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GUIDANCE ON GST FOR NON-DEPARTMENTAL OPERATIONS

Introduction and Summary

1. This circular updates the guidance to departments on the GST treatment of non-departmental receipts and payments, previously contained in Treasury circular 1993/1. It advises departments of the impact of the Public Finance Amendment Act 2004 (PFAA) on the GST treatment on non-departmental appropriations and the consequential impact on their operations.

Key points

2. The key guidance points are:

- GST law and obligations have generally not changed since Treasury Circular 1993/1;
- Departments that receive non-departmental revenue for taxable supplies and services should register with the Inland Revenue Department (IRD) for GST purposes;
- Departments continue to complete a GST return for non-departmental revenues ;
- Departments continue <u>not</u> to claim the GST tax input credit relating to non-departmental payments;
- Where relevant, departments continue to receive GST-inclusive cash disbursements from DMO to fund non-departmental payments;
- As a result of the PFAA, appropriations for expenses and capital expenditure are authorised on a GST exclusive basis with effect from 1 July 2005. In work done with departments to date we note significantly more transactions contain a GST component that originally anticipated. Guidance for identifying GST is therefore provided in this circular;

- The authority for payment of GST to IRD and the payment of GST input tax are provided by permanent legislative authority under s6(b) of the Public Finance Act. Departments will therefore continue drawing down the GST inclusive cash amounts, and line 241 ("GST input tax credit) of the Crown operating statement will be added to the appropriation based CFIS net cash disbursements formula to allow this draw down;
- In order to avoid incorrectly reported expenditure at 30 June 2006, it will be necessary to accurately separate the GST component from non-departmental expenses and capital expenditure at the transaction level. Care is needed in this process and the estimation process used in preparing the 2005 Estimates may not be sufficient;
- Departments are responsible for ensuring their GST approach to non-departmental expenses is accurate for year-end audit sign-off requirements;

BACKGROUND

Changes to the Public Finance Act

3. The Public Finance Act Amendment 2004 moved all appropriations to an accrual basis. Previously some appropriations, notably capital contributions, repayment of debt and capital expenditure were on a cash basis. This change has allowed a number of simplifications to the appropriation system, one of which has been the alignment of the GST appropriation treatment with the treatment of GST in financial statements and forecasts.

4. Accounting standards require revenue and expenses to be shown net of GST, and capital items to be shown net of GST where the GST is recoverable.

5. The Public Finance Act, as amended, requires appropriations for accrual-based expenses and capital expenditure measured in accordance with generally accepted accounting practice. It states that public money may not be disbursed except as authorised by an Act of Parliament, but it authorises disbursements for the purposes of meeting appropriated expenses and capital expenditure, goods and services tax, and the repayment of debts and liabilities.

Implications of the changes for non-departmental items

6. As non-departmental revenue and receipts do not require an appropriation, and have always been stated on a GST exclusive basis, the accounting and reporting of these items is not affected.

7. Although input credits are not claimed for non-departmental expenses and capital expenditure, because they are recoverable (either directly from that GST registered person via the IRD or further down the value-added chain), GST input tax does not constitute a GAAP expense and as a consequence does not require appropriation.

8. Therefore, as from 1 July 2005, appropriations are no longer required to cover GST and all non-departmental expense and capital expenditure appropriations are stated GST exclusive. Financial recommendations in Cabinet papers also should be stated GST exclusive.

9. In theory the accounting impacts should be relatively straight forward as GST on Crown expenses has, for several years, been required to be captured as an eliminations line in the department's Crown operating statement in CFISnet. The mechanisms in departments to identify GST on non-departmental expenses should therefore be well in place.

10. In practice however departments now need to take care when they are administering non-departmental expenses or capital expenditure where the Crown is incurring a cost with a non registered person or where the good or service being purchased is exempt from GST. In such cases there is no GST input tax payment made, and it follows that there is not any portion of the payment recoverable to the Crown. No GST component should be reported (nor any forecast). Any incorrectly coded GST may represent unappropriated expenditure.

11. Departments should note it remains their responsibility to ensure that their GST approach to non-departmental expenses is accurate enough for the year-end Audit sign-off requirements.

Hugh Packer
For Secretary to the Treasury

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GST - OBLIGATIONS FOR NON-DEPARTMENTAL ACTIVITIES

BACKGROUND

12. Following the changes to the treatment of GST on appropriations in the Public Finance Amendment Act 2004, Treasury has taken the opportunity to update the guidance material for the management of GST on non-departmental payments and receipts. This material was previously contained in Treasury Circular 1993/1.

13. Treasury Circular 1993/1 is retired with effect 1 July 2005 and is replaced by this circular.

14. Although the PFAA made changes to way the payment of GST is authorised, the amendments did not amend any GST law or obligations.

15. The IRD book "GST Guide - a complete guide to working with GST" (GST 600) contains full information about registering and accounting for GST, so we have not duplicated it here. A copy can be downloaded from the IRD website www.ird.govt.nz.

TAXABLE ACTIVITY AND GST REGISTRATION FOR NON-DEPARTMENT ACTIVITY

16. The Crown is a person for the purposes of the GST Act. If the Crown undertakes a taxable activity then it must be registered for GST purposes.

Taxable Activity

17. Essentially, a taxable activity is any activity which:
   - is carried on continuously or regularly (whether or not for profit); and
   - which involves (or intends to involve) the supply of goods or services for consideration.

18. Generally, all non-departmental receipts other than taxation receipts, investment income or loan repayments are payments for taxable supplies so are liable for GST. A taxable activity, however, excludes exempt supplies. More specifically exempt supplies include:
   - financial services
   - residential accommodation supplied by letting or pursuant to a licence to occupy
   - letting of leasehold land for residential accommodation
   - sale of a house or leasehold land which has been let by the same vendor for residential accommodation for five years immediately prior to the sale
   - supplies of fine metal
   - interest charges; and
   - supplies of donated goods and services.

19. Departments should seek advice from IRD where there is doubt over taxable activities and supply.

GST Registration

20. The Crown is liable for GST on all its taxable supplies. Accordingly, government departments which receive non-departmental revenue as payment for the supply of taxable goods and services must register this taxable activity as a branch of the Crown. This registration as a branch of the Crown is quite separate from the department's own GST registration. The department must therefore keep separate financial records for the Crown activity.

21. The department must also carry out other Crown management functions separately from its own accounting system. These will include issuing GST invoices when necessary to registered people who purchase supplies from the Crown, and filing GST returns on the Crown's behalf.

When not to register?

22. As departments do not claim back from IRD the GST paid on non-departmental purchases (see expenses and payments below), there is no need to register for GST purposes if it does not collect any Crown revenues or all the Crown revenues collected are payment for exempt supplies. This is because it is not making any taxable supplies for a consideration and therefore is not running a taxable activity.

REVENUE AND RECEIPTS (OUTPUT TAX LIABILITY)

23. Government departments must bank all non-departmental revenue (inclusive of GST) that they receive into a Crown Receipts Bank Account.

Filing of GST return and payment of GST liability to Inland Revenue

24. When the non-departmental revenue is payment for taxable goods or services, the GST component of the revenue does not constitute revenue as the department that receives it is merely acting as a collection agent for the Inland Revenue Department (IRD). The department that received the non-departmental revenues is still responsible for paying the GST component to the IRD on behalf of the Crown and will need to file a GST return.

25. GST liability payments should be made from the Crown Receipts Bank Account and paid only to the IRD. If the Notice of Delegation to operate the Crown Receipts Bank account does not provide for such payments, departments should seek this authority by making an application through the Treasury Vote Analyst.

26. Some non-departmental revenues may be zero rated, which means GST is applied at a zero rate. Zero rated supplies include the sale of a going concern, and exports of goods and services. No GST is payable on the receipt of non-departmental revenues for zero rated supplies, however departments must still account for them because they are still taxable supplies.

27. The value of zero rated supplies must be entered onto the GST tax return.

Month-end activities

28. On the last working day of each month, each department must inform the Debt Management Office of the quantity of money to be cleared from the Crown Receipts

Bank Account. At this time you should forecast your department's likely GST liability (and any other non-GST general refunds) to make sure that enough money remains in the Crown Receipts Bank Account to pay this liability when it becomes due.

29. There may be complications where a department issues invoices before being paid for a supply of taxable goods and services. This is because the department could have to pay GST on some invoices it has issued before it receives payment for them.

30. Note that Crown Receipts Bank Accounts are prohibited from going into overdraft.

31. Please see Annex 1 for a worked example of the accounting treatment.

EXPENSES AND PAYMENTS (INPUT TAX LIABILITY)

Disbursements for non-departmental expenses

32. Cash disbursements from DMO into Crown Payments Accounts will be made under an appropriation based formula set in CFISnet. This will not change as a result of the Public Finance Act Amendment with the exception that the GST input tax credit line (Crown operating statement, line 241) will be added to the formula in order to allow departments to continue drawing down the GST-inclusive cash amount to be paid for expenses.

33. This GST line will also be used to track GST authorised under s6 of the PFA.

Do not claim input tax credits

34. To date Treasury has advised departments <u>not</u> to claim input tax credits on behalf of the Crown for non-departmental expenses. This policy is to continue; departments that manage taxable activities as branches of the Crown should not claim any input tax credits on non-departmental expenses they make.

35. This ruling differs from the normal practice for GST-registered persons. If departments claimed input tax credits for non-departmental payments, this would cause compliance and administration costs for departments, without resulting in any net financial benefit for them. It would also make no difference to the Crown's consolidated fiscal position.

Transaction based approach

36. In the preparation of the Estimates for 2005/06, Treasury noted that a number of departments had issues identifying whether non-departmental payments attracted GST or not. Further work revealed significantly more payments required GST to be accounted for than originally envisaged.

37. Accordingly, and as from 1 July 2005, departments are required to take a transaction based approach to identifying GST on non-departmental expenses.

38. Departments should note it remains their own responsibility to ensure that their GST approach to non-departmental expenses is accurate enough for the year-end audit sign-off requirements.

39. Please see Annex 1 for a worked example of the accounting treatment.

Identifying GST on non-departmental expenses (and non departmental capital expenditure)

40. For non-departmental expenses and capital expenditure, the item shall be recorded net of GST where money is:

a. being paid on GST applicable products and services; and

b. to a GST registered person

In other words, if the recipient of the payment is required to account for GST on the amount received, the expense shall be recorded net of GST.

41. Care must be taken when deducting input tax to ensure that it is not related to making GST-exempt supplies. Exempt supplies include financial services, residential rent, supplies of fine metal, interest charges and supplies of donated goods and services. If a purchase is connected with an exempt supply, any full amount should be recognised as part of the related asset or, where the expenditure relates to an expense item, expensed.

42. In relation to money being paid on GST applicable products and services ((a) above), the following table provides further guidance on identifying GST for different transaction types, along with the issues to take into consideration when making judgements in this area:

FURTHER GUIDANCE ON IDENTIFYING GST APPLICATION

Transaction type	GST treatment	Issues to consider
Grants	Generally subject to GST. Any payment in the nature of a grant or subsidy made on behalf of the Crown to any person in relation to their taxable activity is deemed to be consideration for a supply of goods and services. As a result, grants paid to a registered person in relation to their taxable activity are subject to GST. Grants applied to exempt activities (e.g. providing residential accommodation or financial services) and grant paid to non-registered persons are not subject to GST. A grant or subsidy includes a suspensory loan or advance that becomes non-repayable. As a result, suspensory loans expensed by the Crown are generally subject to GST.	Grant application forms may need to be altered to identify whether the applicant is registered for GST. The department should ensure that the grant recipient is aware that the grant is subject to GST. Where possible, a registered person should be asked to issue a tax invoice before the grant is paid.
Benefits	Not subject to GST GST does not apply to any benefit paid under the Social Security Act 1964 (e.g. unemployment benefit) or any payment made for the personal use and benefit of a person or a relative (e.g. family support tax credits).	
Payments to Crown entities	Generally subject to GST For GST purposes, a Crown entity is deemed to supply goods and services where any amount is brought to charge as revenue from the Crown. As a result, a crown entity must account for GST on any amounts recognised as revenue from the Crown. A Crown entity is not required to account for GST on the funding for grants distributed to other entities. However, the ultimate recipient of the grant may be required to account for GST (refer above). A Crown entity is also not required to account for GST on capital contributions, as this is not recognised as revenue from the Crown.	Payments for services provided overseas may be zero-rated (i.e. subject to GST at 0%). Payments for accommodation provided in a commercial dwelling (e.g. rest home) may subject to GST at 7.5%. Where the Crown entity is acting as a distribution agent, it will be necessary to consider whether the ultimate recipient is required to account for GST on the amount received.

Transaction type	GST treatment	Issues to consider
Other payments (including capital expenditure)	Generally subject to GST. Other payments will generally be subject to GST, unless the supply is exempt (e.g. residential accommodation or financial services) or the recipient is not registered for GST.	The department will need to identify whether the recipient is registered for GST. Payments for services provided overseas may be zero-rated (i.e. subject to GST at 0%). Where possible, tax invoices should be requested.

ANNEX 1 - WORKED EXAMPLES

Accounting for GST (non-departmental) where:

a. receipts for taxable goods and services are $270,000 (GST inclusive)

b. payment of $180,000 to purchase an asset – from a registered person

c. payment of $100,000 to purchase an asset – from a non-registered person

d. payment of $90,000 for current expenditure – from a registered person

e. payment of $50,000 for current expenditure – from a non-registered person

Crown transactions managed by Departments

Non-departmental Transactions:	***Expen-diture***	***Revenue***	***DMO***	***GST input Tax credit [1]***	***GST Payable***	***Cash***
Revenue [a]		240 cr			30 cr	270 dr
Purchase of an asset [b]	160 dr			20 dr		180 cr
Purchase of an asset [c]	100 dr					100 cr
Payment of current expenditure [d]	80 dr			10 dr		90 cr
Payment of current expenditure [e]	50 dr					50 cr
NZDMO funding of Crown payments			420 cr			420 dr
Revenue returned to DMO			240 dr			240 cr
Payment of GST to IRD					30 dr	30 cr

Note 1: GST input tax credit.
The input tax credit is recorded in CFISnet on line 241 of the Crown operating statement. This tax credit is not claimed back from IRD.

**Year to date Reporting at the End of Period
Impact on Crown Reporting Package for
Crown Financial Statements**

Schedule of revenue and expenses

Revenue	240
Less expenses	130
Less GST input tax credit [1]	30
	80

Schedule of assets and liabilities

Asset		
	Cash	0
	Asset	260
		260
Liabilities		
Movement in Net Assets		
	Received from DMO	420
	Paid to DMO	-240
	Expenses in excess of revenue	80
		260

Note 1: GST input tax credit (CFISnet)
The CFISnet Crown operating statement contains line 241 "GST input tax Credit" which is eliminated in the preparation process for the consolidated Crown financial statements. Line 241 is essentially being used as a surrogate to having a GST accounts payable that can then be cleared once the payment is made. It is then cleared through the statement of movements in equity as a reduction in the operating balance. Treasury is aware that this treatment gives the appearance of the Crown operating statement schedule being GST inclusive.

For GST on capital spending, the same process as for non-departmental expenses is to be followed.

Note also that the GST amount in line 241 should result in an equivalent reconciling item in Crown expense reconciliation schedule, when reconciling operating expenses to approved appropriations.