

# Regulatory Impact Statement

## GST on cross-border services and intangibles

### Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options to apply Goods and Services Tax (GST) to cross-border services and intangibles consumed in New Zealand (including e-books, music, videos, and software purchased from offshore websites). Currently, GST is not usually collected on cross-border services and intangibles, which results in competition and fairness concerns by New Zealand businesses, as well as a revenue gap in New Zealand's GST system.

This analysis follows submissions received on the discussion document *GST: Cross-border services, intangibles and goods* released on 18 August 2015, which sought public feedback on a proposal to require offshore suppliers of services and intangibles to New Zealand resident consumers to register and return the GST. The analysis also considered international developments to address this issue, including the OECD guidelines on GST and cross-border services and intangibles which are connected with the work on "base erosion and profit shifting" (BEPS). In addition, consideration has been given to approaches adopted in the European Union, and a number of countries including Australia, Norway, Switzerland, South Africa, Japan and South Korea.

There are three key constraints / caveats on the analysis:

1. Because of data limitations it is not possible to accurately determine how many offshore suppliers could be required to register and return GST under the preferred option. Experience in similar countries suggests that around 100 offshore suppliers may register if the preferred approach is adopted.
2. Again owing to data limitations it is not possible to determine exactly how much is spent on services and intangibles purchased offshore and consumed in New Zealand. Officials' best estimate that around \$270 million per annum is spent on services and intangibles from offshore suppliers. This estimate means that around \$40 million of GST is forgone on these purchases. This amount could be growing at a rate of 10% per annum.
3. The extent to which the GST treatment of services and intangibles purchased from offshore influences consumers' purchasing decisions is uncertain. Other factors such as product range, availability and price (exclusive of GST) may have a greater impact on consumers' decision to purchase from an offshore supplier as opposed to a domestic supplier.

A range of options has been considered and measured against the objectives of providing certainty, consistency and fairness of GST treatment whilst minimising compliance costs and disruption to current practices. There are no environmental or cultural impacts from these recommended changes.

There are no other significant constraints, caveats or uncertainties concerning this regulatory impact analysis other than those noted above.

The proposals could impact on the level of competition by discouraging offshore suppliers from entering or continuing to supply to the New Zealand market. However, this impact may depend on the extent to which compliance costs are imposed on offshore suppliers and the extent to which consumers alter their purchasing behaviour in response to the change.

The preferred option would likely impose some compliance costs on offshore suppliers as they would be required to register and return GST. These compliance costs are likely to be comparable to (if not lower than) the compliance costs already imposed on domestic businesses associated with registering and returning GST on domestic supplies. The preferred option also contains a number of compliance savings measures to ensure compliance costs imposed on offshore suppliers are minimised.

The application of GST on services and intangibles purchased from offshore suppliers may also impact New Zealand consumers' purchasing decisions. As noted above, the impact is likely to be limited as other factors such as product range, availability and price (exclusive of GST) may have a greater impact on consumers' decisions than the application of GST on these services and intangibles.

None of the policy options identified is expected to unduly impair private property rights or override fundamental common law principles.

Note that this RIS only considers the application of GST to cross-border services and intangibles. The application of GST to low-value imported goods will be considered at a later time following separate public consultation.

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## **STATUS QUO AND PROBLEM DEFINITION**

1. In principle, GST should apply evenly to all consumption that occurs within New Zealand as this helps to ensure GST is fair, efficient and simple. However, GST is not typically collected on cross-border services and intangibles (including internet downloads and online services) purchased from offshore websites.
2. When GST was introduced in 1986, few New Zealand consumers purchased services from offshore and online digital products were not yet available. Therefore, at that time the compliance and administrative costs involved in taxing cross-border services outweighed the benefits of taxation.
3. The growth in online purchases means that the volume of imported services on which GST is not collected is becoming increasingly significant. This raises the question of whether the existing tax rules will remain suitable and sustainable in the future.
4. Many domestic providers feel the existing tax settings place them at an unfair disadvantage when compared with offshore businesses supplying products with no GST added to the price. There are a number of reasons why New Zealand consumers may purchase services offshore, such as overall cheaper prices, product availability, and convenience. However, ideally, the tax treatment should not be a factor in consumers' purchasing decisions.
5. It is likely that up to \$40 million of GST is forgone on cross-border services and intangibles per year. The growth of imported services is a relatively recent development and the amount is expected to continue to grow – estimates vary but the growth could be around 10 percent per year.

### **International considerations**

6. The non-collection of GST on cross-border services and intangibles is an international issue faced by countries that have a GST or Value Added Tax (VAT) system. The OECD is in the process of developing guidelines which focus on establishing an international set of principles for determining when countries should have the right to tax such supplies.
7. The guidelines were publicly released on 5 October 2015. The guidelines suggest that, for remotely supplied services and intangibles, the consumer's usual place of residence is the predominant test for determining which country has the right to tax. They also suggest that offshore suppliers could be required to register and return the GST on remote supplies, as is the case in the European Union. The guidelines are expected to be finalised later this year.
8. The offshore supplier registration model has been adopted in the European Union for cross-border services and intangibles as well as a number of countries, including Norway, South Korea, Switzerland, Japan and South Africa. The countries that have implemented such a system report some success in collecting GST or VAT.
9. Australia also announced plans to introduce the model as part of their 2015 Federal Government Budget. While some of the detail is still subject to consultation, the broad framework of the proposed rules is consistent with the OECD guidelines and the system that operates in Europe. Australia intends to implement its proposed rules on 1 July 2017.

## **Establishing New Zealand's right to tax**

10. Before considering the various options, it is first important to determine which cross-border services and intangibles New Zealand should tax. New Zealand and other countries' GST systems seek to tax domestic consumption. This is done taxing imports (as well as other goods and services supplied domestically), and not taxing exports.

11. In the case of cross-border goods, the place of consumption will be clear – the consumption occurs in the country of import. There is less certainty when applying GST to cross-border services and intangibles. In many cases it is not clear where the consumption occurs and therefore which country has the taxing right. A number of proxies could be used to determine place of consumption, such as the location of the consumer, location of the supplier, or the residence of the consumer.

12. Without international consensus on taxing rights, it is possible that services could be taxed in multiple jurisdictions or not at all. The OECD has been developing a set of guidelines addressing these issues of double taxation and non-taxation that may arise from inconsistencies in the application of VAT/GST to international trade.

13. The OECD draft guidelines and growing international practice suggest that New Zealand should apply GST to “remote” services and intangibles supplied to New Zealand-residents. Remote services are services where it is not necessary for the supplier and customer to be in the same location when the services are supplied – such as if, for example, a person downloads a song from a website. These services can be distinguished from “on-the-spot” services, where the supplier and the customer are usually required to be in the same location as the supplier in order for the services to be physically performed – for example, the services provided by a hairdresser.

14. In relation to remote services, residence is internationally regarded as a reasonable proxy for determining where a cross-border service or intangible will be consumed. It is recommended that New Zealand follow international consensus to avoid double taxation or double non-taxation in international trade. Therefore, the options considered seek to apply GST to remotely supplied services and intangibles received by New Zealand residents.

## **OBJECTIVES**

The options outlined in this RIS seek to achieve two main objectives:

### **(a) Address the non-taxation of cross-border services and intangibles**

15. New Zealand's GST is a “consumption tax”. Consumption taxes seek to tax consumer spending on goods and services. The country that has the right to tax this consumer spending is generally the country in which the good or service is consumed. This is known as the “destination principle”.

16. Conversely, goods and services that are exported, and therefore consumed offshore, are generally untaxed – that is, exports are zero-rated, meaning GST is charged at a rate of zero percent and businesses can claim GST back on their inputs. Allowing exporters to claim back GST on their inputs ensures that GST is not a cost on business or offshore consumers.

17. If countries apply the destination principle and also recognise that GST is a tax on consumers and not businesses, double taxation and non-taxation in cross-border trade should

largely be averted. Services and intangibles that are exported are zero-rated in most jurisdictions so if jurisdictions do not tax incoming services and intangibles this can lead to double non-taxation. This result is inconsistent with New Zealand's broad-based GST system which seeks to tax virtually all New Zealand based consumption.

18. Therefore, the options discussed in this RIS seek to address the issue of the non-taxation of cross-border services consumed in New Zealand. As discussed above, around \$40 million of GST is forgone on cross-border services and intangibles per year growing at a rate of 10 percent per year.

#### **(b) Reduce competitive distortions**

19. In principle, GST should apply evenly to all consumption that occurs within New Zealand as this helps to ensure GST is fair, efficient and simple. When GST does not apply evenly it has the potential to distort consumer behaviour. Domestic businesses argue that the fact that no GST is charged on services purchased from offshore businesses but, is charged when services are purchased from domestic businesses, is distorting consumers' purchasing decisions in favour of offshore businesses.

20. Therefore, the second objective is to reduce any distortive effects that GST may have on consumers' purchasing decisions. However, any option discussed must also ensure that domestic businesses are not advantaged as compared to offshore businesses as a result of any proposal.

#### **Objectives against which the options are to be assessed**

21. The objectives against which the options are to be assessed are:

- **Certainty and simplicity:** The GST rules should be clear and simple to understand, so that taxpayers are aware of the GST treatment of a particular supply and their GST obligations.
- **Efficiency of compliance and administration:** Compliance costs for taxpayers and administrative costs for Inland Revenue should be minimised as far as possible.
- **Neutrality:** Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.
- **Effectiveness and fairness:** The option must have the ability to meet the objectives of collects the forgone revenue and reducing the distortions the current treatment brings about.

#### **REGULATORY IMPACT ANALYSIS**

22. Three policy options and the status quo were considered for addressing the policy problem and meeting the objectives. These were:

**Option 1:** Require non-resident suppliers to register and return GST on services and intangibles supplied to New Zealand resident customers.

**Option 2:** Require the New Zealand resident customer to return the GST on services and intangibles supplied by non-residents (known as a reverse charge mechanism).

**Option 3:** Require financial institutions to return the GST on credit/debit card transactions involving services and intangibles purchased from non-resident suppliers.

**Option 4:** Retain the current GST treatment where no GST is collected on services and intangibles supplied by non-residents. This is the status quo option to which the other options are being assessed against.

23. All of the options (apart from option 4) impact New Zealand resident consumers as they will likely bear the cost of the application of GST on purchases of services and intangibles received from offshore suppliers. The extent to which the resident consumer will bear the cost will depend on the effectiveness and rate of compliance of each option.

24. With regard to option 1, the extent to which New Zealand resident consumers will bear the GST will also depend on whether the offshore supplier passes the cost on to the consumer. This may be industry or firm specific and depend on factors such as business practices and the elasticity of demand for products.

#### **Option 1: Offshore supplier registration (officials' preferred option)**

25. Option one involves offshore suppliers or offshore electronic market places registering and returning GST on services and intangibles consumed in New Zealand. This option therefore primarily impacts offshore suppliers and offshore electronic market places.

26. Under this option offshore suppliers and marketplaces would be required to register and return GST if their supplies of services to New Zealand-resident customers exceed a certain registration threshold in a 12-month period. This option is consistent with how GST is collected on domestic supplies of goods and services.

27. The offshore supplier registration model is endorsed by the draft OECD guidelines – *Guidelines on place of taxation for business-to-consumer supplies of services and intangibles* – which were released December 2014 and are expected to be finalised later this year.

28. This option has been adopted in other countries, for example members of the European Union, and other countries such as Norway, South Korea, Switzerland, Japan and South Africa have also recently adopted this option. Australia has recently proposed to apply GST to cross-border services and intangibles from 1 July 2017 using an offshore supplier registration system.

#### ***Certainty and simplicity***

29. Adopting a system that is widely used internationally and is, therefore, familiar to international suppliers should make this option relatively simple to apply in practice. For example, the European Union has collected VAT on services and intangibles using this option since 2003. Given the European Union is the largest VAT market, many international suppliers will be familiar with this system and already be registered and returning VAT in Europe.

30. In addition, given New Zealand's GST system is broad-based, with a single rate and few exemptions, it is expected to be relatively simple for offshore suppliers to comply with as compared to countries with multiple VAT/GST rates and exemptions.

### ***Efficiency of compliance and administration***

31. This option is relatively efficient to administer given systems are already in place to register domestic suppliers. Since New Zealand's GST system is relatively simple, compliance costs should be minimal and consistent with (if not lower than) the compliance cost imposed on domestic businesses in registering and returning GST.

32. Implementing simplified registration processes that are tailored to offshore suppliers will assist in reducing the compliance costs associated with the new rules (see the implementation section for more information on the simplified registration system).

33. As a further compliance cost reduction measure, offshore suppliers would not be required to register in New Zealand unless their supplies exceeded a certain registration threshold. This means that offshore suppliers that supply a minimal level of services to New Zealand residents would not have to register.

The rules contain other features that are designed to reduce compliance costs for offshore suppliers. A discussion of these features is included in further analysis on option 1: Offshore supplier registration model.

### ***Neutrality***

34. This option is neutral because offshore suppliers will be subject to the same rules as those applying to domestic businesses. Consequently, for tax purposes consumers should be indifferent as to whether they purchase a remote service from a domestic or offshore supplier as both suppliers would be required to return GST on that service.

### ***Effectiveness and fairness***

35. The effectiveness and fairness of this option may depend on the extent to which liable offshore suppliers comply with the rules. Since New Zealand's tax system is based on voluntary compliance, the system relies on the fact that the vast majority of people do the right thing and comply with their tax obligations. This is largely because our tax system is fair and coherent. It is expected that most offshore suppliers would comply with our rules for the same reasons, albeit there will be some differences in the enforcement mechanisms adopted.

36. When similar rules to those proposed in this document have been applied in other countries, offshore suppliers, particularly large international suppliers that account for the majority of cross-border services and intangibles, have demonstrated a willingness to comply. For many of these suppliers, failure to comply with their obligations would pose a significant risk to their reputation. Furthermore, to generate a similar level of compliance for New Zealand, the option adopts similar and consistent rules with the rules that apply in those other countries.

37. There are a number of detailed design issues with this option. These design issues have a significant impact on the degree to which this option meets the objectives. These detailed design issues are considered in the section "further analysis of option 1".

## **Option 2: Reverse charge**

38. Under this option, when a New Zealand consumer purchases services or intangibles from an offshore supplier, they would be required to return GST by making a separate payment to Inland Revenue or pay the GST as part of a end of year tax return (as opposed to the GST being included in the price paid). This is known as a ‘reverse charge’. This option therefore primarily impacts New Zealand resident consumers that purchases services and intangibles from offshore suppliers.

39. New Zealand already has a limited reverse charge rule for services purchased by New Zealand businesses from non-residents. It applies to the extent the services relate to 5% or more to non-taxable activities, such as those of a financial institution.

40. Under this option the existing reverse charge would be expanded to apply to individual consumers that purchase services and intangibles from offshore suppliers.

41. Like New Zealand, other countries (particularly in the EU) apply reverse charges as the primary collection method in relation to business-to-business offshore supplies of services and digital goods. Canada also uses this approach to collect GST on offshore supplies of services to non-registered individuals. The tax is due by the end of the month following the calendar month in which the amount for the services was paid or became payable.

### ***Certainty and simplicity***

42. The main disadvantage with this option is that a large number of taxpayers will be required to return GST, as compared to options 1 and 3 where a comparably small number of offshore suppliers or financial institutions would be required to return the GST. The amount of GST paid by each consumer is likely to be relatively small.

43. Given this option has the potential to impact a large number of consumers that are unfamiliar with returning GST there is likely to be less certainty as to how the GST rules apply. Consumers would also be required to identify whether or not they are purchasing the service from a New Zealand resident supplier and only return GST on services received by non-resident suppliers.

### ***Efficiency of compliance and administration***

44. As discussed above, this option would impose compliance costs on a relatively large group of consumers that purchase services from offshore suppliers for relatively small amounts of GST. Given that a large proportion of individual taxpayers are currently not required to file tax returns this option has the potential to require a large number of taxpayers to file returns.

45. Administrative costs are also likely to be significant as this option would involve the development of a new system of receiving GST payments. Either a new tax form would need to be developed or existing end of year tax returns would need to be amended. Resources would also need to be allocated to ensuring consumers complied with their tax obligations, by promoting awareness, providing guidance materials and dealing with enquiries, errors and refunds.



### *Neutrality*

46. If applied consistently and successfully, GST would be returned on both services provided domestically and from offshore. However, the method of collection would differ significantly depending upon whether the supplier was offshore or onshore.

### *Effectiveness and fairness*

47. When this option has been applied in other jurisdictions its success has been limited. This is likely due to a number of factors such as lack of awareness of the requirement to return GST given that consumers are accustomed to GST being included in the purchase price, and the difficulty of enforcing a reverse charge on such a large taxpayer base.

48. In many cases, the New Zealand purchaser may not realise they are buying from a non-resident supplier. For example, an offshore supplier could have a New Zealand domain name (.co.nz) or a separate chain of New Zealand retail stores.

### **Option 3: Financial institutions return the GST**

49. Option 3 would impact financial institutions (e.g. New Zealand banks) and other payment intermediaries that would be required to add GST to New Zealand issued credit/debit cards at the time that services are purchased from an offshore supplier.

50. How this collection option would apply in practice would need to be determined through consultation with financial institutions. However, one possible approach would be for the financial institution to add GST to the consumers' credit or debit card when the following conditions are met:

- The card is not physically present when the transaction occurs (e.g. instead of swiping the card, the customer supplies the credit card number).
- The supplier of the service is not in New Zealand.
- The billing address for the card is a New Zealand address.

### *Certainty and simplicity*

51. The development of an automated system to apply GST to purchases of remotely supplied services could be complex. The system would need to identify purchases that would not be subject to GST, such as 'on-the-spot' services consumed outside of New Zealand (for example, overseas accommodation) and international travel<sup>1</sup>. It is unclear as to whether financial institutions have the necessary information and therefore there would be a risk that GST would be applied to services consumed outside of New Zealand.

52. Consumers' use of online intermediary payment systems would have to be considered. Although a credit/debit card is still used, from the perspective of the financial institution it may be difficult to determine who the ultimate supplier of the service is, and therefore, whether GST should be charged. For example, it would be difficult to exclude an industry type (such as overseas accommodation providers) if the payment was made through intermediary payment systems. One solution would be to require the intermediary payment

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<sup>1</sup> International travel is currently zero-rated because it is a service that is considered to be consumed outside of New Zealand.

provider (as opposed to the financial institution who issues the credit or debit card) to collect the GST in such cases.

53. Another disadvantage with this option is that it has not been implemented in any other country. There is no international experience on how well this option will work, what practical difficulties could arise and what compliance costs would be involved. The success of this option would also depend on financial institutions agreeing to develop and implement a system.

#### ***Efficiency of compliance and administration***

54. While there would be some costs involved in setting up the collection system, the collection of GST from credit and debit cards would be an automated process. Automated processes for collection have the potential to significantly lower the cost of collection and the compliance costs.

55. There are only a relatively small number of New Zealand credit and debit card issuers. This should make it easier for the Government to work with those involved to develop practical and realistic processes to address any implementation issues which may arise.

#### ***Neutrality***

56. This collection system would only collect GST on services purchased with a New Zealand issued credit or debit card. Consequently, payment by other means would not be captured under this system. For example, services paid for using overseas bank accounts including overseas domiciled credit/debit cards and consumers could also use online banking to make payments to overseas suppliers.

#### ***Effectiveness and fairness***

57. This option is limited to collecting GST on New Zealand issued credit and debit cards and therefore may not easily respond to future developments in the way consumers pay for services online. Therefore, the longevity of this system could be an issue.

58. As discussed above, if the collection system cannot accurately distinguish between services consumed in New Zealand and services consumed outside of New Zealand, there is a risk that some services will be over taxed or subject to double tax as the overseas jurisdiction may also seek to apply GST/VAT to the services. This would negatively impact the fairness of this option.

### **Option 4: Status quo**

59. Under the status quo, GST would not be collected on supplies of cross-border remote services and intangibles received by New Zealand residents. As a result the competitive distortions between domestic and offshore suppliers would continue and the Government would not collect \$40 million on services and intangibles that are consumed in New Zealand.

#### ***Certainty and simplicity***

60. As GST is not collected on cross-border supplies of services and intangibles, this option is associated with greater certainty and simplicity when compared to the other options.

### ***Efficiency of compliance and administration***

61. As offshore suppliers are not required to return GST on supplies of services and intangibles to New Zealand resident consumers, there are fewer compliance and administration costs associated with this option.

### ***Neutrality***

62. This option is the least neutral of those considered, as the tax treatment of a remote service consumed in New Zealand will depend on whether the service is purchased from a domestic or offshore supplier. These differences in tax treatment may distort consumers' decision making, as purchases of remote services from an offshore supplier are not subject to GST, while those from domestic suppliers are generally taxed.

### ***Effectiveness and fairness***

63. Many domestic suppliers feel that the current tax settings place them at an unfair disadvantage when compared with offshore suppliers who are not required to return GST on supplies of services and intangibles to the same customers. The perception that the GST rules are ineffective in evenly taxing consumption in New Zealand may undermine compliance with tax rules more generally.

64. Domestic suppliers may also restructure their affairs in order to take advantage of the non-collection of GST on services supplied from offshore. This may further exacerbate the risk to the GST base and the competitive unfairness.

### **Summary of the analysis of the options**

65. The table below summarises the impact analysis of the options.

<b>Impacts</b>					
<b>Option</b>	<b>Objectives met or partly met</b>	<b>Economic impact</b>	<b>Compliance cost &amp; administrative impact</b>	<b>Fiscal impact</b>	<b>Fairness impacts</b>
Option 1: Require non-resident suppliers to register and return GST on services and intangibles supplied to New Zealand resident customers.	Best meets objective (a)  Best meets objective (b)	This option would reduce distortions on consumers' purchasing decisions that arise from the differences in tax treatment between domestic and offshore suppliers.	This option would result in some additional compliance costs for offshore suppliers. However, this impact is mitigated by several features of the rules that are designed to reduce compliance costs.	Estimated net gain in revenue of up to \$40m per year.	Improves fairness as offshore suppliers will largely be subject to the same rules that apply to domestic businesses.

Option 2: Require the New Zealand resident customer to return the GST on services and intangibles supplied by non-residents (known as a reverse charge mechanism).	Partly meets objective (a)  Partly meets objective (b)	This option would reduce distortions on consumers' purchasing decisions that arise from the differences in tax treatment between domestic and offshore suppliers. However, the extent to which this occurs may depend on the extent to which there is widespread compliance with the rules.	This option would impose significant compliance on New Zealand resident consumers and would result in additional administrative costs.	No estimate of the fiscal impact of this option is available, though it would be expected to result in lower revenue gains than option 1 as a result of non-compliance with the rules.	This option would improve fairness in the system to the extent that neutrality between domestic and offshore suppliers can be achieved.
Option 3: Require financial institutions to return the GST on credit/debit card transactions involving services and intangibles purchased from non-resident suppliers.	Partly meets objective (a)  Partly meets objective (b)	This option would reduce distortions on consumers' purchasing decisions that arise from the differences in tax treatment between domestic and offshore suppliers. However, the extent to which this occurs may depend on the effectiveness of the system in identifying transactions that should be subject to GST.	This option could result in lower compliance costs than option 1, as there are likely to be fewer entities required to return GST and this could be achieved through automated processes. However, significant challenges in implementing the option have been identified, and it has not been adopted in other countries.	The revenue impact is likely to be similar to option 1 if the system was effective at identifying transactions that should be subject to GST.	This option would improve fairness in the system to the extent that neutrality between domestic and offshore suppliers can be achieved.
Option 4: Retain the current GST treatment where no GST is collected on services and intangibles supplied by non-residents.	Does not meet objective (a)  Does not meet objective (b)	This option results in distortions on consumers' purchasing decisions due to differences in the tax treatment between domestic and offshore suppliers.	This option is not associated with significant compliance or administration costs.	The revenue impact will be neutral, however, the Government will not collect \$40 million on services and intangibles that are consumed in New Zealand.	This option is perceived to result in significant unfairness, which may undermine compliance more generally.

### Further analysis on option 1: Offshore supplier registration model

66. Option 1 involves requiring non-resident suppliers to register and return GST on services and intangibles supplied to New Zealand resident customers. There are a number of design issues for the offshore supplier registration model which require separate impact analysis. The detail design aspects of option 1 are as follows:

- zero-rating the supply of remote services and intangibles to New Zealand GST-registered businesses;
- adopting a broad definition of remote services and intangibles (including digital services and more traditional services);
- requiring offshore suppliers to register and return GST if their total supplies of remote services and intangibles to New Zealand residents exceed \$60,000 in a 12-month period. However, offshore suppliers would not be required to register if they

predominantly made supplies to GST-registered businesses and their supplies to New Zealand resident consumers were less than \$10,000 in a 12-month period;

- requiring offshore suppliers to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of evidence, and an alternative method may be prescribed by the Commissioner of Inland Revenue if the offshore supplier does not have the necessary information;
- implementing a simplified registration and return process to reduce compliance costs for registered offshore suppliers;
- In some situations, requiring an electronic marketplace or intermediary to register instead of the principal offshore supplier.

67. The analysis of these design issues are summarised in the tables below.

### **Zero-rating supplies of services and intangibles to GST-registered New Zealand businesses from the rules**

68. One key design issue is whether offshore suppliers should be required to return GST on supplies of remote services and intangibles to New Zealand GST-registered businesses, or whether GST should apply only to supplies to New Zealand-resident final consumers.

<b>Issue</b>	<b>Options</b>	<b>Advantages</b>	<b>Disadvantages</b>	<b>Recommendations</b>
Should the rules zero-rate supplies to New Zealand GST-registered businesses?	<i>Exclude supplies to New Zealand GST-registered businesses unless the offshore supplier and GST-registered recipient agree to zero-rate the supply.</i>	<p>This option allows the rules requiring tax invoices to be relaxed, as unregistered recipients will not have the ability to claim back GST charged on the services they receive. This would result in lower compliance costs for offshore suppliers.</p> <p>This option is consistent with the approach taken in most other jurisdictions that have adopted an offshore supplier registration model for services and intangibles, and is more consistent with the draft OECD guidelines.</p> <p>The option to zero-rate these supplies will allow non-resident businesses to claim back any New Zealand GST incurred in making these supplies which ensures GST is neutral for these businesses.</p>	<p>This option requires offshore suppliers to determine whether they are supplying to a registered business or an individual customer, which could require the collection of additional information in some cases. However, as other countries have adopted offshore supplier registration systems that do not require offshore suppliers to return GST on business-to-business supplies, it is likely that many suppliers have implemented systems to operate in this environment. Offshore suppliers will also be able to rely on businesses customers GST number to determine their registration status. Additionally, to further reduce compliance costs, an offshore supplier would also be able to agree with the Commissioner of Inland Revenue on an alternative method of determining whether customers are GST-registered businesses.</p>	Recommended

	<i>Require offshore suppliers to return GST at a rate of 15% on all supplies to New Zealand resident consumers and businesses.</i>	This option would mean offshore suppliers would not have to determine whether they were supplying to a business or an individual customer, which may reduce compliance costs for some.	This option would have little value from a revenue perspective as GST-registered businesses would be in a position to claim back GST charged. This option would pose a fiscal risk if an offshore supplier charged GST to a New Zealand business but did not pay the GST to Inland Revenue as the New Zealand business would be entitled to an input tax deduction.	Not recommended
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69. It is proposed that if a GST-registered business is inadvertently charged GST they would need to seek a refund from the offshore supplier. However, if the value of the supply is less than \$1,000, the offshore supplier could provide a tax invoice which would allow the GST-registered business the ability to claim back the GST in their normal GST return. This would reduce the compliance costs imposed on offshore suppliers associated with returning inadvertently charged GST on low-value transactions. At the same time a threshold set at \$1,000 reduces the fiscal risks associated with GST-registered businesses claiming back high value amounts of GST charged by offshore suppliers.

### **Scope of the cross-border services and intangibles that are subject to the rules**

70. In designing the rules, a broad scope could be adopted that applies GST to all cross-border supplies of remote services and intangibles. Alternatively, the rules could apply only to certain supplies of digital services and intangibles.

<b>Issue</b>	<b>Options</b>	<b>Advantages</b>	<b>Disadvantages</b>	<b>Recommendations</b>
What services and intangibles should the rules apply to?	<i>Apply the rules to a wide range of remote services and intangibles</i>	This option is more consistent with the broad-based GST system in New Zealand, which tends to avoid issues with classifying services into particular categories for fairness and efficiency reasons. Using a broad definition may 'future-proof' the rules, as more prescriptive legislation may need to be frequently updated to reflect changes in the types of services that become available.	This option has not been implemented in other countries, though it has been announced to apply in Australia. Therefore unintended consequences could arise from a broad definition of remote services that encompasses traditional cross-border services that are supplied remotely, such as consultancy, accounting or legal services. However, these impacts may be reduced if business-to-business supplies are excluded from the rules, and if the registration threshold is set \$60,000.	Recommended

	<i>Apply the rules only to digital supplies of services and intangibles</i>	This option would apply GST only to digital services that are electronically delivered. Offshore suppliers may be more familiar with this approach as it is consistent with the approach taken in European Union and other countries such as South Africa.	This option could distort consumers' decisions on whether to purchase services through digital or non-digital channels. It would make the rules more complex with the potential for boundary issues to arise around what would be regarded as a "digital service" and could require the rules to be frequently updated to reflect new types of services that should be captured by the rules (as is experienced in the EU).	Not recommended
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71. An exception to the broad definition of services is the supply of telecommunication services to New Zealand residents, specifically the supply of international mobile roaming services. Currently, if these services are supplied by a domestic telecommunication provider to a New Zealand resident customer abroad the services are zero-rated. At the time these rules were introduced it was considered that these services were consumed outside of New Zealand, and therefore, should not be subject to GST.

72. Under the proposed framework, where residence is used as a proxy for consumption, these services should be subject to GST as they are considered to be consumed in New Zealand. This would be consistent with the treatment of international mobile roaming services in majority of OECD countries (excluding Australia and Japan).

73. Ministers preference is to retain the current zero-rated treatment of international mobile roaming services, which is consistent with the treatment in Australia, and to keep a watching brief on any further developments in Australia.

### **Registration threshold**

74. Establishing a registration threshold for offshore suppliers of services and intangibles is intended to reduce compliance costs for small suppliers and suppliers that do not make many supplies to New Zealand residents. A lower threshold (such as NZD \$10,000 of supplies to New Zealand residents over a 12 month period) or a threshold based on the domestic threshold (NZD \$60,000 of supplies to New Zealand residents over a 12 month period) could be adopted.

Issue	Options	Advantages	Disadvantages	Recommendations
What registration threshold should apply to offshore suppliers of remote services?	<i>A registration threshold equal to the domestic registration threshold (NZD \$60,000)</i>	This option is consistent with the registration threshold that applies to domestic suppliers. This will result in competitive neutrality as offshore suppliers and domestic suppliers will be subject to the same registration requirements. This option would also result in lower compliance costs for suppliers that make a relatively small volume of supplies to the New Zealand market. Evidence from other countries suggests that a small number of large suppliers account for a significant proportion of the total revenue collected from offshore registrants.	A higher threshold may increase the incentive for some offshore suppliers to break up their supplies into different entities in order to stay under the registration threshold. A higher registration threshold may be associated with less revenue being collected, as fewer suppliers would be required to register and return GST on their supplies.	Recommended
	<i>A registration threshold that is lower than the domestic registration threshold (for example, NZD \$10,000)</i>	A lower registration threshold would increase the revenue collected, though this may be outweighed by additional compliance costs for offshore suppliers. A lower threshold would be more consistent with the European Union that has no threshold, and other countries that tend to have low thresholds.	A registration threshold that is lower than the domestic registration threshold may reduce the competitive neutrality between domestic and offshore suppliers.	Not recommended

### Determining whether a customer is a New Zealand resident

75. The discussion document compared the EU approach, where an offshore supplier is required to determine where a customer has their residence based on two non-conflicting pieces of evidence (for example, payment information, customer address, and Internet Protocol (IP) address), with the proposed Australian rules, which would require them to take 'reasonable steps' to determine the residency status of the consumer.

Issue	Options	Advantages	Disadvantages	Recommendations
How should an offshore supplier determine whether a customer is a New Zealand resident?	A requirement to determine whether a customer is a New Zealand resident based on two non-conflicting pieces of evidence.	This option has greater certainty and simplicity for offshore suppliers to apply. This option is also consistent with the rules that apply in the European Union and therefore offshore suppliers are likely to have already developed systems to apply this option.	Some offshore suppliers may not have access to two non-conflicting pieces of evidence. To address this issue it is proposed that the Commissioner of Inland Revenue be able to prescribe an alternative method to determine whether a customer is a New Zealand resident.	Recommended



	A requirement to take reasonable steps to determine whether a customer is a New Zealand resident	This option allows more discretion for offshore suppliers to determine the residence of their customers.	The option creates uncertainty about what would be acceptable as a “reasonable step” to determine a customer’s residence. This could increase offshore suppliers’ compliance costs.	Not recommended
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### **Simplified registration and return process**

76. The discussion document proposed that offshore suppliers could be required to register under the domestic system or have the option of registering under a simplified “pay only” system.

77. “Pay-only” registration systems are tailored for offshore suppliers that have no GST to claim and make payments only. The main benefit of a pay-only system is that the system can be very simple. Since these offshore suppliers are not claiming any GST they are relatively low-risk from a revenue perspective. The usual checks and balances focussed on ensuring that input tax deductions/refund claims are correct can be relaxed. The processes and information requirements around registering for GST could also be simplified.

<b>Issue</b>	<b>Options</b>	<b>Advantages</b>	<b>Disadvantages</b>	<b>Recommendations</b>
What registration system should offshore suppliers be required to use.	Simplified ‘pay only’ registration system.	A ‘pay only’ registration system may lower compliance costs for suppliers that are in a pay only position. This should encourage compliance with the rules.	Administrative systems would be required to be developed. However, the development of a ‘pay only’ system can be incorporated into the Inland Revenue business transformation process.	Recommended
	Domestic registration system.	Using the domestic registration system would not require any new administrative systems.  New Zealand’s domestic registration system is already, by international standards, very simple to comply with.  Offshore suppliers are treated in the same way as domestic suppliers.	Offshore suppliers who are only required to return GST will be subject to the same requirements and processes that are in place for suppliers who return and claim GST. This may increase the compliance costs imposed on ‘pay only’ offshore suppliers.	The domestic registration system will initially be available until a ‘pay only’ system is developed as part of the Business Transformation Programme. Still available for offshore suppliers that want to return and claim GST.

## Electronic market places

78. To further reduce compliance costs offshore suppliers who supply services via an electronic marketplace would not be required to register and return GST. The marketplace (such as an app store) would instead be treated as the supplier and be required to register. The electronic marketplace is generally in a better position to register and return GST on supplies compared with the underlying supplier. Typically, the electronic marketplace would be larger, better resourced and have a closer relationship with the customer. Requiring the electronic marketplace to register therefore may reduce compliance costs as a large number of smaller suppliers may not be required to register.

## CONSULTATION

79. The discussion document *GST: Cross-border services, intangibles and goods* was released on 18 August 2015, and sought public feedback on the proposal to require offshore suppliers of services and intangibles to register and return the GST along with a number of key design features.

80. A number of telephone conferences were held with members of the Business and Industry Advisory Committee to the OECD and the Tax Executives Institute (Indirect Tax chapter). This included a number of representatives of offshore suppliers that supply to the global marketplace, and therefore have experience with the offshore supplier registration systems that have been adopted in other countries.

81. A total of 76 submissions were received in response to the discussion document. The proposals in the discussion document were received well, with most submissions supporting the proposed approach for taxing cross-border services and intangibles. A strong theme was the importance of minimising compliance costs for offshore suppliers, to maximise compliance and reduce the risk the rules could restrict the supply of services and intangibles to New Zealand.

82. Of the 76 submissions, 23 were from individuals (30%), 8 were from offshore businesses and professional associations (11%), and 25 were from New Zealand businesses and professional associations (40%). An additional 15 submissions followed a standard form provided by a domestic industry representative.

83. The table below outlines the some of the initial proposals contained in the discussion document, the submissions received on the proposal and the recommend action following consideration of the submissions:

Initial proposal	Submissions	Preferred approach
<b>Basic framework of the rules</b>		
The discussion document proposed that supplies of remote services and intangibles by an offshore supplier to New Zealand-resident consumers will be subject to GST. A broad definition of “services” was proposed, which includes both digital services and more	78% of submissions agreed with the proposal for services and intangibles, with 92% of submissions on the point supporting a distinction between “remote” and “on-the-spot” services. 81% of submissions agreed with a broad definition of services.	The proposal in the discussion document should be retained.

traditional services.		
<b>Supplies to New Zealand registered businesses</b>		
Submissions were sought on whether offshore suppliers should be required to return GST when they supply services and intangibles remotely to New Zealand GST-registered businesses.	90% of submissions supported excluding supplies to GST-registered businesses.	Supplies of remote services and intangibles to GST-registered businesses should not be subject to GST, unless the supplier and recipient agree that the supply is zero-rated.
<b>Registration threshold</b>		
The discussion document sought submissions on the level of the registration threshold, specifically whether a lower threshold (such as \$10,000) or a threshold based on the domestic registration threshold (\$60,000) is preferred.	19 submissions preferred a nil threshold, 1 submission preferred a \$10,000 threshold and 20 submissions preferred the domestic registration threshold of \$60,000 or higher. 9 submissions considered that the threshold should not count supplies to GST-registered businesses.	Offshore suppliers should be required to register when their total supplies of remote services and intangibles to New Zealand residents exceed \$60,000.
<b>Identifying whether a customer is resident in New Zealand</b>		
The discussion document compared the European Union (EU) rules, where an offshore supplier is required to determine place of residence based on two non-conflicting pieces of evidence, with the proposed Australia rules, which require 'reasonable steps' to be taken.	Offshore suppliers expressed a preference for rules that provide certainty and use commercially available information, including the EU rules. Submissions requested extra flexibility where two non-conflicting pieces of information are not available.	It is proposed that offshore suppliers be able to determine whether a customer is a New Zealand resident based on two non-conflicting pieces of evidence. The Commissioner of Inland Revenue would also be able to prescribe an alternative method, in cases where two pieces of non-conflicting evidence are not commercially available.
<b>New Zealand GST-registered businesses inadvertently charged GST</b>		
If a GST-registered business is inadvertently charged GST, the business would be required to seek a refund from them, rather than claim a deduction in their GST return.	4 submissions supported this proposal, 6 submissions argued that if a registered business is incorrectly charged GST, they should be entitled to claim an input tax deduction in their GST return.	If a GST-registered business is inadvertently charged GST, they should seek a refund from the supplier. If the value of the supply is less than \$1,000, the offshore supplier could instead provide a tax invoice which would allow the GST-registered purchaser to claim back the GST in their normal GST return.

84. A strong theme was the importance of minimising compliance costs for offshore suppliers, to maximise compliance and reduce the risk that the rules could restrict the supply

of services and intangibles to New Zealand. This risk has been mitigated by designing the rules to make it as easy as possible for offshore suppliers to comply, which will be complemented by simplified registration and return processes. In addition, the registration threshold would prevent many small suppliers from being required to register under the rules.

85. In response to submissions, several legislative requirements would be relaxed to further reduce compliance costs for offshore suppliers, who would:

- not be required to issue tax invoices, as supplies of GST-registered businesses would not be subject to GST at the 15% rate;
- generally be able to make adjustments in their GST return to take into account refunds of inadvertently charged GST to GST-registered business customers, within two years of the original supply; and
- have an automatic exception from the requirement to keep records in New Zealand and to keep records in English.

86. Recent amendments require an offshore supplier to have a fully functional New Zealand bank account in order to obtain an IRD number, in order to ensure that an offshore person is first subjected to New Zealand's anti-money laundering and Countering Financing of Terrorism rules. Offshore suppliers should be excluded from this requirement in order to reduce the compliance costs associated with registering for GST.

87. Currently, registered businesses are required to express amounts in New Zealand dollars at the time of supply. As offshore suppliers often charge customers in a foreign currency, this would involve significant compliance and transaction costs. Therefore, this requirement would be relaxed, allowing offshore suppliers to elect to convert amounts into NZD at the time of filing their return. A two year 'lock-in' rule would ensure that an offshore supplier could not gain an advantage from switching between these methods.

## **CONCLUSIONS AND RECOMMENDATIONS**

88. The recommended option is to implement option one as outlined in this RIS, specifically offshore suppliers or an offshore electronic marketplace would be required to register and return GST on remote services and intangibles supplied to New Zealand resident consumers. Offshore suppliers would only be required to register if their total supplies of remote services and intangibles to New Zealand residents exceeded \$60,000 in a 12-month period, unless the offshore supplier is only making supplies to New Zealand GST-registered businesses.

89. A broad definition of services would be adopted that would apply GST to all cross-border supplies of remote services and intangibles (this would include digital services and more traditional services, such as legal and accounting services). This approach is consistent with New Zealand's broad-based GST system. Offshore suppliers would be required to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of evidence, or to agree with the Commissioner of Inland Revenue on an alternative method.

90. Supplies of remote services and intangibles to GST-registered businesses should not be subject to GST, unless the offshore supplier and GST-registered recipient agree to zero-rate the supply. The option to zero-rate these supplies will allow non-resident businesses to claim back any New Zealand GST incurred in making these supplies, which ensures GST is neutral for these businesses.

91. Out of the options considered, option one best achieves the objectives and is consistent with draft OECD guidelines on taxing cross-border services and intangibles, as well as being consistent with international practice. When similar rules have been applied in other countries anecdotal evidence is that they have been relatively successful at collecting the forgone GST. To generate a similar level of compliance for New Zealand the recommended option aims to adopt similar and consistent rules with the rules that apply in other countries.

92. Given the simplicity of the New Zealand GST system, the rules should be relatively simply to comply with compared with other countries that have different GST/VAT rates and multiple exemptions. This should further promote compliance with the rules.

## **IMPLEMENTATION**

93. Ministers' preference is to implement the rules on 1 October 2016. Considering legislation is expected to be introduced in November 2015 (and if that legislation is enacted in the first half of 2016), this timeframe should give offshore suppliers around 6 months to adapt their systems to comply with the new rules. This timeframe is consistent with submissions that suggested that offshore suppliers would need at least 6 months to adapt their systems depending upon the complexity of the rules. If there is a delay in the enactment of the legislation there is a risk that some offshore suppliers may not have enough time to adapt their system to comply with the new rules.

94. To implement the proposals, Inland Revenue is developing a simplified registration system that will be tailored to the requirements of offshore suppliers, informed by best practice in other countries and the recommendations in the draft OECD guidelines.

95. A simplified 'pay only' GST return will be developed as part of Inland Revenue's Business Transformation Programme. The system for processing GST returns is scheduled to be replaced with a new system during the first quarter of 2017. Therefore, it is proposed that offshore suppliers could initially begin with a default six-monthly taxable period, running from 1 October 2016 to 31 March 2017. This would mean the first return offshore suppliers will file will use the simplified 'pay only' GST return.

96. A default six-monthly taxable period would also provide a 'soft start' to the new rules, for example, if an offshore supplier is late to register for GST, they would be able to backdate their registration to 1 October 2016 for up to six months without interest or penalties. During this interim period, two-monthly filing could also be allowed as an option as otherwise offshore suppliers may face foreign exchange risk during the longer 6-month period.

97. From 1 April 2017, offshore suppliers would file quarterly. This is intended to reduce compliance costs for offshore suppliers as quarterly filing periods align with filing requirements for equivalent rules in other jurisdictions.

98. Compliance costs can be further minimised by releasing clear and helpful guidance as to the operation of the new rules. Inland Revenue resources will be allocated to develop and provide tailored educational material that will be easily accessible to offshore suppliers.

## **MONITORING, EVALUATION AND REVIEW**

99. Inland Revenue will monitor the outcomes pursuant to the Generic Tax Policy Process ("GTTP") to confirm that they match the policy objectives. The GTTP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995.

100. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation, and the identification of remedial issues. Post-implementation review is expected to occur around 12 months after implementation. Opportunities for external consultation are built into this stage. Any necessary changes identified as a result of the review would be recommended for addition to the Government's tax policy work programme.