GST Changes coming: Fair but Winners & Losers

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GST Changes coming: Fair but Winners & Losers

February 2020 IRD released:

An officials' issues paper on GST

- Suggested Changes – have consulted – in the pipeline
- Covering an extensive range of areas including:
  - Crypto currency
  - International Conferences
  - GST adjustments
  - Land: CZR
  - Tax Invoices
  - Second-hand goods input tax credits on supplies between associated persons

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Cryptocurrency **PROPOSAL**

- Exclude cryptocurrencies from GST and the financial arrangement rules.

- Income tax will still apply to any profits made when cryptocurrencies are sold or traded
- Two options:
  - A) Treat like money – same as Australia
  - B) Treat as exempt for NZ residents and zero rated non residents
- Key difference is that option B) would mean GST input claim for costs related to zero rated supply to non residents

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Cryptocurrency

- Most likely option A) – same as Australia
- Proposed retrospective to 1 January 2009

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Zero-rate conference and staff training services supplied to non-resident businesses PROPOSAL

- Australia and Singapore recently removed local GST:
- conferences & similar to offshore businesses held there
- NZ has to keep up or less attractive for international conferences compared to Australia.
- Currently EU countries apply VAT/GST at full rates on conference services provided to offshore businesses.

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GST Adjustments PROPOSAL

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

- Switch the use of that asset to 100% taxable or non-taxable & washup
- Application: use must be changed to 100% taxable or non-taxable and "this total taxable or non-taxable use remain unchanged for an unbroken period of the remainder of the adjustment period in which the change in use occurred, and the entirety of the following adjustment period"

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GST Adjustments

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

- Looked at **strangeness** of this in a Webinar last year

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Income tax consequence: GST change of use

Observation…

GST change of use rules quite weird if asset owned a long time before change of use.

Small assets: not big dollars but what if it's a helicopter, corporate jet or an expensive boat?

Eg Graham Hartley owns a launch cost $80 mill. Used privately for 6 years – now worth $15 mill. If he sold it that's all he would get. He changes it to 100% charter. GST refund $10.5 mill. Sells a while later and gets $15 mill and output tax of $2 mill.

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GST Adjustments Proposed

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

- Same issue in reverse when going from taxable to non taxable and don't sell till later
- Someone Clicked:

  "consume an asset for private purposes over a period of years and then enjoy full input tax recovery upon a subsequent change to full taxable use. Therefore, the wash-up calculation does not tax the non-taxable usage prior to the change to full taxable use."
- Changed proposed

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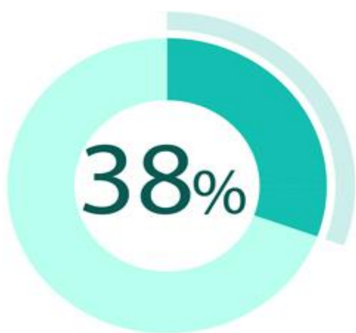
GST Adjustments Proposed

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

- Discussions with practitioners considering extending the wash-up where a permanent change in use to something other than 100%
- Will reduce compliance
- Change proposed



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GST Adjustments Proposed

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

- Proposed 'fix' for these two = New wash up formula

$$\frac{\text{Time remaining} \times (\text{Full input tax deduction} \times \text{Current use} - \text{Actual deduction})}{\text{Total time}}$$

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Example 4: Change to 100% non-taxable

- On 1 April 2017 Caroline, a GST-registered electrician, purchases a van for $46,000 (including GST of $6,000). Caroline's use of this van is seventy five percent taxable as she mainly uses it for her taxable activity but does also use it for private purposes. As such, Caroline claims an input tax deduction of $4,500.

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Example 4: Change to 100% non-taxable cont…

- On 1 April 2019 Caroline switches the use of the van to one hundred percent non-taxable as she has now purchased a new vehicle for use in her taxable activity.
- At the end of her 3rd adjustment period on 31 March 2020 Caroline's actual taxable use of the asset was **fifty percent** so she is required to return $1,500 as output tax.

(75% x 2 years) = 150% minus (100% x 1 year) = 50%

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Example 4: Change to 100% non-taxable cont…

After the end of her 4th adjustment period Caroline is able to perform the wash-up calculation and return $1,200:

Total GST paid: 4,500 – 1,500

$$\frac{2 \text{ years} \times (\$6{,}000 \times 0\% - \$3{,}000)}{5 \text{ years}} = -\$1{,}200 \quad \frac{6{,}000}{5{,}000}$$

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Example 4: Change to 100% non-taxable cont…

4,500 -1500 -1,200 =

- Total amount of inputs Caroline has claimed to $1,800.
- Equals amount of inputs she would have been able to claim under the standard change of use rules (ignoring the current restrictions on performing adjustments).
- I.E. Over the five years in which adjustments were required, 30% of the use of the van was taxable (6,000 x 30% = 1,800).

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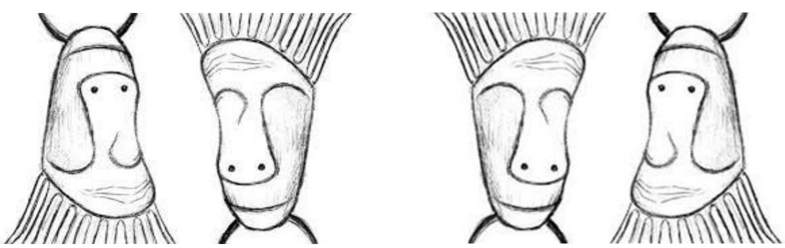
Example 4: Change to 100% non-taxable cont…

Other examples show works the same in reverse and also where the change isnt 100%



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Cap on input adjustment on disposal of mixed use assets

- Where an asset use is a mix of taxable and non-taxable only some of the GST incurred is claimed along the way.
- When disposed return 100% of the output tax but allowed to claim an extra input adjustment proportional to the taxable percentage.
- The formula caps that adjustment to the total GST in original purchase
- Cap no issue for assets that go down in value
- Unfair for asset that goes up in value ie land eg mixed use beach house
- Effectively pay GST on 100% of capital gain even if though portion of asset used privately

Positive

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GST Changes coming: Fair but Winners & Losers

Cap on input adjustment on disposal of mixed use assets

- Fix: is to remove the cap on land except for property developers

Example 13: Short-term commercial accommodation

- Brian and Nita bought a bach in Whangamata for $690,000 that they mainly use privately. However, they also have a taxable use of the bach as they use it for supplying short-term commercial accommodation. Their taxable use of the bach is 40% so they only claim an input tax deduction of $36,000.
- After a few years they sell the bach for $1,035,000 (including GST). As such they return output tax of $135,000.

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Cap on input adjustment on disposal of mixed use assets

Example 13: Short-term commercial accommodation cont..

- In the absence of the supplies of short-term commercial accommodation Brian and Nita made from the bach, the supply of the bach would not be considered as being made in the course or furtherance of a taxable activity. The cap on adjustments in section 21F would therefore not apply to the disposal of the bach so Brian and Nita claim an adjustment of $81,000.
- This recognises that 60% of their use of the bach was non-taxable.
- Total net GST paid is $135,000 – $36,000 - $81,000 = $18,000
- Under the current rules the total input claim would be capped at $90,000. So output $135,000 = $45,000 net payment
- Nice one!

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Change of use: Wash-up calculation for land

For land, the wash-up calculation can result in adjustments that are disproportionately small.

This is because the wash-up calculation is based on the cost of an asset rather than its market value and land tends to appreciate in value.

This creates a concern that a taxpayer could reduce their output tax liability by switching the use of land to one hundred percent non-taxable and performing the wash-up prior to disposal

Drat but always seemed to good to be true

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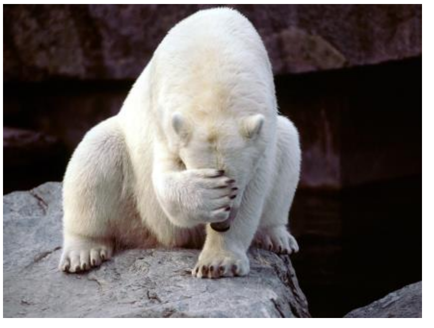
Change of use wash-up calculation for land

Proposed Fix Option 1

- treated as being disposed and reacquired at market value when the change of use wash-up is performed



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Change of use wash-up calculation for land

Proposed Fix Option 1

Example 16 Change to zero percent taxable use

- On 1 April 2020 Joanna purchases a house for $690,000 (including GST) that she intends to use both privately as her main home and for a home office that she uses in her taxable activity. Her intended taxable use of the house is 30% so she claims an input tax deduction of $27,000. **90,000 x 30% = +27,000**
- On 1 October 2023 Joanna switches the use of the house to 0% taxable.

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GST Changes coming: Fair but Winners & Losers

Change of use wash-up calculation for land

Proposed Fix Option 1

Example 16 Change to zero percent taxable use

- On 31 March 2024 Joanna calculates that her taxable use of the land since acquisition has been 26.25% (3.5 years 30% and 0.5 years 0% taxable use) and performs an adjustment, returning $3,375 of input tax she had previously claimed.
- On 31 March 2025 Joanna can perform the wash-up calculation. She is deemed to dispose of the land and reacquire it at its current market value of $920,000 (including GST). She therefore returns output tax of $120,000 but cannot claim any of this back as an input tax deduction.

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Change of use wash-up calculation for land

Proposed Fix Option 1

Example 16 Change to zero percent taxable use

- Joanna also performs an adjustment under section 21F for her deemed disposal of the land. As she was not a property developer the cap in section 21F does not apply so Joanna claims an adjustment of $88,500 (73.75% of the output tax).
- The net effect of performing the change of use wash-up adjustment is that Joanna must return $31,500.

Net GST = -$7,875 payable Option 1 compared to Current Rules = -$30,000 output

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Change of use wash-up calculation for land

Proposed Fix Option 2 Updated Formula

Full input tax deduction × Current use - Actual deduction

- Current use would be the percentage taxable use of the land since the change of use occurred.
- Will come with a clawback if sale occurs within 5 years of the change of use

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Change of use wash-up calculation for land

Proposed Fix Option 2 Updated Formula

Example 18: Change to zero percent taxable use

Consider example 16 with Joanna.

On 31 March 2025 Joanna performs the wash-up calculation and returns the $23,625 of input tax she had previously claimed.

+ $27,000 input - $3,375 Output = + $23,625 net payment

On 30 September 2027 Joanna sells the house for $1,150,000. As this is within five years of the permanent change of use to 0% taxable use the supply of the house is treated as a taxable supply and Joanna must return output tax of $150,000.

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Change of use wash-up calculation for land

Proposed Fix Option 2 Updated Formula

Example 18: Change to zero percent taxable use

Joanna calculates her actual taxable use of the land since acquisition as 14% (3.5 years 30% and four years 0% taxable use). As such, Joanna claims $12,600 in input tax for the land. She then claims an additional adjustment under section 21F of $129,000, being eighty six percent of the output tax.

Overall + $27,000 - $3375 - 23,625 + $12,600 + 129,000 - 150,000 = -$8,400 payable Option 2

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