New Zealand Law Society
Te Kāhui Ture o Aotearoa

Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill

9/11/2021

Submission on the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill

1 Introduction

1.1 The New Zealand Law Society | Te Kāhui Ture o Aoteoroa (**Law Society**) welcomes the opportunity to comment on the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill (**Bill**). This submission has been prepared with input from the Law Society's Tax Law Committee and Property Law Section.

1.2 Additionally, we have provided feedback on excepted residential land, new builds and the bright line test changes included in Supplementary Order Paper 64 to the Bill (**SOP 64**).

1.3 The Law Society does not wish to be heard but is happy to discuss this submission with the Finance and Expenditure Committee or officials if that would assist.

2 Summary

2.1 The Law Society comments below on the following topics in the Bill:

(a) Exclusion of cryptoassets from GST and the financial arrangements rules

(b) Second-hand input tax credits on supplies between associated persons

(c) Penalising the sale or possession of sales suppression software

(d) GST B2B compulsory zero-rating of land rules

(e) Disposal of assets with a mix of taxable and non-taxable use

(f) GST groups

(g) Hybrid and branch mismatches

(h) Restricted transfer pricing

(i) How the Act's provisions are organised

(j) SOP 94 – excepted residential land

(k) SOP 94 – new builds

(l) SOP 94 – bright line test changes

3 Exclusion of cryptoassets from GST and the financial arrangements rules

3.1 The Bill proposes the exclusion of cryptoassets from GST and the financial arrangements rules to ensure that these rules do not impose barriers to developing new products, raising capital, and investing through cryptoassets. The Bill additionally proposes allowing GST-registered businesses that raise funds through issuing cryptoassets with similar features to debt or equity securities to claim input credits for their capital-raising costs.

Cryptoassets and GST – sections 5(2) and (3)

3.2 The Law Society welcomes the clarity afforded by the amendments to section 2(1) of the Goods and Services Tax Act 1985. The proposed amendments remove cryptoassets from the definitions of goods and services, thereby excluding cryptoassets from the GST rules.

3.3 The first limb of the proposed cryptoasset definition is sufficiently wide to be future proof, particularly by including an extension of "another application of the same technology performing an equivalent function".

3.4 On the other hand, the wording "is designed to be fungible" in the second limb of the definition could be improved. "Designed" implies intent, which is difficult to measure and limited to a point in time. Further, fungibility is not an absolute term. This wording leaves the GST treatment uncertain for cryptoassets which are semi-fungible, change in nature over different points of its lifecycle, or differ in practice from the initial intent at the point of "design". It is expected that these issues will be exacerbated as cryptoassets continue to evolve and the boundaries of fungibility become increasingly blurred.

3.5 The definition of cryptoasset should be clarified to address the degree of fungibility required, or potentially address the change in fungibility over a cryptoasset's lifecycle.

Cryptoassets and the financial arrangement rules – sections 79 and 127(2)

3.6 The Law Society welcomes the clarity afforded by the amendments to sections EW 5 and YA 1 of the Income Tax Act 2007. The proposed amendments define cryptoassets for income tax purposes and include cryptoassets as an excepted financial arrangement, provided the requirements of section EW 5(3BAB) are met.

3.7 In relation to the second limb of the proposed definition of cryptoasset, the issues described in paras 3.3 – 3.5 above apply.

4 Second-hand input tax credits on supplies between associated persons

Meaning of input tax - clause 6

4.1 Clause 6 of the Bill proposes new subsection 3A(2)(ab) of the Goods and Services Tax Act 1985 (**GST Act**), which is intended to ensure that the amended second-hand goods credit limitation rule in section 3A(3)(a)(i) of the GST Act does not allow a person to claim a second-hand goods credit for goods which were acquired by the associated supplier, or by another person who is associated with the registered person, before GST was introduced. Proposed section 3A(2)(ab)(ii) is intended to limit this exclusion to situations where the good has been owned by persons who are associated with the registered person at all times since it was acquired on a date before 1 October 1986.

4.2 To achieve the intended result, proposed section 3A(2)(a)(ii) should be amended to read "have not been owned, since 1 October 1986", rather than "since that acquisition". The current wording leaves open the possibility that a second-hand goods credit can be claimed where, for example, an associated person acquired land in 1970, it was sold to a non-associated person in 1978, and purchased by an associated person in 1984.

4.3 It is not clear on the drafting of proposed section 3A(3)(a)(i) and (ib) whether, when tracing through a chain of transactions to find an acquisition from a non-associated supplier, the supplier must not be associated with the registered person who is seeking to claim the second-hand goods credit, or with the recipient of the supply from that supplier. It would be consistent with the policy intent of this amendment to trace back to an earlier supply made by a person who is not associated with the person claiming the second-hand goods credit (and not trace back through all supplies between associated persons, if the associated supplier is not associated with the person claiming the second-hand goods credit). Proposed section 3A(3)(a)(i) and (ib) should be amended to clarify this point.

4.4 As a minor drafting point, proposed section 3A(3)(a)(ib) should refer to the most recent acquisition of the good, and not the most recent acquisition of the supply.

4.5 We note that example 21 in the commentary to the Bill omits a critical fact, and also contains an error. Example 21 should be amended before it is included in a Tax Information Bulletin or other publication. The factual background should state that Sam and John are not associated for GST purposes. Also, the calculation of the amount of GST which can be claimed should be 3/23rds of John's $1.2 million purchase price ($156,521.74) and not 3/23rds of Sam's purchase price.

5 Penalising the sale or possession of sales suppression software

5.1 Clauses 160, 161 and 165 of the Bill create new provisions of the Tax Administration Act 1994 (**TAA**) which impose civil and criminal penalties in relation to sales suppression software.

Clause 160 (new section 141EE of the TAA)

5.2 There are issues with how new section 141EE(4) is drafted:

(a) The use of the word "offence" is inappropriate in a section which deals with civil not criminal penalties;

(b) The reference to a single penalty being imposable "in relation to all tax types and periods" is confusing when set against the ability to impose another penalty later. What appears to be meant is that one penalty is imposable for each period of possession or control of or right to use the suppression tool, and that if there is one or more new periods of possession or control of or right to use the suppression tool after the period to which the penalty relates, then fresh penalties may be imposed for those later periods. The section should be re-worded to reflect this.

Clause 161 (new subsection 141FB(6) of the TAA 1994)

5.3 It would be helpful if the new subsection could more clearly express that the denial of reduction applies to the penalty under section 141E(1).

Clause 165 (new section 143BB and 143BC of the TAA 1994)

5.4 The penalty for the offence in section 143BB (a fine not exceeding $250,000, no imprisonment) is not consistent with penalties for similar offences:

(a) The offence is essentially supplying devices to enable tax evasion;

(b) Tax evasion is a serious offence carrying a penalty of up to 5 years imprisonment;

(c) Criminal law generally regards offences which facilitate an underlying offence as being of equivalent seriousness – for example, money laundering offences typically receive sentences equivalent to the offence (for example drug dealing) whose proceeds are laundered;

(d) Analogously, one would expect a prison sentence to be imposable for supplying the means by which to evade taxes;

(e) It may be expected that many suppliers of sales suppression software, against whom this section is directed, would be based overseas. The section, without a provision for a sentence of imprisonment, would have no effective sanction against such overseas suppliers:

(i) A fine levied by a New Zealand court is not generally enforceable in a foreign Court: *Attorney General of New Zealand v Ortiz & Ors* [1982] 3 All ER 432;

(ii) Such a supplier would not be able to be extradited to New Zealand to face trial as the offence would not be an "extradition offence" as defined in section 4 of the Extradition Act 1999.

5.5 The drafting of section 143BC(4) is problematic for the same reasons as set out in paragraph 5.2(b) above.

6 GST B2B compulsory zero-rating of land rules

6.1 Clauses 7(5), 33(1), 33(3) and 33(4) amend the GST business-to-business compulsory zero-rating of land rules in situations where a registered person has incorrectly zero-rated a supply of land and subsequent adjustment is required.

Clause 7(5)

6.2 Clause 7(5) should be redrafted to provide for a deemed non-taxable supply.

6.3 Section 5(23) is to be amended where land supplies have been incorrectly zero rated and the supply would have been a taxable supply if the correct treatment had been applied.

6.4 The incorrect zero rating supply is itself a taxable supply so the reference to section 11(1)(mb) as applying to a "taxable supply" could lead to ambiguity.

6.5 The amendment is intended to ensure that there is a deemed supply where the zero-rating transaction should instead have been standard rated. However, there is no deemed resupply of secondhand goods, which is required in order for the recipient to claim a secondhand good input tax credit.

6.6 Section 5(23) should retain the reference to section 11(1)(mb) applying to a "supply of goods", and if that is incorrect then there is a deemed supply which is chargeable with tax under section 8(1) if the correct treatment as at the time of settlement was that the first supply should have been subject to tax under section 8(1). This then means that there is also a deemed supply of secondhand goods at the time the error is detected, allowing the deemed resupply to occur to enable the recipient to claim a secondhand goods input tax credit.

Clause 33(1)

6.7 Proposed clause 33(1) should be redrafted to apply to supplies of goods and services by any registered person.

6.8 Clause 33(1) replaces the wording "section 25(1)(a) to (c)" with "section 25AA(1)(a)" within section 25AB. This amendment significantly narrows the scope of section 25AB. Section 25AA(1)(a) relates to supplies of goods and services by a non-resident that is treated by sections 5B and 8(4B) as being made in New Zealand. Section 25(1)(a) to (c) relates to the supply of goods and services by any registered person. As such, clause 33(1) as it stands has the effect of limiting the application of section 25AB to only situations in which a non-resident is treated as making a supply in New Zealand. We do not think that this is the intent of clause 33(1) – although the commentary in the Bill is silent on this particular amendment. It would be helpful if this was clarified.

6.9 Additionally, under proposed clause 33(1), sections 25(1)(ab) will no longer apply to section 25AB. Section 25(1)(ab) relates to supplies where the supplier has incorrectly applied the

GST Act to the treatment of the supply (so that the supply was incorrectly charged) and did not subsequently make an election under section 24(5B) for that supply. It is therefore unclear under the proposed amendments how section 25AB will apply to incorrect supplies (referred to in section 25(1)(ab)) where the amount of input tax exceeds the correct amount of input tax for the supply.

7 Disposal of assets with a mix of taxable and non-taxable use

7.1 Clause 25 introduces amendments to section 21F in respect of the disposal of assets that have both taxable and non-taxable uses. The amendments remove the "cap" on input tax deductions (of the GST fraction of the purchase price paid when the asset was acquired) for everyone other than "property developers". Proposed section 21F(6) should be redrafted to clarify that the "cap" on input tax deductions applies to property developers who are not using the land to conduct another type of taxable activity.

7.2 Proposed section 21F(6) retains the "cap" on input tax deductions if there is a disposal of land that is "a taxable supply in the course or furtherance of a taxable activity of supplying land even in the absence of any other use of the land by the person in a taxable activity". This wording requires clarification to ensure that only GST registered property developers fall under this provision.

7.3 Under proposed section 21F(6), registered persons who are not ordinarily considered "property developers" will be caught under this provision. This contradicts the stated policy intent of section 21F(6) in the commentary to the Bill, which exclusively refers to the cap remaining in place for land disposed of by "property developers". The cap could be targeted by simply referring to a registered person who carries on a business of developing land, and language such as that used in section CB 10(1)(b) of the Income Tax Act 2007 could be used to ensure that the provision is drafted to achieve the stated purpose.

8 GST groups

8.1 The proposed amendments to the GST group rules aim to resolve current ambiguities in relation to the application of the GST grouping provisions within the GST Act (as identified by the Commissioner in a Public Rulings Issues Paper in 2019). Clause 37 proposes significant amendments to section 55 in order to clarify the GST treatment of supplies made by GST groups.

8.2 Clause 37 should be redrafted to make clear the implications of treating a GST group as a single company making separate supplies.

8.3 Under clause 37, the grouping rules apply to treat a GST group as a single registered person, however operating separately and making or receiving separate supplies as part of its respective activity. The practical application of this approach under the current drafting is unclear in relation to the compulsory zero rating of land and the zero rating of the supplies of going concerns.

8.4 An example of when this ambiguity arises is a situation in which two companies, being members of the same GST group, provide supplies to the same GST registered third-party purchaser; one involving the supply of land and the other the supply of plant, property and equipment situated on that land. If the two supplies are made by one registered person but treated as one overall supply which partly consists of land, then zero rating applies.

8.5 Under a grouping situation, for GST purposes, both companies are treated as a single entity under the GST groups rules, and therefore it should follow that both the supply of land and the supply of plant and equipment (which, for GST purposes, is treated as being made by a single entity) should be zero-rated as a supply wholly or partly consisting of land under section 11(1)(mb). However, the proposed rules provide that the supplies are to be treated as separate supplies, which raises doubt as to the application of the zero rating provisions.

8.6 The grouping provisions should be clarified so that in relation to the zero rating of land transactions and going concerns, multiple supplies made by group members in relation to the same transaction should be treated as one supply for the purposes of the land and going concern zero rating rules.

9 Hybrid and branch mismatches

9.1 The proposed amendments to section FH 11 clarify a number of uncertainties that existed within section FH 11 as originally enacted.

9.2 The definition of "hybrid mismatch legislation" should be extended to include regimes intended to comply with the OECD's hybrid mismatch and branch mismatch reports.

9.3 The commentary to the Bill appears to contemplate removing the wording "that counteracts the mismatch" in section FH 11(1B)(g). Removing of this wording would simplify compliance requirements for taxpayers.

9.4 The proposed section FH 11(6)(b), "the funded payment is funded by the denied deduction; and" does not seem necessary. The original temporary denial has arisen due to the funded payment being funded by the denied deduction under section FH 11(1B).

9.5 We do not see any issues in principle to the inclusion of OECD concepts to guide interpretation of our tax legislation, particularly where the OECD guidance relates to a concept of what may be considered "fair and reasonable" as per section FH 11(4). However, reliance on OECD principles to determine the scope of a rule is not ideal, which is the case with the proposed section FH 11(5) insofar as it relates to "whether a payment or charge by a funded provides funds for a funded payment". It would be preferable for section FH 11 to define what a "funded payment" means.

9.6 If it is retained as drafted, this should be a separate sub-section so that it is a clear inclusion to the rule (rather than being included as a component of the sub-section which is providing guidance to the application of section FH 11(4)).

10 Restricted transfer pricing

10.1 It would be helpful if Inland Revenue issued guidance on the effect of clause 51 as to how the interaction of the dividend rules and the NRWT rules working is envisaged. In particular, the interaction between proposed section CD 39(8) and section GC 12 should be clarified.

11 How the Act's provisions are organised

11.1 Clause 9 inserts new section 8AA into the GST Act 1985. The proposed amendment aims to signpost the relevant sections of the GST Act and signal to readers how the rules are intended to be applied when determining the GST treatment of supplies and how to account for GST.

11.2 The proposed inclusion of section 8AA is unnecessary as it provides very little utility and should be removed from the Bill

SOP 64 – Excepted residential land, new builds, and bright-line test changes

12 Excepted residential land

12.1 The commentary to the Bill states that '*In determining whether a property type should be outside the scope of subpart DH, the key consideration is whether the property is of a type that would normally be available for owner-occupiers'.* This makes sense as it addresses the purposes of the legislation, which is to increase the housing stock available for owner/occupiers, for example first home buyers. This does not, however, appear to have fully flowed through to the exceptions as drafted. We note that boarding houses are already under review in terms of being added as an exception and understand that 'build-to-rents' are also being separately considered. We consider the following should also be added as exceptions:

(a) **Existing residential apartment building on one title managed as rental accommodation**: This could include the scenario where a multi-unit building is brought into sole ownership and managed in a 'build-to-rent' style. For example, a body corporate which comprises 80 owners/units is looking to cancel the unit plan and sell the entire building as one fee simple title. Agents have already suggested this could be a suitable proposition for a buyer to retain the building as residential accommodation. This would be no different from a build-to-rent proposition insofar as the buying entity would be supplying a need in the market (long term rental accommodation) and is not a property that would be purchased by someone wanting to acquire a property for an owner/occupier reason (for example first home buyers). The conversion of hotels/motels to residential accommodation is exempt and it would seem logical that an apartment scenario as mentioned should be also.

(b) **Properties with more than one dwelling on a single title**: Properties that have dwellings that cannot be disposed of individually should also be exempt for a similar reason to para (a) above i.e., they are not properties that would be purchased by someone wanting to acquire a property for an owner/occupier reason (an owner/occupier can only own/occupy one dwelling – and not more than one). For example, blocks of flats that are on a single title or 'villa conversions'. These properties are often compliant under housing density rules that applied at the time they were built/converted but would not be able to obtain a subdivision consent to allow separate titles to issue for each flat these days. It seems logical that such properties are also excluded.

13 New builds

13.1 'New build land' is defined to include, amongst other things, 'land…if a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land' (our emphasis). It is unclear what 'added' means in this context. It's not clear whether, if an existing house is lifted off its existing location on the land and moved to a different location on the same title (for example moved to the back of the site) and obtains a CCC for this, this qualifies as an exemption or not. If another house is then also moved onto the site, we understand that would be exempted but it is not clear to whether the relocation

of an existing dwelling on the same site would. It would be helpful if these uncertainties could be clarified in the legislation.

14 Bright-line test changes

Meaning of "reasonable efforts" and further extension of the 365-day "buffer rule" – clause 49

14.1 The Bill proposes to amend section CB 16A(6) of the Income Tax Act to provide that a person will be treated as occupying a dwelling as their main home if they are making "reasonable efforts" to construct a dwelling intended for use as their main home (or, where the land is owned by a trust, the main home of a beneficiary of the trust), even if the period that the person (or beneficiary, as the case may be) does not occupy the dwelling exceeds the 365-day "buffer period".

14.2 The term "reasonable efforts" is not defined in the Bill. An explanation of the term, along with examples of what amounts to "reasonable efforts", should be included in Inland Revenue guidance on the Bill once it has been enacted.

14.3 The extension to the 365-day "buffer period" in proposed section CB 16A(6)(d) of the Income Tax Act 2007 applies only where the person is constructing a dwelling intended for use as their main home. There are a number of other situations where a person is prevented from occupying a dwelling as their main home for extended periods of time, for example, where the person is required to vacate their home while earthquake or leaky home repairs are made. Proposed section CB 16A(6)(d)(ii) should be amended to provide for these situations by inserting the words "or make habitable" after the words "to construct". Inland Revenue guidance on what the words "make habitable" mean should also be provided once the Bill is enacted.

Proposed rollover relief for transfers of residential land to certain family trusts – clause 80D, SOP

14.4 Clause 80D of the SOP proposes rollover relief from the bright-line test for certain transfers of residential land to family trusts, but proposes rollover relief for certain transfers to and from look-through companies and partnerships. Rollover relief for trusts should be extended to trust resettlements where at least one of the principal settlors of the trust resettling the property is also a principal settlor of the recipient trust, and each beneficiary of the recipient trust has the prescribed relationship with the principal settlor. In addition, rollover relief should be extended to distributions of residential land to a principal settlor of the trust. Such distributions could become more commonplace as a result of the new trust reporting rules in section 59BA of the Tax Administration Act 1994.

Cross referencing errors – clauses 48 and 49(2), SOP

14.5 Proposed section CB 6A(11F) of the Income Tax Act refers to section CB 6AB, which does not exist. Presumably the cross reference should be to proposed new sections FC 9B to FC 9E of the Income Tax Act 2007.

14.6 Proposed section CB 16A(6) of the Income Tax Act refers to “the items main home days and adjustment days described in section CB 6A(10)(b) and (11C)”. The cross reference should be to “section CB 6A(11) and (11C)”.

Herman Visagie
Vice President
9 November 2021