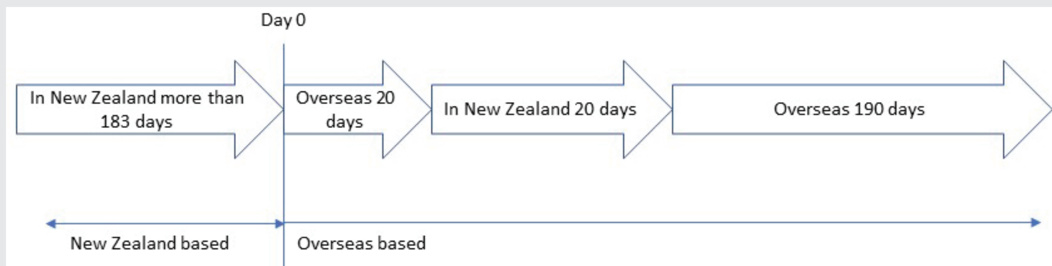
Example 4

Aria is New Zealand-based. She goes overseas for 20 days then returns to New Zealand for 40 days. After this she goes Overseas for 190 days. She is New Zealand based until the beginning of the second period overseas, as the 40 days in New Zealand exceeds the 31 days needed to interrupt the 184-day test.



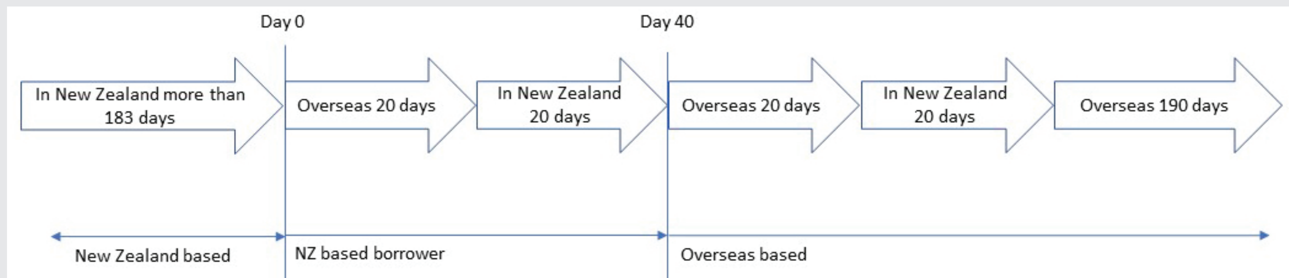
Example 5

Jack is New Zealand-based. He goes overseas for 20 days and returns to New Zealand for 20 days. He then goes overseas for 190 days. He is overseas-based for the entirety of this period as the 20 days in New Zealand is less than the 31 days needed to interrupt the 184-day period overseas for the 184-day test.



Example 6

Charlotte is New Zealand-based. She goes overseas for 20 days and returns to New Zealand for 20 days, twice. She becomes overseas-based from the beginning of her second period overseas. This is because she cannot meet the 184-day test beginning from their first period overseas as the total period in New Zealand in the following 184 days exceeds 31 days. They can meet this test from the first day overseas in the second period.



DEFINITION OF INCOME FOR STUDENT LOANS AND WORKING FOR FAMILIES

Section MB 12B of the Income Tax Act 2007

Schedule 3 of the Student Loan Scheme Act 2011

The definition of "net adjusted income" that is used for student loan purposes and the definition of "family scheme income" that is used for Working for Families tax credits have been more closely aligned.

Background

One of the factors that determines social policy entitlements is the relevant definition of "income". The current approach for social policy products, including the Student Loan Scheme, is to use a common definition of "income", such as the Income Tax Act definition of "net income", and to make adjustments to include or exclude other specific types of income as appropriate.

Changes were made to the Working for Families definition of "family scheme income" in 2011. These changes broadened the definition and were intended to improve the fairness and integrity of Working for Families by, for example, countering arrangements that have the effect of inflating entitlements beyond what people's true economic circumstances justify. In 2014, similar amendments were made to align the definition of income used for student loan purposes with that used for Working for Families.

A number of minor areas were identified where the definitions are not aligned or where wording changes would improve clarity, reduce misunderstanding and prevent structuring.

Key features

For the definition of "family scheme income", a separate legislative provision has been introduced which includes non-beneficiary income from a trust as family scheme income when a person is not a settlor.

For the definition of "net adjusted income", the following amendments have been made:

- For the undistributed income from close companies adjustment, alignment of the voting interest percentage with the percentage used for Working for Families tax credits income. This includes an associated persons test to prevent opportunities to structure shareholdings in close companies to reduce student loan repayment obligations.
- Certain contributions to retirement savings schemes are excluded from net income. This brings in a previously approved policy which was not implemented at the time.
- An amount of depreciation loss allowed in the 2002–03 or earlier years is excluded from net income.

Application dates

The amendment to the Income Tax Act applied from 26 June 2019, the date of Royal assent.

The changes to the Student Loan Scheme Act will apply from April 2020, the date student loans moves to Inland Revenue's new system.

CHILD SUPPORT (DISCRETION TO GRANT PERMANENT EXEMPTION)

Sections 89Y, 89Z, 89ZA, 89ZB and 152A of the Child Support Act 1991

The Child Support Act 1991 has been amended to give Inland Revenue discretion to grant sex offence victims a permanent exemption from paying child support even though there is no convicted offender.

Background

A person can have a child as a result of being the victim of a sex offence and may be made liable to pay child support for that child. Since 2006, a permanent exemption from paying child support has existed for the parent of a child born as a result of a sex offence. Before these amendments, for the parent to qualify for the exemption, the offender must have been convicted.

This strict requirement for an offender to have been identified and convicted meant very few parents qualified for an exemption, despite the reality that an offence occurred.

This result was inconsistent with the underlying policy intention which was to ensure that victims of a sex offence should not be held responsible for legal obligations resulting from that offence.

Key features

Inland Revenue will be able to use discretion to grant an exemption for sex offence victims if satisfied that an offence occurred and the child for whom child support is sought was born as a result of that offence.

Inland Revenue can also now use discretion to back date the exemption in situations when it is satisfied this would not negatively impact on a parent or carer, but no earlier than 26 September 2006 when the permanent exemption was introduced.

Inland Revenue would be obliged to revoke the exemption in situations when it subsequently becomes aware that the exemption should not have been granted.

Application date

The amendments apply 27 June 2019, the day after the date of Royal assent.

ORANGA TAMARIKI FINANCIAL ASSISTANCE PAYMENTS

Sections CW 33 and MB 13 of the Income Tax Act 2007

Background

Oranga Tamariki introduced a new transitions service on 1 July 2019 for young people leaving care. Changes to the Oranga Tamariki Act 1989 support this new service. Under section 386AAG of the Act, Oranga Tamariki can now provide financial assistance to help young people remain with or return to living with their caregiver until the age of 21. Under section 386B of the Act, Oranga Tamariki can provide advice or assistance, including financial assistance, to young people up to the age of 25.

Key features

Section CW 33 of the Income Tax Act 2007 has been amended to tax exempt payments to the young person or their caregiver under either of the sections in the Oranga Tamariki Act 1989. Under Section 386AAG, Oranga Tamariki may make payments to the young person to make to their caregiver, possibly with some additional contribution from the young person. In this case, both Oranga Tamariki's payment to the young person and the young person's payment to the caregiver should be tax exempt.

Section MB 13 of the Income Tax Act 2007 has been amended so that these payments are not included in family scheme income. The payments should not be taken into account for determining any Working for Families, Child Support or Student Loan entitlements or liabilities.

Application date

The amendments apply from 1 July 2019

Other policy changes

KEEPING TAX RECORDS IN TE REO MĀORI

Sections 22, 22A, 22B and 26 of the Tax Administration Act 1994 and section 78 of the Goods and Services Tax Act 1985

The Tax Administration Act 1994 and the Goods and Services Tax Act 1985 (GST Act) have been amended to allow taxpayers to hold tax records in te reo Māori as a matter of right. Obligations remain on taxpayers to produce certain documents in English, such as tax invoices for GST purposes and donation tax receipts that are used by third parties to take a tax position.

The changes ensure the operation and effect of the Inland Revenue Acts are aligned with the spirit and intent of Te Ture mō Te Reo Māori Act 2016 Māori Language Act 2016.

Key features

Taxpayers can choose to hold their tax records in English or te reo Māori. The amendments are directed at internal documents held by taxpayers in compliance with the requirements and obligations of the Tax Administration Act and the GST Act.

The amendments affect section 75 of the GST Act and sections 22, 22A, 22B and 26 of the Tax Administration Act. As a result of the changes taxpayers can hold tax records in te reo Māori without first having to seek Inland Revenue's approval.

The changes do not affect, replace, or alter existing taxpayer obligations or disclosures required in respect of tax documents that are relied on by third party taxpayers when taking a tax position. For example:

- For the purposes of the GST Act, new section 75(8) requires GST-registered persons that hold tax records in a language other than English to prepare documents that are consistent with the obligations under sections 24, 24BA, and 25 relating to English words that must appear on a tax invoice, or a debit note or credit note, provided by the registered person.
- Section 32 of the Tax Administration Act which deals with records held by donee organisations has not been amended as donations receipts are used by donors to establish their entitlement to donation tax credits or tax deductions.

The Tax Administration Act and the GST Act do not prevent taxpayers (at their choice) from providing bi-lingual documentation or including other material that complements the statutory requirements.

Application date

The amendments apply from 26 June 2019.

TE PUPURI PŪKETE TĀKE KUA TUHIA KI TE REO MĀORI

Wāhanga 22, 22A, 22B me 26 o te Tax Administration Act 1994 me wāhanga 78 o te Goods and Services Tax Act 1985

Kua whakarerekētia te Tax Administration Act 1994 me te Goods and Services Tax Act 1985 (GST Act) kia wātea ngā kaiutu tāke te pupuri i ngā pūkete tāke ki te reo Māori hei āheinga tika noa. Ka noho tonu ngā kawenga ki te kaiutu tāke ki te whakaputa mai i ētahi tuhinga ki te reo Ingarihi, pēnei i ngā nama tāke mō ngā kaupapa Tāke Hokohoko me ngā rihīti takoha tāke e whakamahia ana e te hunga i whai wāhi mai e ū ana ki tētahi tūnga tāke.

Ko ngā whakarerekētanga e whakariterite ana i te whakahaere me te pānga o te Inland Revenue Acts ki te wairua me te aronga o Te Ture mō Te Reo Māori 2016 (Māori Language Act 2016).

Ngā Āhuatanga Matua

Ka taea e te kaiutu tāke te pupuri ngā pūkete ki te reo Ingarihi, ki te reo Māori rānei. Kei te aro atu ngā whakatikatika ki ngā tuhinga ā-roto e puritia ana e ngā kaiutu tāke ki te whakatutuki i ngā whakaritenga me ngā kawenga o te Tax Administration Act me te GST Act.

Ka pā ngā whakatikatika ki te wāhanga 75 o te GST Act me ngā wāhanga 22, 22A, 22B, 26 hoki o te Tax Administration Act. Ko te hua o ngā panonitanga, ka taea e ngā kaiutu tāke te pupuri noa ngā pūkete ki te reo Māori, me te kore tono whakaaetanga mai i Te Tari Tāke i te tuatahi.

Kāore ngā panonitanga i te huri, i te whakakapi, i te whakarerekē rānei i ngā kawenga, i ngā puakanga rānei e hiahiatia ana mō te taha ki ngā tuhinga tāke e hiahiatia ana e ngā tāngata takawaenga i tētahi tūnga take. Hei tauira:

- I raro i te tikanga o te GST Act, ka whakatauhia e te wāhanga hou 75(8) ko ngā tāngata whai rēhita GST e pupuri ana i ngā pūkete tāke i tētahi reo atu i te reo Ingarihi me whakarite tuhinga e hāngai ana ki ngā tikanga i raro i ngā wāhanga 24, 24BA, 25 hoki e pā ana ki ngā kupu Ingarihi me matua puta mai i runga i tētahi nama tāke, i tētahi tuhinga nama, i tētahi tuhinga whiwhinga rānei, e whakaratohia ana e te tangata whai rēhita.
- Kāore i panonihia te wāhanga 32 o te Tax Administration Act e pā ana ki ngā pūkete e pupurihia ana e ngā whakahaere tuku koha, nā te mea kei te whakamahia ngā rihīti koha e ngā kaituku koha ki te whakamana i ā rātou whiwhinga i ngā whiwhinga tāke koha, i ngā tangohanga tāke rānei.

Kāore te Tax Administration Act me te GST Act i te aukati i te tuku mai a te kaiutu tāke (ki te hiahia rātou) i ngā tuhinga, i ētahi atu tāpiringa reorua rānei e whakatutuki ana i ngā whakaritenga ā-ture.

Te Rā Tono

Kua whai mana ngā whakatikatika mai i te 26 o Hune 2019.

COLLECTION OF IRD NUMBERS FOR TRANSFERS OF MAIN HOMES

Sections 77, 79 and Schedule 1 of the Land Transfer Act 2017

From 1 January 2020 most people who transfer property - including those who are transferring their main home - will need to include their IRD number and any relevant overseas tax residence information on the transfer documentation.

The remaining non-notifiable reasons, for which transferees or transferors are not required to include their IRD number, are set out in the Land Transfer (Land Information and Offshore Persons Information) Exemption Regulations 2015.

Information collected on the Land Transfer Tax Statement is provided to Land Information New Zealand (LINZ) as part of property transfer documentation and then passed onto Inland Revenue to assist compliance with New Zealand's property tax rules.

Background

Before a transfer of land can be registered, the transferor (seller) and transferee (purchaser) must complete a Land Transfer Tax Statement, prescribed under the Land Transfer Act 2017 (LTA).

The requirement for all transferors and transferees of property to complete a Land Transfer Tax Statement (LTTS) was introduced in October 2015. Information contained in the LTTS is collected by LINZ as part of the land transfer process and is sent onto the Inland Revenue for use in identifying and enforcing the property tax rules. This information can also be provided to overseas tax authorities by Inland Revenue in accordance with existing information-sharing legislation and international obligations.

The content of the LTTS is set out in section 79 of the LTA; it includes the tax details set out below (in relation to either the transferor or transferee):

- their IRD number
- whether they are treated as a tax resident in a jurisdiction other than New Zealand (without taking into account any double tax agreement)
- if they are tax resident in another jurisdiction – the name and country code of that jurisdiction, and their tax identification number for that jurisdiction.

The transferor or transferee is not required to include these tax details if the transfer is "non-notifiable". The current legislation specifies that a transfer was "non-notifiable" if certain main home criteria were met or if another non-notifiable reason applies as set out in regulations. These additional non-notifiable transfers include specific situations where the compliance cost to obtaining the information is likely to be unduly high and the risk of non-compliance is low.

The amendments follow a recommendation made by the Government's Tax Working Group to require the disclosure of IRD numbers on the Land Transfer Tax Statement when the transfer involves a main home. This change will provide ownership information to Inland Revenue for the vast majority of property transfers and assist compliance with the property tax rules.

Key features

These amendments require all transferors (sellers) and transferees (purchasers) to provide their IRD number and, if applicable, any overseas tax information when they are transferring their main home. This change is achieved by removing the transfer of a main home from qualifying as a "non-notifiable" transfer for the purpose of the Land Transfer Tax Statement.

To support this change, the amendments also require natural person or trustee transferors and transferees to provide an indication of whether the property being transferred was or is intended to be their main home (or in the case of the trustee, a main home for a beneficiary of the trust).

For a natural person, a "main home transfer" is defined as:

- For a transferor – land with a home on it, where the transferor has resided in the home for more than 50 percent of the time during which they owned the land;
- For a transferee – land with a home on it, where the transferee intends to reside.

For a trustee, a "main home transfer" is defined as:

- For a transferor – land with a home on it, where a natural person beneficiary has resided in the home for 50% of the time it was owned by the trust.
- For a transferee – land with a home on it, where a natural person beneficiary intends to reside in the home.

Minor other amendments to the Land Transfer Act are made to remove the restriction on an offshore person qualifying for a "non-notifiable" reason, and to include transitional provisions to allow transfers entered into before the commencement of the amendments to be completed on the basis of the existing legislative requirements.

The framework and wider provisions regarding when a Land Transfer Tax Statement must be completed have not changed. There are existing provisions covering the correction of errors and omissions, information disclosure, retention and offence provisions.

Application date

The amendments apply from 1 January 2020.

As a transitional measure, the existing legislative requirements (as at 31 December 2019) will continue for transfers where agreements are entered into before 1 January 2020 and the instrument for registration is lodged on or before 1 July 2020.

Detailed analysis

The information disclosure requirements in the LTA for property transfers are amended. The underlying property tax rules which provide for when a property sale may be taxable are contained in the Income Tax Act 2007 and are not affected by these amendments.

Removal of the non-notifiable reason when a main home is transferred

The amendments remove the ability for transferors or transferees to qualify for a non-notifiable transfer for the transfer of their main home. This means that purchasers and sellers will be required to provide their IRD number and any relevant overseas tax information when they transfer their main homes.

Current section 77(2) specifies what constitutes a non-notifiable transfer, including when the transfer of a main home qualifies as a non-notifiable transfer. Section 77(2) is repealed, and section 77(1) is amended to include a definition of a non-notifiable transfer that is, a transfer specified as a non-notifiable transfer in regulations made under the Land Transfer Act 2017.

The definition of a "main home" in section 77 is also repealed. These amendments provide that IRD numbers and, if applicable, any overseas tax identification number and country of residence, must be provided for all main home transfers.

Main home indicator

To support the removal of the non-notifiable reason for main homes, a main home indicator has been introduced.

Section 79 is amended to include a main home indicator and includes a definition of a main home transfer for this purpose. Section 79(5) sets out what a main home transfer is for a transferor and for a transferee.

Under the property tax rules, in many cases the transfer of an individual's main home is not taxable. Accordingly, it is useful for Inland Revenue to distinguish between transfers of main homes and other transfers to provide an indication of the likelihood that the transfer may trigger a tax compliance obligation.

Section 79(5) has been amended to include a new definition of a main home transfer for the purpose of providing this information. The main home transfer is intended to be a simpler test than the current test for when a main home transfer qualifies as a non-notifiable transfer. This reflects the purpose of the main home indicator as differentiating between types of land transfers rather than as determining whether a person must complete the tax details.

A main home transfer applies only to transfers which include a home on the land being transferred. Further, a transfer may only be considered a main home transfer if it is transferred by a trustee or a natural person and the relevant criteria are met.

The main home transfer test is a broad test which looks at whether the transferor has resided in the home for 50 percent of the time, or the transferee intends to reside in the home. It is important to note that this test does not mirror the tests contained in the Income Tax Act 2007 which determines whether a tax obligation arises when a property is sold.

50 percent test for transferors

A main home transfer is defined as a home which a natural person transferor has resided in for more than 50 percent of the period during which the transferor has been an owner of the land or where the home is held by a trust, a beneficiary of the trust has resided in the home for more than 50 percent of the period that the land was property of that trust. This test looks at whether a beneficiary is residing in the home rather than whether a settlor is residing in the home. However, in the case of a property held in a trust, beneficiaries would often include a settlor who is residing in the home.

The policy intent behind this question is to provide an indication of whether the property being transferred is a main home. The phrasing of the question is intended to strike a balance between simplicity to answer and accuracy of indicating whether a tax obligation is likely. By using a 50 percent test, the intention is that it should be relatively simple for a transferor to determine whether the transfer is a main home transfer as they only need to know the length of ownership and the time they have lived in the property rules.

Where a property held in trust and is transferred by a trustee, the trustee should answer the main home indicator based on their knowledge of the beneficiaries residing in the house.

Example 1: Transfer of main home in family trust

In August 2000, Madeleine and Ed brought a home on Beach Street to live in with their children and subsequently settled the property in a trust (Madeleine and Ed's family trust). On 1 March 2020, Mark, as a trustee of Madeleine and Ed's trust, enters into an agreement to sell the house to Mr and Mrs Green.

As trustee, Mark completes a Land Transfer Tax Statement, and completes the tax details section of the form, including the trust's IRD number. As the transfer includes land with a home on it, Mark also completes the question asking whether the transfer is a main home transfer.

As a transferor who is a trustee, Mark looks at whether a beneficiary of Madeleine and Ed's trust has resided in the home on Beach Street for more than 50% of the time that this trust has owned the property. Madeleine and Ed have lived in the Beach Street house with their children since August 2000. Madeleine, Ed and their children are beneficiaries of the trust. Accordingly, they indicate that the home is a main home.

Example 2: Sale of second home

Felix owns two houses, one on Land Street and one situated on River Street. In February 2020, Felix sells his River Street property to Marama. Felix bought his River Street property in 1985. In 1998 he bought residential land on Land Street, where he built a new house. In early 2000 Felix moved into the newly built home on Land Street.

Felix works out that he has owned the River Street property for 35 years and has lived in it for approximately 15 years. Because he has not lived in the River Street property for greater than 50 percent of the time he has owned it, he does not indicate that it is a main home.

Transferee's intention to reside

For transferees, a main home transfer is defined as transfers involving a home where the natural person transferee intends to reside in the home, or when a trustee is the transferee, where a beneficiary of the trust intends to reside in the home.

For transferees the answer will depend on their intention at the time of purchase. For example, whether they intend to reside in it as their main home, if it is a second home which is intended to be rented out, or if they intend to use it for some of the year.

The use of the word "reside" is intended to convey a stronger connection than simply staying in the property. The definition differentiates between when it is a person's main home where they live and a property where they spend some of their time.

In some cases, a person may have multiple intentions as to how they will use the property, particularly over time. If a person intends to rent out the property, with the potential of living in it for a short period of time, for the purpose of the main home indicator, their intention is most likely not to reside in the home.

Example 3: Purchase of second home

Mr and Mrs Green enter into an agreement to buy the Beach Street house. As transferees they are asked whether they intend to reside in the home to indicate whether the Beach Street house will be their main home.

Mr and Mrs Green currently own a house in Piccadilly Lane, they intend to spend the summer holidays with their grandchildren in Beach Street and rent it out throughout the year. They intend to continue to reside in Piccadilly Lane, accordingly they indicate the Beach Street house is not a main home.

Transitional provisions

Schedule 1 Part 2 of the Land Transfer Act 2017 sets out transitional provisions that are intended to ensure that contracts for transfers that are in place before the commencement date of the legislation (1 January 2020), and are lodged for registration on or before 1 July 2020, are subject to the Land Transfer Tax Statement requirements that were in place before these changes. This means that transfers where agreement is entered into before 1 January 2020 may qualify as a non-notifiable transfer if the main home criteria are met, and the transfer is lodged for registration on or before 1 July 2020.

Non-notifiable reasons may be used for transfers involving offshore persons

Current rules regarding when a non-notifiable transfer may apply, exclude all transfers by an offshore person. The amendments remove this restriction, repealing the definition of "offshore person" in section 77 of the LTA. This reflects that the restriction was directed at the main home category of non-notifiable transfers and, has negligible relevance to the other categories of non-notifiable transfers.

EXTENDING THE TAX EXEMPTION FOR NON-RESIDENT OFFSHORE OIL RIG AND SEISMIC VESSEL OPERATORS

Section CW 57 of the Income Tax Act 2007

Section CW 57 contains a temporary exemption for non-resident offshore oil rig and seismic vessel operators. This exemption was due to expire on 1 January 2020, but has been extended to 31 December 2024.

Background

Offshore rigs and seismic vessels operated by non-residents are covered by an exemption in section CW 57. These rigs and vessels are used to drill for oil and gas and gather data on potential oil and gas finds. There is a worldwide market in rigs and seismic vessels. No New Zealand company owns offshore rigs or seismic vessels, so any company wishing to explore in New Zealand waters needs to use a rig or seismic vessel provided by a non-resident owner.

Section CW 57 was introduced to deal with a problem created by our double tax agreements (DTAs). New Zealand generally taxes non-residents on income that has a source in New Zealand. However, our DTAs provide that non-residents are only taxable on their New Zealand-sourced business profits if they have a "permanent establishment" in New Zealand. Many of our DTAs (such as the New Zealand-United States DTA) have a specific rule providing that a non-resident enterprise involved in exploring for natural resources only has a permanent establishment in New Zealand if they are present for a particular period of time, often 183 days in a year. Once a non-resident has a permanent establishment in New Zealand, they are taxed on all their New Zealand business profits starting from day one.

The issue caused by this DTA provision was that seismic vessels and rigs used in petroleum exploration were leaving New Zealand waters before the 183-day limit was reached so they would not be subject to New Zealand tax. This meant that, in some cases, a rig would leave before 183 days and a different rig was mobilised to complete the exploration programme. This "churning" of rigs increased the cost for companies engaged in exploration and had the potential to delay exploration drilling and any subsequent discovery of oil or gas.

A temporary five-year exemption from tax on the income of non-resident offshore oil rig and seismic vessel operators was introduced in 2004. This exemption was previously rolled over in 2009 and 2014 for a further five years and would have expired on 31 December 2019 if not for the further extension.

Key features

The temporary tax exemption for non-resident offshore oil rig and seismic vessel operators in section CW 57 of the Income Tax Act 2007 has been extended to 31 December 2024.

Application date(s)

The exemption takes effect at the expiry of the existing exemption, on 1 January 2020.

SECURITISED PRE-1990 FOREST LAND EMISSIONS UNITS

Sections CX 54B, DB 17B, EW 5 and EW 52B of the Income Tax Act 2007

Changes have been made to the Income Tax Act 2007 to treat certain securitisation transactions involving pre-1990 forest land emissions units according to their economic substance.

Background

New Zealand's emissions trading scheme (ETS) distinguishes between pre-1990 forest land and post-1989 forest land, 1990 being the base year of measurement under the Paris agreementon climate change. The scheme places mandatory deforestation obligations on exotic forests that were first established before 1990, referred to as 'pre-1990 forests'. This means if pre-1990 landowners choose to deforest, for example when converting forest land to a different use, they face 'deforestation liabilities' under the ETS, have to report on emissions and surrender an equivalent amount of New Zealand emission units to the Government.

When the ETS was introduced, owners of 'pre-1990 forests', were able to apply for a one-off free allocation of New Zealand emissions units. This allocation was intended to recognise the possible impact on land values due to the cost New Zealand's ETS places on deforesting, and the resulting reduction in land-use flexibility for owners of pre-1990 forests.

The Income Tax Act also distinguishes between pre-1990 forestry emissions units and post-1989 forestry emissions units. As a transitional measure, the first disposal of emissions units by taxpayers who received the initial allocation of pre-1990 emission units is generally not treated as income under the Income Tax Act. Subsequent transactions are subject to normal tax treatment on disposal. The special tax treatment for pre-1990 emission units reflects the transitional nature of those units under the ETS, as outlined above. All sales of post-1989 units are taxable.

Some long-term owners of pre-1990 forests have been interested in extracting more value from the emissions units they hold, through agreements involving the sale and compulsory buy back of the units. This is a form of "securitisation". Securitisation involves using a long-term asset as security in return for a payment for up to the asset's worth that is repayable at a specified later date, usually with interest. The borrower can use the asset for the period but the expectation is that the asset or an asset of an equivalent nature will be returned to the original holder when the monies are paid back. The previous tax rules proved to be an impediment to such transactions because they followed the legal form rather than the economic substance of the transactions.

When a taxpayer sells property, such as pre-1990 forest land emission units, with a compulsory obligation to buy the same or equivalent property back, the tax rules were treating the transaction as a disposal with the buyback being a separate purchase.

By treating the sale and compulsory buy-back arrangement as a disposal for tax purposes, the benefit of the tax transitional treatment for pre-1990 forest land emissions units was effectively lost as any subsequent sale would be taxable, making such transactions unviable.

Economically, the set of transactions is in substance a loan or lease of property. The tax consequences should, therefore, treat it as such by using the difference in net cash flows to measure any income, expenditure or loss arising from the transactions. A netting approach is more consistent with existing tax policy frameworks when economic ownership of the asset is not surrendered. This was the approach used in the tax rules that have been in place since 2006 to enable sales and compulsory buybacks of shares to, in effect, be treated as loans (see the share lending rules[39]). The new tax rules, therefore, treat securitisation transactions involving pre-1990 forest land emissions units on a similar basis.

Overall, these changes are intended to facilitate the monetisation of assets that might otherwise be locked away, so that the assets can generate income for their owners and the underlying beneficiaries.

Post-1989 New Zealand emission units are treated as revenue account property and transactions involving the sale and compulsory buy-back are taxable in the year of sale and deductible in the year of repurchase. As such, the tax disincentives for these transactions are not as marked. Submissions made to the Finance and Expenditure Committee during the consideration of the legislation suggested that there is also, in principle, a case for extending the new provisions to post-1989 forests. Consideration of other securitised assets has been included in the tax policy work programme.

Key features

Various sections of the Income Tax Act have been changed to ensure securitisation transactions involving pre-1990 emissions units are treated as a loan for income tax purposes. This is achieved by treating the arrangement as a financial arrangement with an attached excepted financial arrangement under new section EW 5(11B). The excepted financial arrangement is the assignment of the pre-1990 forest land emissions units by the holder to a person who is not an associated person (the lender) and the later (compulsory) assignment of the same or other New Zealand emissions units by the lender to the holder.

The amendments, therefore, provide for the following tax treatment:

- The sale of the emissions units and the return of the equivalent units is ignored for both parties. Instead, there is a loan between the two parties. The interest flows earned/paid by both parties on the borrowed/lent funds would be taxable/deductible.
- If the acquirer of the units on-sells them, any gain or loss on selling the units to a third party would be taxable or deductible according to the ordinary rules that apply to the sales of forest land emissions units.

Ignoring the sale transaction in this instance also means that the emissions units retain their one-off tax-free status on disposal.

Interest

The financial arrangement rules now apply to the "interest" component only. For example, the "interest" paid by the original unitholder is the difference between the amounts they receive from assigning the units and the total amounts they pay the lender under the arrangement.

Accordingly, under new section DB 17B, the lender is denied a deduction for the amount they have lent to the original holder of the units as a result of the transfer of the units.

Change in value of the collateral

Because the same amount of units is being returned, changes in the value of the emissions units are ignored. Under new section CX 54B, the amount that relates to the market value of an emissions unit under a transfer of the excepted financial arrangement is excluded income. Moreover, under section EW 52B(4)(c), the original unit and the returned unit are treated as having a value for the unit holder equal to the cost of the original unit for the unit holder.

Sales to third parties

Any gain or loss made by the lender from subsequently selling the units to a third party and later purchasing replacement units is taxable. The lender is taxed on all the proceeds from the sale of the units to a third party. The cost base for the units they have sold is zero (see new section EW 52B(4)(d)(ii)). However, similar to the share lending rules, the lender is able to deduct the cost of the replacement units that they acquire in order to meet their obligation to return units to the original holder.

Example

The lender sells 1,000 units to a third party for $20 per unit. The lender is taxed on $20 per unit as the cost base for the units is $0. The taxable income is $20,000.

The lender subsequently purchases 1,000 units for $15 to meet their obligation to return units to the original holder. The lender is allowed a deduction of $15,000.

Overall, the lender is taxed on the net gain of $5000 (that is, $20,000 – $0 – $15,000).

Preservation of the one-off tax free status of the units

Provided the requirements of the arrangement are fulfilled, the original owner of the units is considered to hold the units throughout the arrangement under new section EW 52B(2) and (4). This non-recognition of a disposal by the original owner means that the one-off tax free status of the units on disposal is preserved for the purposes of section CX 51B, because the returned units continue to meet the definition of a "pre-1990 forest land emissions unit".

[39] See Inland Revenue Department *Tax Information Bulletin*, Volume 18, No.5 (June 2006), pages 86-94.

When units are not returned by the agreed date

Parties that have entered into a securitisation arrangement in good faith are entitled to apply the new provisions on the assumption that the arrangement is fulfilled as agreed. However, if the units are not returned by the date that the parties have agreed, the arrangement is effectively unwound for tax purposes. The consequences of failing to make a timely return are set out in new section EW 52B(5). The original disposal of the units will then be treated as an ordinary disposal on the date the arrangement began.

Application date

The amendments apply to transactions entered into in the 2018–19 income year, or any subsequent income year, that involve the securitisation of pre-1990 forest land emissions units.

EMPLOYEE SHARE SCHEMES – WITHHOLDING OBLIGATIONS

Section RD 7B

This amendment gives companies offering employee share schemes (ESSs) the option of making an irrevocable election (at the time a share benefit is offered) to withhold tax from the benefit when it is provided to the employee. If made, this irrevocable election creates a statutory obligation on the company to pay the PAYE on the benefit. This statutory obligation will also apply to replacement awards, so an election cannot be revoked by simply issuing a replacement benefit without the withholding obligation. These changes are intended to provide a legislative framework that more clearly allows a company to meet the requirements to adopt equity-settled accounting treatment for the withheld tax under international financial reporting standards (IFRS) (though whether or not it does so will be for the company's auditors to determine).

Background

Before 2017, calculating and paying the tax liability for a benefit provided under an ESS was the responsibility of the employee receiving the benefit. Since 2017, employers have been able to elect to withhold and remit PAYE on the benefit to Inland Revenue.

If an employer elects to withhold tax on the benefit only when the benefit is provided, they are required under international financial reporting standards (IFRS) to use 'cash settled' accounting treatment in relation to the tax portion of the benefit. Any fluctuations in the amount of the tax portion between the time the benefit is offered and the time the shares are provided to the employee must be reflected in the company's annual accounts, which increases volatility in its financial reports.

Companies may prefer 'equity settled' accounting treatment, which in general terms allows the initial value of the benefit expected to be provided to the employee (being the expected value of the shares and the tax payment) to be expensed in straight-line fashion over the period until the share is actually given to the employee and the tax is paid. In relation to the tax portion of the benefit, this treatment can only apply if the company has a 'tax obligation.' The previous legislation did not create a tax obligation for employers to withhold tax on benefits provided under ESSs until the time the benefit was in fact provided.

Key features

Section RD 7B now gives an employer the choice to make an irrevocable election to withhold PAYE in relation to a grant made under an ESS, creating a tax obligation to withhold that cannot be revoked. This is in addition to the existing ability to choose to withhold when benefits are provided.

Application date(s)

The amended section RD 7B applies from the date of Royal Assent of the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019.

BENEFICIARIES AS SETTLORS

Section HC 27 of the Income Tax Act 2007

An amendment has been made to the trust rules to ensure that, in certain circumstances where an amount of income is allocated by a trust to a beneficiary but retained by the trust, such beneficiaries do not become settlors. Prior to this amendment, where no interest was paid by the trust to the beneficiary on such amounts, the beneficiary became a settlor of the trust. This was because by transferring value to the trust (via the provision of interest-free funds) the beneficiary met the definition of "settlor" in section HC 27 of the Income Tax Act 2007. In certain cases, such an outcome was an overreach of this provision.

Background

Beneficiaries of trusts could inadvertently become the settlors of such trusts when the following conditions were met:

- Trustees allocated an amount of money (for example, beneficiary income) to a beneficiary.
- The money was not paid out to the beneficiary but instead was retained in the beneficiary's current account with the trust and was used as working capital of the trust.
- The beneficiary did not receive interest or other return on the money retained by the trust.

Such beneficiaries became settlors in relation to the amount of interest that had not been paid to them, because they "transferred value" to the trust by leaving money in the trust interest-free and, therefore, met the definition of "settlor" in section HC 27 of the Income Tax Act 2007.

Treating such beneficiaries as settlors could have impacted their entitlement to Working for Families, increased their student loan repayment obligations, made them accountable for tax on the trustee income for certain trusts, or inadvertently increased the number of persons associated with the trust.

Key features

New section HC 27(5) of the Income Tax Act 2007 ensures that where a beneficiary of a trust has a current account balance that is not greater than $25,000 at the end of the income year, they do not become a settlor of the trust.

Also, under the amendment, a safe harbour is provided so that if the prescribed rate of interest is paid by the trust to a beneficiary, such beneficiaries do not become settlors. For consistency with other legislative provisions, the prescribed interest rate is the same as the rate used to determine whether there is a fringe benefit in relation to a low-interest loan provided to an employee. The current prescribed rate is 5.77% per annum. A resolution authorising the payment of interest to such beneficiaries should be passed by the earlier of the date the trust files its return and the last day for filing the return for that income year. Interest on the whole amount has to commence no later than the start of the subsequent income year. Interest payments (which constitute income for tax purposes) can be made by way of a journal entry crediting the beneficiary's current account with the trust, or be paid out to the beneficiary.

Example

For the 2020-21 income year, the trustees of the JS Trust allocate $30,000 of beneficiary income to John. The trust retains the money in John's current account with the trust. John has a student loan, so to ensure John does not become a settlor, the trustees resolve to pay the prescribed rate of interest annually on the whole amount of the credit retained in John's current account ($30,000) from 1 April 2021.

The JS trust has a standard income year and has a tax agent, so is required to file its return by 31 March 2022. The trustee resolution must be made no later than the earlier of the date the return is filed and 31 March 2022. Interest is calculated from 1 April 2021 and must be paid no later than 31 March 2022.

John has beneficiary income of $30,000 to include in his 2020-21 tax return and interest income to include in his 2021-22 tax return.

$25,000 de minimis

Beneficiaries who leave a significant amount in their current accounts with a trust at no or below the market rate of interest are intended to be treated as settlors. The $25,000 de minimis ensures that beneficiaries with relatively modest current account balances should not be treated as settlors. This limit is needed to maintain the integrity of social policies, such as Working for Families and student loans (as the forgone interest on current account balances could affect these entitlements and obligations).

Setting the threshold at $25,000 means using the current prescribed rate of interest (5.77%) on a balance of $25,001 would equate to $1,442.55 of interest income per annum.

Application date

The amendment applies from 1 April 2020. This allows trustees of trusts with beneficiaries with current account credits to evaluate their position.

The operational position on page 113 covers the treatment of beneficiaries with credits in their current accounts with trusts before 1 April 2020.

CO-OPERATIVE COMPANIES: NON-DEDUCTIBLE CASH DISTRIBUTIONS

Sections DV 18, OB 78B, OB 82, and OZ 15

The amendments clarify that a co-operative company may elect to make a fully imputed cash distribution of profits attributable to a specific group of shareholders of the company, provided:

- the company's constitution permits distributions to be made to a specific group of members; and
- the amount paid to each shareholder is determined in proportion to the level of trading activity between the members and the company.

Key features

The amendment permits a co-operative company registered under the Cooperative Companies Act 1996 to choose to distribute to a specific group of its shareholders those profits that are attributable only to that group of shareholders as either:

- an association rebate (tax deductible); or
- a fully imputed cash distribution (non-deductible) which is treated as a dividend.

The amendment improves the consistency of the imputation rules with co-operative business practices, such as the use of pool systems to incentivise a higher quality of supply from members.

Application date(s)

The amendments apply for non-deductible cash distributions made on or after the date of Royal assent.

Detailed analysis

The amendments improve the consistency of the imputation rules and general tax settings for co-operative companies registered under the Cooperative Companies Act 1996. The amendments provide consistency with both:

- cooperative principles included in the Cooperative Companies Act 1996; and
- commercial practices in the co-operative sector.

Currently, a co-operative company registered under the Cooperative Companies Act 1996 may choose to distribute its profits generated from co-operative activity either as:

- a tax-deductible distribution (the association rebate) under section DV 19; or
- a non-deductible cash distribution (with imputation credits attached), which is treated as a dividend paid to the shareholder under section OB 78.

However, the requirements of section OB 78 has resulted in the provision not being used to make non-deductible cash distributions because it requires the distribution to be made to all shareholders. This has proved to be inconsistent with cooperative business practices relating to groups of shareholders who choose to provide goods to the cooperative company at a minimum standard of quality (product pool). This amendment is mostly relevant to co-operative companies that adopt product pools to incentivise a higher quality of supply from members to the co-operative.

Under the terms of such practices, only shareholders choosing to participate in these arrangements can receive profit distributions from these pools (participating members). This is consistent with provisions of the Cooperative Companies Act 1996 that permit distributions to be made to such participating members based on trading transactions between the members and the company.

New section OB 78B of the Income Tax Act 2007 aligns the imputation rules more closely with the effect of these provisions in the Cooperative Companies Act 1996. As noted above, members may elect into such a pool system, and only those participating members can receive distributions of such pool profits.

Tax payable on these pool profits is economically borne by those participating members. New section OB 78B ensures that the benefit of the related imputation credits from tax paid on those pool profits may be allocated proportionately only to those participating members.

Sections DV 18, OB 82, and OZ 15 are updated to include a cross-reference to new section OB 78B.

PRE-CONSOLIDATION IMPUTATION CREDITS

Section 244(4) of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration and Remedial Matters) Act 2019

The amendment in section 244 of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration and Remedial Matters) Act 2019 ("The ARMTARM Act") contained incorrect date references. This amendment corrects those dates to ensure the savings provision in section OP 22(4) works as intended for tax positions taken by a consolidated imputation group for the transfer of pre-consolidation imputation credits to the group imputation credit account ("ICA") for periods ending on or before 1 April 2019.

Background

Under section OP 22 of the Income Tax Act 2007, a consolidated imputation group may transfer a pre-consolidation imputation credit from a member company's ICA to the group ICA if all the following are satisfied:

- at any time, a debit entry is made to the group ICA (for example, by attaching imputation credits to a dividend);
- the debit entry results in a debit balance in the group ICA;
- at the time the debit balance arises, a member company of the group has a pre-consolidation credit balance in its ICA;
- the amount transferred from the member company's ICA to the group ICA does not exceed the debit balance in the group ICA; and
- shareholder continuity requirements are met.

Submissions were received requesting a review of the policy for the use of pre-consolidation imputation credits. These submissions asked that consideration be given to the comments expressed on the policy for the use of pre-consolidation imputation credits set out in the Discussion Document: Business Tax Policy — 30 July 1991.

Section 244(3) of the ARMTARM Act provides a savings provision allowing the Government time to consider the relative priority of this review in terms of the tax policy work programme. The savings provision protects a tax position taken for a period beginning on or after 1 April 2008 and before 1 April 2021 if the amount of a pre-consolidation credit transferred to the group ICA:

- exceeds the amount allowed to be transferred under section OP 22; and
- does not exceed the debit balance that has arisen in the ICA of the consolidated imputation group.

Some consolidated groups have taken tax positions that involve a transfer of pre-consolidation credits in excess of the amount allowed under the savings provision in section 244(3) of the ARMTARM ACT. These excess amounts have resulted in over-distributions of imputation credits, and therefore a liability for further income tax arises (which, when paid, is treated as tax paid by the consolidated imputation group).

As these excess distributions would require past years' ICA returns to be refiled, a transitional provision was enacted in section 244(4) of the ARMTARM Act to minimise compliance and administration obligations for these returns.

The transitional provision in section 244(4) of the ARMTARM Act is intended to remove the need to refile past year ICA returns, by allowing the payment of further imputation tax, and the adjustments to the ICA for the overdistribution of imputation credits, to be accumulated and accounted for in the 2019-20 tax year. However, this provision contained incorrect date references, and these are now corrected to ensure the rule works as intended.

Key features

The due date of payment for further income tax arising from adjustments to past years ICA returns is 7 March 2020.

Example: Adjustment for transfer of excess pre-consolidation imputation credit

The following example illustrates how the transitional provision in section 244(4) of the ARMTARM Act should apply when a consolidated imputation group has transferred pre-consolidation imputation credits in any period beginning on or after 1 April 2008 and before 1 April 2019.

This example is based on the following assumed facts:

- Company A and Company B are in a consolidated group, which is also a consolidated imputation group. The opening balance of the group ICA at 1 April 2016 is $1,000.
- Company B, another company in the consolidated group, has a pre-consolidation ICA credit balance of $100,000 at 1 April 2016.
- The group pays $30,000 of income tax in April 2016;

- Company A pays a dividend in September 2016 with $60,000 imputation credits attached;
- The group transfers the entire amount of the pre-consolidation credit balance of company B to the Group ICA following the payment of the dividend in September 2016;
- The group pays $50,000 of income tax in April 2017;
- Company A pays a dividend with $100,000 imputation credits attached in September 2017;
- The group pays $60,000 of income tax in April 2018; and
- Company A pays a dividend with $61,000 imputation credits attached in September 2018.

Section 244(3) of the ARMTARM Act (a savings provision for existing tax positions) protects a tax position taken for the transfer of an amount of a pre-consolidation credit that:

- exceeds the amount allowed to be transferred under section OP 22 of the Income Tax Act 2007; and
- does not exceed the amount of the debit entry to the Group ICA that results in the group ICA having a debit balance after the dividend is paid.

In this example, the amount transferred from the pre-consolidated credit balance of company B ($100,000) exceeds the amount of the debit entry to the group ICA ($640,000) and therefore section 244(4) of the ARMTARM Act applies.

As set out in Table 1 below, section 244(4) requires an adjustment of $40,000 to be made for the 2016-17 tax year for both the group's ICA and company B's ICA. This also means that in later tax years, the ICA opening and closing balances are also adjusted.

Table 1

Date	Group ICA as returned	Group ICA as adjusted	Company B ICA as returned	Company B ICA as adjusted
1/04/2016	1,000	1,000	100,000	100,000
7/4/2016	30,000	30,000		
30/09/2016	(60,000)	(60,000)		
30/09/2016	100,000	100,000	(100,000)	(100,000)
30/09/2016 adjustment		(40,000)		40,000
31/03/2017	51,000	11,000	0	40,000
1/04/2017	51,000	11,000	0	40,000
7/04/2017	50,000	50,000		
30/09/2017	(100,000)	(100,000)		
31/03/2018	1,000	(39,000)	0	40,000
1/04/2018	1,000	(39,000)	0	40,000
7/04/2018	60,000	60,000		
30/09/2018	(61,000)	(61,000)		
31/03/2019	0	(40,000)	0	40,000
Further income tax payable by 7 March 2020		(40,000)		

The above table:

- illustrates the cumulative effect on the group and the individual company's ICA; and
- shows that after adjusting the use of pre-consolidation credits to comply with the limit in section 244(3) of the ARMTARM Act, any remaining pre-consolidation balances are available for future use from the 2019-20 tax year onward.

APPLICATION OF THE COMMON REPORTING STANDARD TO CORPORATE TRUSTEES

Sections 104, 105, Tax Administration Act 1994

Section 185O and Schedule 2 of the Tax Administration Act 1994 (TAA) have been amended to clarify the application of the OECD's *Common Reporting Standard* (CRS) to a financial institution that is an *Investment Entity* or *Custodial Institution* for CRS purposes.

Background

The CRS is a global standard that was incorporated by reference into New Zealand law in 2017. Incorporation by reference effectively means that the provisions of the CRS and its official OECD commentary themselves have legal effect in New Zealand.

Under the CRS, financial institutions must undertake specified due diligence procedures to identify non residents holding (and, in certain circumstances, controlling) financial accounts in New Zealand and report information on those non-residents to Inland Revenue. The reported information is then exchanged with other countries under tax treaties, to assist those jurisdictions in the detection and prevention of offshore tax evasion. The exchanges are reciprocal, meaning that New Zealand also receives information from its tax treaty partners on offshore accounts held (or controlled) by New Zealand residents.

After implementation in 2017, an ambiguity was detected in a technical aspect of the CRS. Under the CRS, the definition of financial institution includes a category of *Investment Entity* which is managed by another entity. With respect to the managing entity, the definition explicitly refers to "the Entity's gross income …". This raises the question of whether the entity needs to be directly remunerated for the definition to be satisfied, or whether indirect remuneration for the entity's activities/services is also covered (i.e. when another group member receives the remuneration).

The issue primarily seems to arise in the case of a managing entity that is a corporate trustee, but it may also apply for other types of managing entity. It could potentially also have relevance for the *Custodial Institution* category of financial institution.

Inland Revenue has always maintained (and stated in its guidance material) that the issue is determined by the nature of the activities/services that the entity performs and that are remunerated, irrespective of which group member actually receives the remuneration for those services (i.e. it is common for a professional firm to invoice a client for services performed by a corporate trustee). This position reflects the clear policy intent and international consensus on the matter and is supported by references in the commentary and in the applicable Financial Action Task Force (FATF) recommendations, which underpin the CRS. The OECD has also updated its website to include specific clarification on this point (as a Frequently Asked Question).

However, to give certainty to those with CRS obligations in New Zealand and to ensure New Zealand complies with its international obligations, New Zealand's legislation has also been amended to clarify the point.

Key features

The inserted clarification states that a reference in a definition to "the Entity's gross income …" is to be treated as meaning the total gross income arising for the entity and other entities that is attributable to the entity's performance of the activities in question.

Section 185O and Schedule 2 of the TAA already allowed for New Zealand specific modifications to the CRS. To accommodate clarifications as well as modifications, Schedule 2 has been restructured into two parts and section 185O amended to reflect the new structure. Modifications of the CRS are now located in Part 1 of Schedule 2, and modifications to and clarifications of the CRS Commentary are in Part 2 of Schedule 2. Accordingly, this clarification has been inserted as item 1 of Part 2.

Application date(s)

These amendments apply retrospectively from 1 July 2017, the original start date for CRS obligations in New Zealand.

LOSS OF EARNINGS INSURANCE

Section CG 5B(2)

The amendment clarifies that loss of earnings insurance proceeds are taxable in all circumstances, including when the rights to receive these proceeds are assigned to another person.

Background

Taxpayers manage risk of business interruption by taking out loss of earnings insurance. When a business experiences a period of economic loss due to an adverse event (for example, an earthquake or fire), it can receive compensation for loss of earnings. Since these proceeds are income of the business, they are subject to income tax.

After the Canterbury earthquake in 2011, a question arose about the tax treatment of amounts received from an assignment of the right to receive an insurance claim made under a loss of earnings policy. The policy intent is to tax loss of earnings compensation, irrespective of whether the right to receive the compensation has been assigned to a third party.

Key features

The amended section CG 5B(2) clarifies that a person who has been assigned the right to receive compensation proceeds, from an interruption or impairment of business activities, will be taxed in the same way that the assignor would have been taxed.

Application date(s)

This amendment applies from the beginning of the 2011-12 income year. However, it does not apply to a person who, during the period from the beginning of the 2011-12 income year to the date of Royal Assent of this Act, took a tax position relying on the wording of section CG 5B(2) prior to this amendment.

GST EXEMPTION FOR RESIDENTIAL PROPERTY THAT IS SOLD AFTER BEING SUB-LET FOR FIVE OR MORE YEARS

Section 14(1)(d) of the GST Act

Background

Most sales of residential land are not subject to GST as they are either not sold by GST-registered persons or are not part of the GST-registered person's taxable activity. However, if a GST-registered person is regularly selling residential land, then they may have a taxable activity of selling property and so they may have to apply GST when they sell residential land.

An exception to this is when the land has been exclusively used by the GST-registered landowner to provide residential rental accommodation for five or more years. In this case the sale of the land will be exempt from GST under section 14(1)(d) of the GST Act 1985.

The original exemption required the land-owner to have rented the dwelling to the ultimate residential tenant. It did not apply to sub-letting arrangements where a GST-registered land-owner has let the property to a housing provider who has sub-let it to tenants for five or more years. This meant that such sub-letting arrangements could be disadvantaged relative to similar arrangements where the property owner had let the property directly to the tenant. This type of sub-letting arrangement has become increasingly common, particularly for social housing providers.

Key features

The exemption in section 14(1)(d) of the GST Act has been expanded so it also exempts the sale of the residential property by a GST registered person where the property has been sub-let to tenants for five or more years.

It achieves this by referring to the existing exemption for supplies of residential accommodation under a sub-leasing arrangement in section 14(1)(cb) of the GST Act.

Prior to this amendment the exemption for a sale of a residential property in section 14(1)(d) could only apply where the GST-registered owner of the residential property had directly rented out the property (or the land underneath the property) to a residential tenant for five or more years.

Application date

The amendment to section 14(1)(d) applies from 26 July 2019.

Example

Homes Co is a GST registered company with a taxable activity of regularly buying and selling land.

In 2010, Homes Co purchases land which includes a twenty-five unit residential apartment complex. Homes Co rents ten of the units directly to residential tenants and rents fifteen of the units to a community housing provider who sub-lets the properties to various residential tenants. The supplies made by Homes Co of renting all twenty units are exempt from GST under sections 14(1)(c) and (cb) of the GST Act.

In 2020, Homes Co decides to sell the land and all of the units in the residential apartment complex to a GST registered property developer. The sale of the land and the residential apartment units will be exempt under 14(1)(d) as all of the units were exclusively used for 5 or more years to make exempt supplies under section 14(1)(c) or 14(1)(cb).

Because the sale of the land by Homes Co is an exempt supply, the zero-rating rule for supplies of land to another GST registered person in section 11(1)(mb) does not apply. This means the GST registered property developer who purchases the land may be able to claim a second-hand goods input tax credit deduction in respect of the tax fraction of their purchase price. The GST registered property developer will return GST when they sell the re-developed properties.

Remedial amendments

GST - CAPITAL RAISING COSTS

Section 20H of the Goods and Services Tax Act 1985

Amendments have been made to clarify the scope of the rules allowing GST-registered persons to deduct GST incurred on costs of raising capital.

Background

The Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 inserted section 20H into the Goods and Services Tax Act 1985. The section allows GST-registered businesses to recover GST on their costs of raising capital to fund a taxable activity and applied from 1 April 2017.

Under the rules that applied prior to 1 April 2017, the exempt treatment of financial services posed a problem when businesses that principally made taxable supplies incurred costs to raise capital, such as through the issue of bonds or shares. Examples of such capital raising costs include NZX listing fees, legal fees and costs associated with preparing a product disclosure statement. The GST incurred in relation to these costs was potentially unrecoverable because the provision of equity and debt securities is an exempt supply of financial services.

Section 20H allows businesses which principally make taxable supplies to recover the GST incurred on goods and services used to raise capital for their taxable activities. In line with the policy intent, the rules do not apply when a business principally supplies financial services, or if they have elected to zero-rate business-to-business supplies of financial services and a deduction is already available as a result of the business-to-business zero-rating rules.

However, there were some minor technical ambiguities and errors in section 20H. Amendments have therefore been made to clarify the scope of the rules to ensure that the policy intent is achieved.

Key features

The amendments make remedial changes to the rules allowing GST-registered persons to deduct GST incurred on goods and services acquired for capital raising purposes. In particular, the changes:

- clarify that the relevant deduction available under the rules is of input tax on supplies of goods and services made to the registered person that are used for the capital raising transaction;
- provide that a deduction is available for goods and services acquired by the registered person, to the extent that a deduction would be available under the ordinary rules if the goods and services were used in the person's usual business activity (instead of being used in the capital raising activity);
- clarify that a GST-registered business which intends to principally make taxable supplies but is not currently making any taxable supplies (such as a start-up), or which raises capital in excess of the value of its taxable supplies, can claim deductions for capital raising costs under the rules;
- clarify that GST-registered persons are entitled to claim input tax deductions for capital raising costs in situations where the funds raised are used to refinance a taxable activity of the registered person; and
- ensure that input tax deductions for capital raising costs are also available in situations where the funds are ultimately used in a taxable activity by a different company in the same group of companies as the company that carried out the capital raising transaction.

Application date

The amendments apply on and after 1 April 2017, being the date that the GST rules specifically allowing input tax deductions for capital raising costs came into force.

A savings provision has been enacted to protect tax positions taken prior to the date of enactment (being 26 June 2019) in cases where taxpayers did not make a deduction of input tax for capital raising costs on the basis of the previous law.

Detailed analysis

Reference to deduction of input tax for the supplies of financial services

An amendment to section 20H(1) is proposed to rectify an inaccuracy in the introductory wording that a registered person has "a deduction under section 20(3)(hd) of input tax for the supplies of financial services". The proposed amendment clarifies that the deduction would be for input tax on supplies made to the registered person (for example, legal services) that are used to make the relevant supplies of financial services (being the raising of debt or equity).

Refinancing a taxable activity

The introductory words to section 20H(1) referred to an "activity of raising funds that are intended for use by the registered person for expenditure in a taxable activity". Former paragraph (d) of the section also contained a similar phrase.

In many cases, the funds that are raised through issuing debt or equity securities will be used to repay existing debt that was incurred to finance a registered person's taxable activity. It is unclear that repayment of debt would be regarded as "expenditure in a taxable activity". However, there was no policy intention to distinguish between capital-raisings where funds are used for that purpose and ones where funds are used for other "taxable activity" purposes, such as acquiring new assets.

The amendments to paragraphs (a) and (e) clarify that registered persons are entitled to claim input tax deductions for capital raising costs in situations where it is intended that the funds planned to be raised would be used to refinance the registered person's taxable activity (provided that the other conditions of section 20H(1) are met).

"Principally makes taxable supplies"

Section 20H(1) required that the registered person principally made taxable supplies in order to be entitled to claim input tax deductions for capital raising costs under the rules. This requirement meant that the law did not technically allow GST-registered businesses to make input tax deductions for capital raising costs in the following situations:

- The business intends to make taxable supplies but is not currently making any taxable supplies. This could include start-ups that raise capital in advance of making any taxable supplies.
- An established business makes taxable supplies but raises capital in excess of the value of those taxable supplies (meaning that it would not meet the "principally" test).

To ensure input tax deductions for capital raising costs can be made in either of the two situations described above, the introductory wording of section 20H(1) has been amended. The provision now refers to a registered person who "is, or intends to be, principally making supplies that would be taxable supplies in the absence of the supplying of the financial services [made to raise capital]".

Capital raising undertaken by different group company to that which uses the funds

Where a capital raising transaction is carried out by a treasury company or a holding company, it may be another group company (such as the trading company) that ultimately uses the funds in a taxable activity (or to refinance a taxable activity). The wording of amended paragraphs (a), (c) and (e) ensures that input tax deductions are available to the company that ultimately uses the funds (or to the representative member if the group of companies has group-registered under section 55) in such situations where the capital raising transaction is carried out by another group company.

Apportionment of input tax deductions

Where a registered person carries on both taxable and exempt activities, the intention has always been that the amount of deduction claimed should be apportioned based on the extent to which the registered person makes taxable supplies as a proportion of their total supplies (excluding the capital raising supplies). However, this intended apportionment rule was not explicit in section 20H.

New section 20H(1B) codifies this apportionment rule to make it explicit that registered persons that have an exempt activity (as well as a taxable activity) and who intend to use the funds raised for both activities are required to apportion input tax deductions for capital raising costs, where the apportionment ratio is based on their taxable supplies as a fraction of their total supplies (excluding the supplies of financial services made to raise capital).

Example

Pilkinton Properties is a property development company. Eighty percent of its supplies are taxable, and twenty percent are exempt. It issues a bond to raise capital in order to finance the purchase of land. In issuing the bond, it spends $11,500 in legal fees, including GST of $1,500. Pilkinton Properties claims a deduction of $1,200 (eighty percent of $1,500) based on Pilkinton Properties' usual ratio of taxable to exempt supplies (excluding the bond issue itself).

GST – DEFINITION OF "ASSOCIATED PERSONS"

Section 2A of the Goods and Services Tax Act 1985

The definition of "associated persons" in the Goods and Services Tax Act 1985 (the GST Act) has been amended to better align it with the original policy intent.

Background

The universal tripartite test of association in section 2A(1)(i) of the GST Act 1985 generally associates two persons, A and B, if person A is associated with a third person (person C) under any one of paragraphs (a) to (h), and person B is also associated with person C under any one of paragraphs (a) to (h).

Section 2A(8) limits the universal tripartite test to prevent the tripartite test unintentionally increasing association past two degrees of blood relationship by chaining together associated relatives. For example, the limitation prevents an uncle and a nephew from being associated under the tripartite test only as a result of their blood relationship with the brother/father (or sister/mother).

Key features

Amendments have been made to rectify two issues relating to the universal tripartite test:

- Under the previous law, it was possible that distant blood relations (such as an uncle and a nephew) could be associated because of the interaction of the universal tripartite test with the partnership and associate of a partner test in section 2A(1)(e). This is contrary to the policy intent. Further, the universal tripartite test means that the partnership and associate of partner test (as a type of "mini"-tripartite test) was not necessary. The partnership and associate of partner test has therefore been repealed.
- A remedial amendment in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 inserted new section 2A(1)(hb) to associate a trustee of a trust with a person who has a power of appointment or removal of the trustee. However, an oversight meant the universal tripartite test was not updated to include a cross-reference to new paragraph (hb). An amendment inserts this cross-reference.

Application date

The amendments came into force on the date of enactment, being 26 June 2019.

APPORTIONING GST FOR MIXED-USE ASSETS

Section 20G(2)(a) of the Goods and Services Tax Act 1985

An amendment has been made to the definition of "input tax for asset" which relates to the formula for apportioning input tax on mixed-use assets. The amended definition excludes expenditure solely related to taxable use of the asset, as well as expenditure solely related to non-taxable use of the asset.

Background

Section 20G of the GST Act is a special apportionment method for mixed-use assets that aims to apply a similar approach for GST as the approach that is used for income tax purposes under subpart DG of the Income Tax Act 2007. A typical example of a mixed-use asset is a holiday home which is used sometimes for family holidays, sometimes by members of the public for a fee, and unoccupied for the remaining period. The aim of subpart DG is to apportion the expenses relating to the unoccupied period according to the relative levels of private and income earning use.

A key difference between the income tax rules and the GST rules is the treatment of associated party use of an asset. For income tax purposes, associated party use is considered to be private use, however, the same use is considered to be income-earning for GST purposes (taxable supply at open market value).

The definition of "input tax for asset" in section 20G(2)(a) excluded expenditure related solely to the private use of the asset, as that term is defined in section DG 4 of the Income Tax Act. The issue was that private use of the asset included any use of the asset by a natural person who is associated with the person who owns or leases the asset, whether or not an amount of income is derived in relation to its use. This meant that asset owners were unable to claim input tax deductions for this use despite it being income earning use for GST purposes.

Example 1

Otto, a GST-registered commercial accommodation provider, purchases a bach in Whangamata. Otto stays in the bach for around 30 days every year. He also rents it out to Jared, Otto's son, for a market rate for approximately 30 days each year. The bach is not rented out to anyone else and is empty when not in use by Otto or Jared.

As Jared is associated with Otto any use of the bach by Jared is private use, as that term is defined in section DG 4 of the Income Tax Act 2007. Therefore, Otto was unable to claim input tax deductions for expenditure on the bach.

Key features

In the exclusions from the definition of "input tax for asset" in section 20G(2)(a):

- The reference to expenditure "related solely to the income-earning use of the asset as described in section DG 7 [of the Income Tax Act 2007]" has been replaced with expenditure "related solely to the taxable use of the asset" (see subparagraph (i)).
- The reference to expenditure "related solely to the private use of the asset, as that term is defined in section DG 4 of that Act" has been replaced with expenditure "related solely to the non-taxable use of the asset" (see subparagraph (ii)).

This means that where expenditure incurred by the person in relation to the use of the asset relates to both taxable (including associated party use) and non-taxable use, the amount of input tax for the asset under section 20G(2)(a) will be apportioned appropriately.

Example 2

Consider Otto and Jared in the previous example.

As the bach is used for 60 days every year and 30 days of that time relates to taxable use, Otto can make input tax deductions for 50% of his expenditure on the bach (input tax for asset × 30 days ÷ 60 days).

Application date

The amendment applies on and after 1 April 2013, the main application date of the mixed-use asset rules.

TREATMENT OF ARRANGING SERVICES RELATING TO GOODS OFFSHORE

Section 11A(1)(jbb) of the Goods and Services Tax Act 1985

An amendment has been made to ensure that the arranging of services supplied directly in connection with moveable personal property located outside New Zealand is zero-rated, in line with the policy intent and the previous treatment that applied prior to 1 October 2016.

Background

The Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016 applied GST to supplies of "remote services" from non-residents to New Zealand-resident consumers with effect from 1 October 2016. It was recognised at the time that, for the new rules to work as intended, an amendment was needed to the zero-rating rule for services that are physically performed outside New Zealand. Section 11A(1)(j) was therefore amended so that services physically performed outside New Zealand (or that arrange services that are physically performed outside New Zealand) are zero-rated, provided that these services are not remote services supplied to a New Zealand resident who is not a registered person.

Services which are provided in relation to goods located overseas may be "remote services" under the current definition in the GST Act – even though these services will be clearly zero-rated by section 11A(1)(f) if they are supplied directly in connection with moveable personal property situated outside New Zealand at the time of performance of the services.

Given that an arranging service cannot be supplied directly in connection with moveable personal property, the 2016 amendment to section 11A(1)(j) meant that the arranging of these services would only be zero-rated if the (New Zealand-resident) recipient of the services was a registered person. This was an unintended policy change, as the general policy intention is that the GST treatment of an arranging service should follow that of the service being arranged.

Key features

New section 11A(1)(jbb) provides that services are zero-rated if they are the arranging of underlying services that are supplied directly in connection with moveable personal property.

This zero-rating treatment applies if the moveable personal property is situated outside New Zealand at the time the underlying services are performed. The new section is not dependent on the residency status of the recipient of the services, nor whether the recipient is registered for GST.

Example – arranging of storage of goods overseas and other associated services

Sistinas Pty Ltd (Sistinas), an Australian company that is registered for GST in New Zealand, carries on a number of business activities related to e-commerce. One of these activities involves the facilitation of a range of underlying services related to goods stored in third-party warehouses in Australia (such as gift wrapping, handling, logistics and transportation) which are sold as bundled packages to customers resident in New Zealand. These customers are typically GST-registered e-commerce businesses selling goods into Australia, but may also include some non-registered microbusinesses and consumers.

While most of the consideration paid by Sistinas' customers relates to the core underlying services, Sistinas charges its customers a "preparation fee" relating to its facilitation services.

Where one of these service packages is supplied to a person in New Zealand who is not a registered person, the underlying services are zero-rated under either section 11A(1)(a) or (f) as the supply of overseas transportation, or of services that are supplied directly in connection with moveable personal property situated outside New Zealand.

Assuming that the arranging services are treated as supplied in New Zealand, section 11A(1)(jbb) applies to zero-rate these services. This means that the preparation fee is subject to GST at the rate of zero percent.

Application date

The amendment applies on and after 1 October 2016, being the date that the previous law change that inadvertently changed the GST treatment of certain arranging services came into force.

BINDING RULINGS MINOR AMENDMENTS

Sections 91CB and 91EB of the Tax Administration Act 1994

Two minor amendments have been made to two provisions in Part 5A of the Tax Administration Act 1994 which contain the rules for binding rulings.

Background

Consistent with the "right-from-the-start" framework, amendments were made to the binding rulings provisions in the Tax Administration Act 1994 following the enactment of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 to enable greater up-front certainty for taxpayers by extending the scope of matters that the Commissioner can issue binding rulings on.

The amendments removed the prohibition on ruling a taxpayer's purpose under certain provisions in the Income Tax Act 2007 and the Goods and Services Tax Act 1985. The amendments also allow the Commissioner to issue binding rulings on more factual questions not involving "arrangements", such as on a person's New Zealand tax residence.[40]

The Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 made two minor amendments that are necessary to ensure the binding rulings provisions operate as intended.

Key features

The amendments:

- Improve the drafting of section 91CB of the Tax Administration Act 1994, which permits the Commissioner to issue binding rulings in respect of certain matters not involving arrangements.
- Clarify that a private ruling made in relation to a matter not involving an arrangement no longer applies if the person's circumstances differ materially from the circumstances to which the ruling was made.

Application date(s)

The amendments both take effect from 18 March 2019 which is the date from which the Commissioner has been able to issue binding rulings on certain matters not involving arrangements.

[40] See section 91CB of the Tax Administration Act 1994.

Detailed analysis

The Commissioner can, under section 91CB(3) of the Tax Administration Act 1994, issue binding rulings on a person's purpose under certain provisions of the Income Tax Act 2007 (such as whether an amount that a person derives from disposing of personal property is income of the person under section CB 4 of the Income Tax Act 2007, or whether an amount that a person derives from disposing of land is income of the person under either sections CB 6 or CB 7 of the Income Tax Act 2007).

Section 91CB(3)(c) of the Tax Administration Act 1994 referred to the "principal purpose of making taxable supplies" test of the Goods and Services Tax Act 1985 which was repealed following the enactment of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019. This provision has been repealed to clarify that the Commissioner will not be able to issue binding rulings on the "principal purpose of making taxable supplies" test.

The other change amends section 91EB of the Tax Administration Act 1994 which outlines when a private ruling no longer has application. In particular, section 91EB(2) of the Tax Administration Act 1994 has been amended to provide that where a private ruling has been issued for a matter that does not involve an arrangement, the ruling no longer has effect if the circumstances of the person to whom the ruling applies are materially different from the circumstances described in the ruling. This is consistent with the purpose of section 91EB(2) of the Tax Administration Act 1994, which is to protect the revenue base from binding rulings given where there has been a material omission or representation in the application for the ruling or when the ruling could be applied in circumstances that are materially different from those outlined in the application.

TAXATION OF LIFE INSURANCE: REMEDIAL CHANGE TO THE TRANSITIONAL RULES

Section EY 30 of the Income Tax Act 2007

Changes have been made to the transitional rules for life insurance policies sold as "level premium" in response to the low rates of inflation experienced in New Zealand over recent years.

"Level premium" life insurance policies are sold on the basis that premiums paid by the policyholder do not increase over a specified period, referred to as the "continuous rate period".

The amendment clarifies that level premium life insurance policies that provide for an increase in premiums as a direct result of an increase in the amount of life cover that does not exceed (whichever percentage is the higher) 3 percent or the percentage increase in the consumer price index (CPI) remain eligible for transitional relief. The amendment sets the measurement of CPI movements for the relevant life policy by reference to the preceeding four calendar quarters that is relevant to the life insurance policy's cover review period or other anniversary.

Section EY 30(5) has also been redrafted. Section EY 30(5)(b) sets the requirements for life insurers tax transitional relief for life insurance policies that were sold as "level premium" on or before 30 June 2010. New section EY 30(5)(BA) specifies the conditions when increases in premium caused by an increase in the amount of life cover are ignored for the purposes of section EY 30(5)(b).

Application date

The proposed changes apply from 1 July 2010 or the beginning of an income year that includes 1 July 2010. A savings provision was inserted in response to submissions on the bill and allows taxpayers to take an alternative tax position if it was filed before 26 June 2019 (the enactment date of the bill).

REIMBURSEMENT ACC ATTENDANT CARE PAYMENTS

Section LB 7 of the Income Tax Act 2007

An unintended consequence of an amendment previously made to exempt backdated ACC payments that reimburse ACC beneficiaries for care they have paid for, is that the tax credit for the tax withheld by ACC is passed through to the carer where it should be assigned to the claimant. This amendment rectifies this unintended consequence.

Background

ACC make payments to a number of ACC claimants who do not have full capacity and are unable to look after themselves. These payments are known as personal service rehabilitation payments and are paid under the Accident Compensation Act 2001 to help provide key aspects of rehabilitation such as attendant care, child care, home help, and training or transport for independence. The payments are treated as schedular payments and ACC withhold tax at a rate of 10.5%. The ACC claimants who are recipients of these payments can then on-pay this income to carers (attendant care payments) who provide services to the ACC claimants.

An amendment was included in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 (ARMTARM) to eliminate the double taxation that arose where a backdated payment was paid to a claimant. This double taxation arose because the payment would be taxed in the hands of the claimant when received from ACC, and in the hands of the carer who paid tax at their marginal rate when the income was derived (usually some years previously). The relevant legislation has been amended to ensure that this does not occur.

However, because the ARMTARM amendments followed the payment structure that applied to ACC attendant care payments that were made in the current year for the purposes of determining the allocation of tax withheld by ACC, it failed to take into account that where a reimbursement payment is made the claimant has previously paid the carer a 'gross' amount and the carer would have paid tax on this amount. As applied, the amendments would deny the claimant a tax credit, and would allow the carer to claim a tax credit to which they were not entitled.

Key features

Section LB 7 of the Income Tax Act 2007 has been amended to ensure that where a reimbursement payment is made, the recipient of the payment (claimant) will have a tax credit, rather than the provider (carer). The carer will still receive the tax credit under LB 7 for the tax withheld by ACC from an ACC attendant care payment that is not a reimbursement payment.

Application date(s)

This amendment applies from 1 April 2018 to ensure that the rule is in place for the 2018/19 tax year, which is the first year to which the new individual's income tax rules apply.

Detailed analysis

The following example demonstrates that, under this amendment, the tax credit will be assigned to the claimant where a reimbursement ACC rehabilitation payment is made. This is necessary to ensure that the claimant is sufficiently reimbursed for payments they would have made from their own pocket in prior years.

Example: Lumpsum backyear entitlement that reimburses the claimant for payments made to the carer

Adam receives a reimbursement payment from ACC of $40,000 which covers attendant care payments he has made to Ben over the past four years ($10,000 per year) out of his own pocket. ACC withholds tax on the $40,000 payment in the year it is paid ($4,200).

Ben has paid tax on the attendant care payments received over the last four years.

To ensure that Adam is reimbursed for the $40,000 he has paid, the tax credit should be attributed to Adam.

Tax treatment		**Cash flow**	
Gross income	$40,000	ACC payment	$35,800
Exempt income	($40,000)	Tax refund	$4,200
Taxable income	Nil		$40,000
Tax credit	$4,200	Payments to Ben	($40,000)
(Refund)			

ALLOWING REFUNDS THAT ARISE FROM A REIMBURSEMENT ACC ATTENDANT CARE PAYMENT TO BE PAID OUTSIDE THE TIMEBAR PERIOD

Section RM 2 of the Income Tax Act 2007

An amendment has been made to section RM 2 of the Income Tax Act 2007 to include an exception that allows a taxpayer to claim a refund from an amended assessment outside the time bar period where the refund arises due to a reimbursement ACC attendant care payment.

Background

An amendment was made in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act ("ARMTARM") to the ACC attendant care payment rules to eliminate the double taxation that occurs when a reimbursement payment is paid to a claimant. The amendment achieves this outcome by legislating that, where certain requirements are met, the reimbursement payment is exempt to the claimant.

Where an ACC claimant has returned that income in a prior year, they must request that the Commissioner amends their assessment under section 113 of the Tax Administration Act 1994. This will allow them to treat the payment as exempt income and therefore claim a tax refund.

Prior to the amendment made in this Act, section RM 2 of the Income Tax Act 2007 acted as an impediment to the issuance of the refund due to the application of the time bar to amended assessments.

Key features

This amendment allows a taxpayer to claim a refund from an amended assessment outside the time bar period where the refund arises due to a reimbursement ACC attendant care payment.

Application date(s)

This amendment applies from 1 April 2008, to coincide with the date that the amendment in ARMTARM was retrospective from.

Detailed analysis

The example below explains the effect of the amendment.

Example

Mary was involved in a car accident in 2006 which impacts her ability to care for herself. Mary pays Mandy $10,000 pa to care for her out of her own pocket.

2006/07 tax year: Mary pays Mandy $10,000. Mandy pays tax on this at her marginal rate.

2007/08 tax year: Same as above ($10,000).

2008/09 tax year: Same as above ($10,000).

2009/10 tax year: Same as above ($10,000).

2010/11 tax year: ACC accept that Mary is entitled to ongoing care. Along with paying Mary an entitlement for the 2010/11 tax year, ACC also pay Mary a lumpsum of $40,000 (less $4,200 withholding tax) as compensation for the previous 4 tax years. Mary files a tax return and also pays additional tax on this amount at her marginal tax rate.

Treatment of the $40,000 reimbursement payment (post ARMTARM amendments)

Under section CZ 35 of the Income Tax Act 2007, the lumpsum reimbursement payment that Mary received during the 2010/11 tax year will be treated as exempt income to Mary in the year in which it was received where the Commissioner is satisfied that the tax obligations relating to the payment have been met. Assuming that the Commissioner was satisfied that the tax obligations in relation to the payment had been met by the carer, this means that Mary could, under section 113 of the Tax Administration Act 1994, request that the Commissioner amend her assessment. The Commissioner would accept this request which would result in Mary being owed a substantial tax refund, as she has paid tax on income that is now determined to be exempt.

Refund time bar

The way that section RM 2 of the Income Tax Act 2007 applies is to limit a taxpayer's ability to claim a refund from an amended assessment to the timebar period, being four years from the end of the tax year in which the taxpayer provides the return. This achieves the desired policy intent in most instances, but means that, in Mary's situation, she would be timebarred from claiming a refund. This is because more than four years have passed from the end of the tax year (2010/11) in which Mary provided the return.

Section RM 2 has now been amended to provide an exception for reimbursement ACC attendant care payments. This means that a refund can now be paid out to Mary.

TAX ADMINISTRATION ACT – INFORMATION COLLECTION

Sections 17(1CB) and 17E of the Tax Administration Act

Background

The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 provided a new power for the Commissioner of Inland Revenue to request information held by a member of a large multinational group.

The policy intent was that criminal penalties would not apply in respect of such information requests. Instead, the civil penalty in section 139AB of the Tax Administration Act could be applied to large multinational groups that fail to provide information requested by the Commissioner of Inland Revenue.

Key features

Remedial amendments have been made to section 17E and the older equivalent provision in section 17(1CB) of the Tax Administration Act 1994 to remove some erroneous references to "sections 143 and 143A" as those sections involve criminal penalties.

The reference to "section 139AB" is retained. This allows the civil penalty in section 139AB to be imposed in relation to the relevant request under section 17E or section 17(1CB) for information held by a member of a large multinational group.

Application date

The amendment to section 17(1CB) applies from 27 June 2018 which is the date that the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 was enacted.

The amendment to section 17E applies from 18 March 2019 which is the date that section 17E was inserted by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019.

DEFINITION OF HIRE PURCHASE AGREEMENT

Section YA 1 of the Income Tax Act

The definition of "hire purchase agreement" in section YA 1 of the Income Tax Act 2007 contains an exclusion in paragraph (d) for agreements under which the legal ownership of the goods passes absolutely to the purchaser of the goods at the time the agreement is made or before the goods are delivered.

However, a drafting error meant that these agreements were not actually excluded from the definition if they met the general criteria set out in paragraphs a(i) and a(ii).

Paragraph (d) of the hire purchase definition has been replaced to remove the error. This ensures that an agreement which meets both the general criteria, and the exclusion in paragraph (d) will be excluded from the definition of a hire purchase agreement.

Application date

The amendment applies from 26 June 2019.

RWT EXEMPT STATUS

Section 32E Tax Administration Act 1994

The amendment removes the requirement for a charity registered under the Charities Act 2005 to apply for RWT exempt status. The amendment reduces compliance costs for such charities by ensuring that as soon as a charity becomes a registered charity, it will also have RWT exempt status. The RWT exempt status will continue until the charity is deregistered.

Key features

Reforms to employment and investment information requirements as part of Inland Revenue's business transformation project will result in a reduction in compliance costs for RWT-exempt people by:

- requiring investors with RWT exempt status to notify payers of investment income of their status; and
- requiring Inland Revenue to maintain a public electronic register of persons having RWT exempt status;
- requiring payers of investment income to verify the RWT exempt status of an investor prior to making a payment.

The amendment contains a legislative cross-reference error to the Charitable Trusts Act 1957. It should refer to the Charities Act 2005 and this will be corrected in an upcoming tax Bill.

Application date

The amendment applies from 1 April 2020.

MAINTENANCE AMENDMENTS

Summary of proposed amendments

The following amendments are minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

Application dates

Commencement dates for each amendment are stated in table 2.

Minor maintenance items

The amendments set out in Table 2 relate to minor maintenance items, which correct any of the following:

- ambiguities;
- compilation issues;
- cross-references;
- drafting consistency, including readers' aids – for example, the defined terms lists;
- grammar;
- consequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

Table 2: Maintenance amendments

Section	Enactment	Amendment	Application date
21HB(4)	Goods and Services Tax Act 1985	Improve clarity of the provision	1 April 2011
CV 9	Income Tax Act 2007	Omit redundant section	Enactment date
CX 60(2)	Income Tax Act 2007	Correction to cross-reference	1 April 2019
DE 4	Income Tax Act 2007	Improve drafting consistency	Enactment date
EH 1	Income Tax Act 2007	Correction to cross-reference	18 March 2019
EW 15F, EX 20B, EX 21E, EX 46, EX 50, HM 35B, and YA 1	Income Tax Act 2007	Updating cross-references for new IFRS standard (IFRS 9)	Enactment date
FE 4	Income Tax Act 2007	Improve drafting consistency	1 April 2015
RE 21	Income Tax Act 2007	Improve drafting consistency	1 April 2008
RF 2B	Income Tax Act 2007	Omit redundant terms	Enactment date
RF 2C	Income Tax Act 2007	Omit redundant term	Enactment date

Social Assistance Legislation (Budget 2019 Welfare Package) Amendment Act 2019

The Social Assistance Legislation (Budget 2019 Welfare Package) Amendment Act was introduced into Parliament on 30 May and received Royal assent on 5 June 2019.

The Budget 2019 Welfare Package is designed to increase the incomes of low-income individuals and families and to support a sustained reduction in child poverty.

The Act provides for changes to increase benefit abatement thresholds, to adjust main benefits annually in line with any upward percentage movement in the average wage and to remove the benefit sanction for sole parents who fail to apply for child support. In addition, it enables the Commissioner of Inland Revenue to excuse a person in receipt of an Unsupported Child's benefit or sole parent rate of benefit from their obligation to apply for child support.

Removing the benefit sanction for sole parents who fail to apply for child support and giving the Commissioner of Inland Revenue the authority to excuse a person from their obligation to apply for child support requires changes to the Child Support Act 1991. These changes are covered in this item.

REPEAL OF BENEFIT SANCTION FOR SOLE PARENTS WHO FAIL TO ASSIST CHILD SUPPORT

Sections 9 and 122 of the Child Support Act 1991

Amendments have been made to the Child Support Act 1991 consequential to the repeal of the s192 benefit sanction on sole parent beneficiaries in the Social Security Act.

Background

The Social Security Act 2018 provides that a person who is granted a sole parent rate of benefit must (subject to some exceptions) have their benefit reduced if they fail to:

- identify in law the other parent of their child;
- apply for child support; or
- give evidence as a compellable witness in a proceeding under the Child Support Act.

The intention of the sanction is to incentivise parents and carers to comply with these obligations to assist child support.

In order to assist the Ministry of Social Development (MSD) with the administration of this benefit sanction, Inland Revenue will inform MSD when a sole parent hasn't fulfilled their obligations for child support so a benefit reduction can be considered.

The new law will see the repeal of this sanction in the Social Security Act 2018 and means a benefit reduction will no longer be applied to sole parent beneficiaries who fail to assist child support.

Key features

Sections 9(6),(6B),(7) and 122(2) of the Child Support Act 1991 are repealed as the Commissioner of Inland Revenue will no longer need to inform MSD if a person fails to meet their obligation to assist child support.

Application date

The amendments come into force on 1 April 2020.

EXCUSING CARERS FROM THEIR OBLIGATION TO APPLY FOR CHILD SUPPORT

Section 9(5B) of the Child Support Act 1991

An amendment has been made to give the Commissioner of Inland Revenue the ability to excuse people receiving an Unsupported Child or sole parent rate of benefit from their obligation to apply for child support in compelling situations.

Background

Sole parent beneficiaries and carers receiving an Unsupported Child's Benefit are obligated to apply for child support unless there is compelling reason for them not to apply – for example a fear of violence.

Under the current law only the Chief Executive of MSD can excuse the beneficiary from this obligation this can sometimes lead to child support obligations being established when they shouldn't because the customer has not disclosed their situation to MSD and Inland Revenue cannot excuse the beneficiary from their obligation.

The new law will mean beneficiaries who are obligated to apply for child support can choose to disclose information about their compelling situation to either Inland Revenue or MSD and be excused from applying for child support.

Key features

Section 9(5B) is updated to give authority to the Commissioner of Inland Revenue to excuse a person from their obligation to apply for child support if they qualify under one of the reasons outlined in this section:

- There is insufficient evidence to establish who the other parent is.
- There is a risk of violence against the person, or other family members (including their children or partner if they are a unsupported child's benefit recipient).
- The other parent is deceased.
- The child was conceived as a result of incest or sexual violation.
- Some other compelling reason.

Application date(s)

The amendment comes into force on 1 April 2020

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

BR Pub 19/03: Income tax – employer issued crypto-assets provided to an employee

This is a public ruling made under s 91D of the Tax Administration Act 1994

Taxation law

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss CX 2, RD 27 and RD 40(1).

The Arrangement to which this Ruling applies

The Arrangement is the agreement to provide crypto-assets to an employee in connection with their employment in circumstances where:

- the employer is issuing crypto-assets (for example through an Initial Coin Offering, an Initial Exchange Offering, a Security Token Offering, or a Token Generating Event);
- the employee will receive the crypto-assets only if they are still employed by the employer at a specified future date (the condition); and
- the employee cannot sell or otherwise transfer the crypto-assets until the specified future date.

The Ruling applies only to salary and wage earners, not to self-employed taxpayers.

The Ruling does not apply where:

- the crypto-asset provided is a “share” for income tax purposes that is received under an “employee share scheme” as defined in s CE 7; or
- Public Ruling “BR Pub 19/01: Income Tax – Salary and wages paid in crypto-assets” or Public Ruling “BR Pub 19/02: Income Tax – Bonuses paid in crypto-assets” applies.

How the taxation law applies to the Arrangement

The taxation laws apply to the Arrangement as follows:

- A fringe benefit will be provided under s CX 2 when the condition is met and the employee becomes entitled to the crypto-assets.
- Where the employer is selling its crypto-assets to arm’s length buyers at the time the crypto-assets are provided to the employee, the value of the fringe benefit is the “market value” determined under s RD 40.
- Where s RD 40 does not apply and at the time the crypto-assets are provided to the employee it can be purchased on the open market, the value of the fringe benefit is the “market value” determined under s RD 27(3).
- Where there is no “market value” under s RD 27 or s RD 40, the Commissioner will need to determine the value of the fringe benefit.

The period or tax year for which this Ruling applies

This Ruling will apply for a period of three years beginning on 30 July 2019.

This Ruling is signed by me 30 July 2019.

Susan Price
Director, Public Rulings

Commentary on public ruling BR Pub 19/03

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 19/X3 ("the Ruling").

Legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

Summary

1. This Ruling considers the income tax treatment of employer-issued crypto-assets provided to employees. In particular, it covers the situation where the crypto-assets are subject to conditions that the employee must satisfy to become entitled to the crypto-assets. The commentary discusses the application of the fringe benefit tax (FBT) rules to the Arrangement. It also briefly discusses the FBT treatment of similar arrangements.

Background

2. The crypto-asset industry is still evolving and there is currently no standard terminology used. The Ruling uses the term "crypto-asset" to cover digital assets that use cryptography and blockchain technology to regulate their generation and verify transfers.[1]
3. It is becoming more common for employees (particularly those working in crypto-asset-related industries) to receive remuneration in crypto-assets. The Commissioner has been asked to provide guidance on how remuneration paid in crypto-assets is taxed.
4. This Ruling sets out the Commissioner's view on the situation where an employee receives crypto-assets issued by their employer (or an associated person). Often this will occur in the context of an Initial Coin Offering (ICO), an Initial Exchange Offering, a Security Token Offering, or Token Generating Event.
5. This Ruling considers the situation, as is common in arrangements of this type, where the crypto-assets are provided subject to a condition that must be satisfied before an employee becomes entitled to the crypto-assets. The condition considered in the Ruling is that the employee remains employed by the employer. However, the same reasoning applies for other conditions that must be satisfied for the employee to become entitled to the crypto-assets – for example, meeting certain performance targets.

Application of the legislation

6. Section CE 1 sets out when an amount derived by a person in connection with their employment will be their income. The crypto-assets covered by this Ruling will not come within any of the paragraphs of s CE 1. Consequently, it is necessary to consider how FBT applies.
7. Section CX 2(1) defines "fringe benefit" as:

   (1) A **fringe benefit** is a benefit that—

   (a) is provided by an employer to an employee in connection with their employment; and

   (b) either—

   (i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

   (ii) is an unclassified benefit; and

   (c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

8. Broadly, a fringe benefit is a benefit an employer provides to an employee in connection with their employment. The following analysis considers:
   - whether there is a "benefit";
   - when the benefit is "provided"; and
   - what the value of the benefit is.

Whether there is a benefit

9. Crypto-assets are not included in ss CX 6, CX 9, CX 10, and CX 12 to CX 16. Therefore, if it is a benefit, it is an unclassified benefit under s CX 37.
10. The Act does not define the term "benefit" for the purposes of the FBT rules. Therefore, "benefit" should be given its ordinary meaning.

[1] These are sometimes referred to by other terms including "cryptocurrencies" and "tokens".

11. The *Concise Oxford English Dictionary* (12th edition, Oxford University Press, New York, 2011) relevantly defines "benefit" as "an advantage or profit gained from something".

12. In *Case M9* (1990) 12 NZTC 2,069, the Taxation Review Authority (TRA) considered the FBT status of contributions to a superannuation fund and the provision of motor vehicles that were available for the private use and enjoyment of two employees. The TRA commented on the general meaning of "benefit" (at 2,074):

> The section itself to an extent explains what is a benefit, for the purposes of a fringe benefit; so long as something is provided by an employer to an employee that can be reasonably, practically and sensibly understood as a benefit to the employee in itself and is not expressly excluded, [that] would be sufficient for it to be a benefit for the purposes of the definition of "fringe benefit" as provided by the section.

13. It can be seen from the quotation above that "benefit" has a wide meaning and includes anything that can be "reasonably, practically and sensibly understood as a benefit to the employee". Crypto-assets provided to an employee would, therefore, be a "benefit".

14. A benefit is treated as being received from an employer where the employer arranges with a third party to provide a benefit to an employee (s CX 2(2)). In the current context, this would apply, for example, when an employer entered into an arrangement for an associated company to provide crypto-assets to the employer's employees.

15. A benefit provided to an associate of an employee is treated as if it were provided by the employer to the employee (s CX 2(5)(b)).

When the benefit is "provided"

16. Where ownership of the crypto-assets will not pass unless certain requirements are met, the Commissioner's view is that no benefit is provided until the requirements are met. For example, if transfer of the crypto-assets is subject to an employee remaining in employment for six months or meeting certain performance targets, there will be no benefit for FBT purposes until those conditions are satisfied and the employee becomes entitled to the crypto-assets.

17. This is because, until the conditions are satisfied, it is not clear whether the employee will receive the crypto-assets – provision of the crypto-assets is contingent on future events that may or may not happen.

What the value of the benefit is

18. Sections RD 27 to RD 57 set out how to determine the value of a benefit for FBT purposes. The potentially relevant provisions are:
    - s RD 40(1)(a), which applies where an employer provides an employee with "goods" the employer has produced; and
    - s RD 27(2), which applies where none of the other valuation provisions applies.

19. Section RD 40(1)(a) states:

> *Market value or cost*
>
> (1) The value of a fringe benefit that an employer provides to an employee in goods is determined as follows:
>
> (a) when the person providing the goods manufactured, produced, or processed them, their market value:

Whether crypto-assets are "goods" for FBT valuation purposes

20. Section RD 40 raises an issue as to whether crypto-assets are "goods" for FBT purposes. The word "goods" is not defined. Further, no case law considers the meaning of "goods" in this context. In the absence of a definition, "goods" takes it meaning from the context in which it is used. In concluding that securities (in the form of bearer bonds or coupons) were "goods", the Privy Council in *The Noordam (No 2)* [1920] AC 904 made the following comments (at 908):

> At first sight the word "goods" might seem to be an equally inappropriate description. It must, however, be observed that the word is of very general and quite indefinite import, and primarily derives its meaning from the context in which it is used.
>
> …
>
> The content of the word "goods" differs greatly according to the context in which it is found and the instrument in which it occurs. … the word may sometimes be of the narrowest and sometimes of the widest scope.

21. The High Court in *Waimea Nurseries Ltd v Director-General for Primary Industries* [2019] 2 NZLR 107 cited *The Noordam (No 2)* favourably. Cooke J stated (at 124) that the meaning to be given to "goods" "will be highly dependent on the context".

22. Potential wide and narrow interpretations were discussed in *Spring House (Freehold) Ltd v Mount Cook Land Ltd* [2002] 2 All ER 822 (CA), where Ward and Rix LJJ stated (at 828):

    It is common ground, as the dictionary definition makes clear, that "goods" can be widely understood to mean "property or possessions", or more narrowly "saleable commodities, merchandise, wares" or … "tangible moveable property viewed as an item or items of commerce".

23. It can be seen from the above discussion that "goods" can be interpreted widely enough to include crypto-assets (which would, for example, be "property or possessions"). Whether this is appropriate depends on the context of s RD 40 and the FBT provisions more generally.

24. Section RD 40 provides a valuation methodology for the situation where an employer provides an employee with "goods" the employer has produced. Section RD 41 provides a similar provision for services the employer provides as part of their business. Where neither provision applies, unclassified benefits fall to be valued under the default provision (and may require the Commissioner to determine the value). Where s RD 40(1) applies, the value of the benefit provided is based on the amount the employer sells those goods to the public for. There seems to be no reason to limit the type of goods that the provision applies to (for example, by distinguishing between tangible and intangible goods). Doing so would mean no specific valuation provision exists for those types of property. Consequently, in the Commissioner's view, crypto-assets are "goods" for the purposes of s RD 40.

Application of s RD 40

25. Section RD 40(1)(a) provides that:

    (1) The value of a fringe benefit that an employer provides to an employee in goods is determined as follows:

        (a) when the person providing the goods manufactured, produced, or processed them, their market value:

26. "Market value" is defined for the purposes of s RD 40 in s RD 40(3) as:

    market value means the lowest price, at the time at which the goods were provided to the employee, for which identical goods were sold by the same person to an arm's length buyer, whether wholesaler, retailer, or the public, in the open market in New Zealand in a sale freely offered and made on ordinary trade terms

27. Therefore, s RD 40(1) applies only where the employer is selling the crypto-assets to arm's length buyers at the time the crypto-assets are provided to the employee.[2] In such a case, the "value" of the crypto-assets will be the lowest price for which the employer was selling identical crypto-assets to arm's length buyers in the open market in New Zealand.

28. Where the employer is not selling the crypto-assets at the time it is provided to the employee (which may be the case, for example, before or after an ICO), s RD 40(1) will not apply.

Valuation where s RD 40 does not apply

29. Section RD 27(2) applies where the value of a benefit cannot be determined under other provisions. It provides that the value of the fringe benefit is the market value or a value determined by the Commissioner:

    When value cannot be ascertained

    (2) If, under sections RD 28, RD 29, and RD 33 to RD 41, the value of a fringe benefit cannot be ascertained, the value is the market value or otherwise as the Commissioner determines.

30. Section RD 27(3) defines "market value" for the purposes of s RD 27(2). Unlike the definition of "market value" for the purposes of s RD 40(1), s RD 27(3) does not require the employer to be selling the crypto-assets. However, it does require the existence of an open market accessible to the public:

    Meaning of market value

    (3) In subsection (2), **market value** means the price normally paid, at the time when the fringe benefit is received by the employee, for the fringe benefit in a sale—

        (a) in the open market; and

        (b) freely offered; and

        (c) made on ordinary trade terms; and

        (d) to a member of the public at arm's length.

[2] Although unlikely to occur in this context, an exception to this statement applies where the employer's sale price is greater than the open market value. In such a case, the open market value calculated under s RD 40(2) applies.

31. Where there is no market value, the Commissioner needs to determine the value of the fringe benefit. In the Commissioner's view, valuation in these circumstances should be determined as follows:
    - Where the crypto-assets are provided to the employee before sale to the public, the employer should use the price at which the crypto-assets will first be sold to the public if such a price has been determined. For example, if the crypto-assets will initially be sold to the public as part of an ICO at $1 per token, crypto-assets provided to employees before the ICO should also be valued at $1. Where the first public sale price has not yet been determined, the employer can use a value based on the last arm's length sale price (if applicable). For example, if seed capital has been invested in return for a share of crypto-assets, a crypto-asset value could be determined from this.
    - Where the crypto-assets are provided to the employee after the employer has ceased selling to the public but before there is an established market for the crypto-assets, the employer should use the price at which the crypto-assets were last sold to the public.
    - If none of the above situations apply, the employer should contact Inland Revenue to discuss their particular situation.

Similar situations

32. This Ruling considers the situation where crypto-assets are promised to an employee at a future date if certain conditions are met. There are other similar arrangements under which an employer could provide its crypto-assets to employees.
33. Determining when a benefit has been provided requires a careful consideration of the legal arrangements between the employer and the employee. Arrangements with similar effect could have different treatments depending on their legal form.
34. Two potential scenarios are briefly considered below. These are both situations where the employee is not required to meet any conditions to be entitled to the crypto-assets.

Crypto-assets transferred to employee without any conditions or restrictions on sale

35. Where crypto-assets are transferred to the employee without any conditions, a benefit will be provided for FBT purposes at the time of transfer.
36. The value of the benefit will be determined under ss RD 40(1) and RD 27 as discussed in paras 18 to 31.

Legal or beneficial ownership transferred to employee subject to restrictions on sale

37. Sometimes crypto-assets are transferred to an employee subject to restrictions on their sale (for example, the crypto-assets cannot be sold for three months). In the Commissioner's view, a benefit would be provided for FBT purposes at the time the employee becomes legally entitled to receive the crypto-assets (regardless of any restrictions on disposal). This is different to the situation considered in the Ruling where the employee does not become legally entitled to the crypto-assets until certain conditions are met.
38. In the Commissioner's view, a benefit will also be provided where the crypto-assets are not physically provided to the employee but are held on trust for the employee until the restricted sale period is over.[3] In such a case, beneficial ownership of the crypto-assets passes to the employee. Any trust would be non-discretionary as there are no conditions that the employee must satisfy to be entitled to the crypto-assets.
39. Where the benefit being provided to the employee is a beneficial interest in the crypto-assets or the crypto-assets are subject to restrictions on sale, there is unlikely to be a "market value" for the benefit provided (under either s RD 40 or s RD 27).[4] In such a case, the Commissioner would need to determine the relevant value, which may differ from the market value for crypto-assets not subject to restrictions.

[3] Where the crypto-assets are is held on a trust of this type, it would generally be expected that any entitlements subsequently arising from the crypto-assets (such as "interest" or "dividend" type payments) would also be held for the benefit of the employee. These additional benefits would not be subject to FBT as they arise after the benefit has been provided to the employee.

[4] A possible exception would be if the employer were also offering crypto-assets with the same restrictions to arm's length parties.

Examples

40. The following examples illustrate the application of the law.

Example 1: Crypto-assets provided as an employee incentive

41. Bionic Animal Services Ltd (Bionic) is developing a new crypto-asset (Bio-record) to be used with a blockchain-based database that stores animal records. Bionic has hired two full stack developers, Lesley and Mei, to assist with the project.

42. To provide an incentive to Lesley and Mei to stay with Bionic until the project is completed, Bionic has agreed to provide Lesley and Mei with 1,000 Bio-record tokens if they are still employed by Bionic in 12 months' time. Bionic is currently offering Bio-record for sale to the public as part of an ICO. The current purchase price is $10 per token.

43. Bionic wants to know whether it should return FBT now. No FBT is payable at the current time as no benefit has been provided to the employees yet.

44. Lesley leaves Bionic within the 12-month period, so does not receive any Bio-record. After 12 months, Mei is still working for Bionic, so she becomes entitled to receive 1,000 Bio-record. Bionic is no longer selling Bio-record to the public. However, it is available through a local cryptocurrency exchange for $12 per token.

45. Bionic is liable for FBT at the time Mei becomes legally entitled to the Bio-record tokens. The value of the benefit for FBT purposes is $12,000 (1,000 tokens x $12 per token).

Example 2: Crypto-assets provided subject to restrictions

46. Bionic also hires a new manager, Raju. Bionic want to incentivise Raju to stay employed with them. However Bionic also wants to avoid its employees affecting the market for Bio-record tokens by selling as soon as they become entitled to their Bio-record.

47. Bionic agrees to provide Raju with 2,000 Bio-record tokens if he is still employed by Bionic in 12 months' time. However, the Bio-record will be provided subject to a restriction preventing Raju from selling the tokens for a further six-months.

48. Bionic wants to know when it should return FBT. No FBT is payable at the current time as no benefit has been provided to Raju yet. FBT will be payable if Raju is still employed with Bionic in 12 months' time, as this is when Raju becomes legally entitled to the Bio-record tokens.

49. As the Bio-record tokens will be subject to a six-month restriction on sale, this may affect their value. Bionic should contact Inland Revenue to discuss an appropriate value for FBT purposes.

References

Related rulings

Public Ruling "BR Pub 19/01: Income tax – salary and wages paid in crypto-assets" Tax Information Bulletin Vol 31, No 7 (August 2019)

Public Ruling "BR Pub 19/02: Income tax – bonuses paid in crypto-assets" *Tax Information Bulletin* Vol 31, No 7 (August 2019)

Subject references

Crypto-asset
Cryptocurrency
Employee
Fringe benefit tax
Income tax

Legislative references

Income Tax Act 2007, ss CE 7, CX 2 ("fringe benefit"), CX 6, CX 9, CX 10, CX 12 – CX 16, CX 37, GB 32, RD 27 – RD 57

Case references

Case M9 (1990) 12 NZTC 2,069 (TRA)
Noordam (No 2), The [1920] AC 904 (PC)
Spring House (Freehold) Ltd v Mount Cook Land Ltd [2002] 2 All ER 822 (CA)
Waimea Nurseries Ltd v Director-General for Primary Industries [2019] 2 NZLR 107 (HC)

Other references

Concise Oxford English Dictionary (12th edition, Oxford University Press, New York, 2011)

Appendix – Legislation

Income Tax Act 2007

1. Section CX 2 provides:

CX 2 Meaning of fringe benefit

Meaning

(1) A fringe benefit is a benefit that—

(a) is provided by an employer to an employee in connection with their employment; and

(b) either—

(i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

(ii) is an unclassified benefit; and

(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

Arrangement to provide benefit

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

Past, present, or future employment

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

Relationship with subpart RD

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

Arrangements

(5) A benefit may be treated for the purposes of the FBT rules as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

50. Section GB 32 provides:

GB 32 Benefits provided to employee's associates

When this section applies

(1) This section applies when—

(a) a benefit is provided to a person who is associated with an employee of an employer; and

(b) the benefit would be a fringe benefit if provided to the employee; and

(c) the benefit is provided either by the employer or by another person under an arrangement with the employer for providing the benefit; and

(d) the exemptions in subsections (2) and (2B) do not apply.

Exemption for shareholder-employees and corporate associates

(2) Subsection (3) does not apply when—

(a) the benefit is provided by an employer that is a company; and

(b) the employee is a shareholder in the company; and

(c) the person associated with the employee is a company; and

(d) the benefit is not provided under an arrangement that has a purpose of providing the benefit either—

(i) in place of employment income; or

(ii) free from fringe benefit tax.

Exemption for LTCs and partnerships

(2B) Subsection (3) does not apply when—

(a) the benefit is provided by an employer that is—

(i) a look-through company (an LTC):

(ii) a partnership or limited partnership; and

(b) the person associated with the employee, described in subsection (1)(a), is—

(i) an owner of the relevant LTC:

(ii) a partner of the relevant partnership or limited partnership.

Benefit treated as provided to employee

(3) For the purposes of the FBT rules, the benefit is treated as provided by the employer to the employee.

Application of section CX 18

(4) Section CX 18 (Benefits provided to associates of both employees and shareholders) applies to determine when a benefit provided to an associate of both an employee and a shareholder is treated as a fringe benefit and not a dividend.

51. Section RD 27 provides:

RD 27 Determining fringe benefit values

What sections RD 28 to RD 53 do

(1) Sections RD 28 to RD 53 set out the rules for determining the value of a fringe benefit provided by an employer to an employee in connection with their employment. The taxable value of a fringe benefit when an employee pays an amount for receiving the benefit is dealt with in sections RD 54 to RD 57.

When value cannot be ascertained

(2) If, under sections RD 28, RD 29, and RD 33 to RD 41, the value of a fringe benefit cannot be ascertained, the value is the market value or otherwise as the Commissioner determines.

Meaning of market value

(3) In subsection (2), **market value** means the price normally paid, at the time when the fringe benefit is received by the employee, for the fringe benefit in a sale—

(a) in the open market; and

(b) freely offered; and

(c) made on ordinary trade terms; and

(d) to a member of the public at arm's length.

52. Section RD 40 provides:

RD 40 Goods

Market value or cost

(1) The value of a fringe benefit that an employer provides to an employee in goods is determined as follows:

(a) when the person providing the goods manufactured, produced, or processed them, their market value:

(b) when the person providing the goods otherwise acquired them, or paid for them to be acquired, dealing at arm's length with the supplier of the goods, the cost of the goods to the person:

(c) if the person providing the goods is a company included in a group of companies, then, as the person chooses, the value of the benefit under either paragraph (a) or (b), applying the provisions as if the group of companies were 1 company.

Sale in open market

(2) Despite subsection (1), if the value of the fringe benefit as determined under that subsection would be more than the amount that would have been paid to the employer for the purchase of the goods in a sale described in paragraphs (a) to (d), then the value is treated as that amount. The sale must be—

(a) at retail in the open market in New Zealand; and

(b) freely offered; and

(c) made on ordinary trade terms; and

(d) to a member of the public with whom the employer is at arm's length.

Some definitions

(3) In this section,—

…

market value means the lowest price, at the time at which the goods were provided to the employee, for which identical goods were sold by the same person to an arm's length buyer, whether wholesaler, retailer, or the public, in the open market in New Zealand in a sale freely offered and made on ordinary trade terms

…

OPERATIONAL POSITION

The purpose of an Operational Position is to outline the legal position that the Commissioner considers is correct for an issue identified and the approach the Commissioner will be taking to applying that position in practice.

Commissioner's Operational Position - New section HC 27(6) – treatment of a beneficiary as a settlor in certain circumstances

[1] The law around whether a beneficiary who leaves distributions in a trust is regarded as a settlor has been unclear, and Inland Revenue has expressed differing views on the issue.

[2] In December 2013 Inland Revenue wrote to NZICA (as it then was) and advised that merely leaving funds available at call in a trust current account did not result in a beneficiary becoming a settlor. The letter relevantly said:

> *Whether a beneficiary of a trust can be deemed a settlor under tax law comes down in the end to a factual enquiry. However, we have concluded that a beneficiary, who simply has money vested in interest or in possession, where such sums remain with the trustee, does not become a settlor under s HC 27(2) Income Tax Act 2007 on that basis. The existence of an amount that is "beneficiary income" in relation to a particular beneficiary, which is (for example) held by the trustee in a current account that contains amounts to be distributed to that beneficiary, does not make that beneficiary a settlor. The fact that the amount could be called for by the beneficiary, and would be provided by the trustee if they did, does not make the beneficiary a settlor on the basis of deciding not to do so.*
>
> …
>
> *However, a beneficiary who has taken possession and enters into a contract to lend the money back to the trust may be deemed a settlor under s HC 27(2) if he or she:*
>
> *a. Contracts to be paid nil or below market-rate interest, or*
>
> *b. Contracts to receive interest but does not make demand for such interest or defers demand, or*
>
> *c. Does not demand repayment of capital.*

[3] This view appears to have been circulated, but not formally published by Inland Revenue.

[4] In the course of preparing a public statement on this matter the issues were reconsidered and ultimately different views were reached, namely:

- simply leaving funds on call in a current account (without market interest being paid) would result in a beneficiary becoming a settlor, and
- if funds were loaned to a trust at less than market interest rates the beneficiary would also become a settlor.

[5] Given the differing views, and the variety of approaches being adopted by affected taxpayers, a legislative clarification was proposed and ultimately enacted by section 67 of the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019. That section enacts an amendment to section HC 27 of the Income Tax Act 2007. That amendment provides that when a beneficiary of a trust is owed an amount by the trust, the beneficiary does not become a settlor of the trust if —

(a) the trustee pays to the beneficiary in the income year interest on the amount owing at a rate equal to or greater than the prescribed rate of interest:

(b) the amount owing at the end of the income year is not more than $25,000.

[6] This amendment comes into force on 1 April 2020, and does not have retrospective effect.

[7] Given the lack of retrospective effect, and the differing communications by Inland Revenue, some taxpayers may be uncertain about which interpretation Inland Revenue will apply until 1 April 2020 (when the new law takes effect).

Operational position

[8] So as to provide greater certainty and to minimise compliance costs, the Commissioner has exercised her care and management power, to provide that up to and including 31 March 2020, Inland Revenue will continue to allow taxpayers to rely on the existing public position, as set out in paragraph [2] of this Operational Position.

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

High Court considers whether a geothermal turbine hall is a building for depreciation purposes

Case	*Mercury NZ Limited v The Commissioner of Inland Revenue* [2019] NZHC 1524
Decision date	1 July 2019
Act(s)	Income Tax Act 2007, Tax Administration Act 1994
Keywords	Depreciation, building, plant, turbine hall, powerhouse, gantry crane, EUL, estimated useful life, geothermal, hydroelectric, PROV 26, PROV 27, ordinary meaning, natural meaning.

Summary

Mercury challenged the 2012 – 2015 income years to determine whether the turbine halls at its Kawerau and Nga Awa Purua geothermal powerstations ("powerstations") were buildings and therefore subject to a depreciation rate of 0%.

Mercury asserted that the turbine halls were to be treated as part of the gantry cranes which are situated within the turbine halls, and therefore were depreciable at a rate of 9.6%.

The Court found in favour of the Commissioner.

Impact

The judgment is significant as it contains the first judicial analysis in New Zealand of what constitutes a building in the modern depreciation context (which has been in force since 1993) and sets out the order of the questions to be asked. It affirms the Commissioner's published approach that the definition of building is its ordinary and natural meaning.

The Court has concluded as a matter of fact that the geothermal turbine halls at Kawerau and Nga Awa Purua are buildings.

Facts

The powerhouse, which forms part of each powerstation, incorporates a turbine hall and any attached annex housing electrical equipment and other plant (*Mercury NZ Limited v The Commissioner of Inland Revenue* [2019] NZHC 1524 ("*Mercury v The Commissioner*") [7]). The turbine halls house the main generating plant (turbines, generators and other equipment) and a gantry crane. Mercury accepted the Commissioner's assessment that the electrical annex to the turbine hall was building with a depreciation rate of 0%.

Prior to 1 July 2011, the Kawerau and Nga Awa Purua turbine halls were depreciated, as "structures (default class)" with an estimated useful life ("EUL") of 50-years, at a rate of 4%. The gantry crane and the foundation for the turbines and generators (known as the TG foundation which is set within the turbine hall but is a separate structure) were not separately depreciated but capitalised as part of the "structures (default class)" at the 4% rate.

When the Taxation (Budget Measures) Act 2010 ("the 2010 Budget Act") came into force, the depreciation rate for a building with an EUL of 50-years or more was set at 0% with effect from the 2012 income year. This change led to the issue in these proceedings. The gantry crane rate was set at 9.6%.

Post 2010 Budget Act and following considerable industry consultations, on 25 March 2015 the Commissioner issued Provisional Determination PROV 26: Depreciation Rate for hydroelectric powerhouses, which provides that a hydroelectric powerhouse has an EUL of 100 years and a provisional depreciation rate of 2%.

Discussions continued with the electricity sector who had geothermal power stations and on 23 February 2016, the Commissioner issued Provisional Determination Rate: PROV 27 Thermal and Geothermal Powerhouses which, applied retrospectively back to the 2012 income year, declared that geothermal powerhouses were buildings with an EUL of 50 years and a depreciation rate of 0%.

Decision

Question 1: What is the item?

The Court concluded that there was only one item – the turbine hall was one structure (neutral term) and therefore one item for the purpose of this inquiry (*Mercury v The Commissioner* [31]). The evidence before the Court from expert witnesses from both sides concluded that the three elements initially referred to by Mercury (as the gantry crane support structural system, the turbine hall base structure and the cladding system) are integrated and interdependent; part of one unit ([32]).

Question 2: Is the turbine hall a building?

The Court noted that Mercury could not realistically dispute the fact that the turbine hall has an EUL of 50-years or more as its own design specifications provided for a physical/design life of 50-years or more ([35]). Furthermore, Mercury's own asset register specifically listed the turbine halls as having an EUL of 50-years ([35]).

The definition of "building" in the Income Tax Act 2007 ("the Act") is exclusionary only. (The exclusion of grandparented structure was incorporated into the Act by the 2010 Budget Act and the exclusion for commercial fitout was inserted by the Taxation (GST and Remedial Matters) Act 2010 – s 132(4)). The Court agreed with the Commissioner that "building" in the Act is to be given its conventional meaning and that some assistance in discerning the intended meaning can be gained from what is excluded from the definition ([39]). This approach made it reasonably clear that buildings would include industrial buildings and buildings that would be considered to be of a specialised industrial nature ([40]).

The Court discussed the definition for "plant" and "commercial building" and concluded that the "combination of these provisions makes it clear that anything that is structural in relation to a building, even if it would otherwise be plant, is not plant. It is part of the building for depreciation purposes" ([44]).

In considering the definition of "temporary building", (The Court considered the definition as defined in the Income Tax Act 2007 since prior to the 2010 Budget Act and also amended by the Taxation (GST and Remedial Matters) Act 2010) the Court said it "makes it clear that even structures erected and used to house specific plant and that are to be demolished once the plant is removed, would fall in the intended definition of building, but are purposefully excluded because they are only useful for the life of the plant" ([46]).

Ordinary and natural meaning

Justice Hinton accepted that the approach to take for answering the question of what was a building for the purposes of depreciation under the Act, was the "ordinary and natural meaning of the word" particularly when nothing in the legislation gives any signal that a building for purposes of the depreciation provisions is anything other than a building in the ordinary sense of the word ([48]).

The Court acknowledged the hypothetical view of the reasonable lay observer which has been useful for other Courts. Justice Hinton said the turbine hall "certainly looks like a building from the outside ([54]), a concession Mr McKay accepted on a "first blush" basis ([55]) before stressing the need to look both inside and outside the turbine hall ([56]). The Court said that "a reasonable observer looking both from inside and outside the turbine hall would say it is a building" ([57]) and disagreed that the common-sense approach should be given low priority ([58]).

Other considerations

Mercury argued that there was no material distinction between a hydroelectric powerhouse and a geothermal powerhouse. The Court did not have information in front of it to draw a meaningful comparison between the two regardless of what reliance was placed on PROV 26 ([89]). However Justice Hinton, after acknowledging that there are likely material differences between the two, went further and said that as hydroelectric powerhouses were situated in rivers, have water flowing through them or part of them and are attached to the dam, this tended to suggest that the hydroelectric powerhouse would fall into the limited category of structures that are integrally involved in the production process ([90]).

Mercury treats the geothermal turbine hall at Rotokawa as a building for which 0% depreciation is claimed. The Court agreed with the Commissioner that Mercury's tax treatment of the three turbine halls appeared to be inconsistent but was not prepared to put any weight on this point ([91]).

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