NEW ZEALAND LAW SOCIETY

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Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill

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1 Introduction

1.1 The Law Society appreciates the opportunity to comment on the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill (the Bill).

1.2 The Law Society's comments address the following matters in the Bill:

- Residential Land Withholding Tax; and
- GST on cross-border supplies of remote services.

2 Residential Land Withholding Tax

2.1 The Bill proposes to amend the Income Tax Act 2007 (ITA) by introducing a new refundable and creditable tax – residential land withholding tax (RLWT). RLWT is intended to be imposed on the disposal of residential property situated in New Zealand by an "offshore person" where the disposal is or would be treated as income of the vendor under the bright-line test in section CB 6A of the ITA, ignoring the "main home" exception.

Withholding Requirement: Who must pay, and how?

2.2 Proposed section RL 2 of the ITA provides that the vendor is liable to pay the amount of RLWT set out in proposed section RL 4. Where the vendor has a conveyancing agent, that agent, or if there is no conveyancing agent, the purchaser's conveyancing agent (the paying agent), must make the assessment, provide the return and satisfy the vendor's liability for RLWT.

2.3 The amount subtracted or retained from a residential land purchase amount by the paying agent to satisfy the vendor's RLWT liability is, in accordance with the provisions of proposed section RL 2(7), treated as received by the vendor at the time the residential land purchase amount is paid to them. Further, the amount subtracted or retained is deemed to be derived by the vendor at the same time and in the same way as the vendor derives the residential purchase amount.

2.4 Under clause 45(9) of the Bill, *"residential land purchase amount"* means, in relation to residential land located in New Zealand, an amount paid or payable for the disposal of land, but excludes a deposit or part payment (the part-amount) if deposits and part payments, including the part-amount, total, in aggregate, less than 50% of the purchase price for the land.

2.5 It is therefore clear that in the case of a sale of land between a vendor and a third party purchaser the amount subtracted or retained by the paying agent is deemed to be income derived by the vendor.

2.6 Where the sale of land is between a vendor and an associated person, proposed section RL 3 provides that:

(a) the vendor is not liable to pay the amount of RLWT provided in section RL 4; and

(b) the purchaser must withhold the amount of RLWT provided in section RL 4. The purchaser must hold the RLWT withheld in a separate bank account, segregated from other money, for the benefit of the Commissioner.

2.7 Proposed section RL 3 shifts the withholding liability from the vendor to the associated person. In such a case, the associated purchaser is required to withhold RLWT from the residential land purchase amount and make payment to the Commissioner. In other words, the amount that comprises RLWT is withheld by the purchaser on settlement and is not paid to the vendor.

Recommendation

2.8 As the amount to be withheld is not actually paid to the vendor by the associated purchaser, the Law Society recommends that section RL 3 be amended to include an additional provision similar to proposed section RL 2(7), to make clear that the amount payable (but not actually paid to the vendor by the associated purchaser) is treated as being received and derived by the vendor.

2.9 Proposed section RL 2(7) provides that:

> *"An amount subtracted or retained from a residential land purchase amount by a paying agent to satisfy the vendor's RLWT liability –*
>
> *(a) is treated as received –*
>
> *(i) by the vendor; and*
>
> *(ii) at the time the residential land purchase amount is paid to them; and*
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> *(b) is treated for the purpose of this Act as derived by the vendor at the same time and in the same way as they derive the residential land purchase amount."*

Recommendation

2.10 The Law Society recommends that the wording of section RL 2(7) also be adopted for the purposes of section RL 3 but amended by replacing the words "*paying agent*" with "*associated person*" and "*vendor's RLWT liability*" with "*associated person's RLWT liability*".

<u>*Definition of Associated Person*</u>

2.11 Currently the definition of "associated persons" in section YB 1 of the ITA does not provide for section CB 6A to be included in the definition of the "land provisions" as defined by section YA 1. As such, the definition of "associated persons" for the purposes of section CB 6A is not limited in the same way as it is for the land provisions.

Recommendation

2.12 The definition of "associated persons" for the purpose of RLWT is presumably also not to be limited to the same extent as it is for the land provisions, but the Law Society recommends that this be clarified. Either way, the relevant provisions in the Bill need to include a

reference to "associated person" in the ITA's defined terms.

Time of application of associated person test

2.13 The Bill does not make it clear at what point in time the test of association is to be applied. As the obligation to withhold RLWT is triggered when a *"residential land purchase amount*" is paid, that appears to be the most logical date for the test of association to be applied, rather than the date the Agreement for Sale and Purchase is entered into.

2.14 It is often the case that between the date the Agreement is signed and the date settlement takes place, the named purchaser may nominate another person or entity to complete settlement and take title to the land. There is a possibility that the original purchaser and vendor may be associated but the nominee and the vendor are not. If the test for association is applied at the date the Agreement is signed, it could result in a position where the associated purchaser (as named under the Agreement) has an obligation to withhold RLWT but is not in a position to do so because the residential land purchase amount is paid or payable by the nominee.

Recommendation

2.15 The Law Society recommends that the Bill be amended to clarify that the test of association is to be applied at the date of payment of a "*residential land purchase amount*".

How much RLWT?

2.16 Proposed section RL 4 provides that the amount of RLWT to be paid or withheld is the lesser of the amounts described in subsections (2), (4) and (6). A calculation under subsection (6) however is available only where the relevant person who must pay the RLWT is the vendor's conveyancer.

2.17 Where it is the purchaser who has an obligation to withhold RLWT (because the purchaser is associated with the vendor), the purchaser is not permitted to take into account the security discharge amount.

2.18 Where the RLWT is withheld by the associated purchaser, it remains possible that the vendor may not have sufficient funds to discharge the security registered against the title and complete settlement. In other words, in the case of transactions between associated persons, the Commissioner appears to require that RLWT be paid in priority to repayment of any security registered against the land being transferred by the vendor. It is unclear in a situation where the associated purchaser withholds funds required to pay RLWT but leaves a shortfall for enabling the vendor to discharge its security obligations, how settlement can proceed without a discharge of the security. If settlement cannot be completed, there is no obligation for the purchaser to withhold RLWT and a stalemate results.

2.19 A stalemate could also occur where the vendor's conveyancer is obliged to pay RLWT but borrowings are secured against the property which were provided by a person who is not an offshore person or an associate or a "*licensed security holder*" as defined in the Bill (such as a vendor financing at the time the current vendor acquired the property).

Recommendation

2.20 The Law Society recommends that the concept of a "*licensed security holder*" be extended to include a person who is not an offshore person or an associate of the vendor, so as to avoid the costs involved of the current vendor possibly needing to obtain a short-term loan from a registered bank or a licensed non-bank deposit-taker (NBDT) to repay other borrowings secured against the property, before settlement.

Offshore persons: Definition

Natural persons

2.21 The Bill provides that a New Zealand citizen who is outside New Zealand and has not been "*in New Zealand within the last 3 years*" is an offshore person, as is a person holding a residence class visa who is outside New Zealand and has not been "*in New Zealand within the last 12 months*". This raises two issues.

2.22 First, as the Law Society noted in its submission on the issues paper[1] it is not clear whether it is intended that presence for just one day (or part of one day) in New Zealand within the 3 year or 12 month period is sufficient for the vendor not to be an "offshore person". If that is the intention, that should be made clear by the definition stating that such persons are offshore persons if they have not been "*personally present in New Zealand at any time within the last*" 3 years or 12 months, as applicable. This appears to be the intention, as the official commentary to the Bill states that an offshore person "*includes a New Zealand citizen who is living overseas, if they have been overseas for the last three years*". (It would, of course, be absurd if in order to avoid being subject to RLWT a New Zealand citizen is required to be personally present in New Zealand for the entirety of the 3 year period – and incongruous if, by contrast, a person with a residence class visa need be present for only 12 months).

2.23 Secondly, the end date which sets the antecedent 3 year and 12 month periods needs to be specified. The bright-line test generally applies if the vendor has entered into a contract to sell the property within two years of acquisition. However, settlement will almost inevitably occur sometime after entry into the contract to sell, and could be considerably later. It is not clear whether the policy intent is that RLWT will apply if the natural person vendor has not been in New Zealand within the requisite 3 year or 12 month time period immediately preceding:

(i) entry into the contract to sell; or

(ii) receipt of the first payment relating to the disposal; or

(iii) receipt of a "residential land purchase amount" (which excludes deposits and part payments totalling in aggregate less than 50% of the purchase price).

2.24 If (i), then RLWT would be payable, even if a natural person vendor has been personally

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1 *Residential Land Withholding Tax – An Officials Issues Paper, August 2015*; NZLS submission 2.10.15, available at http://www.lawsociety.org.nz/__data/assets/pdf_file/0008/95525/l-IRD-Residential-Land-Withholding-Tax-2-10-15.pdf

present in New Zealand since entry into the contract to sell and could even be residing in New Zealand. This seems contrary to the stated policy intent, which is to improve compliance by *offshore persons* with the bright-line test.

2.25 If (ii), then RLWT would be payable, even if the natural person vendor has subsequently been personally present in New Zealand before payment of a "residential land purchase amount" that is subject to RLWT, and could even be residing in New Zealand. Again, this seems contrary to the stated policy intent.

2.26 If (iii), then this should be made clear by the relevant part of the definition of offshore person (concerning natural persons) referring to "*within the 3 years/12 months immediately prior to receipt of a residential land purchase amount*".

2.27 Related to this point, clause 72 of the Bill proposes a new section 54C of the Tax Administration Act 1994 (TAA) requiring the vendor to give information in relation to RLWT "*before the disposal is completed*". That suggests that the end date for the 3 year and 12 month periods may end at the time of disposal. That will be the case under the land information tax measures, as the information to be provided under the Land Transfer Act concerns the status of the transferor and transferee immediately prior to registration of the transfer. But that point in time will be too late for RLWT purposes, if a residential land purchase amount has been paid before settlement.

Recommendation

2.28 The Law Society recommends that the date by which such information is required to be provided for RLWT purposes be changed in proposed section 54C of the TAA to "*before payment of a residential land purchase amount*". However, that change would require conveyancers to keep in mind that the relevant time period for an offshore (natural) person for land information tax statement purposes may be different from the time period for RLWT purposes. As discussed next, conveyancers will also have to deal with two different concepts of offshore persons for purposes of the land information tax statement rules and for RLWT measures.

Non-natural persons

2.29 For land information tax statement measures, a non-individual (such as a partnership, trust or company), will generally be an offshore person if incorporated outside New Zealand or at least 25% owned (legal or beneficial) or controlled by an offshore person. While the discussion document proposed relying on the definition of "offshore person" to be used in the land information tax measures, the Bill's definition of a non-natural offshore person is more extensive.

2.30 The Law Society is concerned that the disparity may cause confusion for conveyancers dealing with two related tax measures – the land information tax statements and the RLWT – with a resulting increase in compliance costs. If the difference is to remain, it is hoped that Inland Revenue will, if the RLWT proposals are enacted, ensure that conveyancers are alerted to the differences in any subsequent explanation of RLWT – and that confusion caused by the differences is taken into account in considering the imposition of penalties for non-compliance.

Non-natural persons other than trusts

2.31 Clause 45(8)(c) of the Bill provides that a non-natural person will be an offshore person if the person:

(i) is incorporated outside New Zealand;

(ii) is registered outside New Zealand;

(iii) is constituted under foreign law;

(iv) has a member that is an offshore person;

(v) has an executive or director that is an offshore person; or

(vi) is a company and 25% or more of the company's shareholder decision-making rights are held directly or indirectly by offshore persons.

2.32 It is unclear why one executive or director that is an offshore person should be sufficient to make the entity an offshore person. Many New Zealand incorporated companies will have an offshore director or executive, and it is unclear why such companies should be regarded as offshore for RLWT purposes.

Recommendation

2.33 The Law Society recommends that the Bill be clarified to confirm whether:

(a) a company incorporated outside New Zealand that is registered as carrying on business in New Zealand will be an offshore person (and if so, it is unclear why it should be so regarded, given its New Zealand business presence);

(b) a company incorporated in New Zealand that is registered in another jurisdiction will be an offshore person (and if so, it is unclear why it should be so regarded given its New Zealand incorporation and hence New Zealand tax residency);

(c) a non-natural person (such as a partnership) is constituted outside New Zealand that is registered as carrying on business in New Zealand will be an offshore person (and if so, it is unclear why it should be so regarded given its New Zealand business presence);

(d) a "member" includes a shareholder or whether the concept of a "member" applies in the context of a company. It is assumed (but should be clarified) that "member" does not include a shareholder, executive or director, given clause (c)(v) and (vi) of the proposed definition;

(e) a partnership, which is tax transparent by operation of section HG 2(1) of the ITA, will be treated as an entity to which the RLWT rules apply if at least one partner is an offshore person, or whether the RLWT rules will only apply to any partner that is an offshore person. If an entity approach is to be taken (with a partner treated as a "member"), then it is unclear why one offshore "member" (say, for instance, one of ten partners) should be sufficient, irrespective of the interest of the "member" in the partnership, to render the partnership an offshore person, whereas a minimum

25% holding of shareholder decision-making rights by an offshore person are required to constitute a company as an offshore person. As a partnership also includes a limited partnership, it is recommended that if an entity approach is to be taken to partnerships for RLWT purposes, a percentage test (by reference to "partner's interests") be adopted in the same way as it is for companies.

Trusts

2.34 Clause 45 of the Bill (which amends section YA 1 of the ITA) provides that for the purposes of subpart RL a person that is acting as a trustee of a trust will be an offshore person if:

- the person is an offshore person;
- the person has a co-trustee that is an offshore person;
- a settlor of the trust is an offshore person;
- all natural person beneficiaries and all natural person discretionary beneficiaries of the trust are offshore persons;
- all beneficiaries and all discretionary beneficiaries of the trust are offshore persons; or
- a beneficiary that is an offshore person has received a distribution from the trust within the last 6 years of a relevant disposal of residential land.

2.35 The breadth of this proposal will increase compliance costs and the Law Society questions whether this is justified. It is not explained why, for example, merely having a co-trustee or a settlor that is an offshore person should be sufficient to bring the trust within the RLWT net.

2.36 Moreover, the explanation for treating a trust as an "offshore person", if a beneficiary who is an offshore person has received a distribution at any time in the six years prior to the relevant disposal of residential land, is flawed. The commentary to the Bill at page 28 states that "*to ensure that the gain does not escape tax by being transferred to an offshore beneficiary, a trust will be an offshore person if (amongst other criteria) one or more of the beneficiaries are offshore persons,* ***and*** *the offshore beneficiary received a distribution from the trust within the last six years of a relevant disposal of residential land*."

2.37 It is difficult to rationalise the basis for treating a trust as an offshore person for the purpose of the sale of land simply because the trustees have made a distribution (whether large or small and/or completely unrelated to the gain made on the sale of residential land to an offshore beneficiary). There are numerous situations where an offshore beneficiary can receive a distribution of funds which are completely unrelated to the sale of land.

2.38 Using the example of Debbie and Greg given on page 29 of the commentary, Debbie and Greg make a distribution to Natalie to enable Natalie to pay for her University studies in Australia. The distribution is made in January 2013. Debbie and Greg sell a residential property in New Zealand in 2016 which is subject to the bright line test. Notwithstanding that Debbie and Greg (who are both the settlors and the trustees of their family trust) are New Zealand citizens and live in New Zealand, and their son Dan, who is a beneficiary, is also a New Zealand citizen and lives in New Zealand, the Bill as currently drafted would treat the trust as an offshore person for RLWT purposes.

2.39 Such an approach is not necessary to realise the goal of ensuring that the gain on disposal of

residential land does not escape tax by being transferred to an offshore beneficiary. Moreover, it does not achieve that goal where, prior to the distribution of the gain, there has been no distribution to an offshore person beneficiary.

2.40 The Law Society submits that if the vendor is a foreign trust with a qualifying resident foreign trustee, the RLWT measures should not apply given the trustee's obligation to satisfy the income tax liability of the trust pursuant to section HC 24 of the ITA. It is also submitted that if the trust is not a foreign trust and has a New Zealand resident trustee, the RLWT measures should not apply for the same reason. That would reduce compliance costs where a trust was concerned.

Recommendation

2.41 That consideration be given to amending the proposed definition of “offshore person” in clause 45 of the Bill.

Liability and conveyancer's obligation to verify

2.42 Proposed section RL 1 provides that the obligation to pay RLWT applies for a "*residential land purchase amount*", in relation to a disposal of New Zealand residential land, if the vendor is an offshore person and the bright-line test applies to the vendor. Proposed section RL 2 requires the vendor's conveyancer, or the purchaser's conveyancer, or the purchaser (as the case may be) to, in relation to RLWT, "*make assessments, provide returns and satisfy the vendor's liability*". Under proposed section RL 2(6)(b), such a person is liable to a penalty if they do not subtract or retain an amount equal to the vendor's RLWT liability from a residential purchase amount.

2.43 An implication of proposed sections RL 1 and RL 2 is that the person on whom the obligation to pay the RLWT is imposed will be required to make an independent determination as to whether the vendor is liable to RLWT. Indeed, the commentary states that:

> "the paying or withholding agent should, in most situations, be able to determine, with little involvement from the vendor, whether the vendor is within the two-year bright-line period."

2.44 This is on the basis that the paying agent should be able to obtain from Landonline or Quotable Value, the date on which the vendor acquired title to the land. The commentary then states:

> "If the paying or withholding agent determines that the vendor is within the two-year bright-line period, new section 54C of the Tax Administration Act 1994 (TAA) will require the vendor to give information in relation to the RLWT in the form prescribed".

2.45 However, proposed section 54C of the TAA (in clause 72 of the Bill) would require every vendor of residential land to give certified information to the vendor's conveyancer, or the purchaser's conveyancer, or the purchaser (as the case may be) to support the vendor's statement that it is not an offshore person and/or whether the bright-line test applies. Proposed section 54C does not oblige the potential paying agent to undertake independent verification of the vendor's statement, or to make an initial determination as to whether the bright-line period applies before the vendor is obliged to provide information to that person. While it seems reasonable that the potential paying agent would need to satisfy itself that

the information provided supports the vendor's stated position, independent verification by the potential paying agent is not required at any time by section 54C.

Recommendations

2.46 The Law Society recommends that section RL 2(6)(b) be amended to clarify that the paying agent has no liability for a penalty if it was reasonable, on the basis of the certified information provided by the vendor, for the paying agent to consider that RLWT was not payable.

2.47 It is also critical that the nature of the possible penalties is clarified. The commentary refers only to "general penalties", instancing late filing penalties. The Bill does not expressly state that agents may be liable for criminal penalties but as currently drafted makes that an option: under proposed section RL 2(6)(b)(in clause 44 of the Bill), if a paying agent does not subtract and pay the RLWT, it is liable for penalties (other than late payment penalties) under Part 9 of the TAA. Part 9 contains both civil *and* criminal penalties. Introducing a criminal penalty would increase professionals' exposure to risk and thus increase professional indemnity insurance premiums, with a consequent increase in the overall cost of conveyancing services.

2.48 In the Law Society's view, where the agent, for no good reason, does not withhold and pay RLWT, the appropriate sanction is debt collection and civil late payment penalties. An additional sanction for flagrant or repeated non-compliance would be to lodge a complaint to the relevant regulatory body (a standards committee of the New Zealand Law Society or New Zealand Society of Conveyancers, or the Legal Complaints Review Office).

2.49 The Law Society recommends that the penalties that the paying agent may be liable for are clearly stated, and that they should not include criminal sanctions.

Prescribed information

2.50 Proposed section 54C(3) of the TAA (set out in clause 72 of the Bill) would oblige the Commissioner to prescribe the information required to be given by the vendor to their conveyancer in relation to RLWT. It is regrettable that the suggested list was not included in the commentary to the Bill, to enable interested persons to consider and provide submissions. The Law Society submits that the Select Committee, in considering the RLWT regime, should be provided with a full list of the information the Commissioner intends to prescribe, so that the Committee can fully understand the extent of the information to be collected and certified by all vendors of residential land, and reviewed by the potential paying agent, in order to gain a full appreciation of the compliance costs that the RLWT measures will impose on all residential land transactions. For instance, the official commentary states that:

> "a vendor may need to provide a certified copy of their New Zealand passport or residence class visa to support their statement that they are not an offshore person."

The difficulty with this statement is that electronic passports do not show whether a person is an offshore person and a New Zealand resident vendor may not have a passport. Proof of residence, such as provided by a utilities bill, should suffice. However, what the Commissioner will require (and hence the compliance costs involved) is unknown.

Practical implications of the RLWT Regime

2.51 Inland Revenue officials met recently with stakeholders, including a New Zealand Law Society representative, to discuss the practical implications of the RLWT regime for property conveyancing transactions. These are brought to the Select Committee's attention, so that advice can be sought from officials before the Bill progresses and the RLWT regime comes into force.

(a) *Chattels and Option Fees*

- The Bill does not mention chattels and options. Currently, the notice of sale that forms the basis of the Quotable Value information includes a chattels value component. That amount is typically excluded from the total sale price. This was historically used as a means of reducing stamp duty by artificially inflating the value of chattels. The Bill should address how the issue of chattels is dealt with on say a maximum percentage attributable to the chattels component which may be rebutted by a registered valuation.

- Similar issues arise where the mechanism of a long term option fee is paid, but no actual agreement for sale and purchase entered into. For example, a potential purchaser pays a refundable $200,000 'option' fee to exercise the right to buy a property worth $500,000. Because the option fee has already been paid, if the option is exercised, the agreement will only show $300,000.

(b) *All directors New Zealand-based*

- As noted in paragraphs 2.31 and 2.32 of this submission, the Bill requires that all directors be New Zealand-based and not an 'offshore person'. Excluding all overseas experts as directors has the potential to be damaging to many industries and New Zealand's commercial development. (While it may be possible to engage overseas experts in capacities other than directors, there are many situations where directorships signify a far greater dedication to the relevant company.) It is suggested that the requirement be for the majority of directors to be New Zealand residents.

3 GST on cross-border supplies of remote services

General Comments

3.1 The Law Society appreciates the rationale for introducing an offshore registration regime in respect of some intangible services provided to persons who ordinarily reside in New Zealand. However, while the proposed provisions operate effectively to introduce such a tax in respect of, for example, a subscription TV service, there are a number of issues that arise from the breadth of the provisions in less archetypal scenarios.

3.2 The Law Society submits that the scope of the provisions should be narrowed, as detailed below, with subsequent amendments being made to increase the scope of the tax over

subsequent years once any issues arising from the initial introduction of the tax are addressed and as the international framework for imposing VAT/GST on remote services becomes more mature.

Rationale for narrowing the scope

3.3 The Law Society is concerned that insufficient weight is being placed on the prospect that New Zealand taxpayers may be charged amounts on account of GST by offshore suppliers, in circumstances where Inland Revenue has no effective means to monitor the charging of those amounts or collect the tax charged.

3.4 The Bill contains provisions (in clause 57) that seek to limit Inland Revenue's exposure to offshore suppliers by only allowing New Zealand taxpayers incorrectly charged GST to claim a credit for this if the amount of tax is less than $131. The rationale being that there is a risk to the revenue base from refunding tax charged by offshore suppliers, because those offshore suppliers may never pay that tax.

3.5 While clause 57 provides practical protection to the revenue base, it does not provide any protection to New Zealand taxpayers. They still face the real risk that they will be charged an additional amount on account of GST, but that this amount is never remitted by the offshore supplier. This results in a net outflow of wealth from New Zealand, arising from the difficulties in monitoring and enforcing the obligation on offshore suppliers to charge and account for GST.

3.6 The overreach inherent in the Bill will also undermine the integrity of the tax system by effectively encouraging non-compliance with New Zealand laws. A simple illustration of this point is the hypothetical case of an Australian law firm providing residential conveyancing services to people buying houses on the Gold Coast of Australia. Under the current provisions of the Bill, that law firm is expected to track the residence status of all its clients and start charging New Zealand GST on services to New Zealand residents purchasing homes on the Gold Coast once the $60,000 annual threshold is met.

3.7 There is little likelihood of the law firm complying, simply because it would never occur to an Australian resident law firm that New Zealand GST would be relevant to legal services provided in Australia in respect of the purchase of Australian property.

3.8 There is also little likelihood that the Australian law firm would ever be followed up by Inland Revenue and asked to confirm its compliance with the rules. In effect, what is likely to develop is that offshore suppliers will naturally split into two groups:

(a) Those that have a sufficient connection with New Zealand to be aware of the GST rules and be reasonably visible to Inland Revenue – this group can be expected to comply;

(b) Everyone else – who can be anticipated not to comply.

3.9 There is no benefit to New Zealand in passing legislation that cannot be enforced and which in practice is likely to be ignored.

Suggestions as to how to narrow the scope of the rules

3.10 The Law Society suggests that the scope of the rules be narrowed by:

- tightening the level of connection that a recipient should have with New Zealand before triggering the requirement for GST to be charged;
- amending the definition of 'remote services' to include only digital services;
- significantly increasing the registration threshold so that offshore suppliers subject to the rule can reasonably be expected to dedicate the resources necessary to comply; and
- removing the $1,000 limit on the ability for residents to claim GST.

Recipient should be both resident and present in New Zealand

3.11 Under the proposed rules, residency under the general income tax test is all that is required of a recipient to trigger the rules. This raises real difficulties where recipients:

- receive the services while they are offshore; or
- are living offshore (notwithstanding that they maintain their New Zealand income tax residency), such as a person on their OE.

3.12 The Law Society submits that the rules should be amended so that a recipient must be both resident in New Zealand and physically present in New Zealand at the time the services are performed, in order to trigger the rules.

Remote services should be limited to digital services

3.13 Digital services are the primary focus of similar rules in offshore jurisdictions. As a result, suppliers of digital services are likely to already be aware of the potential for local GST/VAT to be charged on services supplied to customers present in those jurisdictions. In addition, it is digital services that:

- make use of the 'electronic marketplace' concept, that will significantly improve Inland Revenue's ability to collect tax; and
- can use the indicia as to residency (and presence in New Zealand) set out in clause 50 of the Bill.

3.14 This makes suppliers of digital services much more likely to collect and return GST than other suppliers. We submit that the definition of remote services should be limited accordingly. The Law Society anticipates that VAT systems around the world will develop over the coming years to a point where the definition could be extended to other services.

Threshold should be significantly increased

3.15 The Law Society submits that $60,000 of services supplied annually to New Zealand residents present in New Zealand is far too low a threshold to expect non-resident suppliers of services to be aware of the GST rules and comply with them.

3.16 It is suggested that a threshold of $2,000,000 to $5,000,000 of annual supplies would be more appropriate. Only where supplies reach this level is it reasonable to expect a non-

resident supplier to be aware of the rules and dedicate resources to ensure that their systems comply.

$1,000 limit on claiming input tax should be removed

3.17 In order to ensure that the scope of the rules extends only as quickly as Inland Revenue's ability to enforce them effectively, the Law Society submits that the limit on New Zealand registered recipients claiming GST incorrectly charged should be removed. As noted earlier, there is still a net cost to New Zealand where GST is incorrectly charged to New Zealand taxpayers and not returned by offshore suppliers. It is a core role of Inland Revenue to ensure compliance with the tax laws, and this must extend to those offshore suppliers who fall within the scope of the rules.

Other comments on GST aspects of the Bill

The concept of physical performance should be removed from the definition of remote services

3.18 It is not clear that there is any 'physical performance' in respect of the majority of the services that the rules are intended to apply to. The GST Act uses both the concept of 'performance' and 'physical performance', and it is submitted that the definition of 'remote services' should reference 'performance'. This should also be changed in other related provisions, such as clauses 55(3) and 61.

There need to be certain thresholds for the imposition of the reverse charge in clause 48(5)

3.19 Although this provision is crafted as a charging provision, it effectively operates as a civil penalty imposed on New Zealand recipients who are viewed as having conducted themselves to avoid being charged GST. While it is agreed that such a provision is necessary to discourage false or misleading information being provided to offshore suppliers, the Law Society is concerned at the vagueness of the thresholds in proposed section 5(26)(c) that must be met before the Commissioner is allowed to invoke the reverse charge.

3.20 The concept of 'repeated' occurrence, could be as low as two occurrences, and the concept of there being 'substantial' tax is also unclear ('substantial' by reference to the taxpayers' income? Or by some objective number?).

3.21 The Law Society recommends that absolute values, for example a set number of occurrences in a six or twelve month period, and a minimum level of tax, such as $1,000, should be required.

Indicia provided by the recipient should be determinative of supplier's liability

3.22 The Law Society supports offshore suppliers being able to rely on the indicia listed in clause 50 to determine whether a GST liability arises. However, as currently drafted, these indicia only apply to require a supplier to treat someone as resident. The wording should be amended so that the recipient is treated only as resident (and potentially present in New Zealand) where at least two of the criteria support their residency – with a potential carve-out for the offshore supplier otherwise being aware of the recipient's status.

3.23 The amendment should be drafted so as to ensure that there is no residual exposure to the offshore supplier where they have correctly considered the indicia to determine whether GST should be charged.

Concept of consumption tax should be replaced with 'a tax similar to GST'

3.24 Clause 55(3) currently refers to the undefined term 'consumption tax'. The Law Society submits that it would be appropriate to use a similar concept to that used for foreign tax credits in the income tax context, and refer instead to a tax similar to GST.

Bill should state when a tax invoice has to be obtained

3.25 The wording of clause 55(5) should be amended to require that the recipient obtain the tax invoice before claiming the credit – in line with the general requirements for claiming input tax. Currently, the wording does not stipulate when the invoice has to be obtained, and raises the possibility of a taxpayer being able to cure their claim for an input tax in an earlier period by subsequently obtaining a tax invoice.

Transitional provisions

3.26 The Law Society submits that transitional provisions similar (if not the same) as those applying for the introduction of GST and increases in the GST rate should apply to non-resident suppliers who become liable to account for GST.

Allowing non-resident suppliers to charge GST on goods

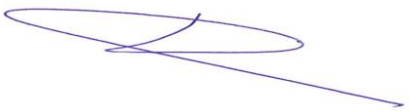
3.27 In addition to providing digital services, New Zealand residents also purchase goods over the internet. Where GST-registered businesses purchase these goods they often incur non-recoverable GST in the form of customs duty charged on the importation of the product into New Zealand by the non-resident supplier – where the supplier is responsible for delivery of the product to the New Zealand customer.

3.28 The Bill could be amended to include an ability for non-resident suppliers to elect to treat goods supplied to New Zealand customers as also being supplied in New Zealand. This would:

- allow non-resident suppliers to charge GST uniformly across all products they sell to New Zealanders; and
- remove the embedded GST charged on supplies to GST registered customers. The supply of the product would be zero-rated (on the same basis as remote services are zero-rated), but the non-resident supplier would be able to claim back the GST charged by New Zealand Customs on the entry into New Zealand of the goods.

Conclusion

3.29 The Law Society does not wish to be heard, but is available to meet with officials advising on the Bill if the Committee considers that this would be of assistance.



Mark Wilton
Vice President
15 February 2016