

The Treasury

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[40]	Not in scope	

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Proposed GST rules for cross-border services and intangibles

Proposal

1. This paper seeks Cabinet approval to proposed amendments to the Goods and Services Tax (GST) Act 1985 which would apply GST to cross-border “remote” services and intangibles (including e-books, music, videos, and software purchased from offshore websites) provided by offshore suppliers to New Zealand-resident consumers.
2. Supplies to New Zealand GST-registered businesses would not be subject to GST, unless the offshore supplier and GST-registered purchaser agreed that these supplies would be subject to GST at the 0% rate, allowing the offshore supplier to claim a deduction for GST incurred in New Zealand in making these supplies.
3. The rules would require offshore suppliers to register and return GST when their total supplies of remote services and intangibles to New Zealand exceeded \$60,000 in a 12-month period.
4. The new rules would apply from 1 October 2016. A Bill to implement these changes is planned for introduction in Parliament in mid-November 2015.

Executive summary

5. In principle, GST should apply to all consumption that occurs in New Zealand, as this ensures the system is fair, efficient and simple. However, currently, GST is not typically collected on cross-border services and intangibles (including internet downloads and online services) purchased from offshore suppliers.
6. This has resulted in a growing gap in New Zealand’s GST revenue base, estimated at \$40 million each year. Many are concerned that the current tax settings place New Zealand suppliers of services and intangibles at a competitive disadvantage relative to offshore suppliers.
7. In order to address these concerns, the Government released a discussion document, *GST: Cross-border services, intangibles and goods* on 18 August 2015. The discussion document proposed new rules that would apply GST to cross-border remote services and intangibles supplied to New Zealand residents, by requiring offshore suppliers to GST-register and return GST on these supplies.
8. The discussion document also contained a preliminary discussion on the collection of GST on low-value imported goods, and the de minimis threshold, below which GST and tariff

duties are not collected on imported goods. I understand that the Minister of Customs, Hon Nicky Wagner, will report to EGI on 11 November, seeking approval for the release of a discussion document which considers these issues.

9. The 18 August 2015 discussion document has generally been well-received, with submissions broadly supporting the proposed rules for cross-border services and intangibles. As a result, the proposals have not substantially changed from those in the discussion document.

10. A strong theme was the importance of minimising compliance costs for offshore suppliers. In response to these concerns, the rules contain several features to minimise compliance costs for offshore suppliers, in order to maximise the likelihood of compliance and to reduce the risk that the proposed rules could affect the range of services and intangibles available to New Zealand consumers.

11. Following this consultation, I propose new rules that would apply GST at the 15% rate to cross-border “remote” services and intangibles provided by offshore suppliers to New Zealand resident consumers.

12. GST would not apply to supplies of remote services and intangibles provided by offshore suppliers to New Zealand GST-registered businesses, unless the offshore supplier and GST-registered purchaser agreed that these supplies would be subject to GST at the 0% rate. If the parties agree that the supply is subject to GST at the 0% rate, this would allow the offshore supplier to deduct any New Zealand GST costs incurred in making these supplies, in the same way as suppliers based in New Zealand.

13. “Remote” services are services where there is no necessary connection between the physical location of the customer and the place where the service is provided. Examples of remote services include internet downloads and online services, as well as traditional services such as remotely supplied consultancy, accounting, legal and insurance services.

14. The rules would require offshore suppliers to register and return GST when their total supplies of remote services and intangibles to New Zealand exceeded \$60,000 in a 12-month period. Supplies to New Zealand GST-registered businesses would only be counted towards this threshold if the parties agreed that the supply was to be zero-rated.

15. These proposals are consistent with Organisation for Economic Co-operation and Development (OECD) guidelines and with international practice, including the proposals announced in Australia that are expected to come into effect on 1 July 2017.

16. The proposals will prevent the erosion of the revenue base and will maintain the broad base of New Zealand’s GST system. The proposals will create a level playing field between domestic and offshore suppliers of services and intangibles, reducing the extent to which differences in GST treatment distort consumers’ purchasing decisions.

Background

17. The proposals in this paper seek to address the non-taxation of cross-border services consumed in New Zealand, which is estimated to result in around \$40 million in forgone GST each year. Given the growth in e-commerce, this amount is likely to become increasingly significant, impacting on the future sustainability of the GST revenue base, if not addressed.

18. The current tax settings distort consumer and business decisions, resulting in a lack of competitive neutrality between domestic and offshore suppliers. For example, an offshore supplier of video streaming services would not be required to charge GST, though domestic suppliers of the same services would have to return GST on supplies to New Zealand customers.

19. Non-collection of GST on cross-border services and intangibles is an international issue faced by countries that have a GST or Value Added Tax (VAT) system. The OECD has developed draft guidelines on the GST treatment of cross-border services and intangibles, which are expected to be finalised later this year. The draft guidelines establish an international set of principles for determining when countries should have the right to tax these supplies. An internationally consistent application of the guidelines is expected to minimise the potential for double taxation or double non-taxation.

20. The draft guidelines recommend that for supplies to a final consumer, “remote” services should be taxed in the place of the consumer’s usual residence, and that “on-the-spot” services should be taxed in the place where the services are performed. The draft guidelines also suggest that offshore suppliers of remote services and intangibles should be required to register and return GST on these supplies.

21. The offshore supplier registration model has been adopted with success in the European Union and a number of other countries, including Norway, Japan, South Korea, Switzerland and South Africa. Australia has announced plans to introduce the model with an effective date of 1 July 2017.

22. On 17 August 2015, Cabinet approved the release of a discussion document, *GST: Cross-border services, intangibles and goods* which proposed new rules that are consistent with the draft OECD guidelines and with growing international practice [CAB-15-MIN-0020 refers]. I now report back to you with the final policy recommendations.

Proposed final design

Basic framework of the rules

23. Consistently with the draft OECD guidelines, the new rules would apply GST at the 15% rate to supplies of remote services and intangibles received by New Zealand resident consumers.

24. “Remote” services are those where there is no necessary connection between the physical location of the customer and the place in which the service is provided. Examples of “remote” services include internet downloads and online services, as well as traditional services such as remotely supplied consultancy, accounting and legal services. By contrast, ‘on-the-spot’ services, such as hairdressing, restaurant services and hotel accommodation, would continue to be taxed in the place where the service is performed.

25. The new rules would apply GST to a broad range of remote services, rather than targeting the rules at specific digital services, which has been the approach taken in other countries. Most submissions supported this approach, as it is more consistent with the broad base of New Zealand’s GST system and avoids the issues encountered in other jurisdictions from applying the rules only to digital services, including definitional issues at the margins and the need to continually update the definition because of changes in technology.

26. General insurance (meaning non-life insurance) and gambling services are subject to special GST rules that apply tax on a net basis, as they both involve the supplier making payments to the customer. Amendments will extend these rules to apply where offshore suppliers provide these services to New Zealand resident consumers. Further targeted consultation on the detailed design of these rules may be required during the drafting process, to ensure they work in practice.

Telecommunications services

27. Currently, cross-border telecommunications services are subject to special rules, which apply GST based on the place where the customer is located when initiating or receiving the services. These special rules provide a code for determining the GST treatment of telecommunications services.

28. Under the current rules, GST does not apply where domestic telecommunications providers supply international roaming services to New Zealand residents who are temporarily offshore. Offshore telecommunications providers are, however, required to charge GST on roaming services used by customers who are temporarily in New Zealand, though these providers are only required to register for GST if they have other taxable activities in New Zealand that cause them to exceed the \$60,000 registration threshold. (Offshore telecommunications providers are required to GST-register in any case where non-roaming services to New Zealand residents exceed the threshold). Australia has similar rules in that international roaming services are not subject to GST, and have not announced any changes to this through their proposal on cross-border services and intangibles.

29. The discussion document did not propose any changes to the special rules for telecommunications services. Six submissions opposed changes to these rules, specifically in relation to domestic telecommunications providers. I propose that we retain the current GST rules for telecommunications services for both domestic and foreign telecommunications service providers so that the level playing field between resident and non-resident suppliers within the industry is maintained, keeping a watching brief on developments in Australia before making a change in this area.

Supplies to New Zealand GST-registered businesses

30. Supplies of remote services and intangibles to GST-registered businesses would not be subject to GST. Requiring an offshore supplier to charge GST on these supplies would increase compliance costs (without any net revenue gain), as tax invoices would be required to allow the purchaser to deduct the GST charged.

31. However, the offshore supplier and the GST-registered purchaser would be able to agree that the supply was subject to GST at the 0% rate. This would allow the offshore supplier to deduct any New Zealand GST costs incurred in making these supplies. This would ensure that transactions between an offshore supplier and a GST-registered business are GST-neutral in the same way as for resident suppliers, so that GST was not a cost to registered business.

32. If a GST-registered business is inadvertently charged GST by an offshore supplier, they would be required to seek a refund from the supplier, rather than being able to claim a deduction in their return. However, if the value of the supply is less than \$1,000, an offshore supplier would have the option to provide a tax invoice to the purchaser to allow them to

claim a deduction, rather than to refund the GST charged. This option is intended to reduce compliance costs imposed on offshore suppliers where the cost of refunding the inadvertently charged GST is disproportionate to the value of the transaction.

Registration threshold

33. The rules would require offshore suppliers to register and return GST when their total supplies of remote services and intangibles to New Zealand exceeded \$60,000 in a 12-month period. This registration threshold is equivalent to the domestic registration threshold, which means that offshore and domestic suppliers making the same level of supplies in New Zealand would receive comparable treatment. Supplies to New Zealand GST-registered businesses would only be counted towards this threshold if the parties agreed that a supply was zero-rated.

34. This ensures that the compliance burden associated with the requirement to register and file returns is not imposed on smaller suppliers into the New Zealand market, which could otherwise pose a barrier to trade with New Zealand.

Electronic marketplaces

35. An electronic marketplace is a platform through which suppliers offer services and intangibles to potential customers, such as a mobile app store through which app developers sell their apps. The new rules would require the operator of an electronic marketplace to register and return GST on these supplies, when certain criteria are met.

36. This recognises that an electronic marketplace is generally in a better position to account for GST on these supplies when compared with the underlying suppliers, as the marketplace is likely to have the best access to the information needed to determine the GST liability arising from a transaction.

37. The rules for electronic marketplaces would be broadly consistent with those in the European Union and Norway, and those proposed in Australia.

38. The operator of an electronic marketplace would be responsible for GST on a supply that it has substantial involvement in, unless:

- the electronic marketplace does not authorise the charge to the customer, deliver the supply or set the terms and conditions under which the supply is made; and
- the documentation issued to the customer identifies the supply as being made by the underlying supplier; and
- the parties have agreed in writing that the underlying supplier is responsible for the payment of GST.

39. An intermediary who merely processes payments on a supplier's behalf would not fall within the scope of these rules. If several intermediaries could be caught by the electronic marketplace rule, the intermediary closest to the final consumer would be liable for GST on the supply.

Identifying a New Zealand resident customer

40. Offshore suppliers would be required to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of evidence, including:

- the billing address of the customer;
- the internet Protocol address of the device used by the customer or any method of geolocation;
- details concerning the origin of the payment for the service or intangible;
- the Mobile Country Code (MCC) of the International Mobile Subscriber Identity (IMSI) stored on the Subscriber Identity Module (SIM) card used by the customer;
- the location of the customer's fixed land line through which the service is supplied to the customer; or
- other commercially relevant information.

41. This approach strikes a balance between accuracy in determining the place of taxation and the compliance burden imposed on offshore suppliers. It reduces compliance costs by allowing an offshore supplier to use information that is routinely collected from customers, rather than requiring them to request additional information. As many suppliers to the global market have put systems solutions in place to comply with equivalent rules for members of the European Union, it is likely that adopting similar rules in New Zealand will result in lower compliance costs.

42. To provide additional flexibility, the Commissioner of Inland Revenue would be able to prescribe an alternative method to determine whether a customer is a New Zealand resident, in circumstances where sufficient information is not commercially available.

Identifying New Zealand GST-registered businesses

43. As a default rule, an offshore supplier would be required to presume that a customer is not a registered business unless the customer had communicated their GST registration number, New Zealand Business Number or self-certification as a GST-registered business to the supplier.

44. In consultation, offshore suppliers have emphasised that requesting additional information at the point of sale, such as a GST registration number, would result in additional compliance costs. In response to this feedback, the proposed rules have been adjusted to provide greater flexibility.

45. The rules would allow an offshore supplier to charge GST by default, and then to have the option of providing a refund or issuing a tax invoice if the value of the supply was under \$1,000, and the customer later provided evidence of their registration. This would mean, if applicable, that the offshore supplier's purchasing system would not need to be adjusted to require additional information.

46. Additionally, an offshore supplier would be able to agree with the Commissioner of Inland Revenue on an alternative method of determining whether a customer was a GST-registered business. For example, if an offshore supplier could show that for a particular type of product, 100% of a reasonable sample of customers are registered businesses, it could be appropriate to dispense with the requirement to request GST registration numbers.

Penalties for misrepresentations by customers

47. The existing knowledge offences would apply when a person deliberately supplied incorrect information for the purpose of avoiding GST, by misrepresenting themselves as a registered business or a resident of another country. For these penalties, the maximum fine a court could impose would be \$25,000 for a first time offender or \$50,000 for a repeat offender.

48. Thirteen submissions raised concerns that the knowledge offences could apply where a person provided incorrect information to access geographically limited content and would result in disproportionately high penalties. However, if a customer provided incorrect information to access content that was geographically restricted, and this inadvertently led to GST not being charged, the offence would not arise and the penalty would not apply.

49. In egregious cases, the Commissioner of Inland Revenue would also have the discretion to require a person to register and pay the GST that should have been charged. This would apply only in cases such as where a person repeatedly provided false or misleading information about themselves in order to avoid GST.

Filing periods

50. Currently, GST returns must be filed on a 1-monthly, 2-monthly or 6-monthly basis, depending on turnover levels. In consultation, offshore suppliers expressed a preference for quarterly GST returns, which would align with their filing obligations in other countries.

51. However, the system currently used by Inland Revenue to process GST returns is unable to support quarterly filing. This system will be replaced with a new solution during the first quarter of 2017, as part of Inland Revenue's Business Transformation programme.

52. Therefore, offshore suppliers would initially begin with a 6-month filing period until 31 March 2017, after which quarterly filing would become mandatory for offshore suppliers. Two-monthly filing would also be allowed as an option during this period, as offshore suppliers may face foreign exchange risk during the longer 6-month period.

53. Offshore suppliers would be under the same obligations to file and pay on time as other registered businesses. However, the initial 6-month filing period provides a 'soft start' to the rules, where an offshore supplier could register, file and pay by 7 May 2017 without facing interest or penalties. This may assist offshore suppliers who may be unaware of their obligations or who require additional time to comply fully with the new rules.

Other measures to reduce compliance costs for offshore suppliers

54. In response to submissions, several legislative requirements would be relaxed to reduce compliance costs for offshore suppliers, who would:

- not be required to issue tax invoices, as supplies of GST-registered businesses would not be subject to GST at the 15% rate;
- generally be able to make adjustments in a current GST return to take into account refunds of inadvertently charged GST to GST-registered business customers, within two years of the original supply; and
- have an automatic exception from the requirement to keep records in New Zealand and to keep records in English.

55. Recent amendments to the Tax Administration Act 1994 require an offshore supplier to have a fully functional New Zealand bank account in order to obtain an IRD number, in order to ensure that an offshore person is first subjected to New Zealand's anti-money laundering and Countering Financing of Terrorism rules. Offshore suppliers without any other New Zealand-based activities would be exempted from this requirement in order to reduce the compliance burden associated with registering for GST. Often offshore suppliers would have no connection with New Zealand other than supplying a digital service to New Zealand customers, and therefore the requirement to obtain a fully functional bank account would impose significant compliance costs.

56. Currently, registered businesses are required to express amounts in New Zealand dollars at the time of supply. As offshore suppliers often charge customers in a foreign currency, this would involve significant compliance and transaction costs. Therefore, this requirement would be relaxed, allowing offshore suppliers to elect to convert amounts into NZD at the time of filing their return. A two year 'lock-in' rule would help ensure that an offshore supplier could not gain an advantage from switching between these methods.

Submissions

57. Seventy-six submissions were received on the Government discussion document *GST: Cross-border services, intangibles and goods*. Officials held a number of teleconferences with representatives of offshore suppliers to consult on the design of the rules.

58. The discussion document was well-received with most submissions (34 out of 41 that expressed a view) supporting the approach for GST on cross-border services and intangibles.

59. The key concerns raised in submissions were that:

- sufficient lead time should be provided for offshore suppliers to implement systems changes, with six months as a suggested minimum timeframe from enactment of the legislation to the start date for the rules;
- 19 submissions supported excluding supplies to GST-registered businesses from the rules, with nine submissions considering that these supplies should not count towards the registration threshold;
- there were mixed views on the appropriate registration threshold, with 19 submissions preferring no registration threshold, one preferring a \$10,000 registration threshold, and 20 preferring a \$60,000 or higher registration threshold;
- six submissions considered that registered businesses should be able to claim a deduction in their return for inadvertently charged GST, rather than being required to seek a refund from the offshore supplier; and
- several offshore suppliers raised concerns that overly prescriptive rules for determining whether a customer is a New Zealand resident consumer could impose significant compliance costs.

60. Many of these concerns are addressed in the detailed design of the rules, as:

- if legislation is introduced in November and planned to be enacted in March 2016, the application date of 1 October 2016 should provide sufficient lead time for offshore suppliers;

- supplies to GST-registered businesses would not be subject to GST at the 15% rate. These supplies would be excluded unless the offshore supplier and GST-registered purchaser agreed that GST will apply at the 0% rate;
- a registration threshold equal to the domestic threshold of \$60,000 of taxable supplies in a 12-month period has been proposed;
- a GST-registered business would be able to deduct inadvertently charged GST where an invoice is provided by an offshore supplier, and the supply is valued at under \$1,000;
- the Commissioner would be able to prescribe an alternative method for determining whether a customer is a resident of New Zealand or a GST-registered business.

61. A strong theme was the importance of minimising compliance costs for offshore suppliers, to maximise compliance and reduce the risk that the rules could restrict the supply of services and intangibles to New Zealand. This risk has been mitigated by designing the rules to make it as easy as possible for offshore suppliers to comply, which will be complemented by simplified registration and return processes. In addition, the registration threshold would prevent many small suppliers from being required to register under the rules.

62. One submission raised concerns that New Zealand would not be able to monitor and enforce compliance with the rules, and that effective mechanisms to do so should be in place prior to the implementation of offshore supplier registration rules.

63. The experience in other countries is that offshore suppliers, particularly large international suppliers that account for the majority of cross-border services and intangibles, have demonstrated a willingness to comply with these rules. For many of these companies, failure to comply with their obligations would pose a significant risk to their reputation.

64. New Zealand also cooperates with many other jurisdictions in tax administration matters, both under bilateral agreements – such as double tax agreements or tax information exchange agreements – and under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. These agreements establish a network of countries which New Zealand can request to collect and provide information, assist in service of documents, and collect unpaid tax. New Zealand may request GST-related information from 73 jurisdictions under these agreements.

65. The OECD is also working on further detailed guidance for the effective exchange of information and other forms of mutual assistance between tax authorities in the field of indirect taxes.

66. One submission raised a concern that double taxation could occur where a non-resident consumer received remote services that were performed in New Zealand. Under current rules, GST would apply to services that are performed in New Zealand and supplied to a non-resident in New Zealand. However, according to the OECD principles, if that service was a ‘remote’ service, the country of the recipient’s usual residence would have taxing rights over this consumption.

67. An example of this could arise once the proposed Australian rules are implemented. If an Australian tourist purchased a digital service from a New Zealand-based provider (such as an online betting service), GST could possibly be charged in both countries, if the New Zealand supplier exceeded the Australian registration threshold. For these limited cases, a provision has been incorporated into the proposal that would relieve a supplier from the New

Zealand GST burden when the supply had been subject to GST in another country. This is expected to apply only in a very limited range of circumstances.

Financial implications

68. The new rules are expected to result in additional revenue of \$40 million per annum, with a corresponding impact on the operating balance, as outlined in the table below:

	\$m increase/(decrease)			
	2015/16	2016/17	2017/18	2019/20 and out-years
Vote Revenue Minister of Revenue				
Tax Revenue	0	30	40	40

Administrative impacts

69. The proposals outlined in this paper will give rise to administrative implications for Inland Revenue. Consultation with offshore suppliers has emphasised that the key to maximising compliance with the rules is to make it as easy as possible for offshore suppliers to register and return GST.

70. To implement the new rules, Inland Revenue will develop a simplified registration system that will be tailored to the requirements of offshore suppliers, which is informed by best practice in other countries and the recommendations in the draft OECD guidelines.

71. The total project cost over 5 years from 2015/16 to 2019/20 is estimated at \$1.610 million. Inland Revenue will fund the implementation and administration costs arising from the changes out of its existing baseline.

Consultation

72. The New Zealand Treasury, the Ministry of Business Innovation and Employment and the New Zealand Customs Service were consulted in the development of this Cabinet paper.

Human rights

73. There are no inconsistencies with the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993 arising from the proposals recommended in this paper.

Legislative implications

74. Subject to Cabinet approval, a Bill including the amendments will be introduced in Parliament in mid-November.

Regulatory impact analysis

75. The Regulatory Impact Analysis (RIA) requirements apply to the proposal in this paper and a Regulatory Impact Statement (RIS) has been prepared and is attached.

76. The Regulatory Impact Analysis Team (RIAT) has reviewed the RIS prepared by Inland Revenue and associated supporting material, and considers that the information and analysis summarised in the RIS meets the quality assurance criteria.

Recommendations

77. I recommend that the Cabinet Business Committee:

1. **Agree** that GST would apply at the 15% rate to the supply of “remote” services and intangibles provided by offshore suppliers to New Zealand resident consumers. “Remote” services are services where there is no necessary connection between the physical location of the customer and the place where the service is provided.
2. **Agree** that GST would not apply to remote services and intangibles provided by offshore suppliers to New Zealand GST-registered businesses. An offshore supplier and a GST-registered purchaser would be able to agree to zero-rate the supply, which would allow the offshore supplier to deduct any GST costs incurred in New Zealand.
3. **Agree** that offshore suppliers would be required to register and return GST when their total supplies of remote services and intangibles to New Zealand exceeded \$60,000 in a 12-month period. Supplies to New Zealand GST-registered businesses would only count towards this threshold if the parties agreed that GST would apply at the zero rate.
4. **Agree** that offshore suppliers would be required to determine whether a customer is a New Zealand resident on the basis of two non-conflicting pieces of commercially available evidence, and an alternative method may be prescribed by the Commissioner of Inland Revenue.
5. **Agree** that offshore suppliers would be required to determine whether a customer is a GST-registered business on the basis of whether they provided a GST registration number, New Zealand Business Number or the business’ self-certification. An offshore supplier would be able to agree with the Commissioner of Inland Revenue on an alternative method of determining whether a customer was a GST-registered business.
6. **Agree** that the new rules would apply from 1 October 2016.
7. **Note** the following changes as a result of the decision in recommendation 1 above, with a corresponding impact on the operating balance:

	\$m increase/(decrease)				
Vote Revenue Minister of Revenue	2015/16	2016/17	2017/18	2018/19	2019/20 & Outyears
Tax Revenue	0	30	40	40	40

8. **Note** that total project cost to implement and administer the proposed changes is estimated at \$1.610 million over 5 years, which will be funded by Inland Revenue out of its existing baseline.

Hon Todd McClay
Minister for Revenue

____ / ____ / ____
Date

