Lumley House
3-11 Hunter Street
PO Box 1925
Wellington 6001
New Zealand

Tel: 04 496-6555
Fax: 04 496-6550
www.businessnz.org.nz

12 October 2011

Deputy Commissioner
Policy Advice Division
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear Sir/Madam

Re: GST: Business-to-business neutrality across borders discussion document

I am writing to you in regard to the questions raised in the discussion document released by IRD entitled *GST: business-to-business neutrality across borders*.

BusinessNZ would first like to congratulate the Government for releasing a discussion document on this issue given it has a great deal of importance for a number of businesses in New Zealand. If introduced, this document's proposals should go a long way to minimising GST problems faced by non-resident businesses wanting to trade in New Zealand. Simply put, they will help improve New Zealand's competitiveness by removing GST impediments to doing business with non-residents.

In particular, BusinessNZ wishes to comment on two areas, namely the business-to-business (B2B) options going forward, as well as the options for tooling costs.

1. Business-to-Business Options for New Zealand

In terms of expanding the rules around the registration for GST of non-residents, we note three proposals have been put forward in the document:

- Extending the current zero-rating rules;
- An enhanced registration system; and
- A direct refund system.

Given the document has provided a useful analysis of the relative strengths and weaknesses of each of the three options, we do not intend to go over these points. However, we concur with the views of IRD that the best way forward in terms of a balance between achieving B2B neutrality and protecting the revenue base is an enhanced registration system.

Recommendation: That an enhanced registration system proceeds as the best option for business-to-business GST neutrality across borders.

2. *Tooling Costs Options*

Given a large proportion of BusinessNZ's membership involves companies in the manufacturing sector, we have a strong interest in any proposed policy changes that could affect this sector, especially since the backdrop of international competitiveness is very much to the fore of this issue.

The need for change

First, BusinessNZ wishes to point out that our overall tax policy position is for a flat, broad-based system with minimal exemptions. We have supported moves by the Government over recent years to move tax policy further in that direction, with lower overall tax rates and ensuring GST is broad-based in its coverage. Any policy directions or exemptions that move away from this broad-based system need to pass a higher threshold, so that any unintended consequences or related issues are minimised.

In the case of tooling costs, we believe the document succinctly outlines the complex issues at play here, which need to be weighed up carefully. On one side, the document points out that absorbing the GST on a small fraction of the overall income derived from a contract could be a price worth paying for both the overall revenue stream that a contract would generate, and in respect to the way other countries in direct competition with New Zealand treat GST when quoting/invoicing. The need to absorb tooling costs is no different from the need to absorb other costs such as premises, plant and labour which naturally fluctuate between various jurisdictions.

However, on the other side of the equation there are international as well as practical issues to take into consideration. First, BusinessNZ believes the adoption of offshore policies/regulations should only take place if it produces a sufficient net economic benefit to New Zealand. As paragraphs 5.5 and 5.6 of the document point out, Australia and the UK already recognise this problem specifically in their legislation. The simple recognition of the problem by itself would probably be insufficient for similar change here. This is because the standard international procedure for quoting/invoicing involves quoting separately for tooling costs, giving countries like Australia and the UK a competitive advantage when trying to successfully quote on offshore orders.

Also, we believe the complexities of this issue present a very precise and defined situation that is extremely unlikely to have ramifications elsewhere in terms of tax policy. Although the tools in question are not physically exported and thus subject to existing zero-rating rules, they are owned by a customer who has no intention of ever taking delivery of them. Therefore, the value of them is never realised in the domestic market.

Therefore, on balance, while BusinessNZ generally does not favour exemptions for GST, in this instance the issue outlined is so specific it would be difficult to see similar issues arising in other sectors. We therefore agree that this issue needs to be addressed.

The best way forward for change

The discussion document outlines two options:

- Relying on the enhanced registration system; and
- Introducing a special zero-rating rule.

While we support an enhanced registration system for the overall B2B options for New Zealand, in terms of tooling costs we agree with paragraph 5.14 of the document that given the similarities between tooling costs and services provided directly in connection with exported goods, this could be a situation where a specific zero-rating rule may be justified.

We also agree that if these tools or resulting goods were later on-supplied by the non-resident owner back into the New Zealand domestic market (or allowed by the non-resident to be used for manufacturing for the domestic market) there would need to be additional rules to ensure the tools would be treated as imports and GST then paid at an appropriate level.

We agree that this exclusivity requirement would add some complexity to a zero-rating system, along with definitional issues that would have to be addressed. However, we would expect IRD to address any additional complexity by clearly identifying various scenarios to resident and non-resident businesses to provide clarity in the future. Also, we would expect existing definitions for zero-rating from other countries dealing with tooling costs to provide a useful platform to minimise any uncertainty regarding what is or is not included for tooling costs.

Recommendation: That a special zero-rating rule for tooling costs is introduced.

Thank you for the opportunity to comment, and we look forward to further developments in the future.

Kind regards,

Steve Summers
Economist
BusinessNZ