CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

WEEKLY COMMENT: FRIDAY 6 MAY 2016

1. The *Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill* ("the Bill") was introduced on 3 May. It includes the GST law changes proposed in *GST – Current issues – An officials' issues paper* (the "GST Issues Paper") released by Inland Revenue last September. I will be spending the next 4 weeks looking at the proposed GST law changes.

2. This first week I look at financial services, large businesses making taxable and exempt supplies and the GST treatment of alloy gold.

Financial services

3. Officials stated in the GST Issues Paper that they are keen to resolve "a longstanding issue associated with the exempt treatment of financial services" when businesses that primarily provide taxable goods and services incur costs to raise capital. Because the entitlement to GST input deductions relates to particular transactions, rather than to the taxpayer's broader activity, GST is not recoverable in capital raising costs because capital raising is a supply of financial services.

4. Proposed new s. 11A(1)(rb) in cl. 307 of the Bill, which will apply from 1 April 2017, provides for the following types of financial services supplied in the course of obtaining funds to be zero-rated, provided that they are not supplied by a registered person who principally makes supplies of financial services:

   (a) The issue or allotment of a debt security or equity security;

   (b) The renewal of a debt security or equity security;

   (c) The payment of an amount of interest, principal or dividend in respect of a debt security or equity security;

   (d) The provision or variation of a guarantee of the performance of obligations in the issue, allotment, or renewal, of a debt security or equity security.

5. The zero-rating under new s. 11A(1)(rb) will apply only to the extent to which the funds obtained are used by the registered person for expenditure in an activity of making taxable supplies. It is noted in the *Commentary on the Bill* ("the Commentary") that this means that the apportionment rules will apply:

   (a) When the expenditure is first incurred where the funds are not raised only for expenditure in a taxable activity, or where the broader activity involves making both taxable and exempt supplies; and

(b) At the end of subsequent adjustment periods where the taxable exempt mix may have altered.

6. It is noted in the GST Issues Paper that the capital raising costs would be treated as relating to the business as a whole, and businesses would not be able to attribute the cost of raising capital to a particular activity or to a particular part of the business. This follows the principle established in the leading European case on the issue, *Kretztechnik AG v Finanzamt Linz* (Case C-465/03), that businesses are entitled to recover input tax incurred on the costs of issuing shares to the extent that they make taxable supplies.

7. It was also stated in the GST issues Paper that the types of costs that would be covered include legal and advisory fees, costs of preparing a product disclosure statement or other documents, valuation fees, and printing and advertising costs.

8. The ability to zero-rate supplies under proposed new s. 11A(1)(rb) will not apply to registered persons who principally make supplies of financial services, or to the extent that they have made an election to zero-rate business-to-business supplies of financial services, as a deduction is already available under these rules.

Retirement village operators and other large businesses that make taxable and exempt supplies

9. Effective from the date of enactment, proposed new s. 20(3EB) in cl. 314 of the Bill and s. 21(4B) in cl. 315 of the Bill provide for a registered person to choose, for apportioning input tax under the old or new apportionment rules, a "fair and reasonable method of apportionment" that is agreed with the Commissioner and has regard to the outcomes that would be reached if the apportionment and adjustment rules were applied.

10. The proposed alternative apportionment method is available only to:

    (a) A registered person who reasonable expects to make supplies of goods or services with a value of more that $24m in a 12-month period that includes the month in which the registered person proposes the agreement; or

    (b) An industry association if the method is intended to be available to a registered person as described above (it is stated in the Commentary that the Commissioner and the association would need to agree the person or class of persons that are eligible to apply the method).

11. The availability of this alternative method stems from officials' concerns that the existing apportionment rules lead to significant compliance costs for retirement village operators for the following reasons:

    (a) Goods and services used within different parts of the village could have different intended uses – for example, head office costs relate to the whole village whereas other costs might be specific to a particular part of the village – requiring multiple apportionment rates to be determined, applied and tracked.

    (b) Construction costs could relate to the construction of "exempt" units, "taxable" units, and shared facilities, and the relative proportions and apportionment is difficult to determine in advance.

    (c) Services provided to residents change over time resulting in continuous calculations to reflect the correct taxable or exempt use.

(d) The taxable or exempt use of supplies may not be able to be determined in advance because it would depend on how the resident uses the supplies - either as independent living accommodation (exempt) or as part of a care package (taxable).

(e) Once an adjustment becomes necessary, additional adjustments become required in subsequent periods as the overall proportion of taxable use changes.

(f) When the use of a good or service in an early adjustment period differs from its use in subsequent adjustment periods, incremental adjustments may be required in the subsequent periods, as the use in the early periods progressively becomes a smaller proportion of actual use.

12. The proposed legislation does not provide a list of factors, but officials stated in the GST Issues Paper and it is re-stated in the Commentary that they expect agreements to set out:

(a) All relevant business activities of the applicant;

(b) The methodology proposed (for example, calculation based on turnover, floor space, time spent, number of transactions or cost allocations);

(c) Categories of costs specific to either taxable or non-taxable supplies, and categories of costs that relate to both taxable and non-taxable supplies;

(d) The methodology proposed for significant one-off acquisitions such as land;

(e) The method by which disposals of assets will be dealt with (for example, what input tax adjustments will be made);

(f) Adjustments for already acquired goods and services subject to existing apportionment rules;

(g) Any proposed variations to:

(i) The minimum number of adjustment periods for which adjustments will be made; and

(ii) The period in which adjustments will be returned; and

(h) An explanation of why the proposed methodology is fair and reasonable, and how it reflects the outcomes that would be reached under the apportionment rules.

13. It is stated in the GST issues Paper that financial service providers are already able to reach an apportionment agreement with the Commissioner, and would not be covered by the proposed new rule. However, there is no specific prohibition on financial services providers applying the proposed new rule in the proposed legislation or in the Commentary.

GST treatment of alloy gold

14. Effective from the date of enactment, but also applying to deductions for goods acquired in the 4 years preceding the date of enactment, secondhand goods will include, for the purposes of allowing input tax deductions, goods composed of gold, silver or platinum, and of a kind manufactured for sale to the public.

15. The supply of any fine metal is an exempt supply under s. 14(1)(e) of the GST Act, unless it is zero-rated as a first supply by a refiner to a dealer under s. 11(1)(n). Therefore, no input tax deduction is available for a supply of fine metal that is not a first supply.

16. In addition, no secondhand goods input tax deduction is available under the existing rules for secondhand goods to the extent to which they are manufactured from gold, silver, platinum or other fine metal. This is apparently to prevent an "extra" secondhand goods input tax deduction being taken in the following scenario referred to as "carousel fraud involving gold":

    (a) An unregistered person converts fine gold acquired as an exempt supply (i.e. not a first supply) into alloy gold and sells the alloy gold to a registered person.

    (b) In the absence of the exclusion, the registered person would get a secondhand goods input tax deduction.

    (c) The registered person could then sell the alloy gold plus GST to a refiner and the registered person would pay output GST.

    (d) The refiner would then sell the refined gold as a zero-rated first supply and claim an input tax deduction for the GST charged by the registered person.

17. Officials have responded to industry concerns that:

    (a) The rules are poorly understood and complied with; and

    (b) The compliance costs are high because the gold component must be determined and valued to distinguish the fine from non-fine portions; and

    (c) The rules do not recognise the widespread use of gold in a variety of consumer goods, such as in electronics.

18. Therefore, officials have recommended allowing a secondhand goods input tax deduction for secondhand goods that are manufactured from non-fine gold, silver or platinum. Conversion of fine gold into alloy gold manufactured goods is apparently a more expensive process than on-selling alloy gold in an unprocessed state. Therefore, officials accept that allowing a secondhand goods input tax deduction for manufactured goods poses less of a fraud risk.

19. At present the definition of secondhand goods in the GST Act excludes:

    (a) Secondhand goods consisting of any fine metal (defined as gold to a fineness of not less than 99.5%, silver to a fineness of at least 99.9% and platinum to a fineness of at least 99%); or

    (b) Secondhand goods which are, or to the extent to which they are, manufactured or made from gold, silver, platinum, or any other substance which, if it were of the required fineness, would be fine metal.

20. The proposed new definition of secondhand goods involves paragraph (b) above being replaced by "secondhand goods which are:

    (i) Manufactured or made from, or to the extent to which they are manufactured or made from, gold, silver, platinum, or other substance, that would be fine metal if it were of the required fineness; and

    (ii) Of a kind not manufactured for sale to the public."

21. It is stated in the Commentary that this will allow deductions to be claimed for the gold, silver or platinum content of a variety of goods, such as jewellery.

22. Officials understand that a number of taxpayers may already have claimed secondhand goods input tax deductions as proposed because the industry meaning of "gold", "silver"

and "platinum" is the fine metal form and goods consisting of non-fine metal are not recognised as goods for which secondhand input tax deductions are denied.

23. The unexpected liability to repay these amounts may have a significant effect on their business. Therefore, the proposed amendment is to be retrospective by four years before the date of enactment. This would provide certainty to taxpayers by allowing previously claimed deductions, while ensuring compliant taxpayers are not disadvantaged, by being able to claim deductions within the four-year period.

Arun David

Arun David, Director,
DavidCo Limited