

# taxation

September 2001

**Significant GST changes are proposed that could affect anyone that imports services. The changes follow Australian GST legislation which we currently advise on. The new rules would apply from about this time next year.**

## GST and imported services

A discussion document entitled "GST and Imported Services - a Challenge in an Electronic Commerce Environment" outlines how the proposals alter the GST treatment of services supplied by non-resident businesses which are "consumed" in New Zealand.

Currently, imported goods and imported services are treated differently for GST. GST is levied by the New Zealand Customs Service on goods imported into New Zealand. The extent to which the GST levied by Customs can be recovered is determined by whether the importer acquires the goods for the purpose of making taxable supplies.

On the other hand, imported services are not subject to GST. For example, an American law firm providing advice from the United States to a New Zealand company on its proposed expansion into the American market would not charge New Zealand GST on the services rendered.

The discussion document notes that the general objective of these proposals is:

"... to improve the efficiency and equity of GST, reduce future erosion of the tax base resulting from the growth in electronic commerce and bring New Zealand into line with the internationally accepted GST framework. The proposals are also intended to clarify the international boundary in relation to GST".

The discussion document proposes that GST be charged on imported services:

- Imported services will be subject to a "reverse charge" where the recipient of the service acquires the service for purposes other than making taxable supplies;
- Imported digitised products will be treated as supplies of services rather than goods;



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- Telecommunication services will be deemed to be supplied in New Zealand when a New Zealand customer initiates the supply of that service.

## Reverse charge

A "reverse charge" requires the recipient of a supply to return GST to Inland Revenue, as if the recipient were the supplier of that supply.

The proposal is intended to "limit erosion" of the New Zealand tax base and so would only be imposed where the recipient acquires imported services for purposes other than making taxable supplies - ie. where the recipient would not have been entitled to recover all of the GST charged to it had the supply been acquired from a GST registered supplier.

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Vantage point

## Inside

Inter-branch and  
Intra-group supplies

•  
Supplies of digitised  
products

•  
Telecommunications  
supplies

**“It is proposed that charges between an offshore company and its New Zealand branch would be subject to the reverse charge.”**

The following example illustrates the point.

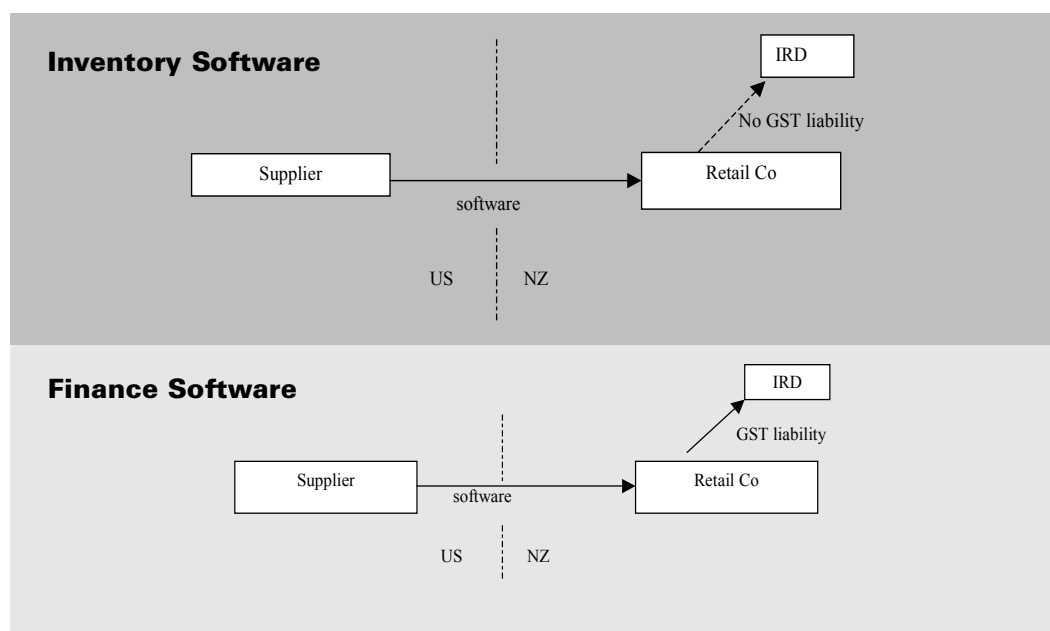
Retail Co is a GST registered New Zealand retailer. Retail Co purchases two computer programs for its business. The first tracks its inventory. The second administers the finance packages that Retail Co offers its customers.

Both programs are purchased from American software developers and are downloaded via the Internet.

Retail Co would not be subject to the reverse charge on the importation of the first software package. The software is designed to track Retail Co's inventory – ie. it is acquired for the purpose of making taxable supplies.

Retail Co would be subject to the reverse charge in respect of the second software package. This is because Retail Co makes exempt supplies using the second package. As a result, Retail Co would be liable to pay to Inland Revenue GST of  $\frac{1}{8}$ <sup>th</sup> of that part of the price paid that is attributable to making exempt supplies. The GST is payable by Retail Co as if it had sold the package. In determining when the GST on this imported service must be returned, it is proposed the general time of supply rules will apply as if Retail Co had supplied this software.

The effect of the reverse charge is illustrated in the diagrams below.



The example illustrates that the proposed reverse charge would increase the cost of imported services for companies in the financial services industry.

### **Inter-branch and Intra-group supplies**

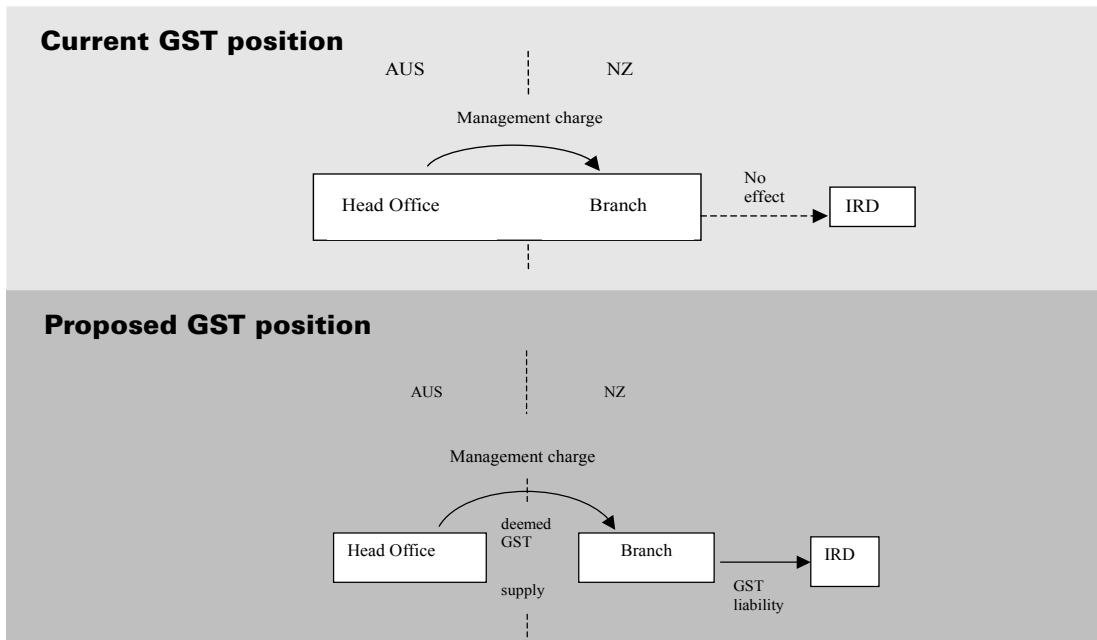
It is proposed that charges between an offshore company and its New Zealand branch would be subject to the reverse charge. In determining whether GST is payable, the New Zealand branch of an overseas company would be treated as a separate entity to the offshore entity. The following example illustrates the point.

Ozlife Co is an Australian life insurer. Ozlife Co provides life insurance in Australia and also provides life insurance in New Zealand through a branch office in Auckland.

Ozlife Co allocates a range of costs to its New Zealand branch operations. These include a range of acquisitions it makes in Australia in relation to the New Zealand business – eg. advertising contracts and IT supply contracts.

It is proposed that the New Zealand branch would be treated as a separate entity to the Australian company so that Ozlife Co would, in this example, be deemed to supply advertising and IT services to a New Zealand resident entity. Ozlife Co's New Zealand branch would have acquired those services to make non-taxable life insurance supplies and by the reverse charge would be deemed to have supplied those services and have a GST liability.

The effect of the reverse charge is illustrated in the diagrams below.



Due to the difficulty Inland Revenue would have in identifying the components of a global re-charge from an offshore parent to its New Zealand branch it is proposed that, as a starting point, the reverse charge would apply to all costs allocated to the New Zealand branch. This would then be reduced to the extent that that New Zealand branch could show that components of the global re-charge should be excluded. The exclusion would be either because:

- (a) The New Zealand branch would have been entitled to a full input tax credit had it acquired that component from a New Zealand supplier; or
- (b) The component represents an exempt supply, eg interest allocated to a New Zealand branch for funds advanced to it.

Similar provisions are also proposed for companies that are grouped for GST purposes. Effectively, grouping would be ignored in determining whether the reverse charge applies.

**Supplies of digitised products**

The discussion document defines digitised products as:

“Goods and services that are delivered by electronic means in digital form. These products can be delivered to a computer through the internet, by way of telephone or cable network, or by satellite. Music in the form of compressed music files, film and software are examples of digitised products”.

It is proposed that digitised products be treated as services for GST purposes. The reverse charge would apply to the importation of digitised products

other than those imported on physical medium.

Currently, New Zealand Customs levies GST on the value of the physical medium, eg the CD-Rom, rather than on the total value of the product. New Zealand Customs does not levy GST on the value of the software contained on the CD-Rom. For example, software with a total value of \$800 is imported into New Zealand. The value of the CD ROMs on which the software is imported is \$50. Customs only levies GST on the \$50 value and not the \$750 balance.

For those digitised products that are imported in a tangible form, eg computer software on CD-Rom, two options are suggested.

The first would be for Customs to charge GST on the full value of the digitised product when it is imported into New Zealand. This would result in Customs levying GST on the total \$800 value of the software package.

The second alternative is to retain the current approach but then apply the proposed reverse charge provisions to the remaining value of the product. Using the above example, Customs would levy GST on the \$50 value of the physical medium. The recipient of the software may then be liable for a reverse charge on the remaining \$750 value, depending on the purpose for which it acquired the software.

**Telecommunication supplies**

The discussion document defines telecommunication services as:

“The transmission, emission or reception of signals, writing, images, sounds or information of

**“The discussion document proposes to impose GST on supplies of telecommunication services when a New Zealand customer initiates the service from a non-resident supplier.”**

any kind by wire, radio, optical or other electromagnetic system, or by any similar technical system. It would include:

- The related transfer or assignment of the right to use capacity for such transmission, emission or reception; and
- The provision of access to global information networks (the internet)“.

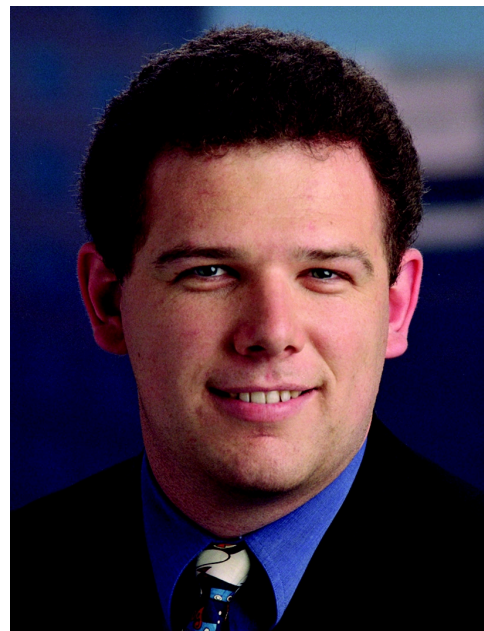
The discussion document proposes to impose GST on supplies of telecommunication services when a New Zealand customer initiates the service from a non-resident supplier eg a New Zealand customer “buying” telephone services from an Australian telecom service provider. Another example would be a New Zealand customer using a non-resident internet service provider (ISP) to access the internet.

There are two alternative approaches suggested to determine whether there is a “New Zealand customer”.

The first is to treat a person as a New Zealand customer if the person is usually resident in New Zealand. This would cause difficulties for telecommunication suppliers in determining whether or not to charge GST – for example, an Australian resident who visits New Zealand and then phones his family in Australia would not be a New Zealand customer as he is usually resident in Australia.

The second alternative would be to treat a person as a New Zealand customer if the person is physically present in New Zealand. Again, there may be practical problems for the supplier in implementing such a proposal, particularly if it is difficult for the non-resident supplier to identify the physical location of the person consuming its services.

Either of these proposals could increase compliance costs for offshore



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telecommunications suppliers doing business with New Zealand residents.

Bell Gully has participated in making submissions to the Government on all of these proposals. Our aim has been to stress the need for balance to protect New Zealand’s tax base against imposing an additional burden on taxpayers.

If you wish to discuss any of these issues, please contact your usual Bell Gully adviser; or in our Tax team:

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in our Communications Technology and Media team:

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