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GST policy issues
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GST policy issues: An officials' issues paper

1. The New Zealand Law Society (**Law Society**) welcomes the opportunity to comment on *GST policy issues: An officials' issues paper* (**Issues Paper**) regarding proposed changes to the Goods and Services Tax Act 1985 (**Act**). Comments from the Law Society's Tax Law Committee are set out below in relation to chapter 3 (cryptocurrencies), chapter 4 (apportionment and adjustment) and chapter 7 (managed funds). All legislative references in this submission are to the Act (as amended), unless stated otherwise.

Chapter 3: Cryptocurrencies

General comments

2. The Issues Paper addresses two of the most important tax issues relevant to cryptocurrencies (referred to in the Issues Paper more generally as **crypto-assets**) and endorses a cohesive and coherent approach to these issues.

3. We support Inland Revenue's aim to provide more certainty around the taxation of crypto-assets and mitigate unintended taxation consequences. In particular, we commend Inland Revenue for suggesting a practical broad-based approach to resolving these issues and proposing that these changes should have retrospective effect from 1 January 2009. This additional certainty should be seen as a positive development by many investors in New Zealand's crypto-asset sector, and their advisers.

Summary

4. The Tax Law Committee makes the following points in this submission:

   (a) We support having a broad exemption that extends to all crypto-assets, rather than having a different approach for different classes of tokens.

   (b) "Crypto-asset" should be broadly defined but this should be future-proofed by extending the definition beyond cryptography and blockchain.

   (c) The exclusion should operate by having crypto-assets not subject to GST (i.e. akin to money), rather than exempt or zero rated.

   (d) Section 20H of the Act should be expanded to include fundraising involving the issue of all crypto-assets generally, rather than just those involving tokens with features similar to equity or debt securities.

(e) Clarification may be needed as to the GST treatment of crypto-asset mining and some exchange services.

(f) The GST treatment of central bank issued digital currencies may need to be separately considered – possibly as a form of "money".

(g) The distinction between fungible and non-fungible tokens should be considered.

(h) Any GST exemption should be retrospective to 2009.

Initial Comments

5. In this submission, the term "crypto-assets" is used as a blanket term that encompasses a broad range of asset types including blockchain-based cryptocurrencies, tokens, non-fungible blockchain assets and other types of digital currency using distributed ledgers and similar technologies.

6. As noted in the Issues Paper, the cryptocurrency and blockchain sector is growing at an extremely rapid pace. By way of example, in 2013 the total number of "crypto-assets" was around twenty – most which were copies or forks of the first cryptocurrency, Bitcoin. Seven years later that total is as much as 8,000[1] – with a very diverse range of assets, many with features and properties that go beyond Bitcoin's original concept of a peer-to-peer form of money.

7. Given the rapid and constant development of different types of crypto-assets any new legislation should be future-proofed by making it as broad and flexible as possible to minimise the need for further amendments and uncertainty. A key objective of any new legislation should be to encourage innovation and investment into the crypto-asset sector, and to discourage new projects operating outside of New Zealand due to GST or other tax costs that cannot otherwise be recovered.

8. Practical consequences of any amendment to the tax treatment of crypto-assets are significant, both in terms of enforcement and encouraging compliance with the legislation.

Questions raised in the Issues Paper

Should different types of crypto-assets have different GST treatments, or should a broad definition of crypto-asset be developed to exclude all types from GST?

9. The Issues Paper proposes two possible approaches to a GST exemption for crypto-assets:

(a) Some form of classification framework, with a different GST treatment for each type of category. Such an approach might classify crypto-assets in rigid categories which might include the following:

i. Intrinsic / currency tokens.

ii. Utility tokens.

iii. Security tokens (some which might be considered as debt or equity securities under the Act, others which simply have similar properties to securities).

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1 The exact number is difficult to gauge and varies based on different references – for example, the Blockfolio app has listings for over 8000 crypto-assets, whereas www.coinmarket.com lists 5,356 and www.coingecko.com lists 7090.

iv. Asset-backed tokens (including "stable" coins).

(b) Having a broad-based definition that would encompass the vast majority of crypto-assets with very limited exceptions (if any).

10. The Tax Law Committee favours the second approach of a broad-based definition, for the reasons explained below.

11. The first approach discussed in the Issues Paper, described as a "tax neutral" approach, would apply different GST treatments to different types of crypto-asset. In theory, that approach would minimise tax distortions in the marketplace by aligning the taxation of crypto-assets with the taxation of economically equivalent assets. However, we agree that practical difficulties in taking this approach would need to be addressed. As identified in the Issues Paper, there are over 5,000 different types of crypto-assets currently on issue, with a wide range of rights and features. Some crypto-assets are "hybrids", with features that do not easily fit within New Zealand's existing tax framework. Accordingly, we agree that it could be difficult to apply the tax neutral approach across the board.

12. Classifying thousands of different crypto-assets into distinct categories is likely to be fraught with difficulty, if not impossible for officials, for a number of reasons:

(a) The sheer range of crypto-assets would mean that some form of register or list would be required, similar to the Working Tariff of New Zealand. Extensive resources would need to be allocated to prepare and update that list – despite many tokens having limited use or trading activity within New Zealand.[2] Many tokens become inactive after a fairly short period of time or never see significant uptake. Other less prominent tokens may not be listed on public registers so active effort would be needed to monitor the creation of new crypto-assets.

(b) Many tokens do not easily fall within any particular classification or might have a range of different properties.[3]

(c) Some tokens might be launched with an initial use in mind, but the use or properties of the token might change over time.[4]

(d) Investors with a portfolio of crypto-assets would have increased compliance costs as they would need to segregate their holdings between different classifications and adopt a different approach for each. While in many cases GST on crypto-asset transfers would be zero-rated, having to potentially pay GST upon the disposal of certain investments would not be economical, as that GST would represent a final cost.

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2 For examples, the number of crypt-assets on www.coinmarketcap.com has increased by around 3,000 tokens in just over 2 years.

3 A possible example of such a 'hybrid' token is Ethereum (ETH). In some ways, Ethereum operates as an intrinsic token that can be used as a currency to acquire blockchain assets or participate in initial coin offerings (ICOs). However, Ethereum also has features of a utility token as the Ether token is used to pay for the cost of transactions on the Ethereum blockchain.

4 For example - Binance token (BNB) – initially starting as a utility token on the Ethereum network, it later developed a function of being able to be invested into initial exchange offerings (IEOs), and has now transferred to its own blockchain and may soon may allow for 'staking' activities whereby holders of the token can generate passive returns.

(e) Suppliers of goods and services that accept payment in crypto-assets would have an incentive to only accept payment in crypto-assets that are not subject to GST.

(f) An issuer of a new token would have to make their own assessment of how their token is classified or would need to seek a ruling in advance of a token launch – this may be impractical, especially if New Zealand investors are likely to be few in number.

13. The Australian and Singaporean GST exemptions for crypto-assets are narrower than what the Issues Paper proposes, with exemptions generally limited to intrinsic tokens of the likes of Bitcoin. However, we think that simply reflects that those rules were developed and drafted at an earlier time where the issues above were not as readily apparent. Further, having a broad GST exemption might place New Zealand at an advantage in terms of making our jurisdiction more attractive for blockchain-based projects or similar pilot schemes. A simple definition with a broad GST exemption could encourage innovation and investment into the New Zealand crypto-asset sector.

14. If the broad-based approach discussed in the Issues Paper is adopted, it could be permissively applied. As identified by Inland Revenue, one option is that the financial arrangements rules could still apply to a limited number of crypto-assets, including crypto-assets that are economically equivalent to debt, and crypto-assets that are derivatives. However, on balance we agree with Inland Revenue that such an approach would still raise difficulties in the margins and could overcomplicate the taxation of crypto-assets. There would also be technical questions to resolve, such as which crypto-assets would be excluded from GST.

15. Having a broad exemption should not create any significant revenue loss for the New Zealand government. Most crypto-assets transactions are likely to be cross-border – that is, there are relatively few crypto transactions between New Zealand residents and most of those are probably transfers of intrinsic tokens. Those cross-border transactions would likely have been zero-rated or outside the scope of GST regardless. Therefore, a broad GST exemption should result in little revenue loss for the New Zealand government as there are few transactions to which GST would apply.

16. The nature of blockchain means that it is not practical or always technically possible to identify the nature of a counterparty to a crypto-asset transaction. The very fact that in most crypto-asset transactions the parties are not identified to each other would make compliance very difficult, and in most cases unnecessary given that many transactions would be cross-border and often with other individuals that either do not have a taxable activity or are below the mandatory registration threshold. As such the amount of revenue collected would be disproportionately small compared to the compliance costs involved.

17. Technically, the GST provisions for "remote services" could apply to a sale of crypto-assets by a non-resident to a New Zealand consumer. However, we expect that compliance would be limited, as in many cases the seller will be unaware of the counterparty's residence (for example, where tokens are sold via an exchange). In the event that GST was required to be charged on such sales and added to the price (for example, tokens sold via an initial exchange offering), having GST added to the price would require the seller to increase their price by 15% before breaking even.

How should a crypto-asset be defined?

18. We agree with Inland Revenue's proposal that a broad definition of crypto-assets be developed, and that it be used to remove all crypto-assets from both the GST rules and the

financial arrangements rules. We agree that such a broad definition should be adopted that captures nearly all classes and types of crypto-assets. Ideally that definition should be future-proofed so newly developed crypto-assets will also be captured.

19. The exact definition of what constitutes a crypto-asset should be determined in conjunction with the New Zealand crypto-asset industry. The requirement that the token use cryptography and a blockchain is a sensible starting suggestion, but this needs further development.

20. Thought should be given to how broad the definition should be, as the term "blockchain" is not universally defined or agreed. For example, a crypto-asset could be defined as a digital asset which utilises cryptography through a decentralised peer-to-peer public (or private) ledger of transactions.

21. We suggest widening these concepts to include "or other technologies having similar properties and functions". This addition is mainly intended to ensure that crypto-assets that do not use blockchain[5] are covered by the exemption. This addition also seeks to avoid a position where a taxpayer needs to consider the precise meaning of "blockchain" (which itself is a term that may be contentious).

22. Neither the equivalent Australian or Singaporean GST definitions of Digital Currency or Digital Payment Token make specific reference to blockchain. As such, limiting the exemption to blockchain-based assets would seem to make the New Zealand definition potentially too narrow and not future-proofed against developments in this sector.

23. We agree that requiring that a token be "generally available" would produce technical issues in terms of applying that definition and would mean that certain crypto-assets would be inadvertently excluded from the definition (i.e. tokens issued to private investors that are not yet available for sale or exchange, or certain security tokens that are not available on any exchange). In particular, crypto-assets should not be subject to GST simply because they utilise a "private" blockchain.

How should GST be removed from supplies of crypto-assets? Should the same GST treatment apply to supplies to residents and non-residents?

24. We agree with Inland Revenue's proposal that all supplies of crypto-assets be made not subject to GST whatsoever (i.e. rather than qualifying for a particular exemption), including supplies to non-residents. This is on the basis that it is difficult, if not impossible, to determine the residence of a counterparty to a crypto-asset transaction – as such it would be difficult to split crypto-asset transactions between exempt and zero-rated supplies.

<u>Input credits for capital raising</u>

25. We generally agree with allowing GST input tax credits on expenditure involved in capital raising via the issue of certain crypto-assets.

26. However, there are some concerns that the proposal to confine this to "security tokens which have features that are <u>similar</u> to debt or equity securities" creates the same definitional problems that are acknowledged earlier in the Issues Paper. The Issues Paper gives an example of such a token function as "a right to a share of the profits of a project". This would

[5] Examples of crypto-assets that do not strictly use blockchain are the IOTA and Nano tokens, which use directed acyclic graph ("DAG") technology.

seem to encompass certain exchange tokens that provide for some form of profit sharing,[6] but do not allow for any share in the underlying capital value of the issuer.

27. The current wording of section 20H seems to extend to security tokens that are substitutes for shares. This is on the basis that section 20H requires the fund raiser to be making exempt supplies – i.e. the issue of a debt or equity security. "Equity security" is defined to mean any interest in or right to a share in the capital of a body corporate, rather than a registered share. The same would be true of crypto-assets that are effectively debt securities.

28. On that basis, the scope of the proposed amendment to section 20H is not entirely clear, as it would seem to only change the position to crypto-assets that are not substitutes for shares / debt securities, but still have some similar properties.

29. Given the difficulties of classifying crypto-assets into specific categories and the stated objective in paragraph 3.10 of the Issues Paper to "contribute to the further growth and development of the crypto-asset sector in New Zealand" we suggest it would be more effective to expand section 20H to include capital raising via any form of crypto-asset issuance. This would further encourage companies to raise funds via a token offering through a New Zealand based enterprise (which in turn might have a positive revenue effect from income tax liabilities).

30. This proposed expansion of section 20H would also avoid a distortion where different GST consequences apply to different types of crypto-asset fund raising events. It also avoids the scenario where an issuer contends that their token will have similar properties to shares, but then changes the use of the token at a later date so those properties no longer exist.

<u>Other services related to crypto-assets</u>

31. We generally agree that conventional goods and services that are provided in relation to the blockchain and crypto-asset industry should be subject to the ordinary GST rules (for example, legal or technical advice provided in relation to a blockchain project). However, paragraph 3.55 the Issues Paper notes:

> **"**Similarly, for GST purposes, other services related to crypto-assets, that are not in themselves supplies of crypto-assets such as mining, providing crypto-asset exchange services or providing advice, general business services or computer services will continue to be subject to the existing GST rules."

32. The words "continue to be subject to the existing GST rules" might imply that "mining" is itself an activity that involves making taxable supplies that would not qualify for an exemption. On the face of it, this seems unlikely as the activity of mining involves a computer providing security to a blockchain network by carrying out complex mathematical equations. That process does not involve any goods and services being provided to a particular person, so it would not seem that GST could apply. It may be that the GST treatment of mining could be clarified by way of further commentary.

33. A similar comment follows for crypto-asset exchange services. Whether a GST liability arises would depend on the type of service provided. For example, consider a crypto-exchange service selling crypto-assets directly to customers and generating its revenue by way of a

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[6] For example, exchange tokens such as "Kucoin Shares" (KCS) and "Binance Coin" (BNB) (although the latter provides for an indirect profit share via quarterly buy-back of tokens using a portion of profits).

premium. Here, it would seem that the sale of the crypto-asset to the customer would not be subject to GST (assuming an exemption is adopted). However, the issue of fees charged more generally (such as trading and withdrawal fees) is unclear – it would seem that if crypto-assets are not financial services, then on the face of it those fees may be subject to GST.

34. If transfers of crypto-assets are not treated as being a supply then it would be appropriate to have the definition of financial services amended to exempt services provided by a crypto-asset exchange. This is on the basis that a crypto-asset exchange is comparable to a foreign currency or stock exchange in the sense that the platform provides for the exchange of assets that are not taxable supplies. It does not seem appropriate to have GST imposed on the facilitation of a transaction that is not itself subject to GST.

Financial arrangement rules

35. The comments above are directed at the application of GST to crypto-assets. However, our submissions are broadly the same in terms of the application of the financial arrangement rules in the Income Tax Act 2007. That is, there should be a very broad based exemption from the financial arrangement rules for all crypto-assets – with that term very broadly defined rather than on an asset-by-asset basis.

36. Arguably, one category of crypto-assets where the financial arrangement rules could be reasonably applied are tokens that mirror the economic return of a bond or similar instrument. An example is a crypto-asset issued with a face value of $1 and redeemable after a period for $1.20 (in fiat / local currency). The difficulty with this approach is clearly defining these types of assets in a way that does not inadvertently capture more conventional crypto-assets. It might be that some kind of anti-avoidance provision could be introduced to prevent any deliberate abuse (i.e. an issuer of bonds converting its bond instruments into tokens for the purpose of reducing the tax impact for its investors).

37. In particular, having to adopt accrual-based taxation to especially volatile assets and then requiring investors to allocate that method to some, but not all of their portfolio would result in an unnecessarily high level of administrative costs. This could result in errors and would certainly make compliance more difficult.

38. Arguably, crypto-assets already have a disadvantageous tax profile when compared to more conventional investments in real estate or shares.[7] Having to create a further layer of complexity would discourage investing in this sector purely for tax reasons.

39. Thought should be given as to how the financial arrangement rules might deal with central bank issued digital currencies as these are analogous to foreign currencies (refer to the comment on this below).

Other concerns

Central Bank Digital Currencies (CBDCs)

40. An aspect not dealt with by the Issues Paper is the GST and financial arrangement treatment of digital money issued by a central bank. An example is the upcoming launch of the "DC/EP"

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[7] This comment is based on the initial IRD guidance "taxing cryptocurrency" which suggests that "Bitcoin and similar cryptocurrencies" generally don't produce and income stream or provide any benefits and therefore might be generally acquired with the purpose of selling or exchanging. It is acknowledged this was an early commentary on the issue and this particular stance may require further development.

digital currency by the People's Bank of China. A number of other jurisdictions are developing their own versions of digital currency, including Iran, Australia and India. Further jurisdictions will likely follow. It is not yet clear to what extent these currencies will be blockchain based and whether they would fall within the proposed definition of "crypto-asset" (it may be that this depends on the technical properties of each asset and whether they use cryptography and / or blockchain).

41. In such a case, thought should be given to whether it should be clarified that CBDCs fall within the existing definition of "money" in the GST Act on the basis that they are: "… other currency … whether of New Zealand or any other country". If officials consider digital currencies are not a "currency" as contemplated by that definition, then we suggest an expansion of that definition is appropriate.

42. The above clarification to the definition of money may be particularly important if some CBDCs do not use cryptography or a blockchain-like technology and therefore fall outside the adopted definition of crypto-asset.

43. As well as ensuring that bank-issued digital currencies are not subject to GST, the treatment of such assets as "money" may have implications for whether related services qualify for exemption from GST as financial services – for example section 3(1)(a) of the Act which exempts services involving the exchange of "currency" from GST. This would be very important if private banks are involved in the holding or transfer of CBDCs.

Non-Fungible Tokens (NFTs)

44. Officials should give thought to whether any definition of crypto-asset should make reference to fungibility. NFTs are digital tokens with unique features that are not mutually interchangeable by their individual specification. This is in contrast to cryptocurrencies such as Bitcoin that are fungible in nature. These often take the form of collectible assets, digital artwork, trading cards or in-game video assets – in each case with ownership controlled by possession of a blockchain based token.

45. Exempting these types of tokens from GST might create an unusual distortion when compared to the GST treatment of physical equivalents or non-blockchain based digital items. For example, the difference between an in-game video game asset that is blockchain based versus a purely digital version might be seen as arbitrary in the context of a GST exemption.[8] This might in turn require any definition of crypto-asset to make reference to fungible properties (as is the case with the Singaporean GST definition of Digital Payment Token).

46. If such a distinction is made, care should be taken with defining the concept of an NFT. In particular, if a crypto-asset that has properties of a currency also has some non-fungible features (e.g. each token is assigned a particular identifying code) then that by itself should not result in the exemption being lost. This is particularly important given that arguably even bitcoin has some non-fungible features (e.g. a newly mined bitcoin might be seen as distinct from a bitcoin that has an extensive ownership history).

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8 For example, consider the potential treatment of online digital trading cards – on one hand, trading cards that are non-fungible block chain assets (e.g. the trading game *Gods Unchained*) as opposed to an online trading game where cards can be purchased but are stored on the server of the provider (e.g. *Hearthstone*). The sale of the latter would likely be subject to GST under the rules for remote services.

Application date

47. We agree with the proposed retrospective application date for GST and financial arrangements from 1 January 2009 and for the capital raising deduction rules from 1 April 2017.

48. A savings provisions to preserve existing provisions does not seem likely to provide any substantial benefits to taxpayers, but if officials are aware of taxpayers that would be prejudiced then such a provision could be introduced.

Chapter 4: Apportionment and Adjustments

49. It would be helpful if the apportionment and adjustment rules were amended to make them simpler and easier to apply.

Change of use wash-up calculation (non-land assets)

50. We agree with the proposal to extend the application of the wash-up adjustment to situations where there is a permanent change to the use of an asset to something other than 100% taxable or non-taxable.

51. We agree that an amendment is necessary to switch off the adjustment provisions after a permanent change of use, but note that the amendment should allow for the adjustment rules to be switched on again in the event of a subsequent change in use.

52. It would be consistent with the principles of the apportionment and adjustment rules if the wash-up adjustment for non-land assets recognised the actual use of the asset in the period before the permanent change of use.

53. The Issues Paper, and the proposed new formula, appear to assume that the number of adjustment periods in section 21G(4)(a) is the maximum number of adjustment periods for which a registered person can make adjustments. Section 21G(4) in fact provides a minimum number of adjustment periods, and registered persons are entitled to continue to make adjustments beyond the number of adjustment periods specified in section 21G(4). This means that the proposed formula may result in over-taxation of a registered person who changes to 100% taxable use, and continues that taxable use beyond the minimum number of adjustment periods specified in section 21G(4).

54. For example, if Leigh in examples 2 and 6 continued to make adjustments beyond the minimum number of adjustment periods, he could have claimed a further $15,000 by his 15th adjustment if he continued to make adjustments beyond the minimum number of adjustment periods. We note that the final adjustment period to the date of disposal under section 21G(7B) applies only if the asset is sold before the minimum number of adjustment periods in section 21G(4). As such, in this example, Leigh's final adjustment under section 21F would be based on a 70% taxable use percentage, when his actual taxable use percentage of the boat will have increased over the period until the boat is disposed of.

55. We recommend that section 21G(7B) be reviewed to consider whether it is appropriate to limit its application to situations where the good is sold before the number of adjustment periods specified in section 21G(4) is reached.

Disposal of land with a mix of taxable and non-taxable use

56. We agree that section 21F results in all appreciation in the value of land as being attributed to the registered person's taxable use of the land, which is not an appropriate outcome.

57. We also agree with the removal of the cap on the adjustment made under section 21F for registered persons who would not be subject to GST on the sale of the land but for the fact that the land was used to make taxable supplies other than the supply of the land.

58. We consider that the cap on the section 21F adjustment should be removed for all registered persons, including property developers. The overriding principle of the GST adjustment rules is that the input tax claims should reflect the use of the land over the entire period it has been owned, and the GST payable on the sale of land is adjusted to also reflect the use of the land over the period it was owned.

59. As noted in the Issues Paper, the effect of the cap in section 21F is that any gain made on the sale of land is treated as being subject to GST. This is no more appropriate for property developers than it is for other registered persons. The overriding principle of the GST treatment of a good reflecting the proportion of use of the good to make taxable supplies is as applicable to property developers as it is to any other registered person. If a property developer has used land for a non-taxable use, the GST treatment of the sale of the land should reflect that.

60. In addition, we note that the gain made by a property developer cannot necessarily be attributed to the property development activity. For example, a property developer may purchase land and use it to make exempt supplies of accommodation in a dwelling for a period before they commence development of the land. Any increase in the value of the land in the period before the development of the land commences is simply a holding gain which is not attributable to the property development activity and so is not properly attributable to the development activity.

Change of use wash-up calculation for land

61. We do not support amending the change of use wash-up calculation for land to Option 1: Deemed sale and reacquisition. Under this option, a registered person who changes to non-taxable use of land will pay GST on the increase in value of the land up to the date of the wash-up adjustment.

62. This is illustrated in example 16, where Joanna pays GST of $31,500 on the sale of the property (being GST of $120,000 on the supply of the land, less the section 21F adjustment of $88,500). This GST liability arising on the wash-up adjustment exceeds the GST Joanna claimed by $7,575, which is GST on 26.25% of the increase in the value of the land from the date that she acquired it to the end of the 2025 adjustment period. This outcome is inappropriate both because the gain which is calculated on the date of the adjustment may never be realised by the registered person, and because the GST liability arises on a notional sale is not funded by any sale proceeds.

63. We support the updated formula in Option 2, which allows for a wash-up adjustment to be made where there is a permanent change of use to something other than 100% taxable or 100% non-taxable use.

64. We do not support the introduction of a special rule which would apply where a registered person makes a wash-up adjustment on a permanent change to 100% non-taxable use, and

disposes of the property within five years of the change of use. This rule is proposed to address fiscal risk. It is neither appropriate nor effective to address the perceived fiscal risk by a rule based on a specified time period. This would both capture situations where there was a genuine change in circumstances over the five-year period which leads to the subsequent sale of the property, and would be easily circumvented by the sale of the property five years and one day after the wash-up adjustment.

65. We consider that the fiscal risk would be better addressed by a provision which applied where the change of use wash-up adjustment is made in contemplation of the sale of the land (similar to section 21D of the Goods and Services Tax Act 1985 as it applied before the introduction of the current GST adjustment and apportionment rules on 1 April 2011).

<u>De minimis thresholds for minor taxable use</u>

66. We support the introduction of a de minimis threshold for minor taxable use.

<u>Typographical errors</u>

67. The Issues Paper contains the following minor typographical errors:

    (a) In example 10, the denominator in the fraction in brackets in the formula should read "$15,000".

    (b) In example 15, the market value on 31 March 2025 would need to be $1,265,000 (not $1,285,000) in order for the remaining calculations in this example to be correct.

Chapter 7: Managed funds

68. We welcome Inland Revenue's decision to review the GST treatment of investment management fees charged to funds.

69. We agree with Inland Revenue that the approach of asset managers (including investment fund managers, private equity fund managers, KiwiSaver Managers, Retirement Scheme Managers and third party services providers) is inconsistent, both within each category of asset manager and between the different types of asset managers. There is also inconsistency between different types of funds, with some funds recovering some, or all, GST on costs incurred and others not recovering any GST.

70. The approach adopted by the Inland Revenue should:

    (a) be consistent;

    (b) apply to the broadest range of investment managers possible; and

    (c) take into account the GST position of both the asset manager and the funds.

71. In addition, asset managers should be allowed at least one year before changes take effect, so as to enable existing arrangements to be amended in line with whatever approach is adopted.

72. We understand that asset managers have different views as to which approach will be preferable. Two of those views can be summarised as follows:

    (a) Some asset managers do not apply GST on investment management fees or only charge GST on a proportion of investment management fees (generally 10%). Those asset managers are particularly concerned that if investment management fees become subject to GST, and the fund is not able to recover GST, this will pass on additional costs (i.e. irrecoverable GST) to investors. This could also impact on the return to investors and the overall return generated by the fund (which is an important marketing consideration between different funds).

(b) Other asset managers already charge GST on investment management fees. Those asset managers are concerned that if investment management fees become exempt from GST, that will impact the GST recovery position of the manager and will have a significant impact on the manager's financial position. Charging GST on investment management fees is particularly common when the nature of the services being provided to the funds is more in the nature of advisory services, such as a private equity fund and private investments established by advisors.

73. The Issues Paper proposes a number of possible options. These options include:

(a) treating all management services supplied by investment managers and other fund managers as taxable supplies;

(b) exempting all management services supplied by investment managers and other fund managers;

(c) treating management services supplied by investment managers and other fund managers as partly taxable and partly exempt; and

(d) treating management services supplied by investment managers and other fund managers as zero-rated (and applying a reduced input credit mechanism).

74. One option to address the concerns of the different asset managers (outlined above) would be most effectively resolved if all investment management fees were subject to GST (option a. above) and by allowing a broader range of funds the ability to fully recover of GST on costs incurred, including the management fees.

75. It is not feasible to determine whether GST should be charged on investment management fees, without considering whether a fund should be entitled to recover GST on costs incurred.

76. Funds incur a range of costs from 'third party' services providers, including:

(a) legal and advisor costs expenses;

(b) supervision and custody (the trustee's role and therefore must be 'outsourced');

(c) administration (investor registry including PIE tax calculations and fund accounting including unit pricing);

(d) investment management (this can be investment advisory, investment management on segregated mandate, investment management in pooled vehicles etc); and

(e) distribution costs (e.g. financial advisors, wrap platforms, direct marketing and solicitation).

77. As noted in the Issues Paper these can occur either at the level of the fund in question (which could be a retirement or non-retirement scheme) or, where the fund invests in underlying funds, at the underlying fund level. Whether these costs are subject to GST will depend whether the supplier of the services charges GST, which comes down to factors such as their location (i.e. if they are offshore) and their GST status.

78. Allowing asset management and funds to recover all GST would remove a number of these inconsistent outcomes. This approach would also resolve the current bias by asset managers to prefer that services to the funds be provided in-house, rather than by specialised third

party providers. For example, if a third party provides investor services to a fund that is subject to GST, the fund will be able to fully recover that GST.

79. In practice, asset manager and fund clients are often surprised to discover they are not able to recover the GST on costs incurred. This is particularly the case for start-ups, who will often incur considerable legal and advisor fees getting established without realising the GST is not recoverable.

80. Finally, having a consistent approach to GST recovery in the manager and the fund would remove any potential preference that costs be either charged to the manager or a fund depending on the ability to recover the GST on those costs.

Further information

The Law Society is happy to discuss these comments further with officials if that would assist. The convenor of the Law Society's Tax Law Committee, Neil Russ, can be contacted via Law Reform Adviser, Emily Sutton (Emily.Sutton@lawsociety.org.nz).

Yours faithfully

Herman Visagie
Vice President