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GST: Strengthening Business-to-Business Neutrality
C/- Deputy Commissioner, Policy
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Dear Sir

Submission on Officials' Issue Paper of June 2008 – Options for Strengthening GST Neutrality in Business-to-Business Transactions

The following is Grant Thornton's submission on the above named Issues Paper.

Grant Thornton New Zealand is a national association of independently owned and operated firms. This submission is made on behalf of those firms.

In making our submission we follow the structure of the officials' issues paper. Firstly however we would make the general comment that a number of statements of risks to the revenue are prima facie unsubstantiated and therefore any judgement as to whether the proposals to amend the legislation are warranted can not be made without further detail being provided. If we take the reference "carousel fraud" in Chapter 5 as an example the chances of such a fraud being successfully applied in New Zealand are extremely remote given that it runs off the relationships between countries in the European Union. We are of course supportive of the closing down of any "rorts" which erode the New Zealand tax base which of course means other New Zealand taxpayers are required to make up any shortfall. However these same taxpayers can also suffer from over reaching remedies that impose onerous requirements on innocent taxpayers. Once a problem/rort is substantiated a targeted discrete solution is what is required, rather than wide-reaching catchall solutions.

The other preliminary point we would make that the title of the paper is misleading and that the focus of the paper is not on neutrality between businesses to business transactions but rather on situations where, in the officials' view, the revenue base is at risk. It is effectively a GST base maintenance paper, and we have no problem with it being so.

For completeness, we note the paper points out a number of cases where because of timing differences the Revenue makes a timing loss. However, there are also many occasions where the Revenue makes timing gains because of mismatches between taxable periods and bases but there is no mention of that. Perhaps recognition of the "swings and roundabouts" nature of GST would give a more balanced viewpoint. This is of course a design feature of the GST system, is deliberate, and in respect of the past 20 years and the hundreds of millions of transactions subject to GST has worked extremely well and has played a significant part in New Zealand tax take. Therefore we consider that in remedying any clear policy deficiencies that as far as possible any remedial action should only be applied to that specific problem.

For example in Chapters 6 and 7 of the Officials Paper problems arise in respect of associated persons. Therefore any remedial measures should be specifically targeted to associated persons.

Our specific comments are as follows:

Paragraphs 3.20-3.23

Rather than showing any deficiencies in the system the *Chelle* case shows the current system is working efficiently and as intended and there is no need for “other measures” to protect the integrity of the GST system.

Paragraphs 4.2-4.31

In our experience the large majority of the issues that have arisen in relation to going concerns have been of the IRD’s making. That is, while the majority of vendors and purchasers have an agreement how the sale of the business/going concern is to be treated (it is covered in the documentation after all) many IRD investigators see the opportunity to find a “discrepancy” and therefore look for reasons why a transaction may not technically qualify as a “going concern”. In situations where there is some “skulduggery” in play where the purchaser attempts to claim an input credit in respect of the sale of a going concern – there will not be a valid tax invoice. Where the vendor does not return GST in respect of the sale of a non-going concern then they will be in default and the normal provisions of the Act, and IRD normal checking procedures will apply.

Paragraphs 4.28 – 4.30

We have some sympathy with the IRD in this regard as we do not believe (and consider that most practitioners would agree with us) that this is an issue at all and has been pushed by some practitioners (one in particular) for no apparent reason other than self-serving ones. However the issue could easily be resolved by IRD issuing a ruling or an interpretation statement that follows the economic reality of the situation rather than a strained literal interpretation. If IRD is unable or unwilling to do this then a legislative amendment is the only alternative.

Chapter 5

IRD has more than sufficient powers and resources to manage any perceived or real risks. Further there is no justification for extending the timeframe by which the Commissioner must inform the taxpayer if he is not going to process a GST refund. As it is the vast majority of taxpayers bend over backwards to provide early warning to IRD that a refund will be owing, inform IRD why a refund is due and provide documentation to support the claim.

Inland Revenue considers that it needs an “insight” into when certain types of property transactions are undertaken so as to “detect transactions that might be viewed as detrimental to the GST base at a much earlier stage”. What transactions are detrimental to the GST base is not elaborated upon but it appears that IRD is concerned that it is “missing out” on GST when land is sold and the vendor has previously claimed an input deduction. However there is nothing peculiar to land that makes it such a potential detriment to the GST base. Rather it is because of the land’s high value that potentially poses a risk if the correct procedures are not followed. Land is no different to any other high value asset and should not be singled out just because someone at IRD wants further “insight” into transactions. The benefits (which are solely to the

IRD) far outweigh the needless imposition and interference of IRD on commercial systems and processes, which are set up to service commercial needs, not those of the revenue.

Chapters 6 and 7

As noted above officials have failed to recognise that “timing mismatches” fall both ways and that these mismatches, generally, even out over a 12 month period. Of course some of these mismatches occur over greater periods and these are of concern to the Revenue where the Revenue is carrying the cost of the GST. However these concerns should have all but eliminated by the success that the IRD had in *Chelle* as noted above. While Officials concern at the supposed uncertainty caused by general anti-avoidance provisions is noted we believe that the alternative of introducing specific legislation that would affect a number of taxpayers not involved in these nefarious activities would clearly be unjustified and the uncertainty referred to does not justify such action.

In regard to the discussion on accounting bases it would appear that officials suffer from a lack of commercial/accounting knowledge. As much as possible the collection of GST “fits in” with the commercial world and standard accounting practice, as it should. It is such practice that accounts are prepared on an “accrual” basis which equates to the “invoice” basis of GST accounting. This is also the basis that is used to calculate taxable income for income tax purposes. It is the payments method which is the alternative method and the method that requires adjustments to be made when calculating GST. Therefore the statement made in 6.16 that:

... the payments basis dispenses with the need to maintain debtors’ or creditors’ ledgers to complete the calculation of ‘tax payable’ at the end of each taxable period

is incorrect. No adjustments are required to calculate GST for a taxable period on the invoice basis – it is merely a statement of sales and purchases – on an invoice basis, which as mentioned is the same as the standard accounting method. It is the payments basis which requires adjustments for sale where payment has not been received or purchases that have not been paid.

Because the Invoice basis is the standard option there should be no limitation on who can use it. It is the “payments” basis which is the alternative and therefore there should be restrictions placed on its use. For many small businesses who do not prepare “ongoing” accounts and calculate their GST on the basis of entries to their bank account the payments basis is entirely appropriate. These businesses GST returns are usually self prepared i.e. not by their accountants and accounts are prepared at year end and on an invoice/accruals basis as required for income tax purposes. While there are valid reasons why small businesses should be able to use the payments basis the more appropriate method is the invoice basis and there is no reason why medium to large businesses should not use the invoice basis and indeed in using the “payments” basis they are increasing their own compliance costs.

However we must question why this is an issue for discussion at all in this paper and the fact that the system has been working well for over 20 years would tend to suggest that even though there may be small issues they are not of such magnitude that the system needs to be as dramatically overhauled as is proposed. That is not to say that there will not be occasions where change is required however this needs to be done on the basis of a thorough unbiased analysis and be based on facts and statistics available to all. We do not believe this to be the case in this instance.

Our understanding of the revenue risk is particularly between associated parties i.e. one party is on invoice and the other on payments. A simple remedy would be to require matched accounting basis for associated party transactions.

Second hand goods

This proposal (contained in 8.62) lacks any merit. A specific provision was introduced in 2000 to counter a perceived loss to the revenue of associated persons claiming an (inflated) second hand input credit. Without doubt this creates consistency issues but to solve this by making non-associated persons subject to the same rule is nonsensical and attempting to justify it by limiting it to “land” because people can find the cost of land in previous transactions is verging on the dishonest. There is no valid policy reason for extending the 2000 amendments to non-associated persons.

Chapter 9 – Accommodation

The proposals included in this chapter are generally welcomed.

Clearly the definition of “commercial dwelling” which causes the most problems, is outdated and needs replacing. However in the interests of consistency between taxpayers and across all types of supplies we do not agree for a need to insert a “threshold” under which taxpayers supplying guest accommodation are not carrying on a taxable activity. Clearly Inland Revenue has concerns about taxpayers claiming relatively large input tax deductions in respect of properties which they believe are properties acquired primarily as dwellings. These were the reasons behind the ill fated IS0049 but again these concerns fail to stand up to any scrutiny. This is because:

- No refund can be paid without the taxpayer proving to the satisfaction of Inland Revenue that the property acquired has been acquired for the principal purpose of making taxable supplies;
- Any subsequent application, either in whole or in part, means that a change of use adjustment is required;
- Upon sale of the property GST is payable on the proceeds which when the property’s value means that the GST paid on sale will exceed that refunded on purchase (except if it is sold as a going concern).

These issues tend to be sorted out in the long term.

Further such a threshold would undoubtedly cause many practical problems such as an activity which did not initially meet the threshold, then did etc etc

Transitional Rules?

If the Government should decide to change the legislation in the manner proposed it should apply in a completely prospective manner. That is the amended legislation should not apply in a manner that forces taxpayers to de-register. These taxpayers acted in good faith in accordance with the legislation that applied at the time and these “activities” should be left to run their natural course – whatever that may be. In this respect we refer you to the Institute of Chartered Accountants submission of 16 February 2007 on the draft interpretation statement IS0049 and the transitional rules proposed at that time. The submissions made by the Institute at that time are relevant to any transitional rules (and to the proposed thresholds discussed above also).



Grant Thornton

Should you wish to discuss any of the issues please contact me.

Kind Regards

Grant Thornton

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