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17 April 2018

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Inland Revenue
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Wellington

Dear Grant and Kim

IRRUIP 13: Consequences of GST group registration

Thank you for the opportunity to review IRRUIP 13 (the Issues Paper) and provide feedback.

The Issues Paper sets out two possible interpretations of the grouping rules and asks whether the "narrow interpretation" or the "wide interpretation" should be preferred. In summary, we believe that the "wide interpretation" should be preferred.

We have also suggested that some amendments be made to the grouping rules so that they better reflect the policy intent.

We would be happy to discuss our submission with you. We would also appreciate the opportunity to consider amendments made as the result of submissions. The complexity of this topic does in our view merit such further consultation to consider whether any unintended or unforeseen consequences arise. If you would like to speak to us, please contact Jolayne Trim.

Yours sincerely

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Specific submissions

The Issues Paper provides an indepth analysis of the group registration rules in the Goods and Services Tax Act 1985 (GST Act).

In summary, the group registration rules allow a group of related entities to be treated as a single registered person for GST purposes.

The Issues Paper considers two different interpretations of the group registration rules.

The first is that, by deeming the representative member to make a group member's supply, the supply is still treated as "made" by the group member and simply attributed to the representative member. The Issues Paper refers to this as the "narrow interpretation".

The second interpretation is that by deeming the representative member to make a group member's supply, the supply is treated as "made" by the representative member. The Issues Paper refers to this as the "wide interpretation".

Policy intent

Our starting point is that the GST group registration rules should be interpreted in a way that is consistent with the policy intent.

The GST grouping rules were introduced principally as a compliance cost saving measure. They allow a group of companies (and others) to file one return for the group rather than several separate returns.

It is our understanding that the grouping rules were developed to mirror the concept of a "single entity". That is, a GST group should have the same GST result a single entity would have. The group should be no better or worse off than if the group were a single entity.

Registered persons transacting with the GST group should also be no better or worse off than if the group were a single entity. This does not mean that they should view the group as a single entity, but that the GST outcomes should be the same.

There is little background material to ascertain the purpose. However, the White Paper on Goods and Services Tax March 1985 (the White Paper) states at paragraph 82:

> "The effect of group registration is that supplies of goods or services between group members will not be subject to the GST. The full GST liability will arise only when there is a supply made outside the group."

This indicates that the policy intent is that the GST grouping rules should allow GST group registered persons to have the same outcomes as if the group were a single entity.

This is achieved principally by ignoring intra-group transactions for GST purposes.

Statutory context

Interpretation of deeming provisions

The Issues Paper notes the principle of statutory interpretation that a statutory fiction should be "read down"; or to put it another way, should be interpreted as applying only to the extent necessary to fulfil the purpose of the statutory fiction and not more broadly.

We interpret the case law as meaning that a deeming provision should be read in its statutory context and not applied to matters outside of the deeming statute. In this case, the effect of GST grouping under section 55 applies only for GST purposes. It does not affect contractual or other statutory provisions. This can be seen in the tax context, being a member of a GST group does not mean that registered persons are members of an income tax consolidation group. The statutory fiction is given effect only for GST.

The approach we have taken is to give effect to section 55 in the context of GST only consistent with what we see as the policy intent of the grouping rules. We consider that "reading down" does not impose any further limitation on the interpretation of section 55.

Financial services

The Issues Paper provides little discussion on the application of the rules to financial service providers.

It is our understanding that most financial services providers would favour the wide interpretation and could be disadvantaged if IR were to adopt the narrow interpretation.

Most financial service providers are in GST groups. It is common for financial services groups to have separate operating companies for each of their regulated businesses – for example, banking, general insurance, life insurance and funds management. Each of these operate under different regulatory regimes.

A service company will typically provide services to each of the operating companies including a finance function, actuarial services, fund administration and legal services. The service company will charge a fee for the services supplied.

The entities generally form a GST group because taxable supplies are made from the service company to the operating companies. Grouping allows the service fee to be disregarded for GST purposes. Without the grouping, the service company would need to charge GST and the operating company would not be able to recover it. The service company's GST input tax is adjusted based on the supplies made by the GST group.

This is the same result as if the financial services group operated through a single company.

Without the grouping rules, the operating companies would not be able to overcome the insource bias of GST and would need to change their mode of operation. GST grouping allows the groups to maintain their operating model (which is driven by regulatory requirements). It reduces or eliminates potential distortions in behavior due to tax legislation.

GST input tax apportionment

The GST recovery ratios for financial services groups are not necessarily calculated on a group basis. This is for two reasons. First, there are different industry agreements and guidelines for determining the taxable ratio for the different services being offered. Second, the legislation requires that the calculation produce a "fair and reasonable result". Such a result is generally achieved by taking into account different recovery ratios for different business units. We note that this methodology would apply whether the group members were separate companies or were branches of the same legal entity.

Grouping of non-residents

The most difficult issues arise where a non-resident company is a member of a GST group. We understand the view taken in the draft is that:

- A GST group's residence is based on the residence of the representative member.
- If the representative member is a New Zealand resident, the activities of each company are in effect activities of a branch of a New Zealand GST resident person. (In the examples, an Australian company's activities in Australia are an Australian branch of the New Zealand representative member).
- If the representative member is non-resident, the activities of each company are resident to the extent the supplies are connected to a fixed or permanent place (paragraph (a) of the definition of residence) and of a non-resident to the extent they are not. This would mean that the representative member's overseas activities or transactions made with third parties would remain those of a non-resident and would be outside the scope of the GST Act. So if, for example, the representative member was an Australian company, its Australian supplies to Australian third party recipients would remain those of a non-resident and outside the scope of New Zealand GST.

We request that IR OCTC confirms whether it agrees with the above conclusions, or whether further work is needed.

The above conclusions are consistent with the view that an unregistered person can be part of a GST Group (so that when the non-resident elects to be part of a GST group both in and outside scope activities are included in the GST Group). We consider this to be the better view.

However, it is unclear whether a non-resident, resident to the extent of a fixed or permanent place, is still a single person or two persons. Section 56 can be read as suggesting there are separate persons (as the New Zealand activity would typically be a branch or division). However, most non-residents deemed resident would not be registered for that activity under section 56. Further, section 56B can be read as the non-resident is treated as two persons only for the limited purposes covered by section 56B.

The conclusion reached on this issue will affect calculations of taxable supply ratios. Arguably, under the above interpretation, financial services supplies made outside New Zealand would qualify to be zero-rated taxable supplies. Thus, if a GST group includes a foreign company which makes financial services supplies outside New Zealand, those taxable supplies may be able to be included in the numerator of the input ratio formulae.

We note however, that there may be a "fair and reasonable" objection to prevent the inclusion of such taxable supplies in the formulae as the supplies acquired may not have been acquired to make supplies in New Zealand.

Inland Revenue should consider these consequences further. If it considers that the approach is correct, as we consider likely, it needs to consider whether there are other operational statements it needs to make.

We also consider that the relevant examples could be clearer (for example, example 11 does not specify the problem for the narrow interpretation which is presumably an effect on input tax of making an outside the scope supply?)

Land transactions

The GST rules regarding land transactions were reconsidered in 2010 and were amended to require supplies of land to be zero rated.

Zero rating was introduced to prevent fraudulent or disingenuous activity that resulted in full input tax being claimed by the recipient with no corresponding output tax returned by the supplier. The sections were drafted to be as inclusive as possible in order to minimise or eliminate the risk of avoidance and/or fraud.

Thus, the zero rating rules should be read as broadly as possible.

Example 31 of the Issues Paper considers the situation where members of a GST group sell their respective parts of a business to a single GST-registered entity. One of the group members is selling land. The others are selling fixed and intangible assets respectively. The sale is effected through one agreement, rather than separate sale and purchase agreements.

The Issues Paper concludes that this transaction should be standard rated.

In our view, this supply should be attributed to the representative member. Following the legal form and substance, there is one agreement for the supply. It is in our view a single supply as no part of the supply occurs without any other part. As the supply includes land, the whole supply should be zero rated.

Reading the legislation to require zero rating in this situation accords with the policy intent of the land zero rating rules. They were intended to capture as many transactions as possible to reduce the avoidance and fraud risk. It also accords with the policy intent of the grouping rules to effect the same outcomes as if the group were a single entity.

We acknowledge that our answer may be different if there were separate legal agreements. In that case, the representative member would still be deemed to make the supply but, following the legal agreements, they would more likely be treated as separate supplies. However, we note that separate agreements which are not interdependent are rare. In practice, a vendor and purchaser would seek to ensure that all that is required would be supplied and acquired.

We understand that this type of transaction is common in practice and that both practitioners and parts of IR would treat this transaction as zero rated. A Tax Invoice would be issued by the representative member of the group.

Remedial clarification

If it is the final view of IR OCTC that this transaction may not be zero rated, the issue should be referred to IR Policy and Strategy (PAS) for consideration and possible law change.

Ability of a representative member to issue a Tax Invoice

One practical issue that arises from the wide interpretation is the ability of the representative member to issue Tax Invoices. Section 55(7) (h) states that grouping does not affect a registered person's obligations under section 24. Section 24 requires a registered person to issue tax invoices (if requested although in practice this is generally done automatically). The draft assumes that this is therefore still an obligation of the group members rather than of the representative member (despite the deemed supply by the representative member per 55(7) (d)).

Supplies made by registered group members

We understand there is a view that shared tax invoices under section 24BA can be issued to address the section 24 obligation.

Section 24BA(4) defines “shared invoice” as being “a single invoice for goods and services … supplied by 2 or more suppliers…”. Interpretation of this definition has been the subject of debate. However, it is our view that the representative member may not technically issue a shared Tax Invoice where the supply has been made only by the group member and not by the representative member.

Supplies made by unregistered group members

Unregistered group members are generally those who are unable to register but may also be those entities that are under the registration threshold. Despite this, section 55 allows them to be included in a group (with consequent impact on input tax deductions for the group).

We consider the effect of section 55 is to make supplies made by those members taxable. (In effect, the registration threshold no longer applies to their specific activity. This is of course the result that would apply if the activities were carried on by a single company).

If the representative member issues a Tax Invoice, in our view, this is not contrary to section 55(h). It is only registered persons who are required by section 24 to issue a Tax Invoice. An unregistered member is not subject to section 24. The deemed supply by the representative member by 55(7)(d) is therefore unaffected by 55(7)(h). Accordingly, the representative member does not act contrary to section 24 in issuing a tax invoice for a supply by the unregistered member.

Remedial clarification

We recommend that this issue be referred to PAS to consider a remedial to ensure a representative member is able to issue a Tax Invoice on behalf of all members.

Amendments to the grouping rules

The publication of the Issues Paper has prompted many in the tax community to re-examine the grouping rules in light of the issues posed.

We recommend IR consider further changes:

- To clarify the intended effect of “subject to paragraph (c)” in paragraph (dab) and “subject to paragraphs (db) and (dc)” in paragraph (c);
- To clarify the intended effect of paragraphs (db) and (dc), which may only apply to supplies acquired prior to grouping or to supplies were their use has changed; and
- To ensure that the single entity result applies.

Transition and next steps

The Issues Paper considers two interpretations of the GST grouping rules and no preference is expressed for either view.

We expect that the next step will be for IR to release a statement outlining a preferred view and the consequences for those who are group registered.

The statement should consider the consequences for those who have adopted the other view. This will be particularly important if the "narrow view" is adopted.

Conclusion

We consider that the policy intent of the GST grouping rules best supports the wide approach. The legislative context also supports a wide approach.

Moreover, we understand that most practitioners employ a wide approach.

Arguably some of the rules as drafted are not consistent with this approach. These issues should be referred to PAS for consideration and future law change.

Responses to questions for discussion

In paragraph 1.19 of the Issues Paper you ask for feedback on three specific points. Our response to these queries is as follows:

1. Of the two interpretations, do you consider one stronger interpretation?

The wider interpretation

2. Do you see any practical or compliance difficulties with either interpretation?

The narrow interpretation will not give effect to the policy intent. If it were to be the preferred interpretation, the GST grouping rules should be amended to give effect to the policy intent.

3. Is there an alternative way to interpret the GST group registration rules?

It would be possible to interpret the grouping rules to mean that the wide interpretation be preferred in some situations and the narrow interpretation in others. For example, the requirement in the apportionment rules to achieve a "fair and reasonable result" may arguably mean that the apportionment should be done by looking at each entity separately. However, it is our view that the wider interpretation will best give effect to the overall policy intent.