

THE GOODS AND SERVICES TAX: REFLECTIONS ON THE NEW ZEALAND EXPERIENCE, SIX YEARS ON



Rodger S Muir

Taxation Consulting Partner
Ernst & Young
Auckland
New Zealand

The Goods and Services Tax (GST) is a form of value added tax (VAT). It was imposed in New Zealand at a single rate of 10 per cent from 1 October 1986, after a two-year development period. In the six years since then, the tax has become accepted as an integral part of the New Zealand social, business and economic environment.

In the writer's view, the introduction and subsequent operation of GST has been a major success from a technical viewpoint. The tax was well accepted by both business and the general public. This is due, in the main, to the process of developing and implementing the tax – public justification, consultation and education over a two-year period. The tax is simple to administer because it has a single rate and minimal exemptions. The legislation establishing the tax is generally well thought out and has been subject to only minimal “fine tuning” amendment since implementation.

From the government's perspective, the tax has been very successful. Prior to its introduction in 1985, the government believed GST (at 10 per cent) would contribute 17 per cent¹ to annual taxation revenues. In 1991, GST (at 12.5 per cent) actually contributed 23.8 per cent² of taxation revenues and was expected to contribute 25.1 per cent³ in 1992.

It has been acknowledged to be successful by the courts⁴ and the New Zealand model of VAT has since been adopted with very little change in two other jurisdictions (South Africa and Fiji). Its model structure from an

- 1 *Statement on Taxation and Benefit Reform*, 20 August 1985, Hon RO Douglas, Wellington, New Zealand Government, Parliamentary Paper B 6B, p 24.
- 2 *Budget 1992*, Hon R Richardson, Wellington, New Zealand Government, Parliamentary Paper B 6A, 2 July 1992, p 14.
- 3 *Budget 1992*, Hon R Richardson, Wellington, New Zealand Government, Parliamentary Paper B 6A, 2 July 1992, p 14.
- 4 *C of IR v Databank Systems Ltd* (1989) 11 NZTC 6093, per Cooke P at 6100; “There are arguments that GST is such a successful tax that there should be no exemptions...”

economic efficiency viewpoint has been acknowledged in studies since carried out⁵ and in writings by overseas academics⁶

This article canvasses the development and introduction of the tax, offers an overview of its operation, and comments on the reasons for its success. Also discussed are some of the areas of difficulty.

History of GST

Development

The introduction of a VAT-type tax was first publicly announced in the Budget of 1984,⁷ as the first major component of the then Labour Government's taxation reform process.

A "White Paper" was issued in March 1985 for general circulation among the business community and public. This paper briefly outlined the major proposals for the operation of the tax and modifications to those proposals to deal with special cases – for example application thresholds, exemptions, etc. It also contained draft legislation prepared by the Inland Revenue Department.

The purpose for the issue of the paper was set out in the document as follows:

A key objective of this White Paper is to elicit submissions on the proposed Goods and Services Tax (GST) ... The public and interested groups are invited to submit their comments on these proposals and to indicate ways in which they might be modified to improve and simplify the operation of the GST.⁸

A process of public consultation commenced. Oral and written submissions were taken by the Inland Revenue Department and an independent advisory panel, consisting of individuals representing economic sectors most affected by the tax. These two groups then reported their findings back to the government and these were used to determine the form in which the tax was introduced. This consultative process resulted in a number of changes to the initial proposals in the White Paper (for example, sales of bare land were to be not subject to GST in the White Paper, but became taxable under the Act passed into law), and the introduction of the tax was delayed from 1 April to 1 October 1986 to allow for more preparation and education.

The then government commenced an extensive public education program, one of the key elements in the successful introduction of the tax. A

5 *The Compliance Costs of Business Taxes in New Zealand*, Cedric Sandford and John Hasseldine, Wellington, Institute of Policy Studies, 1992, p 57.

6 John F Due, "The New Zealand Goods and Services (Value Added) Tax – A Model for Other Countries" (1988) 36 *Canadian Tax Journal* 125.

7 *1984 Budget*, Hon RO Douglas, Wellington, New Zealand Government, Parliamentary Paper B 6, 8 November 1984, p 22.

8 *Proposals for the Administration of the Goods and Services Tax*, Wellington, New Zealand Government, Parliamentary Paper B 27, March 1985, p 9.

television advertising campaign was commissioned, and a “GST Co-ordinating Office” was established. This office was responsible for the education program and oversaw the production of various publications and a video, all explaining, in simplified form, the operation of GST and the impact the tax would have on the general public and various business sectors. This process of open consultation and education was new and had not been seen before in New Zealand. In the writer's view, it contributed greatly to the successful introduction of GST, enhancing acceptance and understanding of the tax.

It also produced a tax regime that was readily understood by the community, which also contributed significantly to the success of GST. The GST regime is relatively simple which makes it easy for businesses to administer and for the public to comprehend. There are minimal exemptions from the tax and those that exist are reasonably distinctive. In addition, GST is applied at a single rate on the vast majority of transactions. Hence there is little thought needed by the buying public as to whether an item of expenditure suffers tax or not – it is accepted that most items do. Because there is only one rate of tax there is no decision needed between items that may suffer more or less tax.

Businesses also find the tax relatively simple. Almost all transactions are subject to the tax, hence only limited attention is needed to identify those not, and the rate is uniform, making it easy to administer in terms of pricing and calculation. The single tax rate and limited number of exemptions also avoided problems associated with classification differences (as occurs, for example, under the Australian sales tax regime).

Taxation reform

Another key factor in the successful introduction of the GST was the announcement of a major reform of the taxation system. A major government platform in the “selling” of the tax to the public of New Zealand was that the then existing taxation system was in need of reform and the GST would, in part, address this.

The objective of the changes which will be made in April next year is to make basic improvements in the fairness of the tax system by taxing people more equally in relation to their ability to pay.⁹

In the writer's experience, the taxation system was, at that time, widely perceived as being inequitable. It was generally believed (and to some extent it was true) that those with sufficient wealth could avoid or minimise their income tax liability by adequate structuring of their affairs, whereas those earning income from salary and wages only, or of limited economic resource, could not so easily avoid their obligations. In addition, there were a large number of taxation avoidance schemes in existence, most of which

9 *Proposals for the Administration of the Goods and Services Tax*; Wellington, New Zealand Government, Parliamentary Paper B 27, March 1985, p 3.

were of dubious economic merit, but provided tax relief to the participant. Many people entered into these schemes because the very high marginal tax rate meant more was potentially saved through tax relief than was at risk because of economic failure. The easily circumvented legislation and high marginal tax rates had led to the income tax system falling into disrepute.

A reason for the introduction of a consumption-type tax was to broaden the tax base to shift the emphasis of revenue collection away from direct personal income tax at very high marginal rates (66 per cent of incomes over \$38,000 at the time) to a system which collected revenue at much lower marginal rates across a wider range of economic activity.

In addition, the government promoted the tax as a method of forcing those then avoiding or evading tax (and doing so because of the high marginal rate) to contribute to government revenues.

An important object of these changes is to broaden the New Zealand tax base so that people who are at present able to escape without paying their fair share of income tax will then come back within the tax net automatically when they spend money. As more people are brought back into the tax system, it stands to reason those who have been doing more than their fair share of the paying will carry a lighter burden in the future.¹⁰

This theme was followed consistently by the government during this period, stressing the lack of equity in the existing taxation system, the need for reform to restore fairness and voluntary compliance with the taxation regime, and the key role GST played in this.

In August 1985 the Minister of Finance said:

Mr Speaker: This statement will outline the most far-reaching reform of taxes and benefits in New Zealand's recent history. The introduction of GST is the key to this reform. Major reform of taxes and benefits is not possible without GST, or before it comes into operation.¹¹

The document from which this extract is quoted then went on to announce the introduction of full imputation for company dividends and a domestic withholding tax on interest income. It also confirmed the rate of GST at 10 per cent applying from 1 October 1986, and the reduction in the personal income tax rates.

In his 1986 Budget speech, the Minister of Finance stated:

The objectives of this reform are:

- to broaden the income and consumption tax bases;
- to reduce the scope for avoidance and evasion;
- to lower rates of tax;
- to make the system fairer; and,

10 *Proposals for the Administration of the Goods and Services Tax*, Wellington, New Zealand Government, Parliamentary Paper B 27, March 1985, p 4.

11 *Statement on Taxation and Benefit Reform*, Hon RO Douglas, Wellington, New Zealand Government, Parliamentary Paper B 6B, 23 August 1985, p 1.

- to simplify the tax system and make it more certain.¹²

The Minister then went on to announce a number of anti-avoidance measures, including the accrual treatment of financial transactions, information requirements regarding offshore payments and limitation of losses available from special partnerships.

Another significant factor (perhaps the most significant as far as the general public were concerned) in the GST introduction/taxation reform process was the simultaneous and subsequent reductions made to marginal income tax rates for both individuals and companies. This trade-off of taxes made the imposition of GST seem less onerous to the general public.

Tables I, II and III below set out the change in cumulative and marginal tax occurring over the 1985 to 1990 income years.

1985		1986		1987	
Income Range	%	Income Range	%	Income Range	%
0-6,000	20.00	0-6,000	20.00	0-6,000	17.50
6,001-24,000	32.00	6,001-25,000	33.00	6,000-9,500	24.00
24,001-25,000	41.06	25,001-30,000	41.00	9,501-25,000	31.50
25,001-30,000	45.10	30,001-38,000	51.00	25,001-30,000	37.55
30,001-38,000	56.10	Over 38,000	66.00	30,001-38,000	52.05
Over 38,000	66.00			Over 38,000	57.00
1988		1989		1989	
Income Range	%	Income Range	%	Income Range	%
0-9,500	15.00	0-9,500	19.50	0-30,875	24.00
9,501-30,000	30.00	9,501-30,000	27.00	Over 30,875	33.00
Over 30,000	48.00	30,001-30,875	36.00		
		Over 30,875	40.50		

1985	1986	1987	1988	1989	1990
45%	45%	48%	48%	28%	33%

12 *Budget 1986*, Hon RO Douglas, Wellington, New Zealand Government, Parliamentary Paper B 6, 31 July 1985, p 14.

13 *Income Tax Act 1976*, First Schedule, Part B.

14 *Income Tax Act 1976*, First Schedule, Part A, Clause 7.

TABLE III: INDIVIDUAL PRIMARY TAX LIABILITY*						
Taxable Income	1985	1986	1987	1988	1989	1990
5,000	1,000	1,000	875	750	975	1,200
10,000	2,480	2,520	2,047	1,575	1,987	2,400
15,000	4,080	4,170	3,622	3,075	3,337	3,600
20,000	5,680	5,820	5,197	4,575	4,687	4,800
25,000	7,370	7,470	6,772	6,075	6,037	6,000
30,000	9,625	9,725	8,650	7,575	7,387	7,200
35,000	12,430	12,530	11,252	9,975	9,373	8,771
40,000	15,433	15,533	13,954	12,375	11,398	10,421
50,000	22,033	22,133	19,654	17,175	15,448	13,721
60,000	28,633	28,733	25,354	21,975	19,498	17,021
100,000	55,033	55,133	48,154	41,175	35,698	30,221
150,000	88,033	88,133	76,654	65,175	55,948	46,721

(*Ignores rebates possibly available)

Economic activity

Inflation

At the time of introduction of the GST, the New Zealand economy was extremely buoyant and economic activity was high. Real GDP was growing at relatively high rates compared with historical growth in New Zealand (2.2 per cent in 1985, 1.7 per cent in 1986 and 2.0 per cent in 1987).

The introduction of the tax had a significant impact on inflation. Table IV sets out the quarterly percentage changes in the average Consumer Price Index over the period March 1986 to March 1989.

TABLE IV: CONSUMER PRICE INDEX - ALL GROUPS ¹⁵					
Percentage change quarterly on corresponding quarter of previous year					
1985	March	13.4	1987	March	18.3
	June	16.6		June	18.9
	September	16.3		September	16.9
	December	15.3		December	9.6
1986	March	13.0	1988	March	9.0
	June	10.4		June	6.3
	September	11.0		September	5.6
	December*	18.2		December	4.7

*GST introduced at 10%

As can be seen, inflation before the introduction of GST was relatively high as compared with other OECD nations (average OECD inflation in 1985 – 2.6 per cent). With the impact of GST (showing up in the December 1986 quarter above), the level of inflation reached what would normally be considered to be an alarmingly high rate. However, inflation in New Zealand had then been nearly as high in recent times (for example, September 1985 – 16.3 per cent), and the rate was not seen as publicly unacceptable. In addition, economists and business people automatically took into account the “one-off” effect of the introduction of the tax when considering inflation figures, accepting that the uplift was a necessary part of the economic reform process.

Retail spending

The introduction of the GST also had a significant impact on retail spending patterns. Statistics available show that, in the months immediately before the coming into force of the tax, the public spent considerable sums of money on “durable” retail commodities such as motor vehicles and appliances that were perceived as going to increase in price as a result of GST. By comparison, retail spending on consumable commodities such as meat and other foods did not vary in any significant way.

TABLE V: RETAIL SPENDING - 1986 ¹⁶									
Analysis by selected store-type (\$ millions)									
Month	Butcher	Super-market	Clothing	Furniture	H/Hold Appl.	Pharmacy	Motor Vehs.	Restaurants	All Stores
Jan	33.7	316.4	64.0	52.9	48.1	48.1	434.4	75.6	1781.6
Feb	33.5	296.5	57.4	57.4	64.7	51.5	442.0	77.8	1767.1
Mar	34.2	316.0	62.4	60.5	71.4	50.4	487.6	87.2	1910.5
Apr	36.9	322.8	83.2	68.3	71.4	50.4	503.3	89.4	1964.3
May	38.4	336.1	92.9	80.3	85.4	55.1	513.5	92.0	2060.1
June	34.0	309.4	79.1	78.3	81.9	52.9	460.9	85.4	1870.2
July	36.3	340.0	84.6	86.1	85.9	57.5	549.2	93.5	2077.0
Aug	32.9	337.4	77.8	91.8	89.5	57.8	577.0	91.4	2112.0
Sept	34.3	365.9	96.9	140.1	110.8	58.9	731.7	92.4	2513.9
Oct*	35.5	343.1	71.7	48.0	63.3	56.3	410.3	93.4	1840.5
Nov	33.4	341.5	74.5	55.2	67.2	55.7	437.0	88.3	1898.5
Dec	47.0	414.6	111.3	85.0	97.7	83.0	485.3	98.3	2426.3
*GST introduced ...									

16 Department of Statistics, Monthly Abstract of Statistics, March 1987, Table 14.01, pp 66-67.

The statistics also show that the raising of the tax rate to 12.5 per cent in July 1989 produced a similar increase in retail spending in the few months before the change.

Of note is that, before the introduction of GST, New Zealand had a sales tax regime which operated at the wholesale level over a relatively small range of goods. The regime was extremely complex and difficult to administer, both for the government agency responsible and the business dealing in commodities subject to the tax. The regime selectively applied sales tax at a range of rates from 10 per cent to 50 per cent. This regime was entirely replaced by the GST and the substitution caused the retail price of some commodities to fall.

Overview of the GST regime

First, essential phraseology needs to be explained:¹⁷

Taxable activity: Any activity carried on continuously or regularly by any person which involves or is intended to involve the supply of goods or services to any other person for a consideration, whether or not for profit. It specifically includes activity carried on in the form of a business, trade, manufacture, profession, vocation, association or club. (s 6(1))

The term excludes activities carried on as a hobby, any occupation or employment under any contract of service, and any activity to the extent to which it involves making exempt supplies. (s 6(3))

Registered person: Any person who, in the course of a taxable activity, makes supplies in New Zealand in excess of NZ\$30,000 in value annually. Where persons make supplies of less than NZ\$30,000, they may voluntarily register as long as they conduct a taxable activity. (s 51)

Supply: Supply is very widely defined to include, simply, all forms of supply. (s 5(1))

Goods: All forms of real or personal property, but not choses in action or money. (s 2)

Services: Anything which is not goods or money. (s 2)

Exempt Supply: Supply of any of the following:

- financial services;
- residential accommodation;
- donated goods by a non-profit body;
- supply of fine metal. (s 14)

Zero-rated: Certain forms of supply (principally, most exports) where the transaction is subject to the tax but at a rate of zero per cent. (s 11)

17 Section references are to the Goods and Services Tax Act 1985.

Output Tax: This is the tax a registered person is required to charge on supplies they make. (s 2)

Input Tax: This is the tax a registered person incurs in conducting their taxable activity. (s 2)

Return Period: The frequency with which a registered person is required to file a return of tax collected and pay the tax to the Inland Revenue Department. Periods available are monthly (large businesses), two monthly (most businesses), and six monthly (small businesses). (s 15)

Inland Revenue Department: Government agency charged with the principal responsibility of administering and collecting the GST (as well as other New Zealand taxes).

Goods and Services: Also means goods or services. (s 2(2))

Taxable Supply: A supply made in the course or conduct of a taxable activity. (s 2)

Financial Services: This covers a wide range of activities normally associated with the banking and capital market sectors of the economy and includes:

- exchange of currency;
- issue and payment of cheques;
- dealings in equity securities;
- provision of credit;
- dealings in life insurance and superannuation;
- futures transactions;
- payment or collection of interest, principal, or dividend;
- arranging one of the above transactions. (s 3(1))

Operation of the tax

Taxable supply

GST is imposed at the appropriate rate (generally 12.5 per cent, currently) on the supply of goods and services, where that supply is made in New Zealand by a registered person in the course of a taxable activity, by reference to the value of the supply made. The tax so charged, and to be collected and accounted for by the supplier, is “output tax”.

A person acquiring any of a wide range of goods and services in New Zealand will incur GST in that purchase. The only exceptions will be where the transaction is exempt (for example, a financial transaction such as a bank loan) or the supplier is not a registered person (for example, the sale of secondhand motor vehicles by individuals in their private capacity).

Where the purchaser is a registered person and acquires the goods and services for the purpose of carrying on taxable activity, the GST that person incurs (input tax) may be claimed as a credit against the output tax charged

by the registered person on supplies that person may have made. In any return period where the output tax charged exceeds the input tax incurred, the registered person is required to pay the excess to the Inland Revenue Department. Where the input tax incurred exceeds the output tax charged in any return period, the difference is refundable to the registered person.

As a registered person is entitled to recover all input tax incurred either by credit or refund, such a person does not bear any GST. The tax is borne by persons who acquire goods and services for purposes other than to conduct taxable activity. This is the “ordinary person in the street”, who purchases goods and services for personal consumption, and the person acquiring goods and services to make exempt supply (for example, financial institutions).

Zero-rated supply

A zero-rated supply is one that is subject to GST, but the rate used is zero per cent. This applies principally to exported supplies of goods and services. The registered person carrying on business in New Zealand and selling products or services to overseas customers is able to exclude GST from the selling price of the commodity being sold. Because the person is a registered person and is making a taxable supply, the person is able to recover GST incurred in New Zealand in producing the commodity for sale.

As the exporter does not incur any GST, the tax does not become a cost of operation to be considered when pricing commodities for international trade.

Zero-rating is also applied to transactions which involve the supply of a business or part of a business which is capable of ongoing operation. This is referred to as the supply of a “going concern” and such transactions are zero-rated to ease the funding requirements in business acquisitions and to protect the Revenue to some degree. Because the term “going concern” is not defined in the legislation, there is some doubt as to its meaning, and this particular provision has been the subject of a number of judicial proceedings; and several guidelines have been issued by the Inland Revenue Department. This concept is also unclear under VAT in the United Kingdom and has been the subject of various court proceedings in that jurisdiction.

Exempt supply

There are few classes of exempt supply under GST. The two major categories are financial transactions and the supply of residential accommodation. The reasons for the exemptions are discussed below.

Where a person conducts an activity involving the making of exempt supplies, there is no requirement to charge and account for GST on the value of exempt supplies made. However, such a person is unable to recover, as an input tax, GST suffered to the extent it is incurred in conducting that exempt

supply. Thus the GST incurred becomes a cost to the operation and is passed on to the consumer in higher prices.

Mixed supply

Many operations conduct activity which involves the making of both taxable and exempt supply. For example, a bank will provide not only financial services but will often also own and rent out commercial and retail space, a taxable activity.

In a mixed-supply situation, output tax is charged to the extent of taxable supply made and input tax incurred is recoverable to the extent it relates to the making of taxable supply. Input tax suffered that is directly attributable to taxable supply made is fully recoverable. Where the item of expenditure giving rise to the input tax is used in both making taxable and exempt supply (for example, those relating to premises), an apportionment of the input claim is required. The basis of the apportionment may vary, but must be reasonable in light of the type of expenditure involved.

Commentary on the GST regime

As noted earlier, GST is a “value added” tax regime, similar in concept to that found in many European countries. The essential feature of value added tax systems is that the tax base is the amount by which a firm has added value to the product at that particular stage of production or distribution. The tax on the increment in value is collected each time a good or service is exchanged. Under GST this is achieved by allowing a deduction of the tax on the inputs to the business.

In *The Gist of GST*, published in 1985, before the first formulation of the GST legislation, Scott and Davis proposed features they saw as important to preserve in the design of the tax in New Zealand.¹⁸ These were:

- the GST should be applied to the widest possible base covering goods and services;
- it should be set at a single rate to minimise distortions and administrative and compliance costs;
- there should be very few exemptions for uses or users of goods and services and zero-rating should, in most cases, be used rather than exemptions;
- if required, adjustments for the regressivity of sales taxes on particular groups should be achieved through changes to the tax and benefit systems, rather than by introducing exemptions or multiple rates;

18 Claudia Scott and Howard Davis, *The Gist of GST*, Wellington, Institute of Policy Studies 1985, p 7.

- GST should be introduced in a form which minimises the net administrative and compliance costs for a given revenue goal. Revenue authorities must undertake extensive programs of education to ease the transition to this new tax and consideration should be given to ways of easing the burden of the tax on traders who will incur substantial increases in their net compliance costs.¹⁹

Looking back at these desired features, it is possible to say to a very large degree they were achieved in the GST regime in operation today.

There are only two significant categories of exemption, those of financial services and residential accommodation. There was a huge amount of work done by those involved in the development of GST to find an acceptable method of applying the tax to financial transactions²⁰ but in the end this was not achieved, and this activity was exempted. In the interests of horizontal equity, rentals of domestic accommodation were also exempted.

Substantially all transactions are subject to a single rate of tax. The exceptions to this are zero-rated transactions and suppliers of accommodation in certain commercial dwellings where the rate used is 60 per cent of the standard GST rate.

Zero-rating applies to exported goods and services. The regime also allows zero-rating of exported financial services, enabling suppliers of services which are exempt in New Zealand to recover tax suffered on inputs when provided to non-residents.

The GST regime has not been used as a mechanism to deliver social benefits to the community. As part of the taxation and benefit reform process that started with the introduction of GST, social benefits are now substantially delivered directly rather than via the tax system. As noted earlier, considerable effort was put into education of both the public and the business community as to the nature and operation of GST.

Perhaps the only area where the criteria suggested by Scott and Davis have not been entirely met is in net compliance costs. A recent study²¹ has shown that the compliance cost burden of GST is remarkably regressive. Smaller operators, those with turnovers under \$100,000 pa, suffer very high GST compliance costs in comparison with larger traders and other forms of business tax (possibly because computerised systems in large organisations reduce the GST processing costs). The solution may be to raise the level of turnover level at which registration is required.

These features of GST lead the writer to conclude that the tax is a relatively pure form of VAT, especially when compared with VAT regimes existing in some European countries. For example, Belgium has multiple tax

19 Ibid at p 38.

20 A Teixeira, C Scott and M Delvin, *Inside GST: The Development of the Goods and Services Tax*, Wellington, Institute of Policy Studies, 1986, p 42.

21 C Stanford and J Hassildine, *The Compliance Costs of Business Taxes in New Zealand*, Wellington, Institute of Policy Studies, 1992, ch 6.

rates, ranging from 1 per cent to 33 per cent, certain inputs not deductible irrespective of use (ie, for social policy reasons) and multiple exemption without credit ranging across the activities of banks, insurance companies, lawyers, doctors, as well as certain educational cultural and sporting activities.

It is perhaps because of this purity that the New Zealand GST regime has become a model which other countries contemplating the introduction of a consumption-type tax consider with some care. In 1991, the Republic of South Africa adopted a VAT regime based almost exclusively on the New Zealand GST legislation and in July 1992 Fiji did the same. The GST regime was also studied by the Canadian Revenue authorities before the introduction of a VAT system there.

Difficulties with GST

While the writer views the GST regime as relatively pure, it is not perfect and areas of technical and administrative difficulty remain.

Initial administrative difficulties

Initially there were considerable administrative difficulties with the tax. It was estimated that there would be 180,000 registrations for the tax. It is understood that in reality there were more than 250,000, severely trying the clerical registration system. At first, the volume of returns and untried systems caused delays in processing, particularly of refunds. The consequent public pressure led to the issuing of refunds to traders, which, in hindsight, arose in rather dubious circumstances. As a result, a number of prosecutions for fraud were made under the Crimes Act 1961, and those convicted were imprisoned for their actions. The Inland Revenue Department also altered its systems and procedures to ensure more rigorous checks of refund claims were made.

Legislative structure

Considerable time was spent in developing the initial legislative framework for GST. Subsequent amendment has not been significant, usually only to remedy unforeseen circumstances or to clarify policy issues. In the writer's view, some of these subsequent changes have not had the same attention the initial legislation received, resulting in further confusion and uncertainty. An area of particular relevance is the ongoing treatment of retirement housing. There are also some significant deficiencies in the legislation which still require attention. An example of this is the GST consequence in respect of pre-GST owned assets that are used in an activity which, by change of law, goes from being taxable to exempt. It would appear that the owner of the asset suffers GST in these circumstances, which

in the writer's view is inequitable when the converse does not provide an input credit.

Interpretation issues

In any taxation regime, the major area of contention is whether or not a particular transaction is subject to the tax. In income tax, at least in New Zealand, the issue is often whether or not the transaction is capital in nature. The GST regime is also vulnerable to this form of debate. The issues that become contentious relate to whether a transaction is exempt or taxable (for example, what is the nature of a credit card transaction?), or whether it is part of a taxable activity or not (for example, if a Bank sells all its branch sites, is this a taxable activity?), or if a transaction takes place in New Zealand or elsewhere (for example, where is insurance supplied?). These are "border" issues that arise because there are classes of transaction that will fall either side of the taxable/non-taxable boundary.

The exempt/taxable, taxable activity/other activity boundaries have given rise to considerable litigation in New Zealand since GST was introduced. Perhaps the most well known matter is the *Databank*²² case, which was appealed to the Privy Council. This case focused on the nature of financial services and whether a cheque clearing house owned by participating banks provided exempt financial services or taxable services.

Also pending appeal is a case involving the threshold of activity needed to constitute a taxable activity.²³ In this case, a builder has been held liable to account for GST in relation to the subdivision of his residential property.

The other "border" area of some difficulty is the New Zealand/overseas distinction. Mechanisms exist within the GST legislation to define when supply takes place in New Zealand and when it takes place elsewhere. However, the interaction of the provisions is complex and, in some circumstances, while it is technically possible to have supply in New Zealand and obtain registration and thus relief for inputs, the administrative costs are prohibitive. This aspect of the legislation has not yet been the subject of litigation, but in the writer's experience it provides significant difficulty for non-residents conducting business in New Zealand.

The legislation encompasses some concepts which are not defined or not defined with sufficient clarity. Examples are the term "going concern" (for zero-rating purposes) and the definition of "supply" (which is circular).

22 *Databank Systems Ltd v C of IR* (1987) 9 NZTC 6213; *C of IR v Databank Systems Ltd* (1989) 11 NZTC 6053 (CA); *C of IR v Databank Systems Ltd* (1990) 12 NZTC 7227 (PC).

23 *Case P 4* (1992) 14 NZTC 4024.

The term “going concern” has led to a significant amount of litigation, and to two public rulings from the Inland Revenue Department,²⁴ as to what will be accepted as supply of a going concern and thereby zero-rated. It is still a matter of confusion and uncertainty.

Supply is defined simply as “including all forms of supply”. This definition is not particularly enlightening. The definition does go on to clarify a number of specific forms of supply, but there are some transactions that do not appear to involve a “supply”, but their status is unclear – for example, damages for non-performance or loss of profits, distributions to beneficiaries of a trust.

No doubt these hazy concepts will be subject to further litigation and clarification over time, but in the interim, uncertainty and confusion exists.

Summary

GST is a relatively pure form of VAT with a single rate of tax and minimal exemptions. It was introduced in New Zealand at a time when taxation reform was publicly acceptable and economic activity was high. The process of public consultation and education made the tax understood. The process of taxation reform and marginal tax rate reduction made the tax acceptable. It has been preserved as a pure VAT and not used to deliver social policy.

In the writer's view the tax has been, and continues to be, very successful. It will be interesting to revisit the issue in the year 2000 to observe whether the success continues or GST has been abandoned in favour of some other revenue gathering mechanism.

24 *Tax Information Bulletin*, Volume One, No 5, Inland Revenue Department, November 1989, p 1; *Tax Information Bulletin*, Volume Three, No 5, Inland Revenue Department, March 1992, p 4.