

11 June 2018

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### **GST on assets sold by non-profit bodies**

#### **Introduction**

1. The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the officials' issues paper: *GST on assets sold by non-profit bodies* (Issues Paper).
2. The revenue base issue addressed in the Issues Paper was alluded to in paragraph 13.9 of the June 2001 government discussion document *Tax and charities* (2001 discussion document). It was also raised in paragraphs 13 and 14 of the Law Society's 2015 submission on *draft Question We've Been Asked QWB00078, Goods and services tax – non-profit bodies – registration, accounting for GST, and de-registration* (**attached** for ease of reference). As such, it is surprising that this issue has not been addressed earlier.
3. The Law Society notes that this issue has existed since Inland Revenue first developed the practice of allowing non-profit bodies to claim input credits on all expenditure other than expenditure relating to exempt supplies. That practice was summarised in paragraphs 13.8 and 13.9 of the 2001 discussion document. Parliament then chose to codify Inland Revenue's practice as section 3A(4A) of the Goods and Services Tax Act 1985 (refer to the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002) with effect from 17 October 2002. It is not clear why the revenue base risk associated with the concessionary treatment of inputs for non-profit bodies was not addressed at the same time.
4. The Law Society agrees in principle to the proposed solution to the revenue base issue set out in the Issues Paper, but has concerns about the manner in which the government proposes to deal with the revenue risk. This includes the circumstances in which an asset will be treated as being part of a non-profit body's taxable activity, the obligations imposed on non-profit bodies who wish to remove assets from the GST base as a consequence of the proposed legislative response, and the proposed application date of the new matching rule. A summary of these concerns is set out below.

#### **Comments**

##### *Proposed application date*

5. The Issues Paper states that the new matching rule will apply from 15 May 2018, being the date of the Ministerial announcement.
6. The Law Society is concerned about the retrospective nature of the proposed matching rule and considers that the new matching rule should only apply from the date on which the Bill

containing the proposed reforms is enacted. While retrospective legislation can be justified in rare situations (such as where the amendment is of a clarifying nature), that is not the case here. The proposal to introduce substantive change to the law by reference to a Ministerial announcement is also concerning.<sup>1</sup>

7. The Issues Paper creates the impression that the revenue base risk has recently arisen as a consequence of a “new interpretation” of what supplies are treated as having been made in the course or furtherance of a taxable activity. The Law Society does not agree that this is a new issue; on the contrary, for many years there has been a general awareness of the matching issue and the consequential risk to the tax base. As noted above, in 2002 Parliament chose not to introduce a matching rule when it codified Inland Revenue’s practice of allowing non-profit bodies to claim back GST on all inputs other than those relating to exempt supplies, notwithstanding that the issue was alluded to in the 2001 discussion document.
8. In light of the above, the proposed matching rule should only apply from the date of enactment.

#### *Application of proposed matching rule to pre-GST assets*

9. Paragraph 3.4 of the Issues Paper states that the proposed matching rule will apply to pre-GST assets where input tax deductions have been claimed for expenses attributable to that asset. The Law Society is concerned that this proposal could apply where input tax deductions have been claimed on expenses that only indirectly relate to the asset. Where the pre-GST asset is a building, such expenses may include rates, repairs and maintenance, and expenditure relating to activities carried on in the building (e.g. a church claiming back GST on communion wine used in services conducted in the building).
10. The Law Society considers that the matching rule should only apply to pre-GST assets where the expenditure relates to ‘improvements’ to the asset in question. To legislate otherwise would significantly undermine the concessionary nature of the rule which enables non-profit bodies to claim back GST on expenditure not incurred to make exempt supplies. Many non-profit bodies have GST-registered in good faith in reliance on this concessionary rule, and would not have expected that claiming back GST on rates, for example, would have resulted in a pre-GST asset forming part of the non-profit body’s taxable activity.

#### *Operation of proposed transitional rule*

11. The Law Society agrees that a transitional rule is necessary for non-profit bodies who would not have expected that claiming input credits for goods and services would result in an output tax liability on the disposal of the asset in question. The Law Society is concerned, however, that it will be impossible for non-profit bodies to apply the proposed transitional rule, given that affected assets may have been held for many years (a point acknowledged in paragraph 3.8 of the Issues Paper).
12. The difficulty in applying the transitional rule is exacerbated by the approach taken in the Issues Paper of applying the proposed matching rule to assets where input tax deductions have been claimed on expenditure that only indirectly relates to the asset in question. If the

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<sup>1</sup> “Following the announcement [on 15 May 2018] by the Minister of Revenue about the GST treatment of assets sold by non-profit bodies *that is to apply from 15 May 2018*, this issues paper outlines [reform] proposals ...”: Issues Paper at [1.2], emphasis added.

proposed matching rule only applied to assets where input tax deductions had been claimed on the acquisition of, or improvements to, the asset itself (as suggested above in relation to pre-GST assets), then logically non-profit bodies should be able to apply the transitional rule by only repaying input tax deductions claimed on the acquisition of the affected asset or improvements to that affected asset. This approach respects the concessional nature of the input tax deduction rule that applies to non-profit bodies, and would significantly reduce the compliance costs arising from the proposed transitional rule (and should obviate the need for a “reasonable estimate” test to be introduced).

13. The Law Society considers that all non-profit bodies should be able to apply the transitional rule to all affected assets, irrespective of the market value of those assets. Further, the Law Society considers that use-of-money interest should not apply to any amount repaid under the transitional rule, given the retroactive nature of the proposed matching rule.

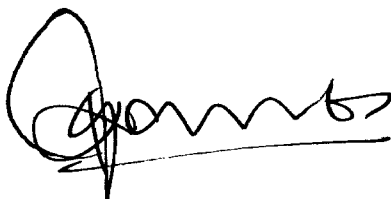
#### *Other issues*

14. Example 4 (on page 9 of the Issues Paper) implies that a non-profit body is entitled to claim a second-hand goods credit on assets it has not paid for, based on the market value of that asset (for example an asset bequeathed under a donor’s will). The Law Society notes however that a second-hand goods credit is only available for supplies made by way of sale, and is then limited to the GST fraction of the amount paid for the second-hand goods. These rules apply to all registered persons, including non-profit bodies.
15. If a non-profit body attempted to claim a second-hand goods credit in the circumstances set out in Example 4 it is likely that it would be subject to a shortfall penalty for failing to take reasonable care, even if the non-profit body did not have any particular expertise in tax matters. It is surprising that Inland Revenue should make an error of this nature.
16. To avoid confusion and risk for taxpayers, the Law Society recommends that the error in Example 4 is corrected, with confirmation that the special rules relating to second-hand goods credits also apply to non-profit bodies.

#### **Conclusion**

17. This submission was prepared with assistance of the Law Society’s Tax Law Committee. If you wish to discuss this further, please contact the committee’s convenor Neil Russ, via the committee secretary, Jo Holland at [jo.holland@lawsociety.org.nz](mailto:jo.holland@lawsociety.org.nz), (04) 463 2967.

Yours faithfully



Tim Jones  
**Vice-President**

Enclosure: NZLS submission (24 April 2015) on *Draft Question We’ve Been Asked QWB00078, Goods and services tax – non-profit bodies – registration, accounting for GST, and de-registration*