Regulatory Impact Statement

Bodies corporate GST obligations

This Regulatory Impact Statement has been prepared by Inland Revenue.

It provides an analysis of options to determine the appropriate GST treatment of bodies corporate. This is the second RIS that considers the GST treatment of bodies corporate; the first was prepared on 28 March 2014. This analysis follows submissions received on the discussion document *GST Treatment of Bodies Corporate* released on 6 June 2014, which sought public feedback on the approach preferred under the previous RIS (option 2 in this RIS).

As a result of feedback received on the discussion document, the preferred option has changed to being option 4 (optional approach).

There are four key constraints / caveats on the analysis:

1. Because of data limitations it is not possible to determine exactly how many bodies corporate are currently registered for GST, or would be required to register because they exceed the $60,000 registration threshold. (This threshold is made up of levies received by unit owners but could also be made up of sales of goods and services to third parties).

2. Again because of data limitations it is not usually possible for Inland Revenue to identify whether a GST return is from a body corporate. This means we have incomplete information on the number of bodies corporate which may have taken a tax position to claim input tax deductions in respect of leaky building repairs.

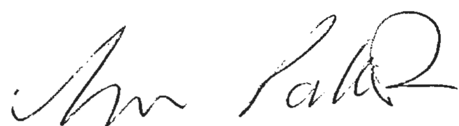
3. The estimate of the potential fiscal cost of refunds for leaky buildings is uncertain as it is based on a 2009 PricewaterhouseCoopers estimate of the costs associated with fixing weathertightness problems in multi-unit dwellings.

4. The estimate of the potential fiscal cost of cashing out reserves if all bodies corporate were to be deregistered is uncertain again due to data limitations. The estimate is based on an assumption about the average level of cash reserves held by registered bodies corporate.

A range of options has been considered and measured against the objectives of providing certainty, consistency and fairness of GST treatment whilst minimising compliance costs and disruption to current practices. There are no environmental or cultural impacts from these recommended changes.

There are no other significant constraints, caveats or uncertainties concerning this regulatory impact analysis other than those noted above.

None of the policy options would restrict market competition, reduce the incentives for businesses to innovate and invest, unduly impair private property rights or override fundamental common law principles.



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STATUS QUO AND PROBLEM DEFINITION

Background

Bodies corporate

1. The GST system requires businesses and other entities to register for GST if they supply goods or services worth more than $60,000 in a 12-month period. Generally, GST-registered persons are required to file GST returns and pay GST on the majority of the goods and services they supply. In simple terms, the amount of GST that they pay is based on the value of these supplies less the GST cost of any inputs that they purchase from other GST registered persons. In this respect the GST system only taxes the "value added" by each business in a supply chain.

2. A body corporate is a legal entity created under the Unit Titles Act 2010[1] when multiple owners have unit title properties in an apartment building or similar complex. The body corporate is made up of all of the property owners and provides a way for the owners to act together with regard to their common and shared interests. Because bodies corporate always intend to spend all of their money, they are, in the ordinary course of events, largely tax neutral over time.

Historic position

3. Currently, most bodies corporate (of which there are approximately 13,800 in total) are not registered for GST and Inland Revenue's historic position has been to not allow bodies corporate to register. A High Court decision in *Taupo Ika Nui Body Corporate v CIR* (1997) appeared to support this position by suggesting that most residential bodies corporate would not be required to register for GST because they did not make supplies to unit owners for consideration.

4. However, despite this longstanding view, some bodies corporate have registered for GST (which is likely due to inconsistent administrative practice), including some that have been able to claim refunds in relation to leaky building repairs.

Inland Revenue legal analysis

5. In an effort to resolve the inconsistency, Inland Revenue more recently undertook a legal analysis of the existing law and came to a view that bodies corporate could be considered to be providing services to their owners for consideration (in the form of body corporate fees). Under this interpretation, bodies corporate that receive more than $60,000 in levies (and potentially other payments) should be registered for GST. As with other taxpayers, bodies corporate below the $60,000 threshold would be able to register voluntarily.

6. This legal view was consulted on in *IRRUIP7: Bodies Corporate – GST Registration* which was released in May 2013. Forty-two submissions were received on the legal position and the appropriate policy outcome. Many submissions raised policy arguments as to why bodies corporate should not be required to register for GST.

[1] Previously the Unit Titles Act 1972.

The problem

7. The main problem is that Inland Revenue's new interpretation of the law does not align with the longstanding practices of a large number of bodies corporate, who are not GST-registered.

8. Absent any policy or law change, these bodies corporate would need to change their behaviour to comply with Inland Revenue's new interpretation of the law. This could create compliance costs.

9. In addition, the fact that property owners in bodies corporate would be able claim GST refunds, whilst others such as stand-alone property owners could not, could lead to perceptions of unfair tax outcomes.

Policy process

10. In response to these submissions and concerns about the potential tax outcomes which could arise under this interpretation, the Minister of Revenue instructed officials to consider policy options for the GST treatment of bodies corporate. The Minister of Revenue indicated that a policy response was required to address three main concerns:

- *Uncertainty concerns* – To ensure bodies corporate have certainty over how the GST rules apply to them.
- *Compliance cost concerns* – To ensure bodies corporate that believed they were not required to register do not have to do so as a consequence of the recent Inland Revenue interpretation of the existing rules.
- *Fairness concerns* – To ensure that owners of residential property affected by leaky building issues that have received compensation and who carry out repairs through a body corporate are not tax advantaged compared to residential property owners that do not have a body corporate through which to carry out the repairs.

11. Earlier this year, Cabinet agreed to the development of draft legislation to exempt supplies made by bodies corporate to their unit owners from GST. This would mean the majority of bodies corporate would not be able to register for GST.

12. This decision was publicly announced by the Minister of Revenue on 6 June 2014 along with a proposed rule to allow GST-registered members of a body corporate to claim input deductions on their share of the expenditure incurred by the body corporate (known as the "look-through rule"). The exemption and look-through rule would apply from the date of announcement. The announcement was accompanied by a short discussion document *GST treatment of bodies corporate*. The document provided further detail on the exemption and sought comment on the proposed draft legislation.

13. On 18 July 2014, submissions on the discussion document *GST treatment of bodies corporate* closed. Fifty submissions were received. The majority of submitters did not support the proposal. Submitters argued that the compliance costs associated with the proposal would be significant (discussed further under option 2).

Affected bodies corporate and impacts

14. Because of data limitations it is not possible to determine exactly how many bodies corporate are currently registered for GST, or would be required to register because they collect more than $60,000 in levies (and other payments in some cases). Despite this, it is likely that around 2,500 bodies corporate are currently registered for GST.[2] These taxpayers would be the least affected if the new interpretation of the law was followed.

15. The number of bodies corporate that would be required to register, if the current interpretation of the law was followed, could be as many as 3,100.[3] For most of these bodies corporate there would be compliance costs associated with GST registration but, in most cases, little or no net GST to pay.

16. Compliance costs would include transitional costs imposed on bodies corporate that are not currently registered, but would be required to register because they collect more than $60,000 in levies. These bodies corporate would need to be informed that their existing practice of not being registered for GST was incorrect (and the reasons why). There will also be compliance costs relating to what they need to do to comply with their ongoing GST obligations. These ongoing obligations would involve compliance costs associated with filing GST returns. These include charging GST and providing tax invoices to unit owners, paying GST to Inland Revenue, keeping tax records and possibly hiring the services of tax agents.

17. Most bodies corporate would have little or no net GST to pay over time. This is because the GST charged on body corporate fees would generally be offset by the ability for the body corporate to claim GST input credits when they spent the fees on insurance, repairs, maintenance and so on.

18. There would be GST to pay in some cases such as when the funds were used to pay for ground rent.[4] These GST costs would be passed on to underlying property owners in the form of higher body corporate fees.

19. Some bodies corporate may want to register, particularly those that would be able to receive GST refunds. For example, some bodies corporate may have built up long term maintenance funds. If these funds were raised while the body corporate was not registered, no GST would have been collected when they were levied, but input tax deductions would be available if they later registered. Given GST should be neutral for these taxpayers, the ability to claim input tax deductions with no output liability represents a windfall gain to these bodies corporate.

20. It is difficult to estimate the amount of GST refunds that bodies corporate could claim, nevertheless based on the number of bodies corporate required to register and an estimate of the average amount of cash reserves held by bodies corporate, the fiscal cost could be around

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[2] There are approximately 2,500 registered persons with either the words "body corporate" in the name they registered under, or who have separately identified themselves as a body corporate through their industry classification or their reported nature of business.

[3] We have obtained information from Land Information New Zealand (LINZ) about the total number of bodies corporate (approximately 13,800) and the number of units in each body corporate. Consequently, if we make an assumption about the average body corporate fee we can work out roughly how many bodies corporate would exceed the $60,000 threshold based on the number of units.

[4] Ground rent can be paid when the land underneath the building is owned by a person outside the body corporate.

$116 million or $23.2 million per annum over 5 years.[5] The fiscal cost could be higher if bodies corporate that were not required to register (bodies corporate that have supplies below $60,000) decided to voluntarily register. The windfall gain to this group would further lead to perceptions of unfairness.

21. GST refunds are also likely to be available in cases where a registered body corporate has received a leaky building compensation payment[6] and has used the compensation to pay for repairs. There would be a fiscal cost associated with these refunds. The actual cost would depend on many factors, such as the cost of the repairs, how these costs are funded, and how many bodies corporate register for GST. Based on a 2009 estimate of the costs associated with fixing weathertightness problems in multi-unit dwellings, the fiscal cost could be as much as $58 million spread over the next 6 years.[7]

22. It could be viewed as unfair for the GST system to allow GST refunds for a certain group of property owners but not for other property owners. Residential property owners are not generally able to register for GST so could not claim GST refunds if they paid for repairs themselves as opposed to the repairs being paid for by a registered body corporate.[8] This could lead to perceptions that the tax system is subsidising repairs for some owners but not for others.

Key figures	
Total number of bodies corporate	13,800
Number of bodies corporate already registered for GST	2,500
Number of bodies corporate that might be required to register if the new interpretation of the law was followed	Up to 3,100
Fiscal cost of refunds if unregistered bodies corporate decided to register for GST	$116 million
Fiscal cost of refunds associated with leaky building repairs	$58 million spread over the next 6 years

OBJECTIVES

23. New Zealand's GST system applies broadly with very few exemptions. Accordingly, a wide range of businesses, clubs and other organisations are required to register for GST. This

[5] A maximum of 3,100 bodies corporate may be required to register under the status quo option. As bodies corporate are not required to file annual accounts centrally, it is difficult to estimate the level of these reserves. However, a conservative estimate would suggest these reserves for a body corporate over the registration threshold could be over $250,000.

[6] Compensation payments are not generally subject to GST as they do not relate to a supply of anything in return, or to a normal transaction through the supply chain. In contrast, when a GST-registered person makes an insurance claim, they are generally required to return GST in relation to the insurance payout due to a special deeming rule in the GST Act.

[7] In the 2009 PwC report Weathertightness – Estimating the Cost, it was estimated to cost $1.402 billion to fix weathertightness issues in multi-unit dwellings and that up to 31% of all weathertightness costs could be funded from compensation payments. (The remaining 69% would be funded by the building owners themselves.) This $1.402 billion cost was increased to $1.433 billion to take into account the increase in GST from 12.5% to 15%; 31% of $1.433 billion is $444 million. The GST input credits that could be claimed on $444 million would be $58 million, or $8 million per year until 2020.

[8] In the case of owner-occupiers there is no supply or consideration for GST to apply to as the owner provides accommodation to themselves. When a landlord rents a house to a tenant, the GST Act exempts this supply of residential accommodation to ensure that tenants are not disadvantaged relative to owner-occupiers.

broad-base, low-rate framework is a key reason why New Zealand's GST is regarded to be efficient, fair and relatively simple.

24. Other aspects of the GST system recognise that public acceptance and compliance with GST depends on minimising undue compliance costs and on taxpayers' perceptions of fair and consistent tax outcomes. These include the $60,000 registration threshold which reduces compliance costs for smaller suppliers, and the exemption for the supply of residential accommodation which ensures renters are not disadvantaged relative to owner-occupiers.

25. As described above, the new interpretation of the law regarding the GST treatment of bodies corporate has raised predominantly practical concerns related to certainty, compliance costs and fairness. Unlike most other entities, however, bodies corporate are expected to be fiscally neutral over time because they expect to spend all of the money they accumulate.

26. The objectives against which the options are to be assessed are:

a) To provide certainty of GST treatment. Ideally, the policy should provide certainty for past periods as well as the future.

b) To minimise compliance costs. This includes transitional costs such as requiring bodies corporate to adopt a different practice (by requiring registration or deregistration) or change a previous tax position as well as ongoing costs such as filing tax returns or paying GST. There are also potential flow-on costs to unit owners to consider.

c) To provide fair and consistent tax outcomes between bodies corporate, other property owners, and other taxpayers who have similar circumstances. When assessing fairness there are three different comparisons that can be made:

- *Other property owners.* One comparison is that a person who owns property through a unit title should face similar tax outcomes to a person who owns property under another type of property ownership (such as freehold property).
- *Other types of taxpayer.* Consideration of the extent to which a body corporate is similar to other types of taxpayer such as a property management business or a sports club which provides organisational services for its members.
- *Other bodies corporate.* To ensure consistency between different bodies corporate the policy should apply broadly with few exceptions. In saying this, in a GST system where most supplies are taxable, it is recognised that some entities that supply the same types of goods may be in or out of the GST system depending on whether they are over the compulsory registration threshold.

27. We recognise that there are trade-offs between these policy objectives. For example, because taxpayers have taken different tax positions, a policy which sought to reduce transitional costs by preserving a previous tax position could result in different tax outcomes for one taxpayer compared to another in a similar situation.

REGULATORY IMPACT ANALYSIS

28. Four policy options and the status quo were considered for addressing the policy problem and meeting the objectives. These were:

Option 1: Retain the new interpretation of the law (status quo);

Option 2: Change the law to remove all bodies corporate from the GST system (previously preferred option);

Option 3: Exempt only supplies made by a body corporate to residential unit owners (apportionment model);

Option 4; Give bodies corporate the option of whether or not to register for GST (preferred option); and

Option 5: Introduce a higher GST registration threshold for bodies corporate.

Option 1: Retain the new interpretation of the law (status quo)

29. Under option 1, Inland Revenue would finalise our interpretation of the existing law. Based on the work to date, this interpretation would conclude that bodies corporate that receive more than $60,000 of annual fees are required to register for GST. Other bodies corporate that receive less than $60,000 of annual fees could voluntarily register for GST.

30. As mentioned previously, this legal view was consulted on in *IRRUIP7: Bodies Corporate – GST Registration* which was released in May 2013. Forty-two submissions were received. Many submissions raised policy arguments as to why bodies corporate should not be required to register for GST. Much of the discussion below reflects submitter's comments.

Certainty

31. The purpose of an interpretation statement is to provide certainty. However, it only provides certainty as to Inland Revenue's view of the law. Some bodies corporate who disagreed with Inland Revenue's interpretation of the law may choose to challenge the interpretation in the courts. This risk is increased by the fact that in the only New Zealand court case on this issue, *Taupo Ika Nui Body Corporate v CIR (1997)*, the High Court suggested that most residential bodies corporate would not be required to register for GST.

32. In addition there could be uncertainty as to whether bodies corporate would be required to revise past tax positions that were inconsistent with Inland Revenue's new interpretation, particularly for those bodies corporate who have not registered for GST. An operational practice statement could be used to provide guidance on how Inland Revenue planned to administer the new interpretation but this may not provide the affected bodies corporate with sufficient comfort on their prior tax positions.

Fairness

33. Applying GST to unit title property ownership could be seen to be unfair because GST registration involves compliance costs that would not apply to other types of property ownership (i.e. individuals who own standalone houses). It could potentially discourage unit title ownership.

34. On the other hand, it could also be viewed as unfair that the GST system allowed GST refunds for a certain group of property owners but not for other property owners. Residential property owners are not generally able to register for GST so could not claim GST refunds if they paid for leaky building repairs themselves as opposed to the repairs being paid for by a body corporate. GST refunds could amount to $58 million. This could lead to perceptions that the tax system is subsidising repairs for some owners but not for others.

Compliance costs

35. Requiring bodies corporate to register for GST could impose compliance costs on thousands of property owners and in most cases would result in little, if any, tax to pay. These costs and their impacts are described in paragraphs 15 to 18 of this RIS. The number of bodies corporate that may be required to register could be up to 3,100.

36. Bodies corporate could potentially be required to file or reassess GST returns for prior tax years and pay penalties and interest in respect of unpaid GST obligations. The impact on past tax positions could, however, be reduced by providing a grace period (either through legislation or operational practice) whereby the GST obligations would only be enforced prospectively, after the date that the interpretation statement was finalised.

Option 2: Change the law to remove bodies corporate from the GST system

37. Option 2 would require a legislative amendment to the Goods and Services Tax Act 1985 which would explicitly remove any body corporate that was established under the Unit Titles Act 2010 from the GST system.

38. This option would also be accompanied by a "look-through rule" that deems any third-party services provided to a body corporate (such as insurance and cleaning) to be provided directly to the underlying unit owners in proportion to their shares in the body corporate. Under this approach, if an underlying owner was running a GST-registered business on their property, they would be able to claim back their portion of the GST costs of goods and services purchased by the body corporate on their behalf. If instead, the owner was simply living in the property, they would not have to do anything and would be treated like any other final consumer.

39. This option was the preferred option in the previous RIS, and was consulted on in the 6 June 2014 discussion document. The discussion document suggested that the new rule take effect from the date that the document and draft legislation were released (6 June 2014). A savings provision was also proposed to preserve the tax positions of those bodies corporate which had registered for GST and taken tax positions prior to 6 June.

40. After receiving feedback from submitters, officials no longer prefer this option.

Certainty

41. The proposed law change would provide certainty of GST treatment for future periods after the date the law was changed, while the savings provision would also preserve the tax positions of those bodies corporate which had registered for GST and taken tax positions prior to 6 June.

42. There has however been some uncertainty since the Minister made the announcement on 6 June 2014, especially because the proposal is not yet enacted. An operational statement was

released soon after the announcement (28 June 2014) which was intended to give bodies corporate guidance as to what they should do in the interim. The operational statement advised registered bodies corporate to continue to file GST returns until the proposal was enacted.

Fairness

43. The look-through rule element of this option would ensure that a person who owns property through a unit title should face similar tax outcomes to a person who owns property under another type of property ownership.

44. The option would also prevent bodies corporate from claiming further GST refunds after 6 June 2014. Removing this ability to claim further GST refunds can be justified on the basis that it removes a tax advantage that is not available to other types of residential property owners such as standalone home owners.

45. Submitters considered this option to be unfair for those bodies corporate that would be required to deregister. Specifically, these bodies corporate would have returned GST on fees received while they were registered but would be unable to claim input tax when they spent the fees after deregistration. Given GST is meant to be neutral for these taxpayers, if this option were to be pursued there is a policy argument that registered bodies corporate should be able to claim a GST refund on cash balances held at the time of deregistration. While the fiscal cost of cashing out reserves would over time be neutral, the cost in year one could be around $77 million.[9]

46. Finally, an issue with removing bodies corporate from the GST system is that other taxpayers may argue that they should also be removed from the GST system. For example, a sports or social club may argue that, like a body corporate, they face undue compliance costs from having to register for GST.

Compliance costs

47. For the vast majority of bodies corporate that are not registered for GST, a retrospective law change would align the law with their existing practice and previous tax positions. This means they would not have to take any action with regard to either their past or future behaviour.

48. Submitters argued that the compliance costs associated with this option would be significant. The main compliance cost concern relates to the on-going cost of applying the look-through rule.

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[9] This estimated is based on the assumption that 2,500 bodies corporate would be required to deregister with average reserves of around $250,000.

49. The proposed look-through model has the advantages of being conceptually "pure" in that it would ensure that GST-registered unit owners would be entitled to input deductions on their share of expenses incurred at the body corporate level. However, submissions highlighted that achieving any degree of accuracy in these calculations would mean imposing significant compliance costs on bodies corporate and unit owners. These concerns would largely fall into the following categories:

- Measuring ownership interests in a body corporate;
- Managing information flows;
- Transitional issues associated with filing returns in the period between 6 June 2014 and the date of enactment of any changes.

50. It was stressed that, because the look-through calculations would need to be undertaken for every taxable period (possibly monthly), these costs would be recurring.

Measuring ownership interests

51. The proposed look-through rule suggested that a registered unit owner would be able to claim input tax deductions in proportion to their "ownership interest", as defined in the Unit Titles Act 2010. Submissions noted, however, that an owner's share of the expenses incurred by the body corporate is measured in a number of different ways. For example, a ground floor tenant may not be required to contribute to elevator maintenance. As a result, allowing expenses to be claimed on an ownership interest basis could result in owners being attributed with a greater or lesser share of expenses than should be the case.

52. In practice, to ensure owners are attributed the correct share of expenses, the body corporate would be required to examine each invoice received and attribute it to the owners in the appropriate proportions. This would be a significant compliance burden – particularly for large bodies corporate.

Managing information flows

53. In order for the look-through model to work, unit owners would need accurate information on expenses incurred at the body corporate level. Because input tax deductions represent the equivalent of cash refunds to unit owners, they will, like most registered persons, be motivated to access this entitlement as soon as they can. Bodies corporate would therefore be under pressure to report to suit the unit owner that has the most frequent filing obligations (potentially monthly). Currently bodies corporate are only required to report to owners on a very limited basis.

54. An additional complication could arise when registered unit owners enter or exit a body corporate (through the sale of units). The exiting member will want to know their entitlement up to the date of departure, which could result in further "out of cycle" calculations needing to be undertaken by the body corporate.

Transitional issues

55. If the look-through model was legislated for, the estimated 2,500 bodies corporate currently registered would need to deregister as of 6 June 2014. They would also need to file final returns that unwound the position of returns filed in the period between 6 June 2014 and the date of enactment (which may be in late 2015).

56. As well as calculations required at the body corporate level, individual registered unit owners would also need to perform a "wash-up" calculation, so their GST position accurately reflected the new law for the period.

57. Measures could be put in place to lower the compliance costs of the look-through but, in doing so, the rules will need to trade off simplicity for accuracy. A set of minimum requirements may be relatively easy for a body corporate to administer (although some may even struggle with this), but they are unlikely to result in unit owners' input tax deductions being truly representative of their share of costs incurred at the body corporate level. Irrespective of whether a simple or more complicated method is chosen, these costs will be recurring.

Option 3: Exempt only supplies made by a body corporate to residential unit owners (apportionment model)

58. The apportionment model requires bodies corporate to calculate and claim the appropriate amount on input tax, as opposed to the unit owners. This approach involves deeming bodies corporate to be supplying accommodation to their unit owners. This would mean:

- Supplies of accommodation in residential units would be exempt. Fees charged to residential units would not be taxable and the body corporate would not be able to claim input tax deductions in relation to those supplies.
- Supplies of accommodation in units used for commercial purposes would be taxable. Fees charged to commercial units would be taxable and the body corporate would be able to claim input tax deductions in relation to those supplies.

59. Bodies corporate associated entirely with residential units would not be able to register for GST. Bodies corporate associated with commercial units or a mix of residential and commercial units would either be required to register for GST (if supplies exceed $60,000), or could voluntarily register (if supplies are below $60,000). Bodies corporate with a mix of residential and commercial units would need to apportion their input tax deductions based on the proportion of residential and commercial units.

60. This option and option two have much the same advantages and disadvantages in respect of certainty, fairness and compliance costs. Like the look-through model, the apportionment model has the potential to be conceptually pure, in that GST costs incurred at the body corporate level would be accessed by registered unit owners, but not by unregistered owners. However, the apportionment model has the advantage of not requiring details of invoices and payments to be passed through to unit owners.

61. On the other hand, this model has potential to impose significant compliance costs on bodies corporate. The body corporate will be required to identify the status of its underlying units and/or unit owners. This could be difficult given there are specific GST rules that define what is a commercial and residential dwelling, consequently, the status of the underlying unit may not always be clear. This may also give rise to privacy concerns for the unit owners concerned. If the body corporate did not make enquiries of unit owners this may result in input tax deductions being incorrectly claimed at the body corporate level or denying input deductions to unit owners that would, if they owned a stand-alone residence, be entitled to claim them.

Option 4: Give bodies corporate the option of whether or not to register for GST

62. Option 4 (preferred option) involves giving bodies corporate an option to register. This option would also require a legislative amendment to the Goods and Services Tax Act 1985 and the option would only extend to supplies made to unit owners. Supplies to third parties (for example, car park rental to third parties) would be governed by the ordinary rules (i.e. a body corporate would be required to register if supplies to third-parties exceeded $60,000). Other legislative amendments would be necessary to:

- clarify that services provided by bodies corporate to their members are "supplies" for GST purposes; and
- address a base maintenance risk associated with bodies corporate choosing to register and deregister at times that would effectively mean that the majority of their spending was subsidised by the tax system.

Certainty

63. Option 4 would provide certainty by clarifying that services provided by bodies corporate to their members are "supplies" for GST purposes. It would then allow bodies corporate the option of whether to make those supplies "taxable" by registering for GST.

64. Like option 2, this option would need to apply retrospectively in order to preserve tax positions taken by bodies corporate who had not registered for GST.

65. Unlike option 2, a savings provision would not be required to preserve tax positions taken by bodies corporate who had registered for GST as an optional approach would not prevent bodies corporate from being able to register for GST.

Fairness

66. Previous fairness concerns surrounding registration of bodies corporate centred on their ability to access input tax deductions (and therefore refunds) for leaky building repairs. Because compensation payments are not subject to GST, this would result in a windfall gain for a registered body corporate when compared to an unregistered one, or a standalone homeowner. However, consultation has suggested that a practice may have emerged whereby the payers of compensation payments are reducing the amounts paid to registered bodies corporate to reflect any GST that the body corporate may be able to claim. This makes rational sense because a payer will always be motivated to make any settlement as small as possible. If this practice is now routine, the original concern regarding bodies corporate receiving windfall gains at the expense of the tax base (and gains that would not have been available to stand-alone homeowners) is mitigated.

67. Bodies corporate are only likely to register for GST if they expect to receive GST refunds. Not only would this raise revenue concerns, it could also lead to perceptions of unfairness. This concern could be addressed by imposing an output tax liability on relevant reserves (including funds from compensation payments) held by the body corporate at the time of registration. Such a liability would remove any windfall gain resulting from registration.

68. If this option were to be pursued, it will be necessary to align the application date with the introduction of the relevant legislation. This is necessary to prevent unregistered bodies corporate from registering before the enactment of any legislation in order to avoid the payment of output tax on their reserves.

69. Some bodies corporate may argue that since they are required to pay output tax when they register they should be entitled to an input tax refund on cash reserves held at the time of deregistration. This should not be necessary, however, as a body corporate would be able to deregister at any point in time and therefore is able to choose the most appropriate time to deregister – such as a time when their reserves are low. Cashing out reserves would also have fiscal implications as described in paragraph 45. In addition, those bodies corporate that are currently GST registered will not have entered the system in the expectation that their reserves would be cashed out on deregistration. To do so would provide those bodies corporate with a windfall gain.

70. To remove any residual incentives that bodies corporate may have to register and deregister on a regular basis, it would be desirable to also create a lock-in rule, whereby if a body corporate chooses to register after the effective date of these changes, they must stay registered for a minimum of four years. This would provide some clarity to a body corporate of the minimum compliance costs of registration and would also ensure that those looking to register only for short term gain, such as the GST advantages arising from a future compensation payment, would be discouraged from doing so.

71. Finally, adopting this option may set a precedent for other non-profit bodies to lobby for an increased threshold or a similar optional approach.

Compliance costs

72. Option 4 has the lowest compliance cost of any option, as bodies corporate will be able to decide whether it is worthwhile to register for GST and bear the cost associated with registration. It is anticipated that this approach would require very few, if any, bodies corporate to take immediate action.

73. It is likely that only bodies corporate with GST registered unit owners (commercial bodies corporate) will want to register for GST. Registration may be worthwhile for these bodies corporate to avoid tax cascades – where the body corporate incurs unrecoverable GST which in turn would be passed on to unit owners. However, it is likely that many commercial bodies corporate may already be registered for GST, in which case they could remain registered.[10]

74. There may be an onus on some bodies corporate to decide whether or not they should choose to register for GST. For some bodies corporate there would be costs associated with making this decision which could include paying fees to a tax agent to provide advice on their situation.

Option 5: Introduce a higher GST registration threshold for bodies corporate

75. Taxpayers currently need to register for GST if they have more than $60,000 of taxable supplies. Option 5 would involve increasing the GST registration threshold for bodies corporate so that registration would be compulsory above the threshold and voluntary below the threshold. Like options 2, 3 and 4, this would require a legislative amendment to the Goods and Services Tax Act 1985.

[10] Of the number of registered persons that identified themselves as a body corporate, 60 percent identified themselves as a "commercial" body corporate. The remaining 40 percent identified themselves as a "residential" body corporate.

76. This option has the same advantages and disadvantages as option 4 with one exception: even with a very high threshold there could still be cases where a body corporate exceeds the threshold but does not wish to be GST registered. Consequently, these bodies corporate would still have to deal with all the compliance costs associated with GST registration. In this regard, the threshold would create a "cliff-face", particularly for those bodies corporate that temporarily breached the threshold temporarily due to a large one-off transaction.

77. Option 4 is preferred because it does not have the "cliff-face" associated with option 5. Some may argue that large bodies corporate should be required to register, however, for the reason discussed in paragraphs 15 to 18 there would be little benefit in these taxpayers registering.

Summary of impact analysis

78. The following table summarises for each option which of the objectives it meets or partly meets (for the reasons described above) as well as the economic, administrative, fiscal and fairness impacts. None of the options have environmental, social or cultural impacts.

Option	Objectives met or partly met	Economic impact	Compliance cost & administrative impact	Fiscal impact	fairness impacts
Option 1: Retain the new interpretation of the law	a) Certainty (partly)	No significant impact	Approx. 3100 bodies corporate could face transitional and ongoing costs Inland Revenue would experience difficulties in contacting affected bodies corporate to assist with compliance	Most bodies corporate would have little net GST to pay Cost of refunds associated with leaky buildings could be up to $58 million over the next 6 years	Could be seen to provide a tax advantage (GST refunds) for some unit title owners compared with other property owners
Option 2: Remove all bodies corporate from the GST system	a) Certainty b) Fairness (partly) Improves fairness relative to other property owners but would create unfairness between bodies corporate which have received refunds and those which have not	No significant impact	Bodies corporate with registered unit owners would face on-going compliance costs associated with applying the look-through rule GST registered bodies corporate would face a one-off cost associated with de-registration. Transitional impacts on Inland Revenue in dealing with delay between announcement and enactment of legislation.	Fiscally neutral as it preserves existing tax positions and prevents further GST refunds to bodies corporate Upfront refund of reserves could amount to $92.3 million (although this would be recouped over time)	No significant impact

Option 3: Exempt only supplies made by a body corporate to residential unit owners (apportionment model)	a) Certainty b) Fairness (partly) Improves fairness relative to other property owners but would create unfairness between bodies corporate which have got refunds and those who have not	No significant impact	Bodies corporate with registered unit owners would face on-going compliance costs associated apportioning deductions. GST registered bodies corporate with only residential units would face a one-off cost associated with de-registration. Low administrative impact on Inland Revenue	Same as option 2	No significant impact
Option 4: Give bodies corporate the option of whether or not to register for GST	a) Certainty b) Minimise compliance costs	No significant impact	For most bodies corporate there would be no impact or need to take action Low administrative impact on Inland Revenue	Cost of refunds associated with leaky buildings could be up to $58m over the next 6 years Bodies corporate only likely to be register if they expect to receive GST refunds (estimated to be $116 million). However, a requirement to return output tax on reserves should remove that incentive and address any revenue risk	Other non-profit groups may request similar treatment
Option 5: Higher GST registration threshold for bodies corporate	a) Certainty b) Minimise compliance costs	No significant impact	For most bodies corporate there would be no impact or need to take action Could be compliance costs and "cliff face" issue for bodies corporate that exceed the new threshold Low administrative impact on Inland Revenue	Same as option 4	Other non-profit groups may request similar treatment

CONSULTATION

79. As mentioned earlier, Inland Revenue undertook a legal analysis of the existing law in order to resolve the uncertainty that had arisen as a result of body corporate GST refund claims.

Inland Revenue Issues Paper – new interpretation of the law

80. In May 2013, Inland Revenue released Issues Paper *IRRUIP7: Bodies Corporate – GST Registration* to consult on our initial view that existing law would require bodies corporate that receive more than $60,000 of annual fees to be registered for GST. The issues paper set out an initial interpretative position for consideration and also raised some alternative views. It invited submissions on both the legal position and the appropriate policy outcome.

81. Forty-two submissions were received. Six submissions agreed with the approach taken in the issues paper, considering it both technically correct and appropriate. Three submissions were neutral. Thirty-three submissions disagreed with the approach taken in the issues paper.

82. Many submitters raised policy arguments as to why bodies corporate should not be required to register for GST. These included arguments that a body corporate is, in substance, just a vehicle through which various property owners co-ordinate to pay costs related to accommodation, through a central account, and that requiring bodies corporate to register for GST would impose compliance costs but would collect little additional tax revenue.

Discussion document – policy proposal

83. To address these concerns, on 6 June 2014, the Minister of Revenue publicly announced his intention to introduce legislation that would exempt supplies made by bodies corporate to their unit owners from GST and that the exemption would apply from the date of announcement. The announcement was accompanied by a short discussion document *GST treatment of bodies corporate*. The document included and sought comment on the proposed draft legislation.

84. On 18 July 2014, submissions on the discussion document *GST treatment of bodies corporate* closed. Fifty submissions were received, some on behalf of a large number of bodies corporate. The majority of submitters did not support the proposal. Submitters argued that the compliance costs associated with the proposal would be significant. The main compliance cost concerns related to the application of the look-through rule as discussed in paragraphs 48 to 57. In addition, submitters were concerned with the transitional costs associated with the proposal, such as the unfairness of not refunding input tax on reserves (see discussion in paragraph 45) and the compliance costs associate with the retrospective application date (see discussion in paragraph 55).

85. As a result of the feedback received the preferred option is now option 4 as compared to the previous RIS that recommended option 2. Many submitters preferred the optional approach (option 4) or a higher threshold (option 5).

Next steps

86. Once the Government has made a policy decision, officials will prepare draft legislation for introduction in the next omnibus tax bill scheduled for early in 2015.

87. The Treasury were consulted on and agree with the preferred option (option 4).

CONCLUSIONS AND RECOMMENDATIONS

88. We recommend that the law be changed to give bodies corporate the option of whether to register for GST (option 4). For the reasons explained above, this option best achieves the objectives of providing certainty, consistency and fairness whilst minimising compliance costs and disruption to existing practices. The most effective way to meet these objectives would involve a date of introduction application date with a savings provision for tax positions taken prior to the date of introduction.

89. Retaining the existing law (option 1) is not supported as it does not address the problem, would only provide partial certainty and would not achieve the other objectives.

90. A GST exemption to remove all bodies corporate from the GST system (option 2) is not preferred as the compliance costs of applying the look-through rule would likely be high. Option 3 is not supported for compliance cost reasons associated with bodies corporate apportioning their input tax deductions.

91. A higher GST registration threshold (option 5) is not supported because of the "cliff-face" it creates for those bodies corporate that may make supplies in excess of the higher threshold.

IMPLEMENTATION

92. The preferred option (option 4) would need to be implemented through a taxation bill. Draft legislation can be included in a bill scheduled for early 2015.

93. The proposed application date would be date of introduction. This is necessary to prevent unregistered bodies corporate from registering before enactment to avoid the payment of output tax on their reserves. While it is recognised retrospective application dates should generally be avoided, in this case it is necessary for the fairness and fiscal reasons discussed in paragraph 68.

94. The existing operational statement that was released on 28 June 2014 offers some certainty for the interim. It advises taxpayers to continue to follow the existing law until any legislation is enacted. This means that registered bodies corporate should continue to file GST returns in the normal manner. The operational statement also makes it clear that Inland Revenue will not require bodies corporate to register in the interim.

95. The new rules will be administered by Inland Revenue through existing channels. Compliance costs can be minimised by releasing clear and helpful guidance as to the operation of the new rules using existing Inland Revenue channels. Administration costs are expected to be negligible.

MONITORING, EVALUATION AND REVIEW

96. Inland Revenue will monitor the outcomes pursuant to the Generic Tax Policy Process ("GTTP") to confirm that they match the policy objectives. The GTPP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995.

97. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation, and the identification of remedial issues. Opportunities for external consultation are also built into this stage. Any necessary changes identified as a result of the review would be recommended for addition to the Government's tax policy work programme.