New Zealand Bankers' Association

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11 February 2010

GST: Accounting for Land and Other High-Value Assets
c/- Deputy Commissioner, Policy
Policy Advice Division
Inland Revenue
P O Box 2198
WELLINGTON 6140

Dear Sir/Madam

GST: ACCOUNTING FOR LAND AND OTHER HIGH-VALUE ASSETS (GOVERNMENT DISCUSSION DOCUMENT)

We refer to the meeting (and conference call) between the New Zealand Bankers' Association ("NZBA"), the Inland Revenue's Policy Advice Division ("PAD") team (Marie Pallot, Brandon Sloan and Vlad Skibunov) and John Shewan and Eugen Trombitas of PricewaterhouseCoopers on 2 February 2010 in relation to the above.

The NZBA, on behalf of its members[1], appreciates the opportunity to comment on the Government discussion document issued on 5 November 2009 concerning the goods and services tax ("GST") proposals.

General Observations

The discussion document covers many important GST issues that will have a significant impact on New Zealand businesses including NZBA members. The NZBA acknowledges the effort that has gone into the discussion document and supports the initiatives to promote business-to-business ("B2B") neutrality from a GST perspective, as well as those initiatives designed to ensure that GST does not become a permanent cost.

The NZBA supports measures canvassed in the discussion document to deal with aggressive arrangements which erode the tax base at the expense of other taxpayers. However, NZBA is keen to ensure that these measures are sufficiently targeted and do not create unnecessarily high GST complexity or compliance cost to ordinary business activities.

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[1] Collectively ANZ National Bank Limited, ASB Bank Limited, Bank of New Zealand, Citibank, N.A., The Hongkong and Shanghai Banking Corporation Limited, Kiwibank Limited, TSB Bank Limited, Westpac Banking Corporation (New Zealand division).

The NZBA considers that there is insufficient detail in the discussion document concerning the rationale why existing measures such as the Inland Revenue's ability to make claims against directors or shareholders, require special returns and apply anti-avoidance provisions are not adequate. The NZBA considers that before introducing additional complexity and compliance costs more discussion and a clear rationale is required on why the existing measures are insufficient.

The NZBA notes that the previous 2008 Officials' issues paper 'Options for Strengthening GST Neutrality in Business-to-Business Transactions' also does not sufficiently address why existing powers available to Inland Revenue cannot be utilised e.g. section 61 (of the Goods and Services Tax Act 1985 (the "GST Act")) actions against directors or shareholders.

In addition, the NZBA has significant concerns about the "in substance mortgagee sale" rules discussed in chapter 6 of the discussion document in the context of section 5(2) of the GST Act. As noted above, the NZBA considers that additional consideration needs to be given to why the existing measures are insufficient before considering amendments to section 5(2) of the GST Act. If change is necessary to preserve the overall integrity of the tax system, the NZBA submits that modifications to the current section 5(2) proposals may be further considered as follows:-

a) consideration should be given to extending the proposed domestic reverse charge ("DRC") rules to a number of the "in substance mortgagee sale" transactions. This would mean that the current section 5(2) proposals would be narrower in ambit; and

b) section 5(2) proposals targeted at aggressive arrangements to erode the tax base could be adopted in relation to transactions not covered by the DRC - any such rules should be more specifically targeted so as to be certain enough to apply in practice.

The NZBA would appreciate an opportunity to further discuss these proposals and the need to introduce new "in substance" mortgagee sale rules.

Summary of Submissions

We summarise the main points in our submissions below with a more detailed analysis included in the Appendices.

Existing Measures

The Inland Revenue should consider further and clearly articulate why existing powers are insufficient. In particular, the application of section 61 of the GST Act to situations where aggressive arrangements which erode the tax base at the expense of others have been entered into.

The balance of our submissions is on the basis that it can be shown that existing measures are inadequate to address the Inland Revenue's concerns.

DRC

The NZBA acknowledges that from a tax administration perspective a DRC is a pragmatic solution to the various issues identified in the discussion document, and also acknowledges that it has certain positive features. If a "compulsory" DRC introduces an additional level of complexity for businesses and deviates from the pure design and workings of New Zealand's GST system, we recommend that the Government consider ways of reducing the potential complexities by implementing practical rules in relation to aspects of the DRC (see discussion in Appendix 1).

The NZBA understands that the Government has considered other alternatives to a compulsory DRC, including an optional DRC and an extension of a zero-rating model. The NZBA understands that these alternatives are not regarded as being sufficiently robust to deal with the extent of the tax base abuse currently thought to be taking place.

As discussed at our meeting on 2 February 2010, the scope for abuse of the GST system is substantially reduced where the DRC applies, as cash output tax is not collected. Accordingly, to address the concerns over the scope of the proposed amendments at section 5(2) the NZBA suggests that the Government could consider extending the DRC to a number of the "in substance mortgagee sale" transactions provided there are currently insufficient measures to address the Inland Revenue's concerns.

Section 5(2) Sales

The NZBA agrees that aggressive schemes to avoid GST on mortgagee sales should not be allowed to take place. The NZBA considers that additional consideration needs to be given to why the existing measures are insufficient before considering amendments to section 5(2) of the GST Act. Further, as currently proposed, the NZBA considers that the suggested changes to the mortgagee sale rules would be too uncertain to apply in practice and therefore unworkable. The new rules need to be certain enough to apply in practice. Any such rules should not alter the GST status quo of ordinary business transactions unrelated to pursuing (or exploiting) GST advantages to the detriment of Inland Revenue.

Inland Revenue would achieve greater priority over secured lenders under the new proposals in situations where currently it does not have this priority i.e. if there is a vendor/borrower sale the lender could be liable for the GST in many situations. This is a fundamental policy shift and will be of concern to NZBA members. Under the proposals, lenders pursuing a normal commercial solution could find that they have an unexpected GST liability. This is not ideal and we have made practical suggestions in Appendix 2 about the design issues.

The NZBA submits that consideration could be given to the application of the DRC rules (or even an extension of the zero-rating rules) to land sales which may in practice remove most of the concern that the mortgagee sale proposals are targeted at. Alternatively, a more targeted and specific approach to section 5(2) would be necessary (see Appendix 2).

A meeting has been organised on Wednesday 10 February 2010 between Inland Revenue and a banker and receiver experienced in lending and debt recovery actions to expand on some of the practical problems the proposed expansion of section 5(2) would create.

Input Tax and Adjustments for Change in Use

The NZBA supports the initiatives in this area and the decision to replace the current (complex and cumbersome) change-in-use rules with an apportionment model. However, the potential inflexibility of the proposed annual adjustments scheme and the requirement (if one is imposed) to operate parallel adjustment methodologies under the Memorandum of Understanding between the members of NZBA and the Inland Revenue dated 21 December 2006 ("the MOU") may impose a significant additional compliance burden on NZBA members. We have made various practical recommendations in relation to the operation of the apportionment rules in Appendix 3.

The NZBA also notes that the current MOU will need to be updated to ensure there is consistency between the current apportionment (GST recovery) rules contained in the MOU and the proposed new apportionment rules. It seems sensible for the update to be conducted in parallel with the introduction of the new apportionment rules.

Transitional Issues

The NZBA submits that the following transitional issues should be addressed:-

a) the apportionment rules are proposed to apply to assets acquired **after** the date of enactment of the new legislation. This means that many taxpayers (including NZBA members) will potentially need to apply two sets of rules in relation to changes in use i.e. one set of rules for assets acquired before the new apportionment rules are introduced and another set of rules for assets acquired after the introduction of the new apportionment rules. This will be a particularly heavy burden for NZBA members who must monitor the taxable usage of all assets. Taxpayers should ideally have the ability to treat all of their assets under the new apportionment rules (with transfer adjustment rules introduced as appropriate); and

b) to the extent that any of the new GST rules affect the vested interest of lenders and security holders when vendors/borrowers sell their assets and Inland Revenue is afforded greater priority, consideration should be given to a transitional rule which stipulates that any such greater priority to the Inland Revenue should only apply to mortgages or securities registered **after** the introduction of the new GST rules.

We trust that you find our submission helpful. Eugen Trombitas (telephone: (09) 355-8686) and John Shewan (telephone: (04) 462-7254) are assisting the NZBA on this matter. Please contact either of them if you have any questions about our submission.

Yours faithfully

Sarah Mehrtens
Chief Executive

Appendix 1 – Chapter 2 (Domestic Reverse Charge)

Ambit of a DRC

The NZBA appreciates the Government's concerns regarding neutrality issues in the context of high value transactions and recognises the utility of the proposed DRC model in addressing these issues. The NZBA also acknowledges the considerable effort put into the design of the DRC model since the June 2008 discussion document.

The commentary identifies (at paragraph 2.4) the neutrality problems with the current treatment of land and high value transactions as being:-

a) timing costs to businesses;

b) revenue risk for the Government where fraud or financial distress occurs; and

c) lack of certainty for businesses where going concerns are zero-rated.

The first and third problems above could be addressed by an *optional* DRC.

The proposed *compulsory* DRC appears to be targeted at revenue risk arising out of fraud and business distress (second problem above). The NZBA acknowledges that phoenix arrangements and other frauds erode the GST revenue base creating a shortfall that ultimately falls on all taxpayers. Based on discussions with the Inland Revenue PAD team, the NZBA understands that the level of the fraud is significant - in the tens of millions of dollars each year.

The NZBA supports measures to combat these schemes provided that they are proportionate and as targeted as possible. The NZBA notes that the DRC is a broad measure that will apply to many business transactions. It will potentially, and certainly initially, add to the complexity of GST and result in additional compliance, systems and pricing issues. The NZBA does not object to the introduction of a DRC so long as the Government is of the view that it is targeted and other measures (e.g. zero-rating) would not be more appropriate from a GST design perspective.

Impact on Priority

There is no discussion in the commentary about the fact that an effect of a compulsory DRC would be to advance the Inland Revenue's priority over secured lenders in respect of sale proceeds received by a borrower/vendor to the extent of the GST component. This is because under a DRC a vendor would only receive $8/9^{th}$ of the sale proceeds.

Officials and business stakeholders should be made aware that, in effect, conferring first ranking status to the Inland Revenue in these circumstances represents a change from the established priority position. This raises the question as to whether changes to the GST legislation are the preferred way of dealing with priority issues. Having said this, the NZBA accepts that a necessary consequence of introducing a compulsory DRC will be that vendor borrowers will receive the sale proceeds of a GST-able transaction net of the GST.

Alternatives to a DRC

The NZBA submits that a possible alternative approach of extending the existing and established zero-rating scheme could be traversed in more detail. A zero-rating approach has the immediate advantage of being an extension to existing rules which are, in the main, well understood and embedded in business practices.

The arguments in the discussion document against zero-rating (at paragraphs 2.36 and 2.37) are based on situations where parties treat a transaction as zero-rated and this treatment is subsequently found to be incorrect. The potential for incorrect treatments would be greatly reduced where there was, for example, a clear and comprehensive zero-rating scheme that applies to all land and high value transactions (assuming the purchaser acquires inputs for a taxable purpose).

The NZBA recognises there are practical issues associated with broadening the scope of zero-rating (e.g. where the purchaser does not acquire for wholly taxable purposes), however these issues should ideally be considered and presented in sufficient detail to enable Officials and stakeholders to properly evaluate the respective DRC and zero-rating options.

Overlap with B2B Rules

Clarification is required in relation to the overlap between the DRC and the B2B financial services percentage. In particular, when a lender needs to determine the percentage of taxable supplies made by a borrower who has sold an asset in circumstances where the DRC applies to the sale, does the DRC output form part of the vendor's or the purchaser's 75% calculation? Proposed section 5C(2) suggests that the purchaser makes the supply for the purposes of accounting for output tax i.e for a specific purpose. Therefore, we presume that for other GST purposes (e.g. for the purposes of measuring the borrower vendor's B2B percentage) the vendor will still be treated as making the supply.

If any changes are introduced to the existing way a lender determines the percentage of taxable supplies in relation to their customers under the B2B rules, new guidelines will be required to deal with this aspect.

Other Practical Issues with the Current DRC Proposals

There are a number of practical issues with the form of the current DRC proposals that should be considered and addressed before being implemented:-

a) composite supplies of assets which are only partly subject to DRC: e.g. a sale of a business including land which does not amount to a going concern and is under the $50M threshold. The commentary states the supply will be subject to DRC where land is the "predominant feature" however it is not clear how this will be determined in practice. If land is not the predominant feature, what will be the statutory basis for splitting a single supply? As an alternative DRC design option, consideration could be given to having the DRC apply to all transactions which include land;

b) time of supply: The commentary states (at paragraphs 2.16 to 2.18) that time of supply will occur when full payment is made to the supplier. The draft legislation at section 9(11) states time of supply to be "the date on which

payment is made" – the NZBA assumes this is intended to refer to payment in full; and

c) record keeping requirements: Suppliers will wish to protect against the circumstance where the purchaser incorrectly warrants that they are registered - the DRC does not then apply and the supplier is exposed to an assessment of output tax. The new section 78E(1) seeks to obviate this risk but only where the supplier "has maintained sufficient records". Can a supplier acting in good faith rely upon a misrepresentation of the purchaser's GST registration status and the provision of a fictitious registration number i.e. will the new section 78E(1) afford protection? Clarity should be provided on this point.

Appendix 2 – Chapter 6 (Sales in Satisfaction of Debt Under Section 5(2))

Nature of the Problem

The problem being addressed in chapter 6 is stated to relate to "de facto mortgagee sales" or "in substance" mortgagee sales. The proposed rules are intended to ensure that the liability to account for the GST rests on a person who is likely to be solvent rather than a person who might be insolvent.

The NZBA understands that the Government believes that certain mortgagor sales, where there is a degree of involvement by the mortgagee (e.g. engaging the estate agent, paying the auctioneer's fee, or signing the sale and purchase agreement), should be treated for GST purposes as a *mortgagee* sale. This would have the effect of affording greater priority to the Inland Revenue for the GST component as against the mortgagee.

What is not clear from the discussion document is the extent of this problem in monetary terms and under what circumstances transactions are considered to be "de facto mortgagee sales". The issue of how the proposals will interact with the provisions of the Property Law Act 2007 ("PLA") is also not addressed.

Therefore, it is not evident if the proposed amendments are sufficiently targeted to the particular transactions causing concern to the Government or whether they would have the impact of applying to all sales by borrowers, and consequently affect all lenders and financiers e.g. a mortgagee's solicitor also being the mortgagor's solicitor is common with residential property sales.

In summary, NZBA's view is that unless the size and extent of the problem is such that it cannot adequately be addressed by proper application of the existing rules, the proposed change should **not** be implemented.

Potential Alternatives – Apply the DRC

Given that GST does not apply to residential properties sold outside a taxable activity (not subject to GST) and to sales of a going concern by a GST-registered vendor (zero-rated), the main transactions of potential concern would be:-

a) supplies by GST-registered persons that are **not** capable of being zero-rated (e.g. land sales, asset sales); and

b) business-to-consumer ("B2C") sales e.g. property developer to individual.

In relation to category a) above, the NZBA submits that the proposed DRC will resolve the problem with land sales and high value asset/services transfers ($50m+). The NZBA submits that section 5(2) should be amended to stipulate that the section does not apply to transactions that are the subject of the DRC. That would leave other assets (and services) subject to GST – not covered by a DRC – being the only ones that are prone to aggressive schemes detrimental to the GST base.

However, given that these types of assets/services would be narrow (e.g. plant and equipment <$50m, intangibles <$50m) it may be possible to:-

a) option 1: Consider extending the DRC rules to cover these other assets/services; or

b) option 2: Specifically target the “in substance mortgagee sale” rules to the more narrow class of transactions above but improve their practical design.

In the event that option 2 is considered viable by the Government, the NZBA has commented below on the practicalities of, and potential modifications to, the proposed “in substance” rules to enhance their practical operation.

In relation to category b) above (B2C transactions), a better targeted section 5(2) rule could be considered.

De Facto Mortgagee Sales

In our experience a sale by a mortgagor will very rarely amount to a true “de facto mortgagee sale”. At a minimum a “de facto mortgagee sale” can only exist where, as indicated in paragraph 6.2 of the discussion document, the mortgagee receives the full sale proceeds and applies it against the debt and does so to the detriment of Inland Revenue. It would not be a “de facto mortgagee sale” if there is a surplus on the sale and a portion of the purchase price, sufficient to meet the mortgagor’s GST liability, is released to the mortgagor. The proposed amendments fail to exclude this circumstance from its ambit.

Uncertainty of the Criteria

The NZBA considers that the criteria proposed in paragraph 6.8 would lead to uncertainty in practice. The definition of “induced” includes concepts of “persuasion” and “influence”. These concepts are by their very nature difficult to define and contain a significant subjective element. A strongly worded letter from a mortgagee may be intended to “influence” and “persuade”, but whether it does or not will depend on the mortgagor. This will create significant uncertainty for mortgagees.

The criteria listed at paragraph 6.8 are very broad and would be present in many sales of properties by mortgagors that are in some form of financial distress or in fact where there is no financial distress. The NZBA is concerned that the implementation of the new rules would have the effect of changing the GST obligations from the mortgagor to the mortgagee in situations where the mortgagee is simply pursuing a commercial solution. This would also have an impact on the existing priority position.

In many instances the parties would prefer to steer away from a mortgagee sale for commercial reasons unrelated to GST. Generally, properties are sold at a significant discount to open market value at mortgagee sales.

The suggested "carve out" (at paragraph 6.9) deals with the situation where a *mortgagor* sale would be treated as such provided that it was initiated and controlled by the mortgagor, with no undue encouragement by the mortgagee. The NZBA submits that the concept of "undue encouragement" is far too vague and uncertain to apply in practice.

Property Law Act 2007

Under the provisions of the PLA a mortgagee is entitled to payment of the following from the proceeds of a mortgagee sale: a) the GST payable as mortgagee; and b) any debts secured by the mortgage. The mortgagee is therefore entitled to payment of the GST amount in addition to the secured debt.

A “de facto mortgagee sale” will not be a mortgagee sale for the purposes of the PLA. The mortgagee’s rights to the sale proceeds may be limited to the secured debt, particularly where it is unknown whether the mortgagee will have a GST liability under the proposals. A mortgagee may then incur a GST liability without the right to receive payment of the GST amount from the sale proceeds. This issue will be of particular concern where there is more than one secured lender. The lenders with the highest ranked security may not be legally entitled to payment of the GST amount from the sale proceeds (on the basis that it is not a mortgagee sale under the PLA), but may have to pay the GST to Inland Revenue (on the basis that it is deemed a “de facto mortgagee sale” under the GST Act). In some circumstances the “undue encouragement” that triggers the deemed mortgagee sale may have come from a completely separate lender.

Potential Solutions

Taking into account the above concerns, the NZBA submits that the primary focus in this area should be to determine the type of transactions giving rise to the problem and then target those activities. Importantly, the NZBA notes that the Commissioner already has a number of wide powers at his disposal to deal with these arrangements (e.g. section 61 GST Act, section 76 GST Act and section 44 of the TAA). A more vigilant use of these existing powers would most likely deter a number of these transactions without the need to introduce new rules.

Alternatively, as discussed above, the Government could use the DRC to deal with a number of the transaction types where there is a potential for an “in substance mortgagee sale” arrangement to be manufactured. The NZBA also submits that if the DRC applies there should be no fall back on the lender under a section 5(2) approach **if** a purchaser has failed to comply with their DRC obligations.

For assets not covered by the DRC (e.g. non-going concern supplies <$50m, and certain B2C transactions), consideration could be given to introducing a requirement for vendor borrowers in distress to notify the Commissioner where solvency is an issue **before** the sale is made.

As another way to enhance practical certainty, consideration could be given to introducing a targeted specific anti-avoidance rule which looks at the “dominant purpose” of an arrangement taking into account defined criteria. The targeted rule could be designed in a way that requires the Commissioner to look at all of the defined criteria and determine if the dominant purpose of the arrangement (or transaction) was to achieve GST savings by avoiding a mortgagee sale that otherwise would have taken place. The arrangements covered by any such rule could exclude transactions already covered by a DRC.

Appendix 3 – Chapter 7 (Input Tax and Adjustments for Change in Use)

The NZBA welcomes the proposals aimed at simplifying the change-in-use adjustments scheme and largely endorses the initiatives. However, the potential inflexibility of the proposed annual adjustments scheme and the requirement (if one is imposed) to operate parallel adjustment methodologies under the MOU will impose a significant additional compliance burden on NZBA members. The NZBA also wishes to highlight some elements of the proposals that require clarification or further consideration, and note that consequential amendments will be required to the MOU.

Timing of Adjustments

The NZBA is concerned that the inability to align the proposed annual adjustment scheme with the existing MOU annual balancing charge calculation will impose an onerous and unnecessary additional compliance burden.

As set out in the MOU, NZBA members must calculate an annual input recovery ratio based on the financial statements from the preceding year. A balancing charge adjustment is then made to adjust the provisional ratio used in the prior financial year. This annual 'wash-up' calculation and adjustment must be applied in the second or third GST return following balance date e.g. for a 31 December balance date entity, the balancing charge is included in the February or March period GST returns.

Under the proposals, adjustments must be made annually by taxpayers to reflect a change in the taxable use of assets of 5% or more. In the context of NZBA members, this effectively requires the calculation of the input recovery ratio i.e. the taxable versus exempt supplies percentage. The change-in-use adjustments must be included in the taxable period closest to the balance date e.g. for a 31 December balance date entity, the adjustment is included in the December period GST return.

It is not feasible for the final ratio to be calculated in time for use in the balance date change-in-use adjustment. The MOU allows several months to complete the calculation due to the volume of work required, the complexity of the calculation and the availability of financial statements for the preceding year.

NZBA members may therefore be required to calculate their input recovery ratio twice and make an additional adjustment e.g. for a 31 December balance date entity, a change-in-use adjustment would be made in the December period GST return followed by a further 'wash-up' adjustment to the December calculation which is made in February or March.

The NZBA considers that the proposed amendments should be modified to enable taxpayers to have the flexibility to carry out the annual change-in-use adjustment up to several months after the balance date, so that it may be calculated only once using the correct final ratio. In the alternative, the NZBA seeks assurances that Inland Revenue will grant accommodation to its members to align the change-in-use adjustment with the annual input ratio calculation under the MOU.

In relation to another timing matter, it is unclear from the commentary and draft legislation (refer paragraph 7.22 and sections 21(4) and 21F(2)) whether the annual change-in-use adjustment is made in respect of all assets held at that time, or only in respect of assets for which 12 months have passed from the date of acquisition. Where the latter treatment applies, members will need to exclude more recently acquired assets from the adjustment leading to further complexity. Also, where assets are acquired shortly after balance date,

there may be a long delay (of up to almost two years on one interpretation) until the first adjustment may be made, resulting in extended timing advantages or disadvantages where there has been a significant change in a taxpayer's taxable usage of the asset.

The NZBA submits that clarification, and possible amendment, is required to section 21(F)(2) so that the annual change-in-use adjustment covers all assets which are held at that time, regardless of when they were acquired.

Parallel Adjustment Methodologies

It is proposed that the new scheme will only apply to assets acquired **after** its introduction. In practice, this will result in businesses having to maintain dual asset registers and apply different adjustment and change in use methodologies. As noted above, the NZBA is concerned about the compliance burden of operating parallel change-in-use schemes and submits that there should be an option to adopt the new GST apportionment rules for all assets.

Concurrent Usage of Land

The proposed rules apportion concurrent taxable and non-taxable uses of land by the application of a formula based on asset value and market or actual rental returns.

It is made clear that this is targeted at land developer circumstances where property is temporarily applied to residential rental uses pending taxable resale. However, it is unclear from the commentary (and draft legislation) whether the proposed scheme is intended to also apply to usage of land by mixed taxable/exempt businesses in other sectors e.g. NZBA members.

The NZBA submits that where the rental based formula (as set out in proposed section 21D) applies to property that is simultaneously used for both taxable and exempt purposes outside of the specific land developer situations, the resulting apportionment will bear no resemblance to the taxpayer's actual taxable supplies percentage i.e. a NZBA member that is 30% taxable and which applies that percentage to its input tax would almost certainly have a different taxable usage percentage in respect of land by application of the new section 21D formula.

This outcome seems contrary to fundamental principles of GST recovery and there is no policy basis for treating land differently to other business inputs in these circumstances. The proposed rule in section 21D also appears inconsistent with Example Three in the discussion document (where the bank is able to claim an upfront deduction based on the percentage of its taxable supplies). The NZBA also notes that the MOU requires members to apply the input recovery ratio to all expenses (per paragraph 14 although direct attribution is enabled by paragraph 22) and there would be a tension between the terms of the MOU and the new provisions.

Treatment on Disposal

Clarification should be provided on the liability to output tax of the sale of an asset that has been subject to adjustments. The commentary states (at paragraph 7.39):-

> *"On the disposal, or deemed disposal, of an asset that has been subject to the apportionment rules, <u>output tax based on the full consideration for the supply would still need to be accounted for</u>."* [Emphasis added.]

This statement suggests that any sale of an asset that has been adjusted is necessarily subject to output tax. However, where an asset used for taxable purposes has been "wholly" applied to an exempt usage, the sale of that asset would not be in the course or furtherance of a taxable activity under the current section 8 and no output tax liability would arise. There is no draft legislation included to alter the current position hence it appears possible that paragraph 7.39 has mis-stated the position or is simply referring to output tax (if any is actually payable). Clarification should be provided on this point.

Transitional Issues

Please refer to the comments in the cover letter. NZBA members would look to apply the new apportionment rules to **all** assets. The members are currently unable to claim GST inputs upfront on capital assets costing more than $18,000 based on the MOU framework (see paragraph 14 of the MOU in particular). However, NZBA members would be able to make an immediate claim under the new apportionment rules based on the percentage of taxable use. The NZBA submits that consideration should therefore be given to introducing transfer adjustment rules to allow NZBA members to claim an immediate GST input claim under the new apportionment rules based on their percentage of taxable supplies. Otherwise, if the new apportionment rules apply to all assets held by NZBA members there will be a deferred GST input claim for assets acquired **before** the new rules but an ability to claim GST immediately (based on the taxable use percentage) for assets acquired **after** the new rules.